

SMALL AND MEDIUM ENTERPRISE DEVELOPMENT IN SRI LANKA: A Review

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ABSTRACT

Small and Medium Enterprises (SMEs) play an important role in any economy through generation of employments, contributing to the growth of GDP, embarking on innovations and stimulating of other economic activities. This sector is said to be the backbone of all developed and developing nations. So, the development of this sector is paramount important for any country irrespective of their level of development. This is even more important to developing countries where poverty and unemployment are the persisting problems in those economies. Having understood this fact, successive governments in Sri Lanka have taken various steps, from time to time, to promote this vital sector since independence. But, when analyzing the present contribution of this sector in the national economy, it is clear that the sector has not achieved desired level of contribution when compared with other developed and developing countries in the region. So, there seems to be a vast opportunity for Sri Lanka to harness the opportunity by developing this vital sector. So, the objective of this paper is to provide a brief overview of SME sector in Sri Lanka, and to make suggestion for enhancing the capacities of SMEs for a sustainable development in Sri Lanka.

Key words: Small and Medium Enterprises in Sri Lanka, SME Policies in Sri Lanka, Economic Development, Entrepreneurship, Small Scale Industry.

1. INTRODUCTION

Sri Lanka is an Island republic with a total land area of 65,610 square kilometers. It is located on the southeast side of India which is its closest neighbor. It is a multi-racial country which has a total population of 19.4 million at present. The life expectancy at birth is 73 years and literacy rate which is 91.4 is the second highest in Asia. According to the World Bank classification Sri Lanka is a lower-middle income country with one of the highest per capita income in the South Asian region of Rs. 63,752.00 (US\$ 841) in the year 2000. Despite the well-documented ethnic crisis which resulted in a culturally based civil war, with high defense expenditures and increased level of foreign debts, Sri Lanka has been able to maintain an average growth rate of 5 percent over the last 5 decades. The Human Development Index which is 73.0 in 1999 highlight the significant positive changes in the real living standard of Sri Lanka where there has been high level of satisfaction of basic needs although GDP per capita

is relatively low.

As in most Asia and Pacific, Sri Lanka too, has a majority portion of population living in rural areas which is estimated to be 78 percent of the country's total population. The small industries in the rural areas are the major source of employment and production of food and, therefore, the Sri Lankan villagers' livelihood. So, almost all the governments that came to power since independence in 1948, seem to have been understood the great need for developing this vital sector. According to the Central Bank of Sri Lanka (1998), the cottage and Small Scale Industries (CSSI) sector plays an important role in economic development through creation of employment opportunities, the mobilization of domestic savings, poverty alleviation, income distribution, regional development, training of workers and entrepreneurs, creating an economic environment in which large firms flourish and contribute to export earnings. Having understood the positive impact of SMEs development and economic growth, successive governments in Sri Lanka, have taken various steps to develop this vital sector (Gamage, 2000). But when analyzing the present contribution of this sector to the national economy, it seems that it has not yet produced desired results when compared with the other developed and developing countries in the region. So, it seems that there is a vast opportunity for Sri Lanka to develop this sector, thereby harnessing the benefits deriving from it. So, the aim of this paper is to give a brief overview of the current state of SMEs in Sri Lanka and to examine the measures taken to develop this sector thereby making recommendations for further development. It will start by examining the definitions and reviewing the factors influencing the development of SMEs in Sri Lanka. Having overviewed the current state of SME sector in the economy, the study attempts to identify SME policies followed since independence and institutional support measures taken by successive governments to develop this sector. Finally, by examining the problems associated with developing this sector, the study attempts to present policy implications for developing the sector.

1.1 DEFINITIONS OF SMEs IN SRI LANKA:

SMEs are defined in a variety of ways by various countries using such parameters such as number of persons employed, amount of capital invested, amount of turnover or nature of the business, etc. Not only different countries apply different definitions on the concept of SMEs, even within countries, different regions and different institutions adopt varying definitions in this regard.

In Sri Lanka, there is no clear definition for SMEs. Different government agencies use different criteria to identify SMEs. Among these criteria are the number of employees, the size of fixed investment, and the nature of the business and the sector, i.e. formal or informal, in which the industry operates. There are different terms used in different documents to identify this sector. Small and Medium Industries or Enterprises, Micro Enterprises, Rural Enterprises, Small and Medium activities, Cottage and Small Scale Industry, etc., are some of the terms

frequently used.

Using the size of capital and the number of employees as the criteria, the Industrial Development Board (IDB) defines a small industry as an establishment whose capital investment in plant and machinery does not exceed Rs. 4 million (US\$ 42,000) and the total number of regular employees does not exceed 50 persons (Central Bank of Sri Lanka, 1998). The Department of Small Industries (DSI) classifies enterprises with capital investment of less than Rs. 5 million (US\$ 52500) and fewer than 50 employees as SMEs (Ponnamperuma, 2000).

