

# The Impact of COVID-19 on the MSME Sector in Sri Lanka



**United Nations**

Department of  
Economic and  
Social Affairs



## **The Impact of COVID-19 on the Micro-, Small and Medium-Sized Enterprise (MSME) Sector in Sri Lanka**

Department of Economic and Social Affairs of the United Nations Secretariat/Division for Sustainable Development Goals (UN DESA/DSDG)



## Abstract

The present report provides an overview of socioeconomic conditions in Sri Lanka and focuses as well on sectoral contributions to gross domestic product (GDP) and employment. The report also offers a detailed examination of the MSME sector, including its contribution to the economy and employment and its composition and geographical distribution.

The impact of the COVID-19 pandemic on MSMEs is addressed through an in-depth approach which covers the main subsectors. The report summarizes the relief measures introduced by the Government of Sri Lanka to support MSMEs in their efforts to weather the pandemic and analyses in detail their status within the context of the current crisis.

The report also surveys measures aimed at building resilience and presents recommendations for strengthening business continuity and reviving the MSME sector.

## Abbreviations and acronyms

BDS	Business Development Service
CBSL	Central Bank of Sri Lanka
CRIB	Credit Information Bureau of Sri Lanka
DCS	Department of Census and Statistics
EDB	Export Development Board
GDP	gross domestic product
GOSL	Government of Sri Lanka
IDB	Industrial Development Board
MSMEs	micro-, small and medium-sized enterprises
NEDA	National Enterprise Development Authority
SME	small and medium-sized enterprises

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## I. Introduction

Sri Lanka, an island nation with an area of 65,610 square kilometres (km<sup>2</sup>), had a total population of 21.67 million (as of midyear 2018). The country's average literacy rate is 92.5 per cent and average life expectancy rate at birth is 76.8 years. Government expenditures on health and education are 1.67 per cent and 1.9 per cent of gross domestic product (GDP), respectively. The health sector is operated predominantly by the government and health services are offered free of charge. In addition, there are a considerable number of private hospitals, with the majority of them located in the Western Province and other main cities and suburbs around the country. There are 3.6 beds per 1,000 persons, one doctor per 1,203 persons and one nurse per 570 persons in government hospitals.<sup>1</sup>

## II. Overview of the country's economy

### A. Contributions to GDP, by sector

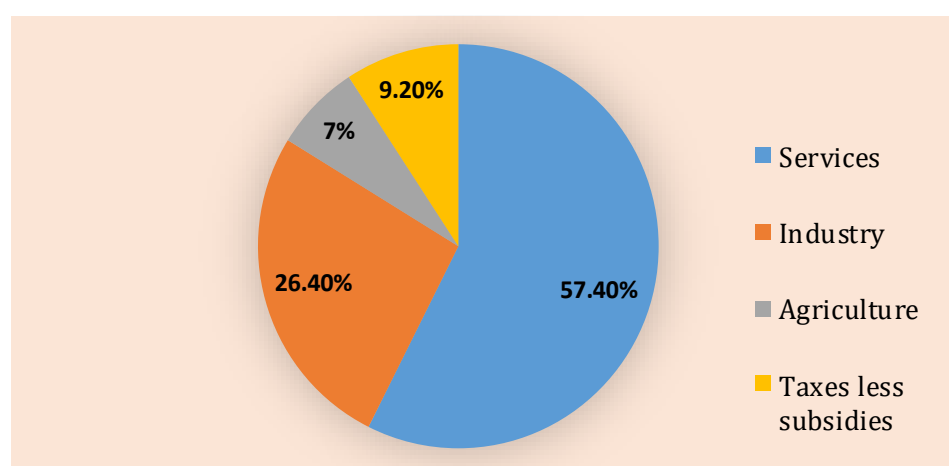


Figure I: Contributions to GDP, by sector

The gross domestic product (GDP) of Sri Lanka was estimated at US\$ 840 billion in 2019, with the contributions of the key sectors of services, industry and agriculture amounting to 57.4 per cent, 26.4 per cent and 7 per cent, respectively. The proportion for taxes less subsidies was 9.2 per cent.<sup>Error! Bookmark not defined.</sup> The country's tourism sector has been integrated with other economic activities classified to the services and industry sectors.

Manufacturing activities registered slow growth in 2019 - at 1.9 per cent - despite a contraction of the production of rubber, plastic, wood and other products. On the other hand, the apparel and textile industry has contributed positively to the growth of the overall manufacturing sector. The agriculture production index remained broadly unchanged in 2019 owing to the contribution of key drivers such as oleaginous fruit production. The Purchasing Managers' Index (PMI) under manufacturing and services fell to historically low

<sup>1</sup> See [www.cbsl.gov.lk/en/publications/economic-and-financial-reports/annual-reports/annual-report-2019](http://www.cbsl.gov.lk/en/publications/economic-and-financial-reports/annual-reports/annual-report-2019); and [www.health.gov.lk/moh\\_final/english/public/elfinder/files/publications/AHB/2020/AHB\\_2018.pdf](http://www.health.gov.lk/moh_final/english/public/elfinder/files/publications/AHB/2020/AHB_2018.pdf).

levels - 41 and 45.3, respectively - in April 2019, reflecting the impacts of the Easter Sunday terrorist attack.<sup>2</sup> . While the country was confronting these setbacks, its situation grew desperate owing to the outbreak of the COVID-19 pandemic.

## B. GDP growth

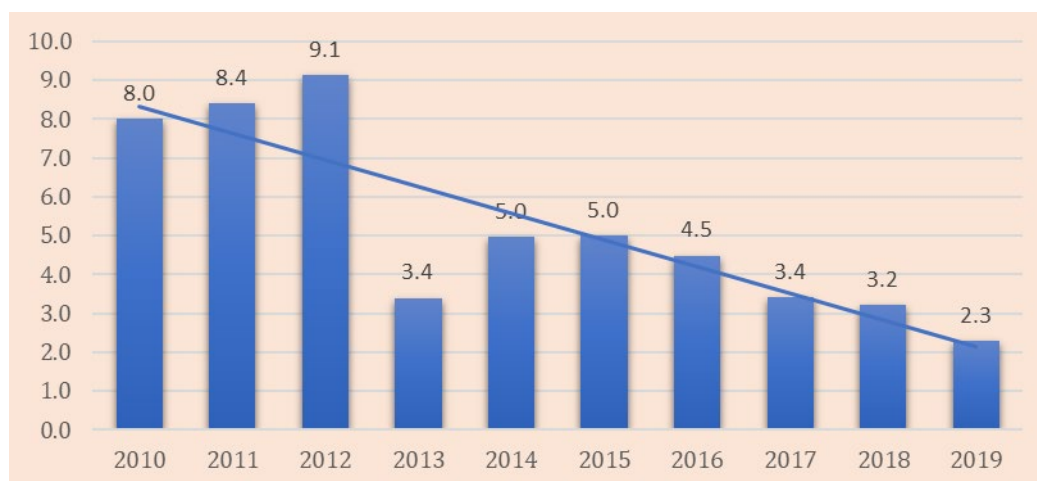


Figure II: GDP growth (annual percentage)

Source: Central Bank of Sri Lanka, *Annual Report for the Year 2019*.

Growth of the country's real GDP in 2019 was sluggish at 2.3 per cent compared with 3 per cent in 2018. The sluggish growth was attributed mainly to the Easter Sunday terrorist attack on churches and some leading hotels in Colombo in April 2019, which adversely affected the income of the tourism industry.

## C. Comparison of Total imports and Total exports

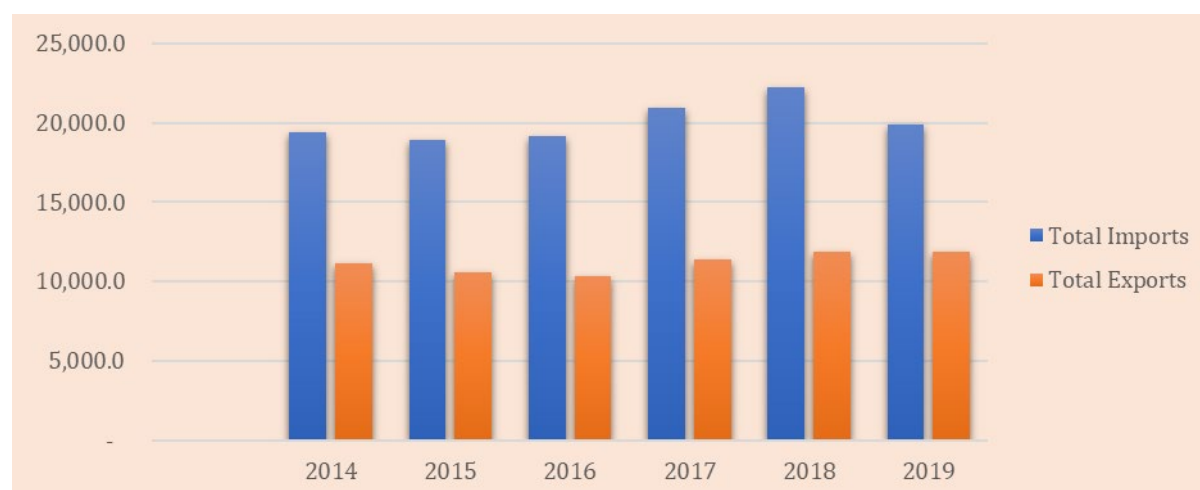


Figure III: Comparison of imports and exports

Source: Central Bank of Sri Lanka, *Annual Report for the Year 2019*.

