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Prof. Lakshman R Watawala

President CMA

FCMA, FCA, FCMA(UK), CGMA, FCPM

Greetings!

I have pleasure in sending a message to the "Certified Management Accountant" journal published by the CMA Sri Lanka. The theme of the December 2018 Journal is on the SME Sector and Entrepreneurship which is very timely and would emphasise the importance of this sector. My heartfelt gratitude is extended to all authors for their fruitful contributions adding to the high quality of the CMA journal. I am confident that our members together with the University, Higher Education and Corporate Partners will be motivated to contribute articles for publication in the journal.

SMEs play a key role in national economies around the world, generating employment and value addition and play a major role in the domestic and export markets. The funding of small and medium-sized enterprises represents a major function of the banking and financial sector for the supply of fixed and recurrent capital. Costing and pricing of products and services are also important areas where management accountants can play a major role contributing to the success of the SME sector. It is widely-accepted that the role played by SMEs towards economic development of any country is of paramount importance leading to sustainable and inclusive growth.

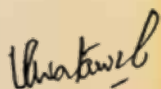
I am grateful to the Chairman and Members of the Journal Committee and the Secretary for their great effort in bringing out this edition.

I am confident that the CMA Journal will produce rich articles which will add to our readers whilst recognizing the important role played by management accountants.

I wish the 5th volume of CMA Journal all success and trust that it would assist in the creation of a knowledge economy.

Whilst wishing you a very bright and prosperous 2019, I look forward to working with you to take CMA Sri Lanka to greater heights.

With warm regards



Prof. Lakshman R Watawala





Message from the **Chairman** Journal Committee

Adrian Perera

FCMA, MBA9PIM-USJ), FCMA(UK), CGMA, BSc(Acc)

My Dear Members

Institute of Certified Management Accountants of Sri Lanka as the National Management Accounting body has been at the forefront in developing the management accounting professionals in Sri Lanka.

Small and Medium Enterprise sector is backbone of the Sri Lankan economy; however the sector has been given step motherly treatment from successive governments. Despite many obstacles the industry is facing, some of which are due to their model of operation and some are due to the industry and political dynamics, the SME sector has been contributing to the Sri Lankan economy in a significant way.

Although successive governments have been discussing assisting the sector, almost all the assistance programs have been with a political motive rather than a concrete, way forward sustainable development

plan for the sector. This has not only burdened the sector but also burdened financial sector significantly, creating massive losses.

CMA Sri Lanka has taken the lead in providing the management accounting expertise to the SME sector by developing Management Accountants with relevant expertise. Being a National body it is our vision to develop the sector to become a significant contributor to the GDP of Sri Lanka. In this backdrop CMA Sri Lanka decided to devote this journal to SME sector development.

I wish to take this opportunity thank the staff of CMA Sri Lanka, without which none of this would not be possible and our founder President Prof Lakshman R Watawela who has contributed immensely to the profession and for his support and guidance.



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Mrs. Ramya Weerakoon,
Chairperson - Ramya Holdings



“Finance and Cost Management is the major tool in my business”

Mrs. Ramya Weerakoon, Chairperson of Ramya Holdings, the parent company of Trendywear (Pvt.) Ltd., Ramya Horticulture (Pvt.) Ltd, Ecorich Pvt. Ltd, Aditi Infinity (Pvt.) Ltd and Amari Class Garden Solutions, entered the business world after the tragic death of her husband, Major Noel Weerakoon, during the insurgency of 1971. As a widow and mother of two infant daughters, she was determined to rise by herself and in 1973 set up a small batik workshop at her parents' residence in Kurunegala with four employees. It proved

to be a good source of income at that time and in 1976, she ventured into the export market with a work force of 52 workers.

In 1988, she expanded her business into the garment industry incorporated as Ramya Apparels with 35 machines and 54 employees. In 1989, her business grew with 100 machines. In 1994, she established her first outstation factory in Katupotha. In 2003, the business was incorporated as Trendywear (Pvt.) Ltd.

The company continued with more factories located in Delgoda, Adhikarigama and Wellawa. Today, it has a workforce of over 5000 and an equal number of indirect employees as sub-contractors and suppliers. Trendywear owns five garment factories in a healthy and sustainable rural environment away from Colombo.

Mrs. Weerakoon received many awards both locally and internationally and plays an active role in several trade chambers in Sri Lanka.

**1. Tell me about yourself?
What kind of a person
are you?**

I would say that I am well-balanced person both physically and emotionally. I am methodical, determined and always tend to support others. I do not criticize people for their desires. But I advise and share my experiences with them for the betterment of their lives. I want others to be happy.

**2. Where did you get
you entrepreneurial
spirit? Are your
parents'entrepreneurs?
Where did the idea of
your business emerge?**

After the death of my husband, I wanted to have a better future for my two children. Also, the negative attitude towards me from society as a widow motivated me to do something on my own for a secure future for my family.

My father was a public servant and my mother was a housewife.

Initially, my hobby of batik making drove me to become an entrepreneur.

**3. What was the key driving
force that made you an
entrepreneur?**

To face the challenges in society and to do something while being with my family.

**4. How did you come up
with a name for your
company?**

My own name. It rhymes and is easy to remember – which is very important for an emerging entrepreneur.

**5. How many hours a
day do you work on
average? Can you
outline a typical day for
you?**

At the beginning I worked 16 hours. With the commencement of the apparel Industry in 1988, it was 10 hours on average. At the moment my time for business is very limited. I spend most of my time on social and charitable activities.

At present, my day starts at 5.15 a.m. with rituals, exercises and meditation. I will be in my office from 9.30 till 1.30 p.m. and attend to any work at home in the

afternoon. I relax in the evening, reading the newspapers. My day ends with pirith and meditation. I go to bed by 10.30.

**6. How has being an
entrepreneur affected
your family life?**

I balanced my work and time with both -without neglecting either.

**7. What is your opinion on
the following theme: "Are
entrepreneurs originally
born as such or are they
raised to be successful?"**

They are raised to be successful.





8. Who is the one entrepreneur who is your greatest example and inspiration?

I have no examples as such. I discovered the true energy within me. But I personally admire Margret Thatcher, once the most powerful woman in the world. I follow one of her quotes: "Disciplining yourself to do what you know is right and important, although difficult, is the highroad to pride, self-esteem, and personal satisfaction."

9. What personality traits have helped you most in becoming a successful entrepreneur?

Certain officials in the trade who assisted me to get the correct path in expansion, approval, financial management, etc.

10. How far have Finance & Cost Management helped you in your business career?

Finance and Cost Management are the major tools in my business. Even in the early days I

planned to manage myself without running out of cash. I followed the Buddhist philosophy of managing finance - ethical earning, wise spending and suitable saving for the future.

11. What has been your biggest failure as an entrepreneur and what did you learn from it?

At one stage, I wanted to expand my business but my savings were not sufficient. But I went ahead without a proper financial plan thinking that all things will fall into place - which was a failure.

Never to repeat.

12. What has been your biggest success as an entrepreneur?

I have been successful in all my business ventures. But our biggest success was achieved via apparel manufacturing. My daughter and son-in-law joined the business and they strove with me to take the business to the pinnacle.

13. How do you evaluate the human resource factor as an inseparable aspect of your company's success?

Human capital plays a major role in the industry. They have to be looked after, motivated and guided to remain.

14. How do you build a successful customer base?

Being honest, reliable, maintaining good quality, best practices and an ethical work environment.

15. How do you market your business, and which tactics have been most successful?

Be simple and humble. Always

understand customer needs and add value to the product.

16. What kind of culture exists in your organization, and how did you establish it?

At Ramya Holdings, there is no difference between employer and employee. We treat them as members of our family where even a minor staff employee could approach the management easily to solve a problem they face. This mutual understanding enables us to build up a good rapport among our employees and they have immense trust in us.





Ajith D Perera
General Secretary/CEO
Federation Chamber of Commerce and Industry
of Sri Lanka

**“SME’s are the
backbone of the
economy”**

Ajith D Perera started his career way back in 1982 as a banker. His early period, as a banker which spans over 20 years had an extensive training and exposure in the fields of branch operations, retail credit marketing and business development.

Later he gained exposure in multinational and multi-cultural business environments in UK, UAE, INDIA and BANGLADESH. In 2014 He joined Federation of Chambers of Commerce and Industry of Sri Lanka – the apex body of the chamber movement in Sri Lanka as secretary general / CEO and serve to date.

He has widely traveled within the Asia pacific region attending many international trade fairs and workshops organized by UNESCAP and United Nations Environment Program in Bangkok. He contributed immensely to the development of APTA –Chamber of commerce and Industry under the patronage of UNESCAP in Bangkok and the

Ajith D Perera has been awarded a MBA and Post Graduate Diploma in Administration by London college of Management and Information Technology and Warnborough university in Ireland , Executive Diploma in Business Administration by University of Colombo and Diploma in Credit Management by Sri Lanka Institute of Credit Management.

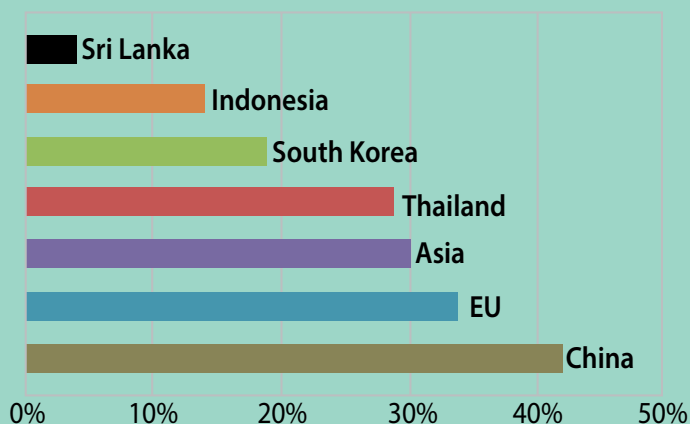


(1) What is the role played by SMEs in the Sri Lankan Economy?

SME's are the backbone of the economy. According to recent research, SMEs provide 45 per cent of employment and 75 per cent of the total enterprises in the economy. Sri Lanka has more than 500,000 SMEs, each employing three to five persons on average. Taken together with other micro enterprises and SMEs that are not

registered, an estimated 52 per cent of GDP comes from this sector. Further, Sri Lanka has a little over 3,000 SMEs (firms with a turnover of less than Rs.150 million) registered as exporters. They collectively contribute to less than 5 percent of Sri Lanka's exports. China, for instance, has over 40 percent contribution by SMEs and the average in Asia is around 30 percent.