For the purpose of a World Bank financed Investment Assistant Scheme, financial institutions defines SMEs as those enterprises whose investment in fixed assets at original book value, excluding land and building, do not exceed Rs. 8 million (US\$ 84,000). In the case of projects where the main investment is land and buildings (for example warehouses), the total investment in fixed assets, inclusive of the cost of land and building should not exceed Rs. 16 million (US\$ 168,000).

For the purpose of assistant programs implemented by the Sri Lanka Export Development Board (SLEDB) for export oriented enterprises, SMEs are defined as those enterprises with a capital investment excluding lands and buildings of less than Rs. 8 million (US\$ 84,000) or with annual export turnover of less than Rs. 50 million (US\$ 525,000) (Hewaliyanage, 2001).

The World Bank defines enterprise size in Sri Lanka based on the number of employees: those with fewer than 49 employees are small; those with 50-99 employees are medium-sized; and those with more than 100 employees are large. The number of employees as the criterion for size appears reasonable because it distinguishes between enterprises regardless the line of business, and the amount of capital investment must be revised frequently due to inflation (Ponnamperuma, 2000).

So, it is clear that there are several definitions for SMEs adopted by various institutions in Sri Lanka and this has led to confusion in identifying SMEs for various supportive measures. In other developing as well as developed countries where there are strong SME sectors have very clear definitions for SMEs. For example, by using the number of employees and size of capital, The New Small and Medium Enterprise Basic law in Japan (amended Dec. 3rd, 1999) clearly defines what SMEs constitute. By using the number of employees, amount of turnover and balance sheet total, the European Union (EU) has clearly defined SMEs in their member countries. As a developing country in the region, India defines Small Scale Industry (SSI) in terms of limits on investment in plant and machinery, excluding investment in land and buildings, testing equipments, anti-pollution measures, etc. So, it is imperative to have a clear definition for SMEs in the attempt of developing the sector for various purposes.

1.2 FACTORS INFLUENCING THE DEVELOPMENT OF SMEs IN SRI LANKA

The justification for the development of the SMEs in developing countries like Sri Lanka is largely due to its multi-faceted merits.

First of all, it is accepted that the SME sector has great potential to generate maximum socio economic benefits to the country with low level of investment. The SME industry requires less capital per unit and relatively less infrastructure. In most developing countries the shortage of capital is the major barrier for promoting an industrial culture. So, as small industry requires relatively less capital per unit and relatively less infrastructure, it justifies the promotion of this vital sector.

Secondly, it absorbs relatively more labor per unit of capital employed. The relatively labor intensive nature of the sector, coupled with regional dispersions of cottage and small scale industrial enterprises, enables them to create substantial employment opportunities particularly in the informal sector. As the agriculture sector alone cannot create sufficient employment opportunities, SME sector has a vital role to play in creating employment opportunities at a relatively low cost in the informal sector. According to a recent survey conducted by the Department of Census and Statistics observed that investment per employee was Rs. 9,900 in small industries compared to Rs. 66,700 in large industries and Rs. 34,000 in medium industries (Central Bank of Sri Lanka, 1998). Although the quality of employment created by large scale industries may be higher than that of SMEs, given the high level of unemployment in the rural areas, and the accommodation and transportation problems in urban industrial centers, the SME sector can play a significant role in economic development. Apart from that, the creation of employment in village areas to discourage migration from rural to urban areas and to increase the scope for fostering a spirit of self reliance has received close attention. And also, the nature of short gestation period may supplement it. So, SMEs have very high employment-generating potential nation wide.

Thirdly, the SMEs have great potential to mobilize and divert financial resources in the economy, which would otherwise have been used for consumption purposes to useful investment purposes in rural areas. A substantial portion of the investment cost of Small Scale units is financed by domestic sources, mainly from their personal savings or informal borrowings. So, the sector contributes to broad-based capital formation throughout the country.

Fourthly, the development of SMEs can be an aid to promote balanced regional development. The promotion of SME sector forms an integral part of poverty alleviation and regional development programs implemented by the Government and non-governmental organizations. And also, the SME sector provides high value addition in view of its greater utilization of indigenous machinery, equipment, and raw materials.

Fifthly, it nurtures entrepreneurial talents and forms good ground for training employees. The majority of employees recruited by SMEs are entry level employees who are lacking skills. SMEs provide good ground for them for training on the job.