<sup>2</sup>

[www.cbsl.gov.lk/sites/default/files/cbslweb\\_documents/press/pr/SL%20Purchasing%20Managers%20Index%20-%20Apr%202019\\_En.pdf](http://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/press/pr/SL%20Purchasing%20Managers%20Index%20-%20Apr%202019_En.pdf)

## 1. Exports

The major destinations of Sri Lankan exports in 2019 were the United States of America (26 per cent), European Union and other (16 per cent), Asia and other (11 per cent), the United Kingdom of Great Britain and Northern Ireland (8 per cent), India (6 per cent), Germany (5 per cent), Middle East (9 per cent) and other (19 per cent). In 2019, industrial exports, which accounted for 78.9 per cent of total export earnings, had increased slightly with marginal growth of earnings from textiles and garments, which were recorded as accounting for 46.9 per cent of industrial exports in the same year. Agricultural exports, which accounted for 20.6 per cent of total exports, have declined owing mainly to price fluctuations in the global tea market, reduction in the production of other agricultural exports and lack of demand, especially in the European Union (EU), for seafood exports. The major industrial exporter is the apparel sector, which accounts for 46.9 per cent of total industrial exports, with the main export destinations being the United States (25 per cent), the EU (22 per cent), the United Kingdom (8 per cent) and India (6 per cent). Women's intimate wear, knitted and woven suits, sweaters, shirts and gloves make up more than 70 per cent of exports to the United States.

## 2. Imports

The major source countries for Sri Lanka's imports are India (20 per cent), China (20 per cent), Asia and other (18 per cent) and the European Union (10 per cent). The major import categories are intermediate goods (accounting for 57 per cent of imports), investment goods (23.1 per cent) and consumer goods (19.8 per cent).

## D. Employment

In 2019, the country's labour force totaled 8.39 million persons, the labour-force participation rate was 51.8 per cent, the total number of employed persons was 8.18 million and the unemployment rate was 4.4 per cent. The household population aged 15 years or over was 16.2 million. The services sector accounted for the largest proportion of total employment (47 per cent), followed by the industrial (and agriculture sectors (28 per cent and 25 per cent, respectively).<sup>3</sup>

### Employment by sector

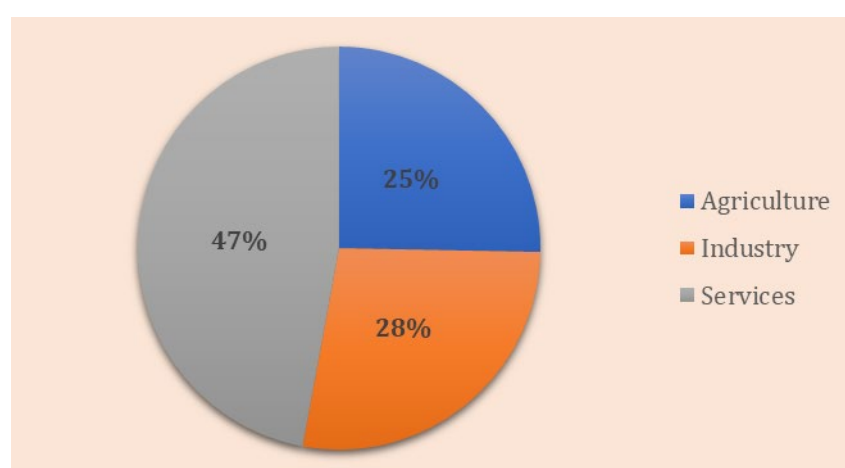


Figure IV: Employment by sector

Source: Central Bank of Sri Lanka, *BSL Annual Report for the Year 2019*

<sup>3</sup> [www.statistics.gov.lk/Pocket%20Book/chap03.pdf](http://www.statistics.gov.lk/Pocket%20Book/chap03.pdf).



### III. The MSME sector in Sri Lanka

Micro-, small and medium-sized enterprises (MSMEs) play a vital role in the socioeconomic development of the country. It is estimated that MSMEs, which are considered the backbone of the economy of Sri Lanka, account for 52 per cent of GDP. It is also estimated that over 90 per cent of the total number of enterprises in the non-agricultural sector are MSMEs, which account for 45 per cent of total employment in that sector. As reported in the Economic Census 2013/14 conducted by the Department of Census and Statistics (DCS), there are 1.017 million establishments in the micro-, small and medium-sized enterprise (MSME) sector, providing nearly 2.255 million persons in the non-agricultural sector with a livelihood.

The defining criteria of micro-, small and medium-sized enterprises, as approved by the Cabinet of Sri Lanka, is given in table 1.

Table 1: *Defining criteria for MSMEs in the manufacturing and services sectors)*

<b>Sector</b>	<b>Criteria</b>	<b>Medium</b>	<b>Small</b>	<b>Micro-</b>
<b>Manufacturing</b>	Annual turnover (millions of Sri Lanka rupees)	251-750	16-250	15 or less
	Number of employees	51-300	11-50	10 or less
<b>Services</b>	Annual turnover (millions of Sri Lanka rupees)	251-750	16-250	15 or less
	Number of employees	51-200	11-50	10 or less

Source: National Policy Framework for Small Medium Enterprise (SME) Development.

#### A. Distribution of establishments by scale

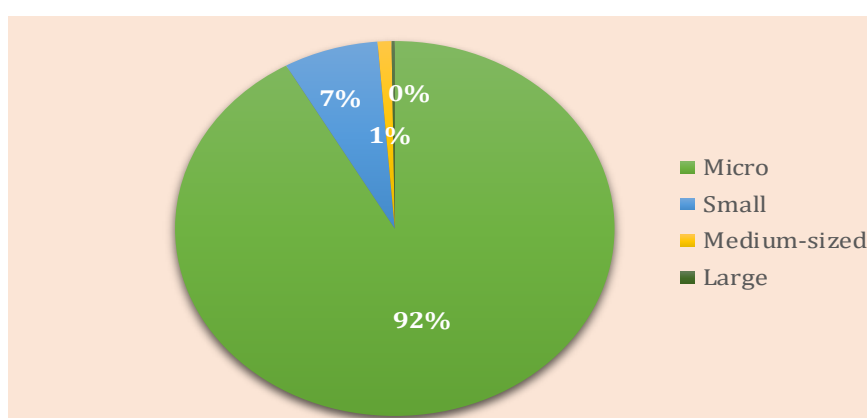


Figure V: Distribution of non-agricultural economic sector establishments by size

Source: Department of Census and Statistics, Non-Agricultural Economic Activities in Sri Lanka, 2013/14.

Figure V displays the number and proportion of establishments in each of the four size categories as distributed across the country in 2013-2014: micro (935,736, 91.8 per cent); small (71,126, 7.0 per cent); medium-sized (10,405, 1 per cent); and large (2,414, 0.2 per cent). The MSME sector accounts for 99.8 per cent of the total number of establishments in the country.

## B. Distribution of employment by scale of establishment

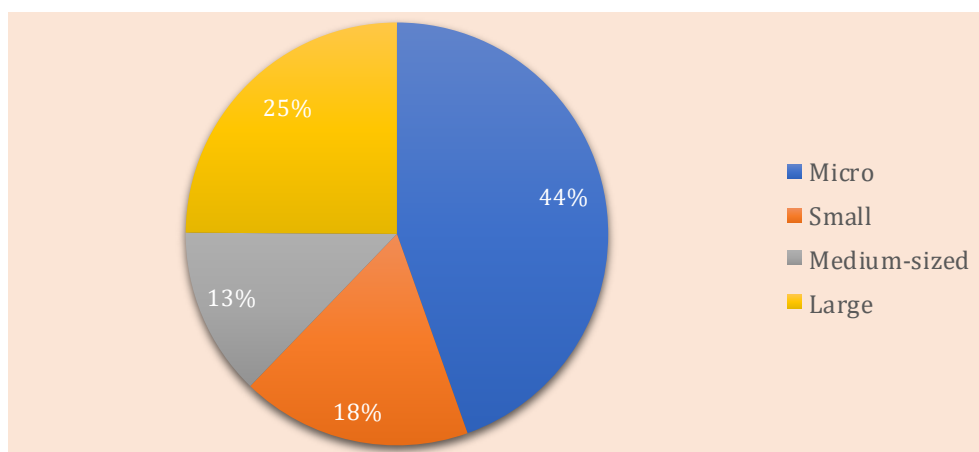


Figure VI: Distribution of employment across the non-agricultural economic sector, by scale of establishment *Source: Department of Census and Statistics. Non-Agricultural Economic Activities in Sri Lanka, 2013/14.*

Figure VI, which displays the distribution of employment across the non-agricultural economic sector, by scale of establishment, shows that in 2013-2014 MSMEs accounted for 75 per cent of the total number of employed persons in that sector (1,338,675 in microenterprises, 529,751 in small enterprises and 386,756 in medium-sized enterprises. Large enterprises employed 747,937 persons (2 per cent of the total number of employed persons).

## C. Distribution of MSMEs by geographical sector: urban, rural and estate

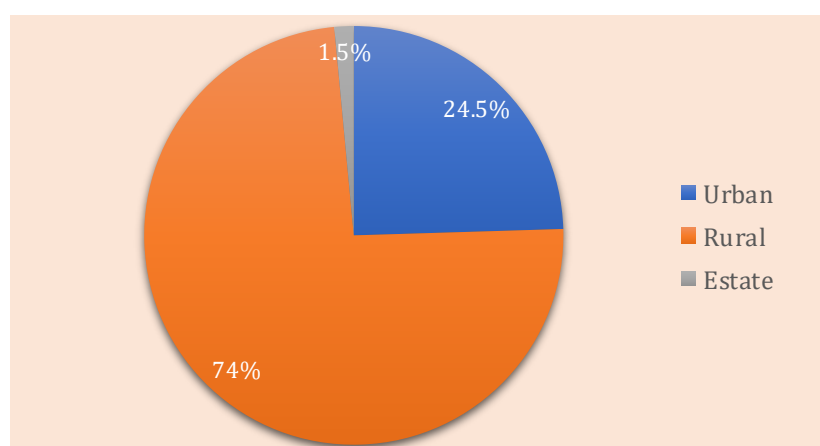


Figure VII: Distribution of MSMEs by geographical sector: urban, rural and estate *Source: Department of Census and Statistics, Non-Agricultural Economic Activities in Sri Lanka, 2013/14.*

Figure VII shows that in 2013-2014 about 75 per cent of MSMEs were located in the rural sector, which indicates the significant socioeconomic impact of MSMEs in rural areas. Further, the estate sector encompasses plantations, which are also located in rural areas. In consequence, any adverse effects on MSMEs will have a greater impact on rural than on urban residents.