SME share of exports in the Region



Source: Annual Report 2014, Central Bank of Sri Lanka, Export Performance Indicators 2004-2013, Asia SME Finance Monitor 2013, ADB

The above diagram shows Sri Lanka's SME export performance against other countries in the region. In fact, the countries have different definitions of SMEs so it makes the comparisons a little bit complicated but the conclusion remains valid: the export contribution of Sri Lankan SMEs is unusually low.

The low export participation of SMEs in Sri Lanka means that Sri Lankan exports are overdependent on the performance of a few large firms. Eighty-one percent of export revenue is generated by around 240 firms, each with an export turnover exceeding a billion LKR. A significant difference between SMEs and large firms is their access to affordable financing to offer credit to buyers – which is critical for success in exports.

The export contribution of Sri Lankan SME's is unusually low

(2) What is the Government policy framework for SME?

The overall objectives of government policies to support SME development are: (a) create jobs and generate income; (b) improve SME performance and competitiveness; and (c) increase their participation in and contribution to the national economy.

The Policy Framework focuses on six key policy intervention strategies for creating a more conducive environment for the SMEs as well as focus towards creating regional balance and resource efficiency in doing business.

- (a) Enabling Environment
- (b) Technology and Innovation
- (c) Research and Development
- (d) Entrepreneurial Culture and Skills Development
- (e) Market Facilitation (Customs / Trade Agreements)
- (f) Access to Finance

(Assessment of the institutional and regulatory framework relating to SME sector in Sri Lanka (DRAFT REPORT) by Ministry of Industry of Commerce, August 2018)

(3) What are the recent policy changes related to SMEs?

The Sri Lankan government has taken a number of initiatives to increase trade competitiveness in Sri Lanka with a focus on SMEs funded by EU. Under this program improving the regulatory environment, introduction of a trade information portal, formulation of a national export

strategy and steps to introduce a national single window to help imports and exports and to reduce the transaction would add significant value to Sri Lankan businesses in the future.

(4) How do you see the access to finance as a common and persistent issue for SMEs?

There are two types of finances available for SME's in Sri Lanka. The first is finances through various government ambitious programs such as 'Enterprise Sri Lanka.' However, most of the funding comes through state banks with rural development banks and private banks contributing a little to SME financing. **A salient feature is that private money lenders too play a key role in SME financing though the finances available at exorbitant rates of interest.** Sri Lanka needs a couple of development banks and venture capital funding mechanisms to help SME's.

In Thailand, the **Small Business Credit Guarantee Corporation (SBCG)** is responsible for the Small Industry Credit Guarantee Fund that provides credit guarantees for unsecured parts of a loan. Three guarantee schemes function: a normal scheme which guarantees unsecured loans between 10 and 40 million baht, a risk diversification scheme where financial institutions and SBCG share the risk of loans provided, and a loan guarantee scheme which guarantees up to 10 million baht and payment of up to 10 million baht for a term of 7 years.

In India, the **Small Industries Development Bank (SIDBI)** has a credit guarantee scheme that provides financial and deferred payment guarantees to its MSME customers. SIDBI, together with India's Ministry of MSMEs, has created the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE). This fund encourages lending institutions to consider the firm's project viability and extend credit based on primary assets rather than secondary collateral.

(5) Factors affecting the growth of small and medium enterprises in Sri Lanka

There are a number of obstacles to overcome in order to achieve these objectives. The following constraints on SME development have been identified by researchers:

- 1. Weak business environment** (e.g. cash flow issues, high taxation and inconsistent government policies,
- 2. Inadequate infrastructure** (e.g., transportation facilities, no access to industrial estates and telecommunications)
- 3. Inadequate access to finance** (e.g., high interest rates for loans, rigid analysis by financiers for obtaining loans, insisting on collateral and non-acceptance of third-party guarantees by financiers.
- 4. Low technological capacities** (e.g., use of ERP (enterprise resource planning) at SME level is poor. Application of ICT (Information communication technology) is still moderate.



5. Lack of a mechanism for protection and nursing of SME's:

A threat is posed through trade and investment liberalization, lower import duties, and cuts in subsidies for local industrialists.).

6. Lack of recognition and lack of drive for innovation:

In Sri Lanka SMEs status wise have a poor public reception and they are at a disadvantage at every level and in all negotiations with stake holders. Unlike in other countries neither rewards for innovations by SME's nor special privileges are accorded to them.

(6) What is the private public partnership (PPP) and its benefits to SMEs?

Among the many benefits that PPPs can bring, PPPs can build local capacity and expertise (resulting in more cost efficiencies),

encourage increased competition, and create opportunities for broader economic growth. To enjoy such benefits, involving small and medium enterprises (SMEs) in PPPs is key.

However, PPPs are often very large or complex and it may be hard for SMEs to compete in the market, particularly in a country like Sri Lanka. SMEs may find it costly, time-consuming, or otherwise challenging to respond to complex prequalification criteria or bidding documents

Governments can provide a number of incentives for SMEs to flourish such as through procurement incentives or capacity building. At the same time, governments must balance the desire to build and use domestic capacity with the interests of good quality service delivery. It is also

important to be realistic about the capacity of SMEs in the relevant market to participate in more complex projects.

Further, even with pro-SME laws and policies in place, in practice, the actual beneficiaries of such policies may not be the intended recipients. Well-designed policies and their implementation procedures are thus crucial, and many different approaches can be combined. For example, bidders can present a small business subcontracting program which has targets but not necessarily upfront commitments. The government could combine these policies with information services for bigger investors about available SMEs, and capacity building support for SMEs to help them be more effective in performing public contracts. It is also useful to be

aware of the diverse policies of the large international contractors, and make use of them. In countries like South Korea, and Japan, SMEs have entered to the Global Value Chain (GVC) through international bidding. However, Sri Lanka is still

far behind in comparison with other countries in the region. PPP would also be a platform for the exchange of information and technological advancement among countries.

(7) What is the role of SMEs in employment creation in Sri Lanka?

Country	Contribution to GDP	Contribution to Employment	No of Enterprises as % of the total	GDP per capital Dec. 2017 in US \$
Sri Lanka	52%	45%	75%	4065
India	32%	40%	95%	*1751
Malaysia	36%	67%	97%	9817
Singapore	Over 50%	70%	99%	57722

*March 2017

Almost 50 % of the employment opportunities are provided by the SME sector? It is worth mentioning that in Sri Lanka most of the SMEs are labour intensive and use less technology.

(8) What is the role played by FCCISL in SME development in Sri Lanka?

In the recent past FCCISL signed a MOU with IBA **Aman Center for Entrepreneurial Development – Karachi** to transfer technical knowhow and expertise to FCCISL to enhance the entrepreneurial skills of youth in Sri Lanka. Under this program FCCISL conducted a series of seminars on improving family entrepreneurial skills among business families in Sri Lanka. Again, FCCISL as the focal point of SAARC, the Chamber of Commerce and Industry of Sri Lanka conducted a series of stakeholder sessions to identify SAARC NTM's (non-tariff measures)

and a sizable participation was from the SME sector. The findings were published as the Colombo Declaration, which was taken up at the ICE Dialogue (Indo –Ceylon Economic Dialogue) with the Federation of Indian Chambers of Commerce and Industry (FICCI). Our efforts, together with lobbying from other chambers in Sri Lanka, paved the way for broader consultation between two governments (Indian and Sri Lankan) and discussions are under way now to solve the issue of non-recognition of quality certificates issued by Sri Lankan quality institutions. FCCISL also provided training for youth entrepreneurs in the North East and Puttalam district funded by the Colombo Plan. At present, FCCISL is engaged in Sri Lankan skills for inclusive growth programmes funded by the Australian government to enhance the skills of the tourism sector in the North and East. This programme is designed to provide basic skill development

–on-the- job training for 1200 employees in the tourism sector.

FCCISL is also rewards SME entrepreneurs all over the country with Sri Lankan Entrepreneur of the Year awards annually, which are undoubtedly a rare recognition received by SME based entrepreneurs in the country.

(9) What are the challenges faced by FCCISL in SME development in Sri Lanka?

We are constrained by funds, poor infrastructure, lack of an SME data base, monitoring mechanism and lack of a well-integrated SME authority (one-stop shop) set up by the government to take up all issues on behalf of the SME sector by FCCISL. We are also constrained by insufficient capacity at regional chamber level to engage in policy advocacy and the lobbying process.



Ravi Bamunusinghe is a Management Consultant attached to Post Graduate Institute of Management, University of Sri Jayewardenepura. He had been a business researcher for over three decades working with SMEs, National and International Corporates in Sri Lanka. He was instrumental in setting up business related professional bodies which is contributing towards development of professionals and standards of performance. His interests are enabling SMEs for greater productivity and sustainability.



Ravi Bamunusinghe
Management Consultant
Post Graduate Institute of
Management (PIM)
University of Sri Jayawardhanapura

LEADING INNOVATION AND CHANGE –

A Perspective

Abstract

The evidence reviews of the novel subject 'leading innovation and change' is bringing groundbreaking thoughts to the field of management. Scholarly articles at present focus on either leadership, innovation and change, or leading innovation and/or leading change. This article is an attempt to look at both leading innovation and leading change, in anticipation of gestalt effect. Accordingly, theories and ideas were reviewed to bring out the relationship between innovation and change, at different levels in an organisation. The review was focused on identifying inadequacies in an organisation by selecting discerning and innovative inadequacies for change. In this regard the work of DeGraff and Quinn (2007) is core to the inquiry and complements the understanding of proposed changes in a company. Further, the review attempts to identify dominant ideas in the field. It also questions the association of Lewin in many articles which focus on groups, but with a lower emphasis