Finally, SMEs can play a complementary role to large industries through sub-contracting, thus facilitating the linkage between the formal and the informal sector. So, a well-organized SME sector provides the foundation for the growth of entire industrial sector.

When analyzing the influencing factors, it is clear that, there is an urgent need for developing this sector and thereby harnessing the inherited potentials of this vital sector.

1.3 SIGNIFICANCE OF SME SECTOR IN SRI LANKAN ECONOMY

SMEs have been identified to play a crucial role in the economic development process by developed as well as developing countries. It is said to be the backbone of the economies in developing as well as developed nations. It is even more important to developing countries as the poverty and unemployment are burning problems in those economies.

SMEs perform a strategic role in Sri Lanka. It accounts for a very high percentage of the total number of industrial and business establishments as in other developing countries. SMEs promote economic growth by import substitution as well as through direct exports, and they mostly supply goods and services to large directly exporting ventures and thereby contribute towards alleviating balance of payments difficulties (Hewaliyanage, 2001).

According to the industrial census conducted by the Department of Census and Statistics in 1983, there were a total of 102,721 registered and informal industrial units in the country producing various types of products and employing 639,256 persons. The survey findings indicated that industrial establishments below 5 employees accounted for 84% of total establishments and 28% of total employment, but accounted for only 7.5% of the total output and 7.0% of the value added in the industrial sector. Enterprises having over 5 employees represented less than 15.7% of all establishments, but accounted for 92.5% of the output and 71.6% of total employment (Central Bank of Sri Lanka, 1998).

In 1977, a report was submitted to the Development and Review Committee on Small and Medium Scale Industries of the Industrialization commission stating that there were 50,000 registered and 125,000 unregistered SMEs. Another survey conducted by the United Nations Development Program estimated that SMEs with fixed assets of Rs. 16 million or less accounted for 90% of all enterprises, 70% of total employment, and 55% of gross value added in the private sector (Ponnampuruma, 2000).

However, it seems that there is no any recently conducted comprehensive industrial survey in Sri Lanka to identify strengths and weaknesses, threats and opportunities in this sector. Although the Department of Census and Statistics of the Ministry of Finance and Planning has been conducting annual industrial surveys, it has not covered the establishments with less than 5 persons engaged, due to the financial limitations and non availability of a proper frame. However it was clear that the majority of small businesses are operating under the category of fewer than 5 employees (84% in 1983). Subject to that limitation, the most recently conducted industrial survey dates back to 1997. The data provided by this survey provide a good frame for analyzing the contribution of industrial enterprises to the national economy in Sri Lanka. The table 1 shows the principle indicators of industrial activity classified by the major industry division & persons engaged size class in 1997.

The scope of this Annual Industrial Survey (AIS) is all activities categorized under the three industry divisions namely, Mining and Quarrying, Manufacturing and Generation and Distribution of Electricity, Gas and Water of the International Standard Industrial Classification (ISIC) of the United Nations. All private sector establishments with five or more persons engaged, state own industries and industries coming within the purview of Board of Investment have been covered in this survey.

According to the table 1, it is clear that there are only two establishments under the category of Electricity, Gas and Water. These two are considered as large enterprises and there is no any SME in this category.

Table 1 Principle indicators of industrial activity classified by major industry division & persons engaged size class-1997 (Establishments with 5 or more persons engaged)

Industry & Persons engaged size class		No. of establishments		Persons engaged		Value of output	
		No.	%	No.	%	Rs.'000	%
Mining & Quarrying	Group Total	1633	100	15665	100	1005617	100
	Less than 10	1344	82	9417	60	160912	16
	10-19	221	13	2585	17	201864	20
	20-39	53	03	1286	08	95896	10
	40-99	10	0.6	470	03	97245	10
	100-499	3	0.2	723	05	139974	14
	500 & above	2	0.1	1184	08	309725	31
	Manufacturing	Group Total	11922	100	458,032	100	275415846
Less than 10	6977	59	38,808	08	3353100	01	
10-19	2541	21	35268	08	6276694	02	
20-39	961	08	26819	06	7,023,947	03	
40-99	760	06	46981	10	30594299	11	
100-499	493	04	106,044	23	79,488,944	29	
500 & above	189	02	204112	45	148678862	54	
Electricity, gas & water	Group Total	2	100	21659	100	19387977	100
	500 & above	2	100	21659	100	19387977	100
Total		13557		495335		295809440	

Source: Annual Survey of industries, 1998, Department of Census and Statistics of Sri Lanka

The majority of establishment in the manufacturing sector are coming under the category of Small Businesses (about 90%). But their contribution to the output is very low (about 6%). On the other hand there are only 2% of large scale establishment in the category of Manufacturing, but it accounts for more than 50% of output. When analyzing the category of Mining and Quarrying, almost similar conclusion can be drawn.