Table 2 presents data on the number and percentage distribution of establishments by scale and on their percentage distribution by sector

Table 2: Number and proportion of establishments by scale and distribution of establishments by sector

Scale	Number Percentage		Industry (%)	Trade (%)	Services (%)
<b>All establishments</b>	<b>1 019 681</b>	<b>100</b>	<b>25.6</b>	<b>41.0</b>	<b>33.4</b>
<b>Micro-</b>	935 736	91.8	25.3	42	32.7
<b>Small</b>	71 126	7.0	28.8	31.3	39.9
<b>Medium-sized</b>	10 405	1.0	32.0	19.6	48.4
<b>Large</b>	2 414	0.2	31.6	36.9	31.5

Source: Non-Agricultural Economic Activities in Sri Lanka, Department of Census and Statistics, 2013/14

The number and proportion of persons engaged and percentage distribution by sector is given in Table 3.

Table 3: Number and proportion of persons engaged by scale of establishment and distribution of establishments by scale and sector

Scale of establishment	Persons engaged		Distribution by sector (percentage)		
	Number	%	Industry	Trade	Services
<b>All establishments</b>	<b>3 003 119</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Micro-</b>	1 338 675	44.6	29.7	68.1	44.6
<b>Small</b>	529 751	17.6	14.0	16.8	22.6
<b>Medium-sized</b>	386 756	12.9	16.7	5.5	13.9
<b>Large</b>	747 937	24.9	39.6	9.5	18.9

Source: Department of Census and Statistics, Non-Agricultural Economic Activities in Sri Lanka, 2013/14

Table 3 indicates that the highest proportion of persons engaged were employed by trade sector microenterprises. Although large-scale establishments represent only 0.2 per cent of the total number of establishments, 24.9 per cent of persons employed were engaged by this sector in 2013-2014.

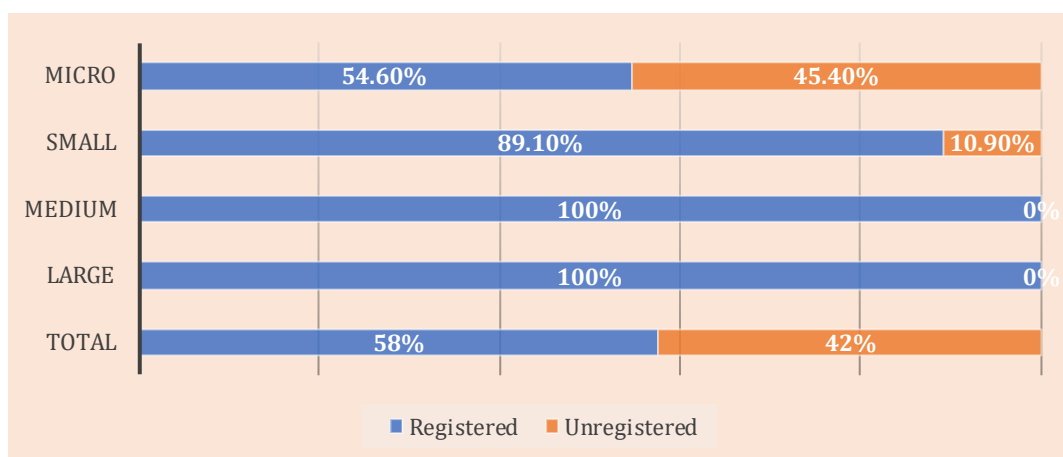


Figure VIII: Proportion of registered and unregistered enterprises, by scale

Source: Department of Census and Statistics, Non-Agricultural Economic Activities in Sri Lanka, 2013/14.

Figure VIII indicates that in 2013-2014, 42 per cent of all enterprises in Sri Lanka were informal in nature and unregistered business entities. Out of a total of 935,736 microenterprises (table 2), 45.4 per cent were informal enterprises and not officially registered. In most cases, micro- and small enterprises are registered as business entities with sole or joint proprietorship, while medium-sized and large enterprises are for the most part registered as limited liability companies. Some large enterprises are also publicly listed companies.

## IV. Impacts of the COVID-19 pandemic on the MSME sector in Sri Lanka

Impacts of the COVID-19 pandemic were experienced in Sri Lanka starting around mid-March 2020 when the first case was detected, at which time schools were closed. Following the detection of more and more cases of infection, especially among persons arriving from abroad, the Government introduced a 14-day quarantine programme for all persons arriving from foreign countries and all those who had come in contact with infected persons. With the increase in the number of infected cases, more quarantine centres were established and self-quarantine systems were introduced as well. Subsequently, curfew and lockdown measures were put in place to control the spread of the virus. Curfews were lifted from time to time to enable people to meet their daily needs. Preventive measures, such as social distancing, compulsory wearing of face mask and use of personal protective equipment, were also introduced. Most economic activities were adversely affected by these measures and MSMEs suffered hardships. Daily wage earners (i.e., persons engaged on a casual basis) were the most affected and in response to their plight, government departments initiated relief measures to help sustain their needs.

Initially, through the proactive measures taken by the government, it appeared that the spread of COVID-19 was successfully contained and confined to identified clusters. It was expected that by early May a good level of containment would be reached and normal activities could be resumed. However, owing to the rapid spread of the pandemic, the number of infections continued to increase and it is difficult to predict when the country will be restored to a state of normalcy once the rules governing the movement of persons are relaxed. At present, however, the spread has been confined to identified clusters in quarantine centres and to some security personnel who were infected while engaged in operational activities. According to the health authorities, COVID-19 has not spread throughout society.

Certain districts were not affected and with the lifting of the curfew, economic activities have resumed in some of them. Activities in the agriculture sector were able to continue without much difficulty, which was a positive aspect of the situation. The main subsectors that have been affected by the COVID-19 pandemic, are discussed below, with special reference made to MSMEs. It is worth noting that those are also the subsectors where most of the country's MSMEs are concentrated.

### A. Tourism industry

Income from the tourism industry totaled US\$ 3.59 billion in 2019, compared with a figure of US\$ 4.38 billion (4.9 per cent of GDP) in 2018. The drop, in the amount of US \$0.79 billion, was the result mainly of the 2019 Easter Sunday attack. The outbreak of the COVID-19 pandemic and closing of the country's borders to foreign travelers in mid-March, combined with global travel restrictions and the shutdown of Sri Lanka's international airports, have resulted in massive revenue losses. In the months of January, February and March 2020, tourist arrivals dropped by 6.5 per cent, 17.7 per cent and 70.8 per cent, respectively. The drop may have reached the 100 per cent level by April.<sup>4</sup>

In 2018, there were 3,926 establishments catering to tourists, according to a survey conducted by the Sri Lanka Tourism Development Authority (SLTDA). The tourism sector employed a total of 169,903 persons. Indirect employment provided along the value chain by, e.g., the handicraft trade, gem and jewelry shops, liquor shops and laundries, which belong to the micro- and small enterprises category (MSEs), brought the total number of

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<sup>4</sup> [https://sltda.gov.lk/storage/common\\_media/Arrivals\\_Report\\_March\\_2020517418073.pdf](https://sltda.gov.lk/storage/common_media/Arrivals_Report_March_2020517418073.pdf).

employed persons to 219,484. Those engaged in indirect employment within the tourism industry, who work mainly in the micro-, small and medium-sized enterprises (MSMEs) sector, are certain to have been severely affected by the COVID-19 outbreak. It is expected that after the global COVID-19 threat has been eliminated, a period of at least six months will be required for MSMEs in the tourism industry to return to a state of normalcy.

## B. Apparel sector

The number of persons employed in the apparel sector is estimated at about 300,000, with about 100,000 employed by micro-, small and medium-sized enterprises (MSMEs). In addition, a large number of those employed in the informal sector are engaged in the production of garments targeted mainly at the local market. When indirect employment is also considered, it is estimated that this sector provides a livelihood to about 600,000 persons in the country, of whom over 80 per cent are female. The United States of America is the major destination for exports from this sector, followed by the European Union. More than 75 per cent of the exports from the sector are exported to the United States and the European Union. Large-scale factories cater to high-end retail chains located mainly in the United States and the small and medium-sized enterprises (SMEs) sector caters to the European Union market under the Generalized System of Preferences Plus (GSP+). According to entrepreneurs in this sector, purchasing orders are being cancelled and some importers are not settling contracts for goods to be supplied. It is estimated that the Small and Medium Garments Exporters Association (SMGEA), which has 80 members, is responsible for 30 per cent of total exports. In an interview, the president of SMGEA, Mr. Bandula Fernando, indicated that SMGEA member enterprises are worst affected by the challenge of limited working capital.

In addition, as most MSMEs in the apparel sector depend on fabrics and accessories supplied by China; the disruption of the supply chain has severely affected them. Further, the microenterprise-level garment manufacturers in this sector obtain their raw material from wholesale agents who import the items in bulk, mainly from China and India. The breakdown of the supply chain, combined with the imposed curfew restrictions, has caused those MSMEs to become almost inactive.

### **Box I. Effect of the COVID-19 pandemic on member businesses of the Small and Medium Garments Exporters Association (SMGEA)**

“Our customers have postponed some of the orders and some have lost the orders while some have deferred payments for our exports. We are facing many financial issues. Given this situation, it is very difficult for us to pay the salaries of these employees for the months of April and May. With no source of income, our members are also unable to repay the capital loans they have already obtained. Our only intention at this moment is to protect our valuable human resources.”