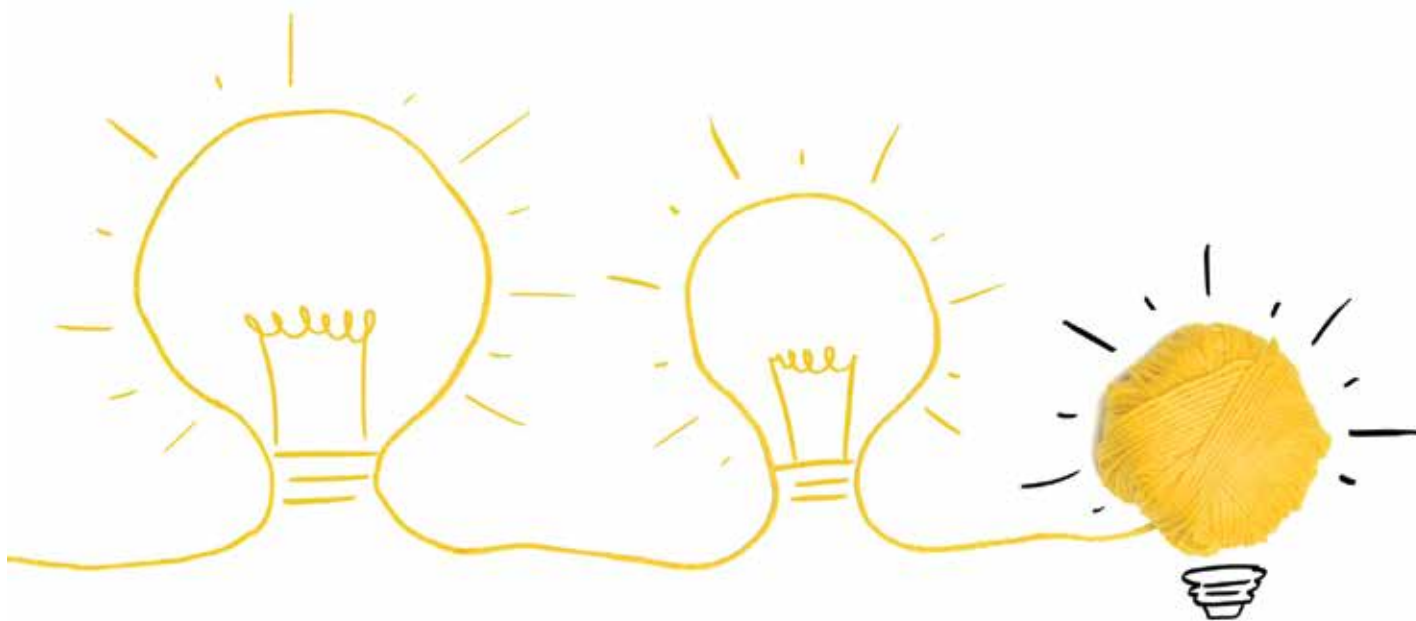
on innovation and change beyond non-human capital. The review thus proposes new areas of research.

Key words: Leading Innovation and Change, Readiness to Change, Change Management, Sustenance of Change, Risk in Change Management.

1.0 Introduction

Will Rogers (in Aaker and McLoughlin, 2010) said that 'Even if you are on the right track you will get run over if you just sit there'. The implication here is a need for innovation. What is innovation? The term innovation is used interchangeably. Therefore, understanding the terms creativity, change and innovation clearly will be necessary. DeGraff and Quinn is of the view that creativity is a set of activities that initiate products, services, processes or ideas that are improved and novel. Change is the reformed state produced by both purposeful and unintentional transformational forces. Innovation is the deliberate improvement of

expressions, products, services and processes, which results from creativity, as well as intentional and unintentional discovery. DeGraff & Quinn further believe that innovation can be discovered when there is a need to improve the current status quo (Google), need to eliminate or destroy what is been currently used (Linux), when going back to past product or service propositions (Tattoos) and over time when things can become opposite (Post It). Organisational sustainability will not depend on maintaining the status quo, but on effective leadership for innovation and change, while being relevant and competitive in the market place (Aaker and McLaughlin, 2010). Therefore, to lead and drive change through invention and innovation will be the focus of this review. Once 'what is innovation' is identified, it is essential to analyse the implication of a leadership that will ensure sustainable change. Again, one could pose a question 'who should lead innovation and how could it be done?' This opens a discussion on leading innovation which will be discussed next.



2.0 Leading Innovation

Leading innovation is a sensitive area as mere innovation can be a trap. As discussed above, innovation is an intentional development through intentional or unintentional discovery. Kanter (2006) is of the view that there is a tension between protecting existing revenue streams that are key to current performance while embracing new ideas that could be critical for the future. Hence, effective leadership of innovation is subjected to identification of discerning innovations. Innovation, therefore, can occur anywhere in the organisation and the innovation genome introduced by DeGraff & Quinn (2007) describes the complete coordination of organisational innovation tasks at all levels. This is the strategic environment, where value is recognised by stakeholders. The innovation genome shows a map of different approaches to innovation by identifying innovation in the areas of collaboration, creation, competition and control.

Accordingly, innovation can be internal or external, flexible or focused, or a mix.

3.0 Leading Change

Leading change is also challenging compared to leading innovation as it requires tacit skills in leadership. Leadership is the role of knowing oneself, having a vision that could communicate efficiently, constructing trust among associates, and taking action to comprehend the leadership prospective (Bennis, 1994 & Hailey, 2004). Further, Bennis (2000) says that leadership is managing relationships and therefore needs to have followers and to have the capacity to align them to the changed vision (Worley, 2006, & Rogers, & Meehan, 2007). Hence, the implication is that change is focused on groups, with an individual reflecting the perceptions, feelings and actions of the group (Lewin in Burnes, 2001). Accordingly, effective leadership in change is one that

can play a role as either a leader or follower (Baker, 2007), or as sharer of the leadership (Worley & Lawler, 2006). Further, the change leader could be an executive, manager or from the top who has a vision and initiation (Cladwell, 2003). Hence, there is a need to encapsulate leading change and change management. DeGraff & Quinn (2007) draw attention to the 7S framework that discusses the synthesis of ideas in a diagnostic manner, develops strategies based on creation of a new vision, establishes shared values through socialization, develops facilities to supervise change, engages identified leaders at all levels, synchronises to operationalise the new vision, and systemises the change by critical reviews and revision.

4.0 Management of Change

The discussion so far indicates a people-oriented leadership over task orientation (Blake and Mouton, 2104) as the recommended

method, and a tacit approach in leading change. The question is 'can there be a sustainable change if the change is not imposed?'. Appreciative Inquiry (AI) of change management is a way to address this issue if it is conducted effectively (Lewis, Passmore & Cantore 2011). The ideas above draw attention to structure and agency and question whether the tacit change can occur through structure contrary to thoughts of Foucault who said death of agency and change; and change without agency (Cladwell, 2007). McKinsey (Waterman, Peters, & Phillips, 1980) seems to have understood this sensitivity when introducing the 7S model of change where the discussion is focused on hard changes – strategy, structure and systems, and soft changes – staff, skills and style, which effectively address the concerns of structure and agency.

5.0 Sustenance of Change

For sustainable change according to Burnes (2004), Lewin's 3-step model still holds where there is a need of unlearning and/or abolishing old methods prior to change. Then the proposed change must be introduced through leaders who have the characteristics discussed above. However, there will be a concern whether the change should be planned or emergent (Burnes & New, 1997, & Burnes, 2004). There are merits and demerits for both schools of thought, but it seems highly subjective depending on the dynamics of the company and cycle of change (Mintzberg, & Westley, 1992). In this context, most companies warranted a planned change with

risks in mind over emergent issues as the focus is external change through creativity and competition (DeGraff & Quinn 2007). The planned change can also be considered incremental, punctuated and continuous and transformational (Burnes, 2007; Bennis 2004). Bennis (2001) also says that one needs to think deep and obtain a generalist view and function as a beginner to question each and every aspect of the proposed process. Hence, vulnerability and quest to learn is more important than certitude. He supports the approach of Shakespeare seeking negatives or learning more from failure than success (Madsen & Desai, 2010). Similarly, Cao (2001) suggests change in process, structure, culture and power distribution which refer to management of interaction where employees feel win-win relationship (Rogers, 2007). This view is further elaborated by Schein (2007), who mentions that organisational forces are stronger than individual when under cohesive conditions, and that changes need to be psychologically safe. Kotter (2002) on the other hand prescribed an eight step process that ensures the change in a practical manner. In this context creating a sense of urgency, identifying effective leaders for change, and celebrating short term gains is crucial in instituting change which is discussed above. Once the change process is established, the critical need is monitoring and measuring the transformation. In this regard the balanced scorecard (Kaplan & Norton, 1996) is necessary to meet the expectations through setting

objectives, measurement tools and targets, together with identifying ways to initiate the measurement process within a budget. Hence there will be indicators that will highlight positive and negative results of action periodically to take strengthening or corrective measures respectively.

6.0 Conclusion

The discussion above on leading innovation and change is to establish a nexus between the words 'leading', 'innovation' and 'change' because there is a gestalt interpretation collectively. However, it is evident that the gestalt effect must be obtained through leading innovation and leading change. DeGraff and Quinn (2007) have reduced the ambiguity of the words and hence the review has clarity in interpretations right through out.

The review is comprehensively focused on leading innovation, leading change, management of change and sustenance of change. In each stage it was evident that the reviewed literature supported the decisions taken on shifting focus from internal to external and addressing creative and competitive platforms instead of development and control. The reviewed literature established the importance of change management and readiness which complemented hard factors over soft factors as per the evolved corporate vision. The concept of change management was elaborated further by way of establishing sound monitoring and measurement processes based on a balanced scorecard.

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Membership Category	Requirements
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Member	Any person with a Degree or equivalent professional qualification with a minimum of 08 years of senior managerial level experience is eligible to apply for this category. This grade of membership is applicable to Senior Managers and Senior Executives.
Fellow	Any person with a Degree or equivalent professional qualification with a minimum of 18 years of senior managerial level experience is eligible to apply for this category. This grade of membership is applicable to those in Senior Management services as CEO's, MD's, Directors and Chairmen of Organizations and those who have made a significant contribution to Management Practices while in employment, practice, board directorates, research, or through faculty contribution, submission of a thesis etc. will be awarded the Fellowship following a viva voce.



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Mr. Ramachanndra Sarmaa Mahalingam,
Managing Director
Pet Packagine (Pvt) Ltd

There is no substitute to Hard Work.... I also had a “no looking back attitude”...this helped me to progress.

Mr. Ramachanndra Sarmaa Mahalingam had his Primary Education at Hindu College and Royal College, Colombo. He holds a Bachelor of Commerce Degree from the University of Jaffna and an MBA from the University of Colombo. And he is part qualified in CIMA (UK) and started his career as Assistant Accountant at MISUI CEMENT in 1986 and was promoted to Accountant in 1988. In 1989 he moved to the Maldives as a Financial Controller with OGOL Resort Management. Within a year he was promoted to Group Chief Financial Officer.

In 1992, he identified the need for Bottled Drinking Water in the Maldives, and returned to Sri Lanka to start the Bottled Drinking Water business under the brand name of CRISTAL for Export. In 2004 ventured into carbonated soft drinks under the brand name of “My Cola”. To date he has created over 300 employment opportunities in Sri Lanka.

He was a visiting lecturer in the MBA programme and the Postgraduate Diploma in Management programme of the

University of Colombo.

Since 2007, he has been an active Executive Committee member of the MBA Alumni Association of the University of Colombo and currently is its President.

He is an Executive committee member of the PET Bottlers' Association.

He has been a Toastmaster for the past twelve years and is at present the Programme Quality Director of District 82 Toastmaster International covering Sri Lanka and Tamil Nadu.



What are the challenges you faced at the beginning?

Challenges were maintaining quality. Local knowledge of bottled drinking water business. Testing facilities in Sri Lanka. Exorbitant freight costs. Bottled drinking water is a volume business; Changes in freight rates hampered our exports.