Therefore, it is clear that, although there are significant numbers of SMEs in Sri Lanka, their contribution to the national economy in terms of output and share in employment has been very low. However, it can be observed in other developing as well as developed countries in the region that the SME sector has contributed significantly to their economies in terms of both the employment share and share in GDP.

For example, in Japan the SME sector is considered to be the backbone of its economy. It has always played a major role in every area of the national economy. Their importance is indicated by the very large share of the economy that they occupy, whether in terms of number of companies, value of shipments, or total number of employees. In 1999 there were 4.8 million SMEs (in non-primary industrial sector) which accounts for 99.7% of all enterprises. It has been only 14,340 large enterprises which represent 0.3% of total establishments. It has employed 31 million employees which account for 69.5% of total workforce (in non-primary industrial sector) while large enterprises has contributed only to employ 13 million employees. It has contributed to the 42.5% of total sales and 52.6% of the value of shipment in manufacturing (www.sme.ne.jp, 2002).

The newly industrializing countries in the Asian Region such as Republic of Korea, Taiwan, Malaysia, etc. have attributed an important role to the SME sector. In Korea, Micro-Enterprises represent a great majority of local business like in many other countries which account for 213,000 enterprises. There are 50,000 Small enterprises and 3,500 Medium-sized enterprises. But only 500 large enterprises are in existence. In 1996 the later category provided only 0.7 millions jobs, compared with 2.5 million for SMEs, representing 80% of the total employment in the secondary sector in Korea. Only the SME, special business with fewer than 10 employees proved capable of additional employment creation. These Micro-enterprises registered the strongest growth in employment in the last several years, contrary to a trend toward job cutting seen in big companies. In recent days employment in this type of enterprises is more widely spread across the major economic sectors, especially, joint venture capital areas (Park, 2000).

According to Sahatop (2001), in 1998, SMEs accounted for about 91% of the total manufacturing establishments in Malaysia. However, although SMEs represent the majority of manufacturing establishments, their contribution to the total value added employment were only about 20.1% and 29.9%, respectively. In terms of contribution to the total output, SMEs contributed 15.8% to the overall output, which was relatively less effective compared with their larger counterparts in terms of contribution to the development in manufacturing sector.

Over the last five decades, the Small Scale Industry (SSI) sector in India has played a significant part in building a strong and stable national economy. Today, it is producing more than 7,500 products accounting for almost 40% of the total production of the manufacturing sector and 35% of the total exports. It also acts as a nursery for promoting entrepreneurial talents and as a catalyze for industrial growth a wide network of more than three million units

in the country, accounting for about 95% of the total industrial units in India. It is one of the largest employers in the country, providing direct employment to an estimated over 17 million persons. Therefore, the SSI sector is meeting key objectives of providing employment, facilitating regional dispersal of industrial units and earning foreign exchange (Jethra, 2001).

So, when compared with other developing as well as developed countries in the region, it is clear that the SME sector in Sri Lanka has not yet achieved its anticipated results. So, there is a great need to further improve the inherent capacities and capabilities of these industries and thereby harnessing the full potentials of the sector.

2 . PROMOTION OF SMEs IN SRI LANKA

Having understood the positive impact of SME development and economic growth, successive governments in Sri Lanka have taken various steps, since independence, towards the development of this vital sector. This is reflected in the proliferation of various policies, provision of institutional support by establishing of a considerable number of supportive institutions and organizing various entrepreneurship development and small business development programs. The aim of the following section is to briefly overview the promotional efforts made by Sri Lankan Governments towards the development of SME sector since its independence, 1948.

2 . 1 SME POLICY IN SRI LANKA

Any attempt to assess the prospects for the development of SMEs in Sri Lanka in the present context must necessarily be in the historical perspective of the economic policies pursued in post independent years. Prior to Independence in 1948, under British Colonial rule, the development of the plantation agricultural industries of tea, rubber and coconut was the policy priority. Manufacturing industry was largely a by product of plantation agriculture-based on the processing of tea, rubber and coconut in large factories and fabrication of tea, rubber and coconut processing machinery in large engineering work shops. With the passage of time however, the diffusion of this engineering technology and the establishment of a wide-spread network of engineering workshops and motor vehicle repair garage provided a sound basis for diversification of the industrial production of the country. In deed, during the period of Second World War, some diversification took place per force. The sheer inability to import requirements of manufactured products compelled the British colonial authority to initiate moves to assist in the transfer of technology for local production of some manufactured goods essential to sustain the production of plantation, and also for the support of the armed forces stationed in the island. For example, the government established a factory to make acetic acid for the coagulation of rubber using coconut shell charcoal as the raw material. Again, technology was imparted to a local private Company through the good offices of British Army to