Executive member at SMGEA press conference, 20 April 2020 \_ [FT TV E-PAPER](#)

## C. Footwear and leather sector

The footwear industry, which is highly labour intensive, has significant potential to become a key contributor to the growth of the country's economy. Footwear sector value added lies between 35 and 45 per cent. The industry currently employs about 40,000 people directly and indirectly and includes 10 large companies, 30 medium-scale companies and about 3,000 small-scale manufacturers. Using a variety of raw materials, the sector produces a diverse range of types of modern footwear, including canvas footwear and rubber boots, thongs, sport shoes, and leather shoes. In the MSME footwear and bags sector, the main raw material is

genuine leather manufactured locally using a meat industry by-product. In 2018, this sector's export income totaled US\$ 119 million <sup>5</sup>

The sector faces problems common to other sectors such as limited working capital, disruption of supply chains and marketing issues.

## D. Processed food industry

### Box II. Effect of the COVID-19 pandemic on the leather and footwear sector

“The leather and footwear sector is not given adequate attention, although it makes a significant contribution to the economy and provides livelihood opportunities to a large number of people. The MSME sector was severely affected by the COVID-19 pandemic as they lost the main sales opportunities of the April festival season. They are currently saddled with unsold stocks and face liquidity problems. Further, their supply channels have been disrupted. At this stage, a helping hand should be given to entrepreneurs for business continuity.”

Nimal Samarakkody, Chairman, Advisory Committee on the leather sector

Processed food is one of Sri Lanka's emerging lucrative industries in terms of production, consumption, export and growth prospects. The sector comprises dehydrated fruits and vegetables, processed gherkins and cucumbers, herbal teas, frozen meat, sauces and tomato ketchup, and prepared foods such as Ambul Thial, Katta Sambol and dried sprats. This sector includes more than 110 manufacturing and marketing companies. As reported by the Processed Food and Beverages Strategy 2018-2022 under the National Export Strategy of Sri Lanka 2018-2022, in 2016 the sector's export value was close to US\$ 400 million, representing about 4 per cent of the value of total goods exported. About 40 per cent of MSMEs nationwide are associated with the sector, which, according to an estimate of the Export Development Board (2017), employs more than 2 million people.

With changes in lifestyles and the appearance of more and more supermarkets, new opportunities have emerged for MSMEs to contribute value added through their agricultural products and processed food items. A sizeable number of entrepreneurs with innovative ideas who have been guided by the National Enterprise Development Authority (NEDA) and the Industrial Development Board (IDB) have recently entered this sector. Many entrepreneurs have received assistance and support through various projects of the Government, the Ministry of Industry and Commerce and non-governmental organizations, which have yielded positive results, despite the big blow dealt by the COVID-19 outbreak to new-entrant MSMEs at this formative stage of their development.

## E. Handloom and handicraft industry

The traditional handloom and handicraft industry provides livelihoods to many of the country's rural residents, especially women. Real data are lacking but it is estimated that there are about 10,000 handlooms being operated in the country by private sector entrepreneurs, provincial councils and social cooperatives. While a major proportion of the producers of handloom fabrics cater to local markets, there are a few well-established producers who cater to export markets. The handloom industry depends on yarn imported mainly from India. Resumption of operations will depend on when access of enterprises to supplies is restored.

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<sup>5</sup> Sri Lanka, Export Development Board, "Industry capability report: footwear industry", December 2019. Available at [www.srilankabusiness.com/ebooks/footwear--2019.pdf](http://www.srilankabusiness.com/ebooks/footwear--2019.pdf).

There is limited local market demand for handicraft products, with producers catering to the tourism sector. Severely harmed by the aforementioned Easter Sunday attack, the handicraft market was slowly recovering when the COVID-19 crisis unfolded. The industry is not experiencing any problems associated with access to raw materials or continuation of production. Product marketing, on the other hand, looms as a big issue. It is mainly the residents of rural areas who engage in this trade, applying skills passed down through generations.

The highest local market demand for handloom and handicrafts products occurs in the period from March through May, which encompasses Sinhala and Hindu New Year in mid-April and the Vesak and Ramadan festival in May. By catering to demand during produce stocks to cater to the main festival season with the stocks they produce, entrepreneurs usually turn a profit and some recoup their prior losses. With the onset of the country's COVID-19 crisis in mid-March 2020, the situation of the industry's entrepreneurs became precarious.

## **F. Other industrial thrust areas**

MSMEs within the rubber, plastic, wood-based and ceramic industry subsectors, which comprise large enterprises and MSMEs, use mostly local raw materials. They will not confront major supply chain-related issues, except with respect to special items like chemicals and tools. Exports of finished rubber products, which constitute the principal driver of business activity, accounted for US\$ 768 million in earnings in 2016. The 400 companies that make up the plastic industry, comprising both large enterprises and MSMEs, cater to both export and local markets. The pandemic has affected exports which has led to a loss of marketing opportunities in the high demand period from March to April which has affected these enterprises severely.

Other industrial sectors - including metal products and machinery, boat building, automobile and transport equipment manufacturing, electrical and electronic products, and pharmaceutical & cosmetics - face similar challenges arising from the pandemic. However, owing to limited imports, there could be greater opportunities in the pharmaceutical and cosmetics industry once movement restrictions are relaxed.



## V. Relief measures offered by the Government of Sri Lanka (GOSL)

The Sri Lanka Central Bank established a refinancing facility pursuant to a decision taken by the Cabinet of Ministers on 20 March 2020, under which a wide range of fiscal and financial concessions were introduced for businesses affected by the COVID-19 pandemic, including self-employment business and individuals. The MSME-related relief measures are summarized below (see annex II of the present report for the text of circular No. 5 (2020), issued on 27 March 2020 by the Monetary Board of the Central Bank of Sri Lanka, as well as the link below<sup>6</sup>).

### I. Eligible businesses/sectors

- (a) Tourism, direct and indirect export-related enterprises, including apparel, information technology, tea, spices, plantation and related logistics suppliers, that have been adversely affected by work disruption and overseas lockdowns resulting from COVID-19;
- (b) SMEs engaged in business sectors such as manufacturing, services, agriculture (including processing), construction, value addition and trading businesses including authorized domestic pharmaceutical suppliers with turnover below 1 billion Sri Lanka rupees (Rs);
- (c) Self-employed individuals who have lost their jobs or incomes owing to the outbreak of COVID-19.

### II. Concessions for existing performing loans as of 25 March 2020

- (a) A six-month debt moratorium on leasing rentals, which includes vehicles, and related assets by self-employed individuals and business owners;
- (b) A debt moratorium until 30 May 2020 on personal loans granted to all private sector non-executive employees;
- (c) A three-month debt moratorium for all personal loans and leasing where the amount granted is less than SL Rs 1 million;
- (d) A six-month debt moratorium for affected MSMEs in tourism, apparel, plantation, information technology and related logistics service providers;
- (e) Extension of permanent overdraft maturity as of 25 March 2020 by six months, extension of temporary overdraft by two months, and interest rate to be limited to 13 per cent during the extended period;
- (f) Eligible trade finance facilities due for settlement or maturation or that were under review as of 25 March 2020 shall be extended to 30 September 2020.

### III. Concessions for existing non-performing loans (NPLs) as of 25 March 2020

- (a) The penal interest charged up to 25 March 2020 to be waived by related financial institutions;
- (b) Rescheduling of loans and advances;
- (c) Suspension of recovery actions;
- (d) All financial institutions shall suspend legal action against non-performing borrowers who have been accepted under this scheme.

### IV. New working capital or investment purpose loans

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<sup>6</sup> Available at [bsd\\_circular\\_no\\_5\\_of\\_2020\\_e1\\_0.pdf](#).

(a) Financial institutions may grant an additional loan or a new loan facility in Sri Lanka rupees (Rs) for working capital or investment purposes, subject to the following conditions, provided that the borrower submits a credible business plan:

(i) The working capital purpose loan facility to eligible performing and non-performing borrowers not exceeding Rs 25 million per bank per borrower and Rs 10 million per other financial institutions per borrower or a two months working capital requirement, whichever is higher, based on the requirement for the working capital cycle. Such loans shall be repaid over two years at an interest rate equal to 4 per cent per annum (p.a.) The Central Bank of Sri Lanka (CBSL) will subsidize interest cost up to 4 per cent for licensed banks and up to 7 per cent for other financial institutions as a rebate;

(ii) The investment purpose loan facility to be granted only by banks and only for performing borrowers not exceeding Rs 300 million per bank per borrower to expand business activities. Such loan shall be repaid over five years at an interest rate equal to maximum of average weighted prime lending rate (AWPLR) plus 1.5 per cent;

(b) A moratorium for the period from 25 March to 30 September 2020 will be granted for both working capital and investment loans;

(c) Financial institutions may obtain suitable collateral to mitigate risks related to any additional credit facilities granted under this re-finance facility.

#### **V. Capital repayment by banks under refinance schemes**

The Government of Sri Lanka has indicated its willingness to defer capital repayments on refinance loans granted to licensed banks falling due from 1 January until 31 December 2020.

**VI. Financial institutions are encouraged to establish a mechanism** for not declining loan applications solely on the basis of an adverse record from the Credit Information Bureau of Sri Lanka (CRIB).

#### **VII. Samurdhi Welfare Programme**

Samurdhi, which has existed for decades, is a highly organized welfare programme that provides monthly financial assistance to poor families. The institutional structure of the programme, which is headed by an authority, facilitates its capacity to cover the entire country. All Samurdhi recipients to be provided with Rs 5,000 to be used to overcome immediate difficulties. A loan of Rs 10,000 to be offered to recipients through the Samurdhi Bank. Issuance of a food card, as approved by the Cabinet, to be used to obtain a package of food items. With possible extension of the grant for a further one or two months depending on the recipient's situation. Microenterprises and the self-employed to receive a grant of Rs 5,000 to manage the challenges associated with their current situation.