How did you get to where you are today, and who / what helped you along the way?

Always remember. There is no substitute for hard Work....I also had a "no looking back attitude"... this helped me to progress. If there is a will, there is a way. Faith too is important. My former employer offered to support me by advancing the funds for his imports, and still continues to by my partner in the business. Creating value among employees is very important. A good relationship with our employees took our business to greater heights. Understanding them and empowering them is the key to success.

What motivated you to become an entrepreneur?

You need to have a dream. If your dream is to create something different, the solution is to start something new on your own. If you have a dream and purpose, try and live that dream, and create a business which satisfies your dream, rather than just follow others.....try and understand why you want to do, what you want to do.....My dream was to be different and to contribute to society.

How did you select the area to start a business?

While working as an accountant in a Resort Hotel in Maldives, I realized the importance of drinking water. Bottled drinking water was imported from Malaysia and Singapore. I realized that Sri Lanka was geographically closer to the Maldives, I saw an opportunity, I brain stormed.....I studied this project, and launched into it.

How do you think an entrepreneur has turned you into a better person?

Understanding our employees and working as a team made things easier. Without people nothing will move. You can have a financial background but everything moves only with the support of your employees. They can make or break your dream. Be humble, simple and transparent.



What advice do you have for others starting their own business?

Identify your dream and purpose. Live with your passion. Do not force yourself into any business that others are pursuing. If you have a passion and purpose, create a venture which is unique.

Did you follow any educational programme that assisted you to become an entrepreneur?

No. But my undergraduate and postgraduate studies helped me to understand my business better and helped me to mitigate many risks.

What is the smartest thing you did in the first year of your business?

Invested in the market. Maintained quality. Selected Modern Trade as the first channel to market the products. Invested in brands and created visibility.

What systems have you set up in your business to help it grow?

Transparency and empowering employees in all jobs.

Understanding our employees. Be transparent and identify the unique selling proposition of your product. Also identify customer needs.

What is your most memorable experience as an entrepreneur?

First, the export of bottled drinking water to Taiwan. Launch of carbonated Beverage drinks in the market. Fire in the factory in 2012. Fire gutted the main areas of the Beverage plant and with the support of the passionate employees, bounced back within one month. Team work and unity were key to putting things back on track in such short time.

What is the single most important reason for your success?

Faith and hard work

What is your greatest fear as an entrepreneur?

We have offered my leading market players and others to

takeover. As an entrepreneur you live with a passion to provide support to people who have been around you and you have a social responsibility. But if someone wanted to cash you with your business, what will happen to the human capital which we built? I do not want to see such selfish situations by forgetting people around you for some time.

How do you achieve a work-life balance?

Do everything with pleasure. Make your family understand what we are doing and why we are doing it. Be involved in a crisis and accept their suggestions and views.

What advice do you have for others who are starting their own businesses?

Best decisions. Believe in you. Live with your dreams. Identify your purposes and live accordingly. Never look back at the past and be positive.

What would you be doing right now if you weren't here?

May be practising and preaching my religion. At times we realize that happiness is the most important thing in your life. The highest happiness comes from finding yourself often referring to Inner Engineering. If I had not been in business I would have chosen the spiritual path.





Mrs. Ayesha Imalika Gamage

Managine Director
Kavum Kokis.com

Tell me about yourself

I came from an IT background. I completed an Action Learning Professional Bachelor's degree in E Business and an Action Learning Professional Master's degree in Modern Business at the O 2 Campus. I also completed an Entrepreneurship and Small Business Management programme. Currently, I am following a Bachelor of Management Studies course at the Open University in Nawala. My main ambition was to become a woman entrepreneur and I have achieved it. I am also a B.Sc. Software Engineering (Hons) graduate of the Open International University, Colombo, Sri Lanka.

How did you get your idea or concept for the business?

Are your parents' entrepreneurs or your husband? Where did the idea of your business derive from? I started this business as a project for my Master's final project and implemented it as a family venture which I am carrying forward. It was my mother's business; she used to make tasty sweets and distribute them among all the villagers. She comes from a village where all the ingredients for this were available and plenty of people to help.

What was the key driving force behind your becoming an entrepreneur?

I wanted to implement what I had studied for my Master's. I gave much thought to it and though there are people who are unemployed if the ingredients are freely available why not do a business with their help and as an income generator for those people who are generous and willing to work.

"Actually, cost management was highly beneficial for my business"

What products do you offer/manufacture?

Sri Lankan traditional sweets such as (kevum, kokis, athirasa, mung kevum, and also dodol and muscat, etc. These sweets are used mostly served at house warming ceremonies New Year celebrations and other events.



As a professional engineer, how did you gain knowledge of entrepreneurship?

In my studies and by implementing what I had studied. I did a case study and thought why not implement it and move forward. Initially it was done on a small scale and gradually it expanded. Even though there is no regular market but only seasonal demand when I started I had a certain target which I never exceeded as these sweets are hand-made by the workers and not by machine. That's what is special about my products and also only original organic ingredients are used to make them.

How do you advertise your business?

Via the Internet and social media. Since I have an IT background I manage to handle the social media and related elements with knowledge and experience. The payment gateway is also managed by me. To manage a business which has an export market you need to have an IT background.

How far have Finance & Cost Management helped you in your business career?

Actually, cost management was highly beneficial for my business. From the beginning I used to keep record of all my operating cost in a very systematic manner. Cost accounting analyzes each and every cost incurred in a business. This helps the entrepreneurs like us to decide which costs are contributing to the profit-making aspect and which are not. Furthermore, it helped me for easy budgeting, identify breakeven and very importantly it facilitated me to reduce overhead costs. Finally, it helped me for making future strategies.

What do you look for in an employee?

The most important thing for us is that they fit into our corporate culture! More than employment it assists the unemployed people in the village. People with hands on

experience in making sweetmeats and its traditions are behind it. They knew the art of making it but they never know how to market it or sell it outside. It was my intention to make use of them and in return they are paid wages. This helped to develop the business. The villagers are an asset to me as when there is a high demand they help me out day and night to deliver on time. It's not only making the sweetmeats; there is packaging involved which takes longer hours than production. Especially when it comes to exports there is a special packaging method that I use to ensure durability and freshness of the items.

What made you choose your current location?

It's my village and I am known to the villagers well and I had my parents around to assist me.

Do you work nationally or internationally?

I supply locally and also export to 17 countries according to the requests. Initially my products were

sold at exhibitions and through known people and gradually it increased. Then I went into advertising on the social media and web sites. Even though it's a seasonal sweet on and off there are export orders as well as local orders.

How did you build a successful customer base internationally?

I built a customer base via the social media and Internet. This came in later but it drastically increased production as I had many export and local orders and also via a local on-line sales agent. 50% of my orders come through the local online agent annually. So even when the export market drops the local supplier has orders for me.

How far has technology helped you to develop your business?

My IT background helped me a lot and also made things very easy for me because I knew the subject very well. As mentioned above, basically I implemented what I had studied, and it was a hands-on experience for me. I did not have any difficulties in terms of monitoring and fulfilling the orders which came via online and tracking them until it reached the end user. I tied up with a well-established courier company who has been there right through with me and delivered on time without delay and damage to packages.

What is unique about your business?

My products are made hygienically and with local ingredients without preservatives. Most of these sweets and the rest are made of rice which is readily available

in Sri Lanka and to help the villagers I get it from the villagers and the quality of the rice is good as they cannot give me low quality since I am a regular buyer and live in the village. That's the privilege I enjoy. I add no preservatives to the sweets and my warranty is only one month.

What are your responsibilities as a woman entrepreneur?

To build and develop my business while assisting the unemployed. As a mother and housewife I fulfill my duties and the rest of the day I am home relaxing, so I manage to do this as well to keep me self-occupied and make a living and assist the villagers by giving them employment and making them my supplier of ingredients.

Does your company help the community where it is located?

Yes, it's very much community-based as the villagers are very much obliged to help me and it's their day to day livelihood. They have talent and ability but they do not come out due to financial constraints and also lack of knowledge. The educational level of the villagers is also very low.

If you had one piece of advice for someone just starting out, what would it be?

My advice is especially to all housewives is that there are many opportunities around that they could make use of. Make use of the unskilled people and skilled people too and the available sources within your village to make a product or a service and become an entrepreneur. We are born with some talent. Make use of it by helping others and make use of their talent too.



What is your opinion to Sri Lankan women?

I guess every successful woman is born with a talent. It's nothing new and if the will power is in them they should be able to manage. There are many opportunities in this country where you can make a living plus; make use of them.

What personality traits have helped you most in becoming a successful entrepreneur?

I have met many people and made loads of contacts after being a woman entrepreneur and it's a pleasure getting to them too. It has helped me to expand the market and get new ideas and leads through them. I have learnt so much about exports from the Export Development Board. In return they have guided me in so many ways and I have followed all their seminars/workshops on exporting to different countries.



B.Nishantha
Senior Lecturer
Department of Management & Organization Studies
Faculty of Management & Finance
University of Colombo



Small and Medium Enterprise Sector (SMEs) in Sri Lanka: **Significance, Opportunities and Challenges**

ABSTRACT

The Sri Lankan Government has taken many measures to support the development of Small and Medium Enterprises (SMEs), which are expected to play a crucial role in employment creation, gross domestic product growth, innovation, equitable income distribution, resource utilization and regional development. More specifically, it aims to address the following research questions: How important are SMEs in Sri Lanka? The paper goes further to review the existing literature, empirical studies as well as the prevailing data bases in order to identify the challenges and opportunities for the development of SMEs. The study found that there is a vast opportunity for Sri Lanka to harness the opportunity by developing this vital sector. The paper further, attempts to identify the policy changes necessary for enhancing the role of SMEs in economic development.

Keywords: Small and Medium Enterprises, Sri Lanka, Economic Development

1. Introduction

It is widely accepted in literature that Small and Medium Enterprises (SMEs) play a crucial role in contributing to overall industrial production, employment generation and poverty reduction in developing countries (Arinaitwe, 2006; Tulus Tambunan, 2011). This paper attempts to discuss the contribution of SMEs to economic development in Sri Lanka and the possibilities for promoting the SME sector. At the same time, the study attempts to explore the prevailing challenges that have limited the growth of the SME sector and finally, try to come up with some policy recommendations. In the afterthought of the three-decade civil war, the Sri Lankan government has given more priority to rebuilding Sri Lanka in order to achieve a higher economic growth. More specifically, the government targets to achieve a balanced development in all parts of the country including Northern and eastern Provinces. According

to the Central Bank of Sri Lanka (1998), the cottage and Small Scale industries 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 contributing to export earnings on one hand. On the other hand, SMEs do not exist in isolation from the rest of the economy, since they are integral of the supply chains; with large enterprises, as suppliers, customers, or complementary producers.