embark on the re-treading of worn out motor vehicle tires. The shortage of essential imported products gave a boost to a host of small domestic producers who responded to the incentive of scarcity prices. In addition, a new entrepreneurial class sprang up to supply the requirements of the British Armed Services encamped in the Island. Thus, when the country gained its Independence in 1948, favorable conditions prevailed for the industrialization of the country through encouragement of private sector initiatives. Unfortunately, with independence, a major policy decision was made by Governments to rely more on direct investment by the Government itself in setting up industrial ventures, rather than on private sector initiatives through the provisions of incentives and subsidies (Wickramasinghe, 1993).

In keeping with this policy, large state owned factories were set up in Sri Lanka to manufacture cement, paper, chlorine and caustic soda, cotton yarn and fabric, canned food products, construction steel, bricks and tiles, ceramic ware, boots and shoes, agricultural implements, petroleum products, fertilizer and a host of other products. Few incentives were given to induce private sector investment which had to face severe competition from imports in the context of relatively low rates of tariff protection inherited from British rule which were not revised upwards.

In 1960, however, there was a reversal of policy motivated by the need to balance foreign exchange outflows to inflows. Drastic import and exchange controls were introduced to conserve foreign exchange. Imports of most manufactured goods were banned or greatly reduced while raw material imports were restricted. While scarcity prices gave an inducement to expand local production and even set up new industries in substitution of imports, it was not possible for private entrepreneurs to respond to these incentives in the absence of the where-withal of machinery and equipment, raw materials and know-how, which could be imported only on licenses issued by the government. Thus, it is not surprising that these economic policies pursued for a period of 18 years from 1960 did little to change the industrial structure of the country, not with standing the establishment of the large state owned industrial enterprises (Wickramasinghe, 1993).

The failure to develop small industry in post Independent Sri Lanka may hence be attributed in the main to this failure in economic policies of Government. In a market economy, small industries develop alongside medium and large industries in competition with or complementary to the former. Small scale production can be competitive with large scale production because of the lower investment per worker and the use of a less sophisticated technology adapted to the skills of available supplies of educated but untrained and inexperienced labor.

Complementary production by small scale industries in support of large scale production is widely practiced in developed countries such as Japan and the newly industrialized countries such as Korea and Taiwan. This may evolve the manufacture of components and/or the sub assembly of components to be incorporated in the final products manufactured by the large scale enterprises.

The budget for the year 1978, of the newly elected government is a land mark in the economic development in Sri Lanka. It began a reversal of economic policies pursued by the governments of Sri Lanka since 1948. In 1978 import controls were abolished while exchange controls were greatly relaxed. Thus the stage was set for the progressive liberalization of the economy. The relaxation of controls has been progressive, enabling Sri Lanka to reintegrate itself not only with the world trading system, but also into the world financial system. It is no exaggeration to say that the reintegration of the Sri Lankan economy with the global economy has created highly favorable conditions for the successful industrialization of the country through investment in large, medium and small enterprises.

The changes in economic policies of Government after 1977 helped the development of small industries in the following significant ways:

1. The massive increase in investment, both of the Government and the private sector, created a demand for a wide range of products which could be met by rapid expansion of small industries in competition with imports and the product of large local enterprises. In particular, the rapid expansion in the demand for building materials for the construction industry, wood products and furniture, and for prepared foods, with the surge in employment and wages, gave much scope to small scale producers to meet the demand.
2. Adjustment of the exchange rate gave rise to rapid increase in tourist arrival, creating a rapid increase in demand for wide range of handicrafts made mostly from local raw materials.
3. Adjustment of the exchange rate created new markets for more traditional exports such as jewelery, pre-packed spices leather products as well as traditional exports of tea packaged in a wide range of containers made of paper, wood, reeds and ceramic made in small factories and workshops.
4. The continued depreciation of the rupee also encouraged import substitution, particularly because of the continued magnification of the rupee price of imported manufactures at the prevailing rates of tariff protection which though relatively low as compared with the rates prevailing prior to 1978 were still significant.

At present, the main features of the strategies for SME Development under the industrialization policy are:

1. Developing a base for economic and industrial growth for SMEs under the broad policies and programs of the government;
2. Creating and strengthening the financial, technical, and managerial infrastructure to fill existing gaps and/ or to provide additional support necessary for efficient and productive growth of small enterprises;

3. Increasing market efficiency by encouraging information exchange and improving the provision of information on new methods and opportunities.
4. Promoting the regional development of industry; and
5. Lending support to governmental, non-governmental, and independent initiatives for creating income-generating opportunities, self-employment, and entrepreneurial ventures in rural and urban areas.