(a) Loss of livelihood opportunities

The self-employed and daily wage earners are the groups most affected by the pandemic. Under this scenario, the relief packages, such as the grant of Rs 5,000 and the free food items provided by the Government, have helped them to meet their very basic needs. The distribution of dry rations and vegetables to persons in need by companies, social organizations, individuals, voluntary groups and religious organizations has been of immense help in enabling families to assure their own upkeep. As the majority of Sri Lankans living in rural areas earn a secondary income through their agricultural

activities or at least have access to basic food items for consumption, rural communities did not experience a real food shortage. A loan of Rs. 10,000 was granted to Samurdhi beneficiaries with the aim of providing the working capital needed to enable them to resume the small-scale business activities in which they had been involved. These are all short-term measures; the economic cycle needs to be reactivated to support resolution of this issue to the extent possible.

It is worth mentioning that enterprises have been compelled to lay off their workforce as they do not have the means to pay salaries. Some have made only partial payments. Those who cannot risk losing highly skilled personnel keep them on board, even at a loss.

## VI. Present status of MSMEs in Sri Lanka

The main issue faced by MSMEs in Sri Lanka appears to be the breakdown of supply chains owing to lockdowns and curfews. In addition, the majority of them face working capital-related problems as they have not been receiving payments for goods supplied and other income sources have declined. Escalation of prices for raw materials due to their limited availability has also affected their operations. The curfews and lockdowns have imposed constraints on disposable income, affecting the economic cycle. Relief measures that were taken by the Government of Sri Lanka did not generate a flow of cash into the hands of these MSMEs and vulnerable groups, such as daily wage earners, with the requisite swiftness. The challenge of the government will be to implement measures capable of sustaining businesses and minimizing job losses.

The lockdown of the western province in which Colombo, the commercial capital, is located poses a major supply chain-related issue. All imports, exports, wholesale warehouses and the entire spectrum of logistics operations are centred in Colombo.

The apparel sector secured some relief through fulfilment of export orders for face masks and safety clothing, which could help sustain a certain level of operations without employee layoffs. However, since it is mainly China that supplies the fabrics and accessories for this trade is from China, the industry will be in jeopardy until such time as the flow of China's exports returns to a normal level. To prevent such challenges in the future. This should incentivize policymakers to promote backward linkages within this industry, which could provide some form buffer against future challenges. The majority of MSMEs that are suppliers to European Union member countries will not receive orders until such time as those countries return to a state of normalcy. Those MSMEs should therefore orient themselves towards producing alternate products and identifying ways to capitalize on the new opportunities that have emerged in sectors such as health. Government organizations, such as NEDA and chambers of commerce, have offering provide online training packages to MSME entrepreneurs focused on e-commerce and development of online marketing skills. The situation of MSMEs associated with the tourism industry is a desperate one. A pick-up even in local tourism may require some time.

Agro-based industries will be able to resume their work once the curfew rules are relaxed, as they will then have fewer problems associated with supply chains and labour availability. However, they are also confronted with working capital issues related to restarting their businesses.

### A. New opportunities

Although the COVID-19 pandemic had many adverse effects, new opportunities have also emerged, especially for agro-based value addition processes. The fact that the agriculture sector was not deeply affected by the pandemic made people realize the value of the country's self-sufficiency with respect to rice and basic food items. Within the context of lockdowns and curfews, the Government has encouraged home gardening and cultivation of bare pieces of land, and many have acted in response. Further import restrictions on items that can be produced domestically might certainly pave the way towards the production of value added agro-based products and expansion of a local cosmetic industry based on herbal products. Many local industries that were successful are facing difficulties or have been compelled to close in recent years owing to their inability to compete against the importation of cheap, low-quality materials.

At the same time, students and SMEs have been responsible for many innovations during this period. The relevant authorities should pursue development of basic ideas for application at the commercial level. Online marketing, online teaching and knowledge sharing, webinars, and web-based lecture programmes have also

expanded significantly. The development by many private sector enterprises of online working arrangements for their staff represents a significant change generated by the challenges arising from the current situation. Online marketing and online teaching, as well as online knowledge sharing, webinars and web-based lecture programmes increased significantly. This trend could create new business opportunities for MSMEs with good experience in the area of online business.

### **Box III: Effect of the COVID-19 pandemic on businesses in Sri Lanka**

The country's current situation has greatly affected almost all businesses. Most entrepreneurs in our list are dependent on external raw materials suppliers. Owing to the present situation, they have difficulty obtaining the essential materials for their production processes. Movement restrictions, limited stocks and import restrictions are the reasons for the shortage of raw materials. Price fluctuations and high prices of raw materials have created working capital issues. Social distancing and restrictions imposed by the government have resulted in the drop in sales. Entrepreneurs in Nuwara-Eliya and Matale districts expected high sales during the April festival season but the prevailing situation has deprived them of that opportunity to generate a good income. Some are faced with a high level of returns and finished goods in their inventories, and have stopped production, while others have difficulty paying their employees' salaries.

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MSMEs are the entities that are most vulnerable to external impacts, as was attested in 2016 and 2017 during the unprecedented natural disaster precipitated by floods and landslides. However, as the direct threats lasted for only a few weeks, recovery along many dimensions was achievable within a reasonable period. As COVID-19 can be life threatening and is associated with a very high, infection rate, the Government was compelled to introduce restrictions which unfortunately imposed hardships on all those engaged in economic activities. The situation is complex, with the COVID-19 pandemic having triggered what the International Monetary Fund (IMF) calls the worst global recession ever.

The major impacts of the COVID-19 pandemic on MSMEs in Sri Lanka, as identified in the present report, encompass:

#### **(a) Working capital issues**

Although the Government of Sri Lanka has crafted a relief package, it is important to determine how many MSMEs have benefited from such assistance. Those data will benefit the formal sector, including those within the sector who operate at lower levels and may in consequence be unaware of their entitlement to such benefits.

The informal sector of course cannot be ignored, as more than 90 per cent of all entities belong to that sector (with the majority of persons engaged by those informal sector entities being women). The 90 per cent exert a huge impact on the socioeconomic dimensions of life in the country, A mechanism therefore needs to be created to enable viable informal businesses to survive, while providing them with the opportunity to convert themselves into formal entities.

Banks and financial institutions are reluctant to grant working capital loans in accordance with CBSL circular No. 5 of 2020 (annex II). Many entrepreneurs who are truly in need are unable to secure the

relief they need under this package, as they have already offered their assets as collateral in order to obtain loans.

#### **(b) Supply chain breakdowns**

Supply chain breakdowns will diminish with the relaxation of curfew and movement restrictions. China accounts for 17 per cent of total imports and a major proportion of industries and services depend on supplies from that country. Once the flow of imports is restored, a large number of enterprises will be able to recommence business. The Government of Sri Lanka should seek to facilitate the logistical solutions that will reduce the obstacles to the smooth flow of goods from Colombo to other areas.

#### **(c) Limited access to markets**

Lockdowns, restrictions on movement and social distancing have severely affected the channels through which the majority of MSMEs cater to the local market. This situation is expected to improve within a few weeks following the relaxation of restrictions. The export market depends on the opening up of other countries; however, some export activity is continuing. The garment industry is now engaged in manufacturing personal protective items such as masks which may enable manufacturers to avoid closing their factories and maintain some level of operations.

#### **(d) Psychological trauma associated with the pandemic**

Researchers warn that the COVID-19 pandemic could inflict long-lasting emotional trauma on an unprecedented scale. The COVID-19 pandemic - unfolding against a backdrop of calamities including the 2019 Easter Sunday terrorist attack, natural disasters and slow recovery in areas of civil conflict - has thrown Sri Lanka, into a worst-case scenario-type situation.

Field-level studies carried out by MSME service providers have found that among those that have been affected, there are still many where positive thinking is practiced and the opportunity to restart operations is eagerly awaited.

Social distancing and the wearing of masks and gloves under hot and humid conditions are demoralizing and result in reduced efficiency. It may take time for people in tropical environments who are not used to wearing those accessories to become accustomed to the practice.

#### **Box IV. A strategic vision is needed to help MSMEs impacted by the COVID-19 pandemic**

The dimension of the global impact of the COVID-19 pandemic that is visible represents only the tip of iceberg. It is certain that the pandemic will create a totally different world with its own “new normal” governing both the conditions under which all of us work and our economic activities. Since the entire business ecosystem is changing owing to the impact of COVID-19 and all businesses are suffering its adverse effects in various ways - with MSMEs being no exception - MSMEs will need to address the massive challenge of maintaining their business continuity and getting back to work. Four courses of action in support of Sri Lanka's MSMEs are paramount: (a) building MSMEs' awareness of the reality of the COVID-19 pandemic's impact on their businesses, (b)) strengthening their entrepreneurial spirit so as to enable them to withstand the blows while motivating them to adopt the appropriate stance for seizing the opportunities vital to sustaining their businesses, (b) encouraging MSMEs to formulate business resilience planning strategies, and (d)) strengthening the environment to ensure ease of doing business.