1.2 Methodology

The current situations of the SMEs are analyzed by using data of latest industrial surveys of Sri Lanka. The Department of Census and Statistics conducted industrial surveys in 2013/14. In addition to this, various other data sources such as Central bank of Sri Lanka, easy of doing business ;world bank report also used

2. Review of Overall

Performance in Small and Medium Enterprise Sector

Sri Lanka is a tiny Island with a total land area of 65,610 square kilometers and a multi-racial country which has total population of 21 million. According to the Asian Development Bank (2008), Sri Lanka is becoming a middle-income country and on track to achieve the Millennium Development Goal (MDG) on poverty reduction. The country is also on track to achieving most other MDGs, as its social indicators are high compared with those of countries of similar income status. However, the civil strife that prevented Sri Lanka from exploiting its full potential and benefiting from its proximity to India, just as Hong Kong profits from being a trade hub to China 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 and other organizations use different criteria to identify SMEs. Among these criteria are the number of employees, the size of fixed investment, energy consumption, and the nature of the business and the sector, (i.e. formal or informal), in which the industry operates. As shown in table 1, Ministry of Industry and Commerce has introduced

comprehensive definitions for SMEs by considering two border criteria namely; annual turnover and number of employees. According to their definitions, the ceiling on employment and annual turnover for manufacturing SMEs are respectively 300 employees and Rs 750 million and for SMEs in service sector, ceiling on employment are 200 employees. SMEs encompass establishments operating in agriculture, mining, manufacturing, constructions and service sectors. They have been identified to play a crucial role in the economic development process by developed as well as developing countries. They are even more important to developing countries as the poverty and unemployment are crucial problems in these economies.

Table 1: Defining SMEs in Sri Lanka

Sector	Criteria	Medium	Small	Micro
Manufacturing	Annual Turnover	Rs. Mn. 251 - 750	Rs. Mn. 16 - 250	Less than Rs. Mn. 15
	No. of Employees	51 - 300	11 - 50	Less than 10
Service	Annual Turnover	Rs. Mn. 251 - 750	Rs. Mn. 16 - 250	Less than Rs. Mn. 15
	No. of Employees	51 - 200	11 - 50	Less than 10

Source : National Policy Framework for SME Development

All successive governments since 1948, have been introduced various policies for promoting SME sector in Sri Lanka. The current policy frame work was introduced in 2016. This SME Policy Framework will support start-up SME enterprises, strengthen the existing enterprises and extend nursing programmes for potentially viable sick SMEs. SME policy focus on the following aspects.

- Promoting high potential, viable and promising sectors
- Focus on cluster approach for SME Development. Under the

cluster approach, the entire value chain from input supply to processing and export will be supported and promoted.

- Promote enterprises with high value addition and encourage enterprises that use the local raw materials as they offer strong comparative advantages due to factor endowments.
- Motivate and encourage export oriented or import substitution enterprises and industries.

- Encourage and promote flagship SME sectors with high potential spillover effects to facilitate job creation or employment generation.
- Promotion and relocation of industries in the backward regions to reduce urban-rural imbalances.
- Transforming the landscape of the SMEs away from mere trade and commerce towards production and industry based with special focus on high value addition, innovative and

usage of modern appropriate technology.

- Strengthening the SME sector in order to enhance inclusive economic development and thus provide opportunities for better employment and higher income.
- Achieve regionally balanced growth across Sri Lanka.
- Promote resource efficiency at all levels including the use of Green Technology

According to the industrial census conducted by the Department of Census and Statistics in

1983, there were a total of 102,721 formal registered and unregistered informal industrial units in the country producing various types of products and employing 639256 persons. The survey findings indicated that industrial establishments below 5 employees accounted for 84% of the 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).

All the existing data sources lack accuracy and complete coverage of the 'enterprise sector' in spite of various government and semi government institutions engaged in compiling SME related data bases. The Department of Census and Statistics 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. The most recently conducted industrial survey dates back to 2015.

Table 02 Overview of Sri Lankan Manufacturing Sector Classified by Industrial Size in 2015

Industrial Size	Industrial Establishments		Industrial Employment		Total Value-Added		Total Output	
	No.	%	No.	%	Million Rs	%	Million Rs	%
Micro Enterprises	5,779	34.12	33,301	2.85	27,080	1.94	52,675	1.40
Small Enterprises	6,914	40.82	136,932	11.72	137,763	9.90	287,806	7.62
Medium Enterprises	2,442	14.42	166,152	14.21	230,732	16.58	774,457	20.51
Total SMEs	15,135	89.36	336,385	28.78	395,575	28.42	1,114,938	29.53
Large Enterprises	1,803	10.64	832,265	71.22	995,961	71.58	2,660,550	70.47
Total	16,938	100	1,168,650	100	1,391,536	100	3,775,488	100

Note: In manufacturing industry only

Source: Author's calculation based on Industrial Census 2016, Sri Lanka

The data provided by this survey provides a good frame for analyzing the contribution of SMEs to the national economy in Sri Lanka in terms of employment generation, value of output and value addition. For the purpose of present analysis, we categorized very small or micro enterprises were those enterprises employing between 5-10 people, small 10-39 people, medium 40-99 people and large 100 or more. As shown in table 2, in 2015, micro enterprises accounted for 34 percent of the total number of enterprises but

contributed to only 2.85 percent of total employment in the manufacturing sector, about 1.94 percent of total value added and 1.4 percent of total output.

Small enterprises which had a work force of 10-39 employees accounted for 40.82 percent of total number of establishments in the manufacturing sector. Small firms accounted for 11.72 percent of industrial employment, 9.9 percent of total value-added and 7.62 percent total output. Medium sized firms which had a workforce of 40-99 employees accounted for

14.42 percent of the total number of industrial establishments accounted for 14.21 percent of total employment, 16.58 percent of total value-added and 20.51 percent of total output. It reveals that medium sized establishments are much better than micro and small enterprises in terms of employments generation and value addition.

All the industrial establishments, which have employed less than 100 employees, can be categorized as small and medium enterprises (SMEs). They accounted for

89.36 percent of total number of industrial establishments but only 28.78 percent of total employment, 28.42 percent of total value-added and 29.53 percent of total industrial output. As for large firms which employed more than 100 employees, while accounting for 10.6 percent of total number of establishments, they contributed to 71.2 percent of total employment, 71.5 percent of total value-added and 70.4 percent total output. It revealed that SMEs are providing more employment opportunities but their contribution for output is relatively low.

3. Geographical Concentration of Manufacturing Industries

Table 3 shows the geographical distribution of industries in Sri Lanka. Small scale enterprises are concentrated in the Western province based districts of Colombo (28%) and Gampaha (15.5%) and North-Western Province based district of Kurunagala (6.6%). Medium and large scale industries are concentrated mainly in Western Province based districts of Colombo (33.9%) and Gampaha

(21.4%). In the case of employment generation in small scale industries Gampaha (16%), Colombo (27%) and Kurunagala (7.5%) are the main districts.

Medium and large enterprises are also mainly generating employment in the Western Province based districts of Gampaha (34%) and Colombo (37%). This clearly shows the heavy concentration of SMEs in Western Province of Sri Lanka.

Table 03 Geographical Concentration of Industries (Formal Industries)

District	Establishments less than 25 employees		Establishments more than 25 employees	
	No. of Establishments	Persons engaged	No. of Establishments	Persons engaged
Colombo	485	6973	1151	309690
Gampaha	267	4019	725	281768
Kalutara	105	1485	246	38152
Kandy	107	1296	271	26291
Matale	5	65	6	4440
Nuwara-Eliya	12	166	37	21702
Galle	110	1639	170	26746
Matra	79	1513	65	4650
Hanbantota	41	746	12	1029
Jaffna	37	559	10	431
Mannar	2	10	na	na
Vavuniya	7	49	na	na
Mullaitivu	2	13	na	na
Kilinochchi	4	38	2	47
Batticaloa	13	180	2	264
Ampara	4	96	4	8615
Trincomalee	10	92	2	534
Kurunegala	114	1916	225	47180
Puttalam	86	1198	142	13525
Anuradhapura	48	665	7	1265
Polonnaruwa	36	562	28	2055
Badulla	34	645	61	2721
Monaragala	9	142	8	5908
Ratnapura	46	735	146	25827
Kegalle	59	805	72	11628
Total	1722	25607	3392	834468

Source: Author's calculation based on Economic Census 2013/14 conducted by Department of Census and Statistics, Sri Lanka



4. Opportunities Associated with the Development of the SME Sector in Sri Lanka

There are multi-faceted opportunities prevailing in the SME sector. Development of SME sector can be used to promote balanced regional development. Due to the war situation, in the past few decades, major commercial activities were more scattered in urban areas, especially the western province of the country. With regard to the overall industries by the end of the year 2006, 80 Percent of the registered industries were located in Colombo district and Gampaha district (next to

Colombo district). According to the World Bank (2009), with the gradual resettlement of the displaced people and restoration of their livelihoods, agriculture and SME production is expected to pick up. At the same time, regional demand will be created for SME products.

Subcontracting

With further improvement in the overall investment climate, foreign direct investment is expected to continue flowing in to the country. More investment opportunities are emerging in following areas; precious and semi-precious stone mining,

fisheries, organic agriculture in large scale, wind and solar energy, oil and gas exploration, Eco-tourism ect. Then SMEs can play a complimentary role to large industries through subcontracting, thus facilitating the linkage between the formal and the informal sector.

Green Businesses

Converting businesses in to a "Greening businesses" can be considered as a strategic avenue for Sri Lankan SMEs. Strategies and policies related to green business ensure a sustainable future for customers, employees and communities through enhancing

quality of life and environmental concerns. Entrepreneurs are expected to conduct experiments continuously to make innovations relation to sustainable practices. It help to reduce energy consumption, carbon footprint, environmental damage and support environmental and human sustainability. Small entrepreneurs who are adopting green practices will have significant advantage over the others in terms of sales, goodwill and sustainability.

Backward Linkages

There is a high possibility to creating a strong backward linkage between SMEs and agricultural sector. Many inputs in to the SME production are based on agricultural and forestry products (Arsyad, 2009). As a result of such linkages SME manufactures will be much less import intensive than large businesses. The North and east parts of the country have more agricultural land. Before the civil war the region's agricultural production compared favorably with that of other parts of the country, mainly rice, vegetables, fruit, and other cash crops. SMEs can add value for those primary products and market to the other parts of the country and export markets.

Employment Opportunities

The SMEs can be started with low investments, mainly from personal savings or informal borrowings. Therefore, the sector contributes to broad-based capital formation throughout the economy. As discussed in earlier section, SMEs especially medium sized firms absorb more labour per unit of capital employed implying that; by promoting this sector large huge employment opportunities can be

created in the informal sector.