2.2 INSTITUTIONAL SUPPORT FOR DEVELOPMENT OF SMEs

The governments who came to power since independence have initiated various measures, from time to time, for the up-liftment of the SME sector. This is reflected in the establishment of various institutions and launching of various programs aim at supporting the sector. By establishing the following institutions, Sri Lanka has tried to boost the SME sector.

- **Ceylon Institute of Scientific and Industrial Research (CISIR)**

The establishment of the Ceylon Institute of Scientific and Industrial Research (CISIR) in 1955 has contributed to the development and dissemination of appropriate technology to enhance the efficiency and productivity of SMEs. Over the years, the CISIR has catered to the technology requirements of cottage and small scale industries especially in the areas of agro and food processing and preserving, wood and wood products, leather products, chemical products, and paper and paper products.

- **The Department of Rural Development and Cottage Industries**

The Department of Rural Development and Cottage Industries was established in 1957 as the main institution responsible for promoting the cottage industrial sector. The Department was renamed as the Department of Rural Development and Small Industries in 1968 and its scope of activities was expanded to include industries such as power looms, hand looms, carpentry, commercial pottery and coir fiber. In 1993, the Department of Small Industries was wound-up and its duties and functions were allocated to the provincial councils.

- **The People's Bank and The Bank of Ceylon**

The establishment of People's Bank and the nationalization of Bank of Ceylon in 1961 were land marks in providing institutional credit to SMEs. Bank of Ceylon branches and its sub offices at Agrarian Services Centers provided credit facilities under special programs to SMEs. Some domestic private banks have also introduced special facilities to these industries with the expansion of their branch network.

- **Laksala**

With the objective of helping to solve marketing problems of handicraft industrialist, "Laksala" was established in 1964. With a view to promoting the export orientation of the Small Business sector, the Department of Handicraft Marketing and Export Promotion was established in 1980 by amalgamating Laksala and other handicraft marketing centers. In 1982, Sri Lanka Handicraft Board was established in place of this Department.

● **Industrial Development Board (IDB)**

With the main objectives of encouraging, promoting and developing SMEs in Sri Lanka, the Industrial Development Board (IDB) was established in 1969. The IDB is considered to be the chief industrial extension institution in the country and was armed with regional offices and industrial extension offices. Over the years, the IDB has concentrated mainly on the development and dissemination of appropriate technologies, marketing facilities and in some cases, financial facilities and conducting entrepreneurship training and Small Business training for the small scale industrial sector.

The Small Scale Industries Credit Scheme (SSI) was introduced in 1974 in order to enlarge the small industry sector credit base. The Central Bank offered credit guarantees from July 1979 on SMI loans provided with financial assistance from the International Development Association (IDA).

● **Department of Textile**

In 1976, the Textile Department was created in view of the importance of textile production as a small industry. In 1984, the Sri Lanka National Design Center (NDC) was established in order to assist the cottage industrial sector through improvement of craft design and the development of new designs, better utilization of raw materials, the development of new production methods, the improvement of local design capability, assistance in market research and the organization of training programs in the field of design, product development and market promotion.

● **The National Development Bank (NDB)**

In 1979 the Government established the National Development Bank with the primary objective of providing project finance for large industry, agriculture and commerce. However, it was also required as an important secondary objective, to ensure that small industrialist are given access to project finance on the same term and conditions as afforded to large borrowers. Accordingly, the Small and Medium Industries Loan Scheme was initiated in 1979.

● **Small Enterprise Development Division (SEDD) of Ministry of Youth Affairs & Sports**

The self-employment programs assisted by the Ministry of Youth Affairs and Sports (MYUAS), as well as several non-government organizations (NGOs) and private institutions have also helped the promotion of SME sector in the country. In this respect, a separate Small Enterprise Development Division (SEDD) was established under the Ministry of Youth Affairs and Sports in 1984 with the objectives of formulating strategies and policies for stimulating self-employment and small scale enterprises.

● **Regional Rural Development Bank (RRDB)**

The establishment of Regional Rural Development Bank (RRDB) in 1985 made available an additional credit outlet to small business sector. Several micro credit schemes were implemented by these banks.

The Janasaviya Trust Fund, the Samurdhi Development Loan Scheme or SAHANA for

Samurdhi beneficiaries and “Surathura Diriya” also provide financial assistance to this sector.

At present, in addition to the Ministry of Industrial Development, there are several other institutions namely, the Ministry of Rural Development, Ministry of Textile industries, Ministry of Rural Industrial Development established to assist the development of the SME sector.

Recently established Vocational Training Authority and the proposed Enterprise Promotion Bank are major steps taken towards the development of SME sector in Sri Lanka in recent years.