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## VIII. Conclusions

1. Among all enterprises, micro-, small and medium-sized enterprises (MSMEs) were the ones most vulnerable to and most affected by the natural disasters including floods and landslides that occurred in the country in 2016 and 2017. They were still slowly recovering from the 2019 Easter Sunday terrorist attack when the COVID-19 pandemic hit.
2. The loss of sales targeted towards the New Year season in April has been the biggest blow suffered by MSMEs catering to the local market. They have not received payment for goods delivered, on mainly a 45-day credit basis, to shops and wholesalers. Further, they have been left with stocks produced and market returns.
3. Agriculture- and local raw materials-based MSMEs have shown good level of resilience to external shocks. . MSMEs that established backward linkages to raw material suppliers were able to cushion themselves against the impact of the pandemic.
4. Most entrepreneurs have not been able to reap the benefits offered by government relief packages owing to lack of awareness of their availability or an inability to meet bank requirements. In their efforts to emerge from the financial crisis, entrepreneurs are fighting a lonely battle.
5. It is significant that many MSMEs in rural areas have a positive mindset and entertain high expectations that conditions will soon return to normal. On the other hand, there are many who need coaching and counselling to help prepare them for the challenge of resuming their business activities once the economy starts to gradually reopen.
6. The current situation has provided some innovative entrepreneurs with new opportunities. Others have diversified their product line.
7. Online marketing and home-based online operations have improved significantly. It is likely that further opportunities for MSMEs will be created in the information technology service sector within the "new normal" environment.



## IX. Recommendations

1. At this critical juncture, it is important to implement strategies aimed at reviving economic activities and to work towards creating a concrete job retention programme while at the same time sustaining the attention being given to containing the COVID-19 pandemic, which has delivered the most rapid and deepest economic shock in history.
2. It is recommended that a task force or coordinating body be created without delay as the basis for a concerted effort to assist MSMEs in reviving their businesses, to include:
  - ✓ Identifying gaps and drawing up strategies
  - ✓ Coordination to avoid duplication and to enable optimization of resources of business development services (BDS) providers
  - ✓ Developing a mechanism for providing one-on-one coaching and guidance sessions focused on generation of working capital, reviving supply chains, developing marketing linkages and business continuity plans
3. Provision of monetary relief packages and food parcels constitutes a good means of mitigating immediate financial shocks. A loan offered to microenterprises and self-employed persons in the amount of Rs 10,000 should be disbursed with the requirement that it be used for economic activities, not for consumption.
4. It is also important that such relief packages reflect political neutrality and transparency, so as to secure people's confidence, and the government's commitment to assistance and to motivating microenterprises and the self-employed.
5. The application process for disbursement of concessionary bank loans and other relief packages should be streamlined. MSMEs would need to have access to the guidance available from public and private service providers, chambers of commerce and trade associations.
6. Often, it is the large and upper-level medium-scale businesses that receive benefits, while micro- and small enterprises are overlooked. The importance of large and upper-level medium-scale businesses is undeniable; at the same time, the micro- and small enterprises (MSEs) sector should receive adequate attention not only as a social imperative but also within the context of MSEs' contribution to GDP. It is recommended that service providing institutions be encouraged to act as catalysts in this regard.
7. Most entrepreneurs have not been able to reap the benefits of government relief packages owing to a lack of awareness of the availability of such packages or an inability to meet banks requirements. It is therefore recommended that a solution to this problem be achieved through the development of a scheme for provision of a government guarantee to enable MSMEs to raise working capital on the basis of project viability.
8. It is also important for gender-sensitive policies to be implemented. As a large number of MSMEs are run by women, women should have equal access to bank facilities.
9. It is important that an island-wide trauma management programme for resource-constrained MSMEs be launched without further delay. Resilience-building and other proactive measures, with an emphasis on positive thinking aimed at making those enterprises competitive, are important as well.

10. It has been noted that several innovative support measures for health services have been developed during this period. It is recommended that ministries of industry, science and technology, and trade, with the support of related institutions, offer to assist the innovators in improving their products, obtaining patent rights and commercializing inventions that are suited for such a process.

11. It is also recommended that work on the Business Service Centre (a one-stop shop located in Monaragala), including laying the groundwork and training staff, be completed in time for a planned opening in March. If this pilot centre were to begin operations in Monaragala, it could implement some of the above-mentioned recommendations.

12. It is recommended that one-stop business service centres be established in other districts as soon as possible, using the existing facilities available in district secretariats, which could serve as focal points for coordination of activities aimed at reviving businesses.

## Annex I: Case studies

The author has interviewed a considerable number of the country's MSMEs during this period. The names used are fictitious. The case studies are of selected MSMEs and depict both the positive and negative dimensions of the impact of the COVID-19 pandemic. The interviews were conducted online owing to the health-related issues arising from the pandemic. The MSMEs in Matale, Kandy and the Eastern Province were selected by the consultant based on field experiences in those provinces. The sample from the Western Province was selected based on the recommendations of a senior project officer at the National Enterprise Development Authority

### I. Packed Foods

Packed Foods, an enterprise located in the Matale District of Central Province, is engaged in the manufacture and sale processed and packaged food and spices. The business, which began operations on a small scale, was registered in 2013. The entrepreneur, while working as a sales representative for some other organizations, conceived the idea of developing a card on which a number of sachets containing different herbal products could be displayed. He restricted his line of products to those used frequently by people in the area, who often opted to purchase items in small quantities to meet their immediate requirements. When displayed in shops, these cards captured the attention of the shoppers and became an instant success.

Encouraged by his success, the entrepreneur decided to devote himself to the business full-time. Together with his wife and another employee, he expanded his market by adding several new products, including packed processed food items. His range of products currently includes Dried Fish Sambal, Lime Pickle and 22 other products packed in sealed plastic bags bearing printed labels in accordance with regulations. He claims to be the leading supplier of Lime pickle in Central Province.

This entrepreneur, who expanded his marketing area to include several towns outside the province has four vehicles engaged in distribution. Sales are also transacted through appointed agents. He has obtained approval for seven of his major products from the Horticulture Crop Research Institute at Gannoruwa, Sri Lanka. Although he had expected that the COVID-19 pandemic would deal a severe blow to his business, in fact it did not, as he had sufficient stocks of raw materials to enable him to continue operations. His customers maintained their purchasing routine in spite of the curfew nor was his cash flow adversely affected, as he bartered his products as payment against the raw materials obtained. Since he lives and works at the same premises and since only he, his wife and one employee are engaged in the work, the curfew has not caused a labour-related issues to arise. During the periods when the Government relaxed curfew regulations as well as restrictions on delivery of food items, the entrepreneur was able to distribute his goods. While he does foresee some setbacks, he nevertheless anticipates that a reasonable level of business activity will continue once the difficult period has ended.

On the other hand, it has been found that he is not maintaining proper records of his financial transactions, which may affect his application for financial support provided by the Government during the pandemic.

### Analysis

The entrepreneur was not adversely affected by the impact of the COVID-19 crisis, owing solely to a localized business model and not to any contingency planning. The fact that proper accounts have not been maintained and that there have been irregular personal withdrawals could put the enterprise in a difficult

situation.to a. Enterprises that start operations on a micro scale should gradually introduce at least basic accounting and enterprise management systems. Otherwise, the business could face challenges when access to financial resources is needed. Further, MSME entrepreneurs need to receive guidance related to business continuity planning.

## 2. Spices

Spices, a small enterprise located in the Kandy District of Central Province, is owned and managed by a female entrepreneur, who started this business in 2008. As the result of a 12-year period of continuous business growth, the enterprise now employs 15 persons. By registering her business in 2010, the owner converted her business from an informal to a formal enterprise. The entrepreneur began operations with the production of chili powder, chili pieces, turmeric powder and curry powder, which were sold by the shops in her locality. In the initial stages, she was faced with working capital issues and had difficulties meeting the quality standards expected by her customers. However, through perseverance, she improved the quality of her products but also. She introduced a special meat curry powder mixture which became popular and picked up market shares at an unexpectedly rapid rate. As few raw materials overall need to be imported for the powder mixture, she uses local raw materials obtained from suppliers in the area as ingredients, . The owner had been running her business successfully up until the COVID-19 pandemic struck in mid-March 2020.

Although the impact on her sales was immediate, they began to gradually resume after a few weeks, despite the restrictions, such as the curfew, imposed by the government. This was due mainly to factors: (a) her products are essential cooking items and (b) she has carved out a niche market for those products among customers in her locality. She maintains a positive attitude and believes that once the curfew restrictions are relaxed, normal conditions will be restored.

### Analysis

This is a case where the entrepreneur has established a group of loyal customers. When people become accustomed to food ingredients with a particular taste - such as the special meat curry powder mixture - they will typically seek to purchase those ingredients from the same seller; When economic activities are resumed, this entrepreneur will have an advantage over others as regards expanding her market since her enterprise has managed to keep operating. Further, she will not be faced with major working capital issues, as her sales have continued and she will be able to collect at least a fair amount of revenues from those sales. The localized business operations model, combined with customer loyalty and the small scale of her enterprise, assures the owner of resilience in the face of any potential impact. Moreover, her positive thinking and determination will carry her forward despite challenges.

## 3. Araliya Garments

Araliya Garments, which is located in the Matale District of Central Province, was started by an enterprising young woman who had had previous experience as an account assistant. She began operations with one standard domestic sewing machine which she used to supply children's wear and shirts to a trader in Colombo. She had never worked in the garment trade, nor had she ever received any formal training in clothing manufacturing. Using her talents, she expanded her business and accepted the offer of a subcontract from an exporter. As profit margins from this order were very low and she could not operate her enterprise profitably, she ventured into the area of supplying her products to some leading clothing stores in Colombo. Her products included children's wear for both girls and boys aged 1 ½-10 years. Her products being of good quality, she received orders from some up-market shops, whose support enabled

her business to run smoothly. When the COVID-19 pandemic struck, she had a 30-machine production line and 18 female employees.

The April 2019 Easter Sunday terrorist attack dealt the first blow to her profitable venture. The supply of goods to leading retail chains dropped significantly and recovery took several months. She experienced delays in the receipt of payments and was unable to pay three instalments of a loan taken out from one of the country's leading banks. She indicated that the bank has taken steps to initiate legal actions against her assets provided as collateral. Further, the name of the enterprise has gone to the Credit Information Bureau of Sri Lanka (CRIB). However, when she had managed to negotiate terms with the bank in an attempt to overcome her difficulties, the COVID-19 pandemic struck.