5. Constraints Associated with Development of SMEs

Development of the SME sector in Sri Lanka is constrained by number of factors. According to the white paper (2002) prepared by Task Force for Small and Medium Enterprise Sector Development Programme, has identified the major constraints that critical for the SME development in Sri Lanka. In addition to that, multilateral and bilateral agencies such as USAID, world bank, JICA, ADB, UNIDO have carried out number of studies on problems of SMEs in Sri Lanka. In order to know more about the business environment of Sri Lanka, we address the annual report of World Bank (Doing Business 2019) that investigate the regulations that enhance business activity and those that constrain it. Doing Business presents quantitative indicators on business regulations and the protection of property rights that can be compared across 190 economies over time. Regulations affecting

11 areas of the life of a business are covered: starting a business, dealing with construction permits, registering property, obtaining credit, protecting investors, paying taxes, trading across borders, enforcing contracts, closing a business, getting electricity, and employing workers. Sri Lanka with 21 million populations and GNI per capita US\$ 3,840, is placed 100 among 190 countries, in the "ease of doing business" (table 04). The rank of Sri Lanka in "starting a business" is 83, while in "obtaining credit", it is ranked 124. Table 4 shows the comparison of easy of doing business indexes between countries in South Asia. India, in 77th place in the Doing Business rankings, is the highest ranked economy in South Asia, followed by Bhutan (81) and Sri Lanka (100). Sri Lanka has carried out four reforms which included making dealing with construction permits easier, while the introduction of online systems made it easier to pay taxes. Sri Lanka has also made it easier for businesses to register property and enforce contracts which made the country to move up in the doing business index.





Economy	Rank (1-190)	Easy of doing business score (0-100)		Number of Reforms	
	DB2019	DB2018	DB2019	DB2018	DB2019
Afghanistan	167	37.13	47.77	0	5
Bangladesh	176	41.06	41.97	0	0
Bhutan	81	65.88	66.08	4	1
India	77	60.60	67.23	8	6
Maldives	139	54.33	54.43	2	0
Nepal	110	59.95	59.63	2	0
Pakistan	136	52.78	55.31	4	3
Sri Lanka	100	59.42	61.22	1	4

Source: Doing Business database

The lack of a comprehensive framework in terms of policies toward SMEs development is one of the most important factors that constraint the growth and development of SMEs. There is no national policy for industrial development of the country and the policies are changing with government changes.

Access to sufficient finance is also a major problem faced by SMEs due to lack of access to bank facilities, lack of regional spread of loans, lack of knowledge of bank facilities, lack of knowledge of bank procedures, and inability to provide collateral. Lending institutions are expecting land based collateral but most of the SME owners do not their own lands. Many of the entrepreneurs are looking for more borrowing for survival, not for business expansion. Low adoption for Information and Communication Technology (ICT) development is a one of the key challenges faced by entrepreneurs

in SME sector. Adaptability for ICT applications support for product improvement, productivity improvement, operational accuracy enhancement, cost reduction, local and global marketing. According to the recent survey done by Athapaththu and Nishantha (2018), there are five perceived barriers for ICT adoption by owner- managers of SMEs in Sri Lanka namely lack of proper internal IT infrastructure, lack of trust, lack of personal motivation, internet connection issues and lack of knowledge.

The use of low level of technology and absence of technical and managerial skills has also been identified as important constraints affecting the development of SME. With low level of technology it is difficult to maintain higher productivity and quality, resulting in higher costs of production and a reduction in

market competitiveness. According to Silva (2013), traditional mind-sets, short term focus on business operations, lack of awareness on technological improvements, cost of technology acquisition, less preparedness of supporting national mechanisms would be obstacles in this regards.

Proliferation of imports of products from emerging global economies is also a threat for Sri Lankan SME sector. More products which could be locally manufactured are being imported from China, India Japan and Thailand. It squeezes the manufacturing segment and replaces the losing layers of manufacturing with trading, altering the SME composition harmfully.

6. Conclusion and Some Policy Recommendations

The purpose of this article was to examine the current situation of the SME sector in Sri Lanka and

explore the opportunities and challenges prevail for developing a healthy SME sector. Available secondary data and extensive literature indicates that 89 percent of the industrial enterprises belonged to the SME category and they play a vital role in the economy and are a major source of various economic contributions. The study revealed that medium sized firms (employees between 40 -99) have been gaining relatively higher productivity and their contribution for value addition, total output and employment generation is also better than micro and small firms. There is a huge potential for this sector to prosper in war affected areas given the high level of human capital and natural resource endowments.

Having identified some of the challenges and opportunities associated with SMEs it is possible to present some strategies that the government and the agencies responsible for development of the SMEs in Sri Lanka.

First, the government has to take measures to formulate national policy for SMEs as an integral part of the overall industrialization policy. Without such policy frame work, it is difficult to develop this sector. Given the, non -diversification of the industrial structure and its heavy concentration in the few low value added industry categories is a main problem for sustainability of the industrial development (Dasanayaka,2009) process. There need to be gradual shift towards high value added domestic resource based production activities. Second, innovative measures should be used to attract investment and business interest from the Diaspora. Diaspora investors have the potential to

play an important role. Even more than most international operators, since they have the local connections and, the personal motivation to contribute to their country's reconstruction. While living abroad, they may have picked up valuable expertise, in addition to amassing funds (Bray,2007). As war is over, the government should provide various incentives and security to them to come again to their motherland and convert the accumulated financial and human capital in to assets of the development process. Third, as lack of finance constrains the growth and development of SMEs, the government and other supportive agencies need to promote micro lending and SME lending on a much bigger scale, with greater participation of women entrepreneurs on the line of the " Grameen" scheme of Bangladesh. Forth, beyond enhancing the coverage and quality of basic infrastructure, initiatives would also help improve access to markets for rural firms.

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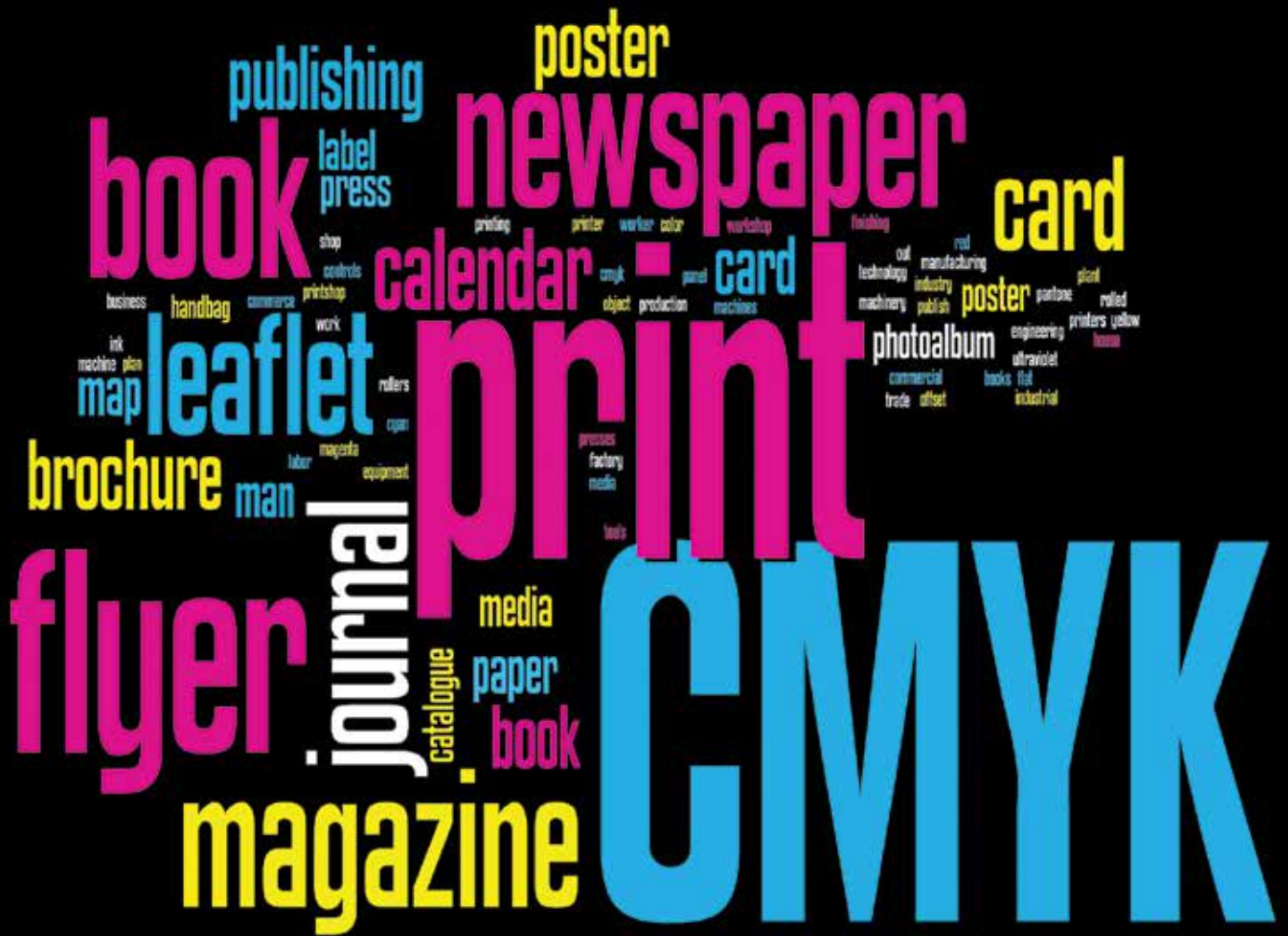
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Adrian Perera
FCMA,FCCA,FCMA(UK),MBA(Sri J),AIB,FCPM



Development of the **SME Sector in a Sustainable Manner**

The writer is a member of the governing council of CMA Sri Lanka, an immediate past president of the member network panel of ACCA Sri Lanka, a former governing council member of CIMA Sri Lanka, a former Vice President of OPA, a former MD/ CEO of Lanka Rating Agency and is currently the director of corporate affairs at OASIS Hospital Pvt. Ltd.

1. Why are SMEs important?

Small and medium enterprises (SME) are recognized for their contribution to employment, innovation and

economic dynamism. SMEs enhance competition and entrepreneurship and thus have economy wide benefits in efficiency, innovation, and productivity growth. For a developing country such as Sri Lanka, where SMEs account for nearly 90% of the industrial establishments, 70% of employment in the industry sector (over 30% of all employment), while contributing to about 26% of GDP, the sector has been considered a veritable engine of economic growth, enhancing productivity, creating new jobs, and reducing poverty. SMEs are nimble and responsive

and not as susceptible as large firms to the unpredictability of financial markets. The sector is marked by the relative ease of entry and exit and scaling up or down. As a labor and capital scarce economy, Sri Lanka can ill afford not to use a vehicle such as SMEs for labor absorption, poverty alleviation, import substitution and economic development.