So, it appears that there are a large number of institutions established aiming at supporting SME sector. However, studies have concluded that objectives of establishing these institutions have not been achieved due to a number of reasons.

In a study of institutional support for entrepreneurship development, Samarasinghe (1994) observes that among a sample of 30 individuals who have been trained by the EDPs in small business creation, not more than 35 percent have obtained institutional support after training. This implies that either the trainees have limited access to institutional support such as credit and extension services or the trainees do not see much use for such services.

2.3 ENTREPRENEURSHIP DEVELOPMENT IN SRI LANKA

In order to boost the SME sector in Sri Lanka, a number of Entrepreneurship Development Programs (EDPs) have been launched. Formal training interventions aimed at developing entrepreneurship in Sri Lanka has commenced in 1987 with the launching of a 12 -day program spread over six weeks by the Chamber of Commerce and Industry with the financial support from the Asia foundation (Ranasingha, 1996). The program titled “How to begin an Industry” has focused on providing knowledge of business and developing linkages with institutions and individuals. According to Ranasingha (1996), at present entrepreneurship training is conducted by several governmental, non-governmental and private sector agencies. They include:

a) Governmental

- i . Industrial Development Board (IDB)
- ii . Small Enterprise Development Division (SEDD) of the Ministry of Youth Affairs and Sports
- iii. Employment Investment and Enterprise Development Division (EIED) of the Mahaweli Authority of Sri Lanka, and
- iv. Integrated Rural Development Projects (IRDPs) of the Regional Development Department of the Ministry of Finance and Planning

b) Non- Governmental

- i . Sri Lanka Business Development Centre (SLBDC)
- ii . Sarvodaya Management Training Institute (SMTI) of the Sarvodaya Shramadana

Movement

c) Private Sector

- i . Business Consultancy Services Ltd. (BCS)
- ii . Business Management Bureau (BMB)
- iii. TEAMS Ltd. and
- iv. Resource Development Consultants Ltd.

Of the above agencies, full fledged EDPs ranging from one week to four weeks are available with the IDB, SEDD of the Ministry of Youth Affairs and Sports, BCS Ltd., SLBDC, and BMB.

In a study of entrepreneurship development among the rural poor, Mohotti (1993) observes that lack of a proper procedure for selection of participant is the main weakness of the existing programs.

In a comparative study of the effectiveness of EDPs conducted by SEDD of Ministry of Youth Affairs and Sports and Industrial Development Board, Gamage (2000) has concluded that, although trained entrepreneurs have performed better than that of their non-trained counterparts, their performances are not statistically significant.

Some critics are of the view that most EDPs have been more product-oriented and less market oriented. Owing to this weakness, in many instances, the trainees have come up with prototype products which have not been successful in marketing sense. Having experienced failure, those who did not have the entrepreneurial qualities have shown a tendency to give up their business.

It was found that some existing EDPs do not adopt systematic follow-up action. On completion of training the trainees are advised to obtain institutional support such as credit and marketing facilities on their own. However, only a few have the entrepreneurial qualities appear to take the initiative and succeed in business.

According to Ranasingha (1996), it appears that the EDPs of longer duration have a high theoretical content which reflects a bias towards Western Models. It could be probably due to the fact that the majority of the EDP trainers in Sri Lanka have been trained abroad in the application of Western models and most of EDPs have been funded by Western donors. A weakness in the content of EDPs is that they have not been able to integrate the indigenous entrepreneurship experiences and values in the curricular.

So, it is clear that, although attempts have been made during past two decades to give an impetus to entrepreneurship through training, it has not achieved the desired level of development.

3 . PROBLEMS ASSOCIATED WITH THE DEVELOPMENT OF SME SECTOR IN SRI LANKA

A major problem in the SME sector is the shortage of capital due to number of reasons such as lack of access to bank facilities, lack of knowledge of bank procedures, long delays and inability to provide guarantees. Although there are some loan schemes available, the high rate of interest makes the venture unattractive. According to the evaluation study of EIED/EDP (Exo & Shan, op. cit) over 85% of the trainees have identified procurement of capital as the area in which they needed most support to succeed in business.

The sector has a weak institutional base due to lack of management skills. Management skills are the critical success factors in all of businesses thus Small Business has no exception. Small business does not mean that they are scaled down version of big business. It has to deal with all most all the functions that large businesses have to deal. So, lack of managerial skills of owner/manager may hamper the progress of the business.