In February 2020, she received orders for large quantities of items in anticipation of the New Year season sales in April. However, she could not deliver because of the pandemic. She is currently saddled with a stock of 1,500 pieces and has not received payments for products delivered prior to the pandemic because the shops that had purchased the products have still not reopened. Nonetheless, she has not given up and has started sewing face masks for the local market. She currently employs six persons and gradually earned an operational profit which keeps the company going. Owing to her well-established business reputation, demand for the sewn masks, which bear her brand name, has sustained her. On the other hand, she now faces a severe working capital issue. She had approached a bank, which agreed to issue a loan in the amount of Rs 1 million. Unfortunately, as her name has been recorded by the CRIB, the bank dropped the loan. She has indicated that she is unable to obtain any relief through the packages announced by the government.

## Analysis

This is a case where an enterprising young woman starting from scratch grew her venture into a small-scale business which provided employment to 18 local women. Though profitable and well-managed, the small enterprise was confronted with two major disasters. Despite the severity of the challenges, through her perseverance the female entrepreneur has managed to keep her business open. It is disappointing that banks and government institutions have not come to her assistance in her hour of need. Like many other MSME entrepreneurs in Sri Lanka, she is fighting a lonely battle. Government relief packages are secured mostly by influential parties who do not need such assistance. Banks and financial institutions prefer to support traders and enterprises that operate on a large scale. There are many similar cases unfolding across the country of struggling MSMEs that are not being given proper attention. This type of situation forces MSME entrepreneurs to seek the assistance of private microfinance entities, which could charge heavy interest rates of up to 24 per cent per annum and of pawnbrokers charging about 30 per annum per annum. The authorities should determine who actually benefits from the loan moratorium and concessional loans at the rate of 4 per cent per annum. A mechanism for providing timely help to MSMEs under a demand-driven approach should be put in place.

## 4. Coco Drinks

Coco Drinks, established by a youth entrepreneur who wanted to do "something different" is an enterprise located in the Western Province. The entrepreneur had read in an article that about 50,000 litres of coconut water go to waste in the country every day. This spurred him to conceive of launching a product that he called bottle king coconut water. After many failures and over 200 trials conducted with the support of his wife, he succeeded in producing both bottled and canned sparkling king coconut water without any chemical additives. The long story of his success starts with his having carried around bottles of coconut water in bus stations and introducing his products to the restaurants and hotels. Despite many rejections, he never gave up. He developed his own technology and designed machines with the help of local technicians. Currently, his company has the capacity to produce 1,200 bottles per day. His company's

product line includes the Orange drink (local Variety) Coco soda. Currently, there is a good level of demand for his products in the local market. His products have been exported to several countries, including China, and the Russian Federation, and exportation is expanding to include Canada and the United States of America.

With the outbreak of the pandemic, people started drinking brewed coriander to develop immunity against COVID-19. Confined to their home during the curfew, he and his wife were quite taken with the idea of adopting a traditional Ayurveda recipe to create a coriander and ginger drink, for packaging both in bottles and in cans. Their efforts have been successful. There has been high demand and his enterprise is running profitably. When interviewed, the entrepreneur noted that while the COVID-19 pandemic had had adverse effects on many MSMEs, it had created a new opportunity for him.

## Analysis

This is a good example of how innovative ideas (in this case the ideas of a youth entrepreneur) can transform adversity into opportunity. The entrepreneur was not confronted with any raw materials-related problems, as the area in which he operates has a number of small-scale king coconut plantations sufficient for meeting his business needs. Those plantations ensured a continuous flow of supplies during this difficult period. On the other hand, this youth entrepreneur has been disturbed by banks' attitudes and behavior towards MSMEs. He therefore decided to bring his business back to normal levels of activity and to pursue further growth through his own efforts.

## 5. Creative Design

Creative Design was formed in 2017 by three young entrepreneurs whose goal was to support and empower struggling artisans in the local community by providing them with a platform through which to market their products. By catering to the local market, they have managed their business venture operations successfully; they are currently exporting to Australia and France, and were on the verge of expanding their reach to other international markets when the COVID-19 pandemic struck, threatening the entire country. Their product line includes coasters, placemats, coconut shell spoons, bamboo straws, floating pool trays, cheeseboards and serving platters. Natural materials and their by-products - with a focus on cork and wood - are utilized in the manufacture of all of their products. Their materials are derived only from sustainable sources and the entrepreneurs do not use plastic in the production process. Reflecting a strong commitment to social betterment, the enterprise provides livelihood opportunities to craftsmen whose wealth of skills have been passed down through generations. The entrepreneurs expect business to pick up once the COVID-19 pandemic has been brought under control and the situation has improved.

Their business was affected by the outbreak of the COVID-19 pandemic. During the curfew period, they undertook to invest their resources in online delivery services provision to the corporate sector as a means of keeping their business afloat. They also engage in online delivery of their business products, although business was limited initially. In the course of discussions, they indicated that so far, they have managed to persevere through use of their own funds and have not applied for financial assistance from banks. They have not been able to obtain the concessionary interest loan offered by the Government, at the interest rate of 4 per cent, owing to various conditions imposed by banks.

## Analysis

The entrepreneurs are oriented towards realization of the social enterprise concept, which in this case

entails providing livelihood opportunities to craftsmen in rural areas. Through their engagement in online marketing and catering to niche markets, the entrepreneurs have enabled the enterprise to remain resilient to the impact of the COVID-19 pandemic. Taking advantage of the opportunity to effect linkages with the corporate sector in the home delivery of goods has helped them maintain operations at a certain level, which in turn allowed them to retain their employees during the pandemic. This demonstrates the capacity of innovation to generate opportunities for sustaining business continuity in the face of external risks. The business has been capable of confronting the negative impact of the COVID-19 pandemic and once the global economic cycle restarts, will be able to gradually return to full-scale business operations.

## 6. Eastern Handloom Centre

The Eastern Handloom Centre is a small-scale enterprise located in the Eastern Province, which has been operating successfully for the past eight years. The centre works with a cluster of handloom weaving workers. There are six looms on site, and off-site weavers who supply the enterprise with weaved products. Their weaving tasks are carried out in accordance with orders received from the enterprise. Yarn and other raw materials are supplied to them through the centre. The main products are sarees and bed sheets. The entrepreneur-owner of the centre is solely responsible for the design and color schemes, and weaving instructions, as well as quality control. Yarn and other raw materials are imported from India. The weavers are paid by the piece. The centre provides direct employment to approximately 15 women who live in the vicinity. Products are collected by traders from Colombo and the centre also serves shops in the city of Kandy and several other cities. During the first quarter of 2020, handloom items were produced by the centre at maximum capacity, in preparation for the sales to be made during the New Year season in April.

The entrepreneur is currently unable to secure payment for the finished goods he supplied in February and March owing to lockdowns and curfews and, in addition, he has a stock of weaved products awaiting delivery. As a result, he is faced with a severe liquidity problem. Further, he has an insufficient quantity of raw materials, as the entire supply chain has broken down. The weavers do not receive an income as they are paid by the piece. However, if the entrepreneur does obtain the raw materials, he can restart work. Meanwhile, the weavers are also waiting for new orders. The entrepreneur is hopeful that he will be able to gradually revive his business. Several months may be required for his business to pick up after the pandemic has ended. The entrepreneur and the weavers have received the Government's special relief payment in the amount of Rs 5,000. That payment has been very helpful to the weavers.

### Analysis

Handloom fabrics are produced predominantly in the Eastern Province, which caters to the local market. This is yet another case where the entrepreneur is faced with the breakdown of supply chains of raw material linked to India. Its inability to secure payments for goods until the economic cycle restarts has saddled this enterprise with a serious liquidity problem. Further, the weavers are also being deprived of their income owing to the pandemic and are undergoing hardships. They are awaiting new orders in order to restart their work. The enterprise needs to be supported in its efforts to obtain a timely supply of yarn, which is the main requirement for keeping the wheels of business turning.

27 March 2020

CIRCULAR

No. 05 of 2020

**RUPEES 50 BILLION, SIX-MONTH RE-FINANCING FACILITY TO  
SUPPORT COVID-19 HIT BUSINESSES INCLUDING  
SELF EMPLOYMENT AND INDIVIDUALS**

## 1. Introduction

- (i) The Central Bank of Sri Lanka has decided to set up the above Re-financing Facility in order to implement the decisions taken by the Cabinet of Ministers on 20.03.2020 to introduce a wide range of fiscal and financial concessions for COVID-19 hit business activities including self-employment businesses and individuals. Among these concessions are debt moratorium (capital and interest) and a working capital loan at the interest rate of 4% p.a. for eligible customers.
- (ii) The licensed commercial banks, licensed specialised banks, licensed finance companies and specialised leasing companies (hereinafter referred to as Financial Institutions) will be eligible to participate in this re-financing facility to support COVID-19 hit businesses including self-employment businesses and individuals commencing 25.03.2020.
- (iii) This Circular is issued to supplement the Circular No. 04 of 2020 dated 24.03.2020 and sets out the operational guidelines to give effect to the re-financing facility.

## 2. General Terms and Conditions of the Financing Facility (i) Eligible

businesses/sectors:

- (a) Tourism, direct and indirect export-related businesses including apparel, IT, tea, spices, plantation and related logistic suppliers that have been adversely affected by work disruption and overseas lockdowns resulting from COVID – 19.
- (b) Small and Medium Enterprises (SMEs) engaged in business sectors such as manufacturing, services, agriculture (including processing), construction, value addition and trading businesses including authorised domestic pharmaceutical suppliers with turnover below Rs. 1 bn.