2. How are SMEs defined in Sri Lanka?

Sri Lanka does not have a single statutory definition for SMEs. Some of the definitions in use in Sri Lanka are given in Table 1.

Table 1: How SMEs have been variously defined in Sri Lanka

Institution	Criterion	Medium Scale	Small Scale
Sri Lanka Standards Institution (SLSI)	No. of Employees	Between 50 - 249	Less than 50
Industrial Development Board (IDB)	Value of Machinery	Between Rs. 4 million to 10 million	Less than Rs. 4 million
Ministry of Industry, Tourism and Investment Promotion	Value of fixed assets other than land and buildings	Up to Rs. 16 million	Less than Rs. 16 million
National Strategy for SME Development in Sri Lanka (Government White Paper 2002)	No. of Employees	30-149 employees	5-29 employees
Federation of Chambers of Commerce and Industry of Sri Lanka	Capital employed	Between Rs. 2 million to 20 million	Less than Rs. 2 million

Institution	Criterion	Medium Scale	Small Scale
Ministry of Small and Rural Industries	Total Investment	Between Rs. 20 million to 50 million	Between Rs. 1 million to 20 million
Ceylon National Chamber of Industries	i) Value of assets other than buildings and lands. ii) No. of employees	Between Rs. 4 million to Rs. 20 million Between 10 -50	Less than Rs. 4 million Less than 10
Sri Lanka Export Development Board (EDB)	i) Capital investment excluding lands and building ii) Annual export turnover	More than Rs. 40 million More than Rs. 100 million	Less than Rs. 20 million Less than Rs.100 million
World Bank (for Sri Lankan country studies and loan programs)	No. of employees	Between 50-99	Less than 1- 49
Dept. of Census and Statistics	No. of Employees	More than 10 (Year 2003/04)	Less than 10 (Year 2003/04)
Task Force for SMEs Development in (2002)	Asset Value excluding land and buildings value	Not exceeding Rs. 50 million	Not exceeding Sri Lanka Rs. 20 million
Sri Lankan Apparel Industry, Task force on five year strategy (2002)	i) Export value ii) No. of Employees	Rs. 101 million to 250 million	Rs. 0.25 million to 100 million
The Dept. of Small Industries	i) Capital investment ii) No. of Employees	Between Rs. 25 – 5 million Between 100 - 50	Less than Rs. 5 million Less than 50 employees

Note: Rs. represents Sri Lankan Rupees

Source: S.W.S.B. Dasanayaka (2009), 'Small and Medium Scale Enterprises in Informal Sector in Pakistan and Sri Lanka with Research Agenda', paper prepared for the Special IARIW-SAIM Conference on "Measuring the Informal Economy in Developing Countries", Kathmandu, Nepal, September 23-26, 2009

3. How have SMEs grown in Sri Lanka over the years?

SMEs in Sri Lanka includes establishments operating in agriculture, mining, manufacturing, construction, and service sectors. A comparison of the number of establishments and value added by various size groups of industry is given in Table 2.

Table 2: Growth of SMEs in Sri Lanka

Size class by no. of employees	1983		1996		2006	
	No. of establishments (%)	Value added (%)	No. of establishments (%)	Value added (%)	No. of establishments (%)	Value added (%)
Small (5-9)	86.6	11.3	70.7	4.1	65.6	5.7
Medium (10 -149)	11.4	19.8	20.1	8.4	25.9	26.1
Large (150 and more)	2	68.9	9.2	87.4	8.4	68.2
Total	100	100	100	100	100	100

4. Support Available for SMEs in Sri Lanka

4.1 Policy support

The importance of SMEs in driving economic growth has long been recognized by governments. Successive governments have articulated their policies and strategies to accelerate economic

growth and development while reducing regional imbalances and poverty on a sustainable basis in a number of policy documents. However, there has been no comprehensive document reviewing the SME sector in Sri Lanka.

the policy document 'Mahinda Chintana: Vision for a New

Sri Lanka, A Ten Year Horizon Development Framework 2006-2016', released in 2010, set for the first time quantifiable targets by sector and ministry for the economy to pursue. Specific strategies included upgrading of SMEs, subsidized loan schemes, setting up of entrepreneurial centers in every district, trade

centers in every province for convenient marketing of produce, and establishment of handicraft.

To implement these policies, a special SME Bank was established in 2005, followed by a National Enterprise Development Agency (NEDA), both of which were under the then Ministry of Enterprise Development and Investment Promotion. The NEDA Act No 17 of 2006 was enacted to promote, support, and facilitate enterprise development within Sri Lanka with special emphasis on SMEs. Subsequently, the SME bank had to be consolidated with the Lankaputhra Bank due to very high NPAs.

4.2 Institutional support

The institutional support system to SMEs in Sri Lanka comprises of four pillars: (a) public sector, (b) financial institutions, (c) non-government organizations (NGOs), and (d) multilateral and bilateral organizations.

4.2.1 Public sector institutions

Under the previous government administrative, SMEs came under the Cabinet Ministry of Traditional Industries and Small Enterprise Development while many other ministries were directly or indirectly engaged in SMEs through (a) policy formulation, (b) regulatory functions, (c) support services, and (d) coordination.

Statutory bodies under different cabinet ministries provide common services relating to the SME sector. The Industrial Technology Institute (ITI), Industrial Development Board (IDB) and Export Development Board (EDB) deserve special mention in view of their involvement with SME development relating to skills development, technology transfer and access to markets.

4.2.2 Financial institutions

Banks: In 2005, the then government established the SME Bank to implement its policies for the SME sector, following a recommendation by an SME-focused cluster of the National Council for Economic Development (NCED). The SME Bank was a licensed specialized bank owned by the government. Its objectives were promoting the growth of SMEs by providing credit, guarantees, venture capital, and entrepreneur development and support services. In 2006, Lankaputhra Development Limited was established solely to provide finance and seed capital to the SME sector. The two banks merged in 2008. State and private sector banks have also offered various loan schemes and projects for the SME sector. The present government had initiated a loan scheme 'Enterprise Sri Lanka' with concessionary interest rates geared at developing the SME sector.

Chambers of commerce and industries: Extend advice on business promotion and development through various associations and projects.

4.2.3 Non-governmental

organizations (NGOs)
A number of local NGOs such as Sarvodaya are involved in providing various services to SMEs. The NGO sector, in general, covers a highly diverse set of institutions representing both national and international participation in enterprise development. Most of them are confined to selected economic sub-sectors or

selected administrative districts of the economy and provide skills development programs on record keeping, accounting procedures, labour management and product development. The well-established NGOs provide a wide range of consultancy and advisory services in the field of marketing, financing, engineering and preparation of project proposals.

4.2.4 Multilateral and bilateral donor agencies

Donor agencies such as Asian Development Bank (ADB), Japan International Cooperation Agency (JICA), World Bank and United States Agency for International Development (USAID), play an important role in promoting SME sector activities in the economy in Sri Lanka. In addition to supply of low cost credit, these agencies have been actively involved in capacity building and policy reform initiatives jointly with private sector organizations. However, SMEs have been unable to fully benefit from these programs due to an absence of an integrated development plan at the national level.

5 What challenges do SMEs face in Sri Lanka?

SMEs in Sri Lanka are often constrained due to limited financial access and high cost of funds. Loan procedures are often complicated. Unreliable power supply, poor state of roads and transport services pose major obstacles to development. SMEs are also hampered by poor technical and management skills, marketing constraints, outdated technology and inflexible labor laws. Primary challenges identified in the National Strategy for Small and Medium Enterprises Development in Sri Lanka (December 2002) are as follows:

- Lack of focused policy framework and reform
- Lack of access to information and technology to facilitate decision making and planning at affordable cost
- Lack of access to finance at a reasonable cost and high emphasis on collateral
- Lack of market information and marketing skills
- Absence of a single standard definition for SMEs
- Lack of adequate infrastructure
- Shortage of skilled manpower
- Lack of professional management skills for the SME sector

6. How are SMEs financed in Sri Lanka?

Lack of access to finance at a reasonable cost and high emphasis on collateral have been cited as major obstacles to SME growth in the National Strategy for Small and Medium Enterprises Development in Sri Lanka (December 2002). Access to finance is in fact a bigger challenge than even rising cost of material.

Though the issue of access to finance and cost of finance are interrelated, they are not identical. Lack of access to finance or high cost of finance to the SMEs merely indicates that financial intermediaries tend to lend to sectors where risk and return match their risk appetite and the risk preferences. Loan sizes to SMEs tend to be small in value while the relative risks and processing cost are comparatively high. This in turn is compensated through high interest rates. To cope with high cost of funds, SMEs across Asian countries are constantly looking for opportunities to diversify their risks and funding sources.

6.1 Sources of funds

The primary sources of SME financing in Sri Lanka is through registered finance companies (RFCs) and leasing companies.

As Sri Lanka graduated from being a 'less developed country' in 1990 to a 'developing country' in 2009, it lost the benefit of concessionary funding for SME development from global development financial institutions. However, multilateral and bilateral institutions do on occasion lend to private leasing companies in Sri Lanka, after conducting stringent due diligence, for ultimate lending to SMEs.

6.1.1 Registered finance companies

Traditionally, RFCs have been the biggest lenders to SMEs in Sri Lanka. Funds raised from public deposits and bank loans are then used to offer advances to SMEs through a diverse range of financial instruments. These include:

- Leasing
- Hire purchase
- Mortgage loans
- Pawning
- Factoring

6.1.2 Commercial banks

Most commercial banks have relied mainly on the central bank and government funded refinancing schemes for SME financing. A few have used their own funds. Although SME lending is considered by and large profitable, commercial banks generally tend not to expose their portfolio to the SME sector to a very great extent (except in the case of pawning since the loans are backed by gold).

For a SME, borrowing from a RFC will come at a significantly higher cost than a similar loan from a commercial bank. The average lending rate of RFCs as of 31 March 2010 was around 16.5% as opposed to 6.3% for commercial banks. However, RFCs have been able to get a firm foothold in the SME financing market over the years due to their small size and flexibility, which are important factors, when catering to a sector which is highly unstructured and informal. Despite the high interest rates, SMEs have grown consistently in number over the years. The high hurdle rate in the market has however created a credible barrier to the entry and survival of efficient SMEs.

6.1.3 Leasing companies

Leasing companies in Sri Lanka are not authorized to accept customer deposits. They source funds through loans from banks and lending agencies both multilateral and bilateral. In the absence of a proper legal and tax infrastructure, securitization remains a cumbersome task. This makes borrowing from leasing companies expensive specially since other lending institutions will be its direct competitors.