The use of obsolete or inappropriate technology results in low productivity, low quality of products, and a high rate of rejection of products, resulting in higher costs to the producer and a reduction in market competitiveness. Again, this is also due to the weak financial base and lack of managerial skills. The weak financial position may hampers the upgrading of technology; expansion of production capacity, production efficiency, and does not allow the firm to go for new and sophisticated technology and spending on training and development of its work force to increase the productivity. In some cases, although fund are available, the management does not utilize them in areas such as training and development as the management do not understand the positive impact of training on business success.

The lack of SME policies and institutional support to protect and encourage SMEs are also hampers the progress of this sector. Specially, small businesses are vulnerable to the changes in the environment. Due to the inherent nature of smallness it will not be able to compete with big businesses. For example, with the introduction of open economic policies in 1977, a large number of handloom textile enterprises had to be abandoned by owners. So, the lack of clear policies, incentives and institutional support will reduced the survival rate and progress of ventures in this sector.

4 . POLICY IMPLICATIONS

At present the government of Sri Lanka is giving high priority in promoting SMEs. It is suggested that to overcome those constraints and problems, Sri Lanka has to have a national policy on SMEs as an integral part of the overall industrialization policy. In developing such a policy it is important to recognize the importance of the following areas.

- **To have a clear legislative definition**

At present there is no clear legislative definition for SMEs. Different institutions adopt different definition for their own programs. This situation has led to confusion in identifying SMEs for providing various concessions and programs. Also, this creates various problems in the implementation of government policy for promoting SMEs. Therefore, the government should recognized the urgent need to develop a legislative definition for Micro, Small, Medium and large enterprises.

- **To conduct a comprehensive industrial survey**

It was clear that there is no any recently conducted comprehensive industrial survey covering SMEs in Sri Lanka. So, it is imperative to conduct a comprehensive industrial survey in order to understand the strengths, weakness, threats and opportunities of this sector thereby understanding the position and contribution of SMEs to the national Economy.

- **To expand institutional support**

At present there are various government, NGOs and private sector institutions that support for the promotion of SMEs. The services extended by these institutions include, arranging credit facilities, conducting entrepreneurship and small business training programs and counseling services, dissemination of appropriate technology conducting research and development etc. However, these institutions do not have a well spread network which would provide extension and assistance to the SMEs on continues and regular basis. The information on such organizations is not available to the most of rural small businesses. So, strengthening of institutional capacity with a nation-wide concern is a part and partial of the development strategy of SMEs. The Enterprise Promotion Bank, which is under proposed stage is a very good step put forward for the development of SMEs in providing credit facilities. It should favor the small industrialists who do not have access to the institutional financial market and cannot afford the collateral and on-going market rate of interest.

- **To give incentives, assistances and tax concessions**

The government must consider giving incentives, assistance and tax concessions to SMEs on a regular, continues basis. A complete package of services, incentives, and tax concessions on the line of those offered in other developed and developing countries, should be develop.

- **To strengthen inter- industrial linkages**

Strengthening inter-industrial linkages among micro, small, medium and large scale industries is very important. In well developed countries such as Japan, have very strong linkages among these industries. In Japan about half of small scale manufacturing enterprises appear as sub-contractors to large business.

- **To create entrepreneurial path within the system of general and vocational education**

Finally, although the economic context in Sri Lanka has changed in favor of entrepreneurship, the socio-cultural context needs further changes to give impetus to entrepreneurship. The changes in values have to be initiated from the level of primary education as the need for

achievement, independence, and perseverance has to be created among the youth from a very early stage. It is also imperative to create entrepreneurial path within the system of general and technical/vocational education. Accordingly, the curricula must be revised in order to lay the foundation for creativity and innovation.

CONCLUSION

SMEs play very important role in both developed and developing countries. Their importance is reflected by the sheer number of establishments, generation of employments, contributing to the GDP, embarking on innovations, stimulating of other economic activities etc. Having understood the positive impact of SMEs development on economic growth, many countries are putting a lot of efforts to develop this vital sector. In Sri Lanka too, successive governments have taken various steps to develop SMEs since independence. But the contribution of SMEs to the national economy in Sri Lanka is still low when compared with the other developed and developing countries in the region. Therefore, there is an urgent need to further improve the inherent capacities and capabilities of these industries to be efficient suppliers. In order to bring this sector to that position, the role that the government has to play is very important. First of all it should have a national policy on SMEs. In order to formulate a national policy, it should recognize the importance of facts such as having a clear definition for SMEs, expanding institutional support, giving incentives, assistance and tax concessions are imperative. Further, creating an inter-industry linkage and establishing funding institution such as Enterprise Development Bank who provides seed capital to SMEs at lower interest rate and which has easy access are very important. Finally, in a broad perspective, it is imperative to change the curricular to give impetus to entrepreneurship through general, technical and vocation education in Sri Lanka.

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