- (c) Self-employment businesses and individuals who have lost their jobs or income due to the outbreak of COVID-19.
- (d) Foreign currency earners (individuals and corporates) who have to repay loans in foreign currency and whose incomes/ businesses have been adversely affected due to the outbreak of COVID-19.
- (ii) For the avoidance of doubt, import facilities shall not be permitted under this re-finance facility, for imports other than pharmaceutical drugs, medical equipment, food, fertilizer and essential raw materials and machinery and equipment.
- (iii) Credit facilities to be supported under this Financing Scheme shall be term loans, leasing facilities, pawning, overdrafts and trade finance facilities denominated in Rupees and foreign currency subject to the requirements specified.
- (iv) Financial institutions shall offer concessions under this Scheme to all borrowers who have been affected by work disruption due to COVID – 19 and overseas lockdowns and requested relief through online facilities or other communication arrangements before 30.04.2020. The financial institutions shall complete processing of such requests within 45 days from the date of receipt of the request. Until the processing of requests is concluded recovery of loans from the respective applicants shall be suspended.

### 3. Concessions for Existing Performing Loans as at 25.03.2020

- (i) Upon a communication by a borrower requesting concessions under this scheme on or before 30.04.2020, the financial institutions shall offer a debt moratorium for the period as given below in respect of all eligible Rupee and foreign currency term loans.
  - (a) A six-month debt moratorium on the leasing rentals of all three wheelers, school vans, lorries, small goods transport vehicles and buses and related assets such as motor bikes and taxis operated by the self employed/ owners.

- (b) A debt moratorium until 30.05.2020 on personal loans granted to all private sector non-executive employees.

- (c) A three-month debt moratorium for all personal loans and leasing where the granted amount is less than Rs. 1 million.
- (d) A six-month debt moratorium for affected industries in small & medium enterprises, tourism, apparel, plantation, IT and related logistic service providers.
- (e) A six-month debt moratorium for all other eligible businesses/sectors specified under 2 (i) above.
- (ii) Financial institutions shall extend the existing tenure of loans eligible for debt moratorium by the respective moratorium period.
- (iii) Permanent Overdraft facilities falling due for settlement or maturing or are reviewed during the period up to 25.03.2020 shall be extended up to 30.09.2020. However, in the case of Temporary Overdraft facilities as at 25.03.2020, the expiry shall be extended by two months for eligible borrowers. Interest rate on such facilities will be capped at 13 percent during the extended period.
- (iv) Eligible trade finance facilities falling due for settlement or maturing or were under review during the period up to 25.03.2020 shall be extended up to 30.09.2020.
- (v) Paving facilities falling due for settlement or maturing during the period up to 25.03.2020 shall be extended up to 30.09.2020.

#### 4. Concessions for Existing Non-Performing Loans (NPLs) as at 25.03.2020

- (i) The penal interest charged up to 25.03.2020 shall be waived off by the concerned financial institutions.
- (ii) Rescheduling of loans and advances shall be as follows:
  - (a) Where the borrower has repaid 50% or more of the initial capital, 50% of the accumulated and unpaid interest (after waiver of penal interest referred to above) of the defaulted instalments up to the date of

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consideration by the concerned financial institutions under this refinancing facility shall be deferred. The balance capital outstanding, balance portion of interest of the defaulted instalments and the future interest shall be rescheduled over a 3 year period. The deferred interest shall be waived by the financial institution, after the borrower settles the rescheduled loans in the manner provided in para (c) and (d) below.

- (b) Where the borrower has repaid less than 50% of the initial capital, 25% of the accumulated and unpaid interest (after waiver of penal interest referred to above) of the defaulted instalments up to the date of consideration by the financial institution under this re-financing facility shall be deferred. The balance capital outstanding, balance portion of interest of the defaulted instalments and the future interest shall be rescheduled over a 3 year period. The deferred interest shall be waived by the financial institutions concerned, after the borrower settles the rescheduled loans in the manner provided in para (c) and (d) below.
- (c) The balance capital outstanding referred to in paragraphs (a) and (b) above shall be rescheduled and repaid over a period of 3 years.
- (d) The balance portion of interest of the defaulted instalments and the future interest referred to in paragraphs (a) and (b) above shall be transferred to a suspense account and recovered over a period of 3 years.
- (e) A moratorium up to 30.09.2020 shall be granted.
- (f) Licensed banks may reclassify NPLs under this Scheme as performing loans and advances provided that the borrower has serviced interest for six consecutive months during the debt moratorium period, if required. However, in the case of instalments in arrears before rescheduling the NPL facility is less than six months, upgrading to performing category shall be done only after the borrower has serviced interest for a period equal to instalments in arrears before rescheduling the NPL facility.

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- (iii) Suspension of recovery actions
  - (a) In the case of eligible borrowers who are in the NPL category as at the date of this Circular, if financial institutions have commenced or given notice of recovery action under the provisions of the Recovery of Loans by Banks (Special Provisions) Act, No. 4 of 1990 or Mortgage Act No. 06 of 1949 as amended or Finance Leasing Act No. 56 of 2000, such recovery action will be

suspended on condition that the concerned financial institution and the client reach a debt re-payment agreement.

- (b) Financial institutions shall defer passing new resolutions under the above Acts, for recovery of loans and advances in respect of borrowers participating in this Scheme. In instances where resolutions for recovery have already been passed, auctioning of assets will be suspended until 30.09.2020 in respect of such borrowers who are participants in the Scheme.
- (c) In instances where there are on-going litigations in courts relating to recovery, borrowers will be permitted to participate in the Scheme upon entering into an agreement by submission of affidavit to Courts agreeing to comply with the requirements set out in this Scheme.
- (d) All financial institutions shall suspend legal action against nonperforming borrowers who have been accepted under this Scheme.

## 5. New Working Capital or Investment Purpose Loan

- (i) Financial institutions may grant an additional loan or a new loan facility in Rupees for working capital or investment purposes subject to the following conditions, provided that the borrower submits a credible business plan:
  - (a) The working capital purpose loan facility shall be granted to eligible performing and non-performing borrowers in Rupees not exceeding Rs. 25 mn per bank per borrower and Rs. 10 mn per other financial institutions per borrower or 2 months working capital requirement

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whichever is higher, based on the requirement for working capital cycle. Such loan shall be repaid over two years at an interest rate equal to 4% p.a. CBSL will subsidise interest cost up to 4% for licensed banks and up to 7% for other financial institutions as a rebate.

(b) The investment purpose loan facility shall be granted only by banks and only for performing borrowers in Rupees not exceeding Rs. 300 mn per bank per borrower to expand business activities. Such loan shall be repaid over five years at an interest rate equal to maximum of AWPLR plus 1.5%.

- (ii) Financial institutions shall properly evaluate the funding requirement of the borrower and agree on the loan size.
- (iii) A moratorium for a period 25.03.2020 to 30.09.2020 will be granted for both working capital loans and investment loans.

- (iv) Financial institutions may obtain suitable collateral to mitigate the risk relating to any additional credit facilities granted under this re-finance facility.

## 6. Repayment of Capital by Banks under Refinance Schemes

The Government has indicated its willingness to defer capital repayments on refinance loans granted to licensed banks falling due from 01.01.2020 until 31.12.2020. However, banks are required to seek extension if required and enter into supplementary agreements with the relevant Government agency in this regard.

## 7. Reporting to the Credit Information Bureau (CRIB) of Sri Lanka

- (i) Financial Institutions are expected to have a mechanism not to decline loan applications solely based on an adverse CRIB record.
- (ii) Financial Institutions, in consultation with CRIB, shall develop a reporting modality in respect of the capital deferment granted under this scheme to performing borrowers, so that participation in the Scheme will not have an

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impact on the credit score of borrowers in the future, or be negatively reflected in future CRIB reports.

- 8. Financial institutions shall discontinue charging for cheque returns, stop payments, late payment fee on all credit cards and other credit facilities during the period up to 30.09.2020.

## 9. Reporting Requirement

Financial institutions shall report the details of moratorium availed by their borrowers to the Bank Supervision Department and the Department of Supervision of Non-bank Financial Institutions, as relevant, as at 15<sup>th</sup> and 30<sup>th</sup> of each month, within 5 working days, commencing from 01.05.2020.



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Governor of the Central Bank of Sri Lanka*

## Author's Comments

1. For many MSME entrepreneurs in Sri Lanka, their situation following the onset of the COVID-19 pandemic has given new meaning to the expression “out of the frying pan into the fire”, since when the pandemic struck, they were still trying to keep their heads above water in the wake of the Easter Sunday terrorist attack of April 2019.
2. Many MSME entrepreneurs have stretched their full production capacities in anticipation of New Year sales in April 2020. Unfortunately, they are now faced with severe liquidity problems, arising from delays in payments for goods supplied, or are saddled with stocks of unsold finished goods.
3. MSMEs that produced processed food items on a small scale have shown resilience to the negative impacts of the COVID-19 pandemic owing to two factors: (a) they cater to local niche markets and (b) their products are viewed as necessities by local households.
4. MSME entrepreneurs with innovative business solutions have found alternative means of keeping their enterprises afloat during this difficult period. Some have ventured into new business areas.
5. The author observed that the majority of MSME entrepreneurs who were interviewed sustained a positive outlook. Hope exists for business to soon return to normal. On the other hand, MSME entrepreneurs need coaching and counselling to help them emerge from their traumatic situation.
6. MSME entrepreneurs are fighting a lonely battle to emerge from their current situation and have very little hope that government authorities and financial institutions will come to their aid.
7. The restrictions imposed by the government on selected imports are welcomed by MSME entrepreneurs. The expectation among MSME entrepreneurs is that this offers a good opportunity for them to substitute raw materials that are imported. On the other hand, they believe that import of raw materials required for their own production should not be restricted.
8. Most of the entrepreneurs have not been able to secure benefits under the relief packages offered by the government for various reasons. It is recommended that government authorities review this issue.

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