6.2 Constraints to financing

Availability of funding is the Achilles' heel of SME sector financing in Sri Lanka. The National Strategy on SME Sector Financing identified the following challenges for SME's access to finance:

1. Existence of marked information asymmetries between SME borrowers and lenders.
2. Sizeable transaction cost for SME financing and high cost of borrowing.
3. High risk of default

4. Lack of acceptable collateral
5. Lack of diversified financing mechanisms
6. Poor management of finance

6.2.1 High lending rates

It has been observed that in Sri Lanka even with dipping inflation in the past, both borrowing and lending rates to SMEs are downward sticky, and financial institutions tend to maintain high margins even on comparatively low risk lending. Interest rates play the role of a credit rationing instrument.

High lending rates must also be viewed in the context of adverse selection. When lending rates increase, the risk of default increases, and safer borrowers are driven out of the pool leaving only the riskier borrowers. This increases the portfolio risk. In order to maintain portfolio quality, banks go in for credit rationing which typically precludes the high risk SME segment from the lending pool. Credit rationing may result in situations where potentially profitable ventures suffer sub-optimal allocation of credit due to small size, lack of collateral etc.

6.2.2 Information asymmetries

SME entrepreneurs are not always able to competently articulate and attractively present information to convince potential lenders about the viability and profitability of their business.

These entrepreneurs have also been known to indulge in malpractice by maintaining two sets of books to reduce their tax liability. Such actions on the part of the potential borrower, perceived as risky behavior, erodes a lender's confidence.

There also may be instances inadvertent and unintended gaps in paperwork which cannot be overlooked by the lender. While the applicant may be an astute businessperson with a great business concept, the information provided to financiers may be incomplete and inaccurate; documentation may be weak or even non-existent. This leads to two problems. First, the lender is unable to fully gauge the risk profile of the project. Second, once funds are disbursed, the lender is unable to ascertain the effectiveness of fund utilization. This could result in the facility being refused or funds offered at high interest rates and high collateral.

6.2.3 High transaction costs

Transaction costs are independent of loan size. Therefore, loans to the SME sector which are smaller in value, bear a disproportionate amount in transaction costs. Banks recover transaction costs through high premiums which add to the overall financing cost.

6.2.4 Zero access to capital markets

SMEs in Sri Lanka have challenges in accessing the capital market as most are incorporated as sole proprietorships, partnerships and private limited companies. Sri Lanka does not have a developed venture capital industry or a developed equity market for SMEs. India has set up a SME exchange. However this may not be best solution for Sri Lanka until some form of financial and management discipline is brought to the SME sector through regulation.

6.2.5 Fall-back option:

Borrowing from the non-formal sector

Difficulties in accessing financing from the formal financial sector invariably pushes SMEs towards the high cost non-formal financial sector for funds. Insignificant economies of scale of SMEs results in low bargaining power and limited choices.

7. How can the barriers to SME financing in Sri Lanka be lowered?

It is evident that policy directed finance, RFCs and leasing companies have been the main sources of finance for the SME sector in Sri Lanka despite the high cost of borrowing. By and large, policy directed lending with massive interest subsidies have created negative tradeoffs for the stakeholders concerned. Most of the donor funding and technical assistance schemes have not achieved the desired results since they are supplier driven. Development financial institutions have played only a minor role.

This section highlights ways in which credit risk evaluation can enable SMEs to access funds in a timely and efficient way by reducing restrictions in current funding channels.

7.1 Building a rationale for a Credit Guarantee Fund

Credit guarantee schemes on debt/equity aim at increasing lender/investor confidence by compensating the lender/investor for much of the risk should the borrower default or the business fail. Sri Lanka does not have an established credit guarantee corporation for SMEs. However, CBSL has been extending credit guarantee on loans to certain

sectors in line with prevailing government policy. To ensure that a guarantee fund does more for the economy than needlessly increasing the government's fiscal burden through high non-performing loans (NPL) ratios, it is important to put in place mechanisms for strict credit risk evaluation and monitoring through registered domestic credit rating agencies (CRAs).

7.2 Building a rationale for credit risk assessment

The merging of the specialized banks for SME lending, ie. The SME Bank and Lankaputhra Development Bank, in 2008, brought attention to the lending portfolio of the two banks which had nearly 40%–50% NPLs. This subsequently reached an unsustainable NPL level of 97%. How did this happen? It happened due to the absence of proper credit risk evaluation and a lack of monitoring credit.

Credit risk rating can be used to gradually replace collateral based lending with information based lending. The rated entity (the potential borrower or issuer of the debt instrument) will be evaluated comprehensively in terms of business, market, and commercial viability to assess risk of default and assigned a certain risk rating. This rating will disperse informational asymmetries for the potential lender while helping to bring down the cost of funds and the need for large collateral requirements.

With a credit risk rating, a SME loan applicant's track record and financial viability of the project will be of greater significance in lending decisions. Good credit risk information would help financial institutions anticipate and avoid

situations of loan default. Of importance is the decrease in transaction costs over time as banks gradually shift to risk based pricing. A credit rating could also help a SME in obtaining longer periods of credit from its suppliers.

7.3 Credit risk evaluation in Sri Lanka: A quick overview

In Sri Lanka credit risk rating is only ten years old. Its three CRAs, Fitch Ratings Lanka Ltd (FRL), RAM Ratings Lanka Ltd (RRL), and ICRA Lanka Ltd, are governed by the Securities and Exchange Commission of Sri Lanka (SEC Sri Lanka). Apart from the three domestic CRAs, the CBSL has also recognized the three global rating agencies, Fitch Ratings, S&P, Moody's, and their respective rating scales.

Sri Lanka does not utilise risk-based pricing of loans. Banks lend to local corporates based on negative pledges and mortgage over receivables. For mid-size corporates, asset mortgages are common. SMEs resort to a plethora of lending arrangements—leasing, hire purchase, mortgages, guarantees and pawning—all of which are collateral-based. Banks lend to SMEs relying on time tested collateral value analysis backed by the borrower's CRIB report and project report. This ensures that the lending decision is based on considerations that are quantitatively justifiable and appropriately supported. Accounting-based lending for SMEs (where there is rampant misreporting and misrepresentation of facts and figures) demands the exercise of qualitative judgment which is a risk lenders in Sri Lanka are

unwilling to take. The Institute of Chartered Accountants of Sri Lanka has published a specific accounting standard for SMEs to standardize financial reporting and information transparency. However, adherence to accounting standards by SMEs has been low.

7.4 How can the credit rating process be made SME-friendly?

The survey-based 'Assessment of Financial Institution Use of Credit Scoring for Small Business Lending' (2006) presents competitiveness, regulatory issues, documentation and transaction costs related issues, SME credit evaluation challenges, absence of low cost additional information and the lack of secondary market loan sales as factors that influence lending institutions to adopt credit scoring as a determinant in a lending decision. Of these, the most relevant to Sri Lanka are issues related to documentation, cost per transaction and lack of low cost additional information. Documentation and transaction costs are disproportionately high in SME lending when compared with the loan size. This predisposes the lender to turn away an SME applicant even if its default risk is low. SME Credit rating is one method where the documentation costs and the information costs can be minimized to an affordable level to both the borrower and lender.

CRAs will have to develop a new credit risk analysis matrix for SMEs where the methodology is simple and the model inexpensive to drive. The methodology must also be robust enough for the ratings to be acceptable to lending institutions such as banks, credit guarantee corporations, RFCs, and leasing companies.

8. Policy Recommendations

1. Credit rating agencies are regulated by the SEC of Sri Lanka while the task of developing SMEs lies with NEDA. The financing aspects are managed by the Ministry of Finance and monitoring of banks and finance companies is done by CBSL. Since there are many interrelated institutions involved **it would be ideal if NEDA took the lead in the establishment of a Credit Guarantee Fund (CGF) and implementation of SME credit ratings in Sri Lanka.**
2. It is important to gain buy in from banks and other financial institutions when establishing the CGF. It is proposed that CBSL and other commercial banks are involved in the process. CBSL should manage the process of obtaining the initial seed capital from multilateral lending agencies.
3. The Board of the Credit Guarantee Fund should comprise of representatives from NEDA, CBSL, commercial banks (public and private), as well as the Institute of Chartered Accountants of Sri Lanka and CMA Sri Lanka. This will increase the confidence and sustainability of the CGF and help in identifying segments where assistance is required.
4. Though Sri Lanka has two CRAs, the number of rated entities as at December 2011 was 98. An important factor is that the rating methodologies are not refitted to the local context of Sri Lanka. The rating committees

sit overseas and lack understanding of Sri Lankan realities and compulsions. The domestic ratings assigned by these CRAs are not viewed favorably by SME clients who lose confidence and revert to applying for collateral-based loans. SMEs are unique to each country and region and have greater fidelity to the local context and culture than corporates. CRAs need to develop new methodologies catering to the SME Sector in Sri Lanka and the methodologies must be approved by CBSL and SEC of Sri Lanka. Since both rating agencies are foreign, they do not have a vested interest in developing the local market by incorporating a local domestic rating agency.

5. A SME credit rating should be made mandatory for all policy directed lending. Non-existence of risk based pricing will result in discouraging SMEs from obtaining a voluntary rating which in itself will carry a financial burden.
6. CRAs will become legally responsible for their ratings under the new Securities and Exchange Commission Act which is expected to be effective mid-2019. This may discourage CRAs from rating SMEs. To encourage CRAs to service the SME sector, directions to mitigate risk and legal liability will be required.
7. CRAs should publish default studies annually and all rating reports should be filed at the SME Credit Guarantee Fund to create a one-stop shop for

financial institutions. Initially, the process could start with medium scale enterprises.

8. Default customers should be blacklisted with relevant details. This report should be provided to the CGF as well as CRIB.

9 Conclusion

This paper attempted to identify the barriers that SMEs in Sri Lanka face in accessing finance at a reasonable cost. Although the government has injected significant sums into policy directed lending, it has not achieved the desired outcomes. With pressure to display greater fiscal prudence, the government finances are severely stretched. Therefore innovative ways to bring down the cost of funds while ensuring easy access for SMEs is strongly required. The solutions should be self-sustaining without placing an excessive burden on the government budget.

In this context, the paper suggests the setting up of a Credit Guarantee Fund (a corpus pooled by representatives from NEDA, CSBL, commercial banks, and multilateral agencies) along with a statutory SME credit rating to bring financial discipline and enhance development in the SME sector. Looking forward, if SMEs are to be listed in the SME Board of the Colombo Stock Exchange (as is planned), their financial discipline will certainly need to be superior to the existing level. Domestic CRAs can help by rating SMEs keeping in mind the unique characteristics of the SME sector in Sri Lanka.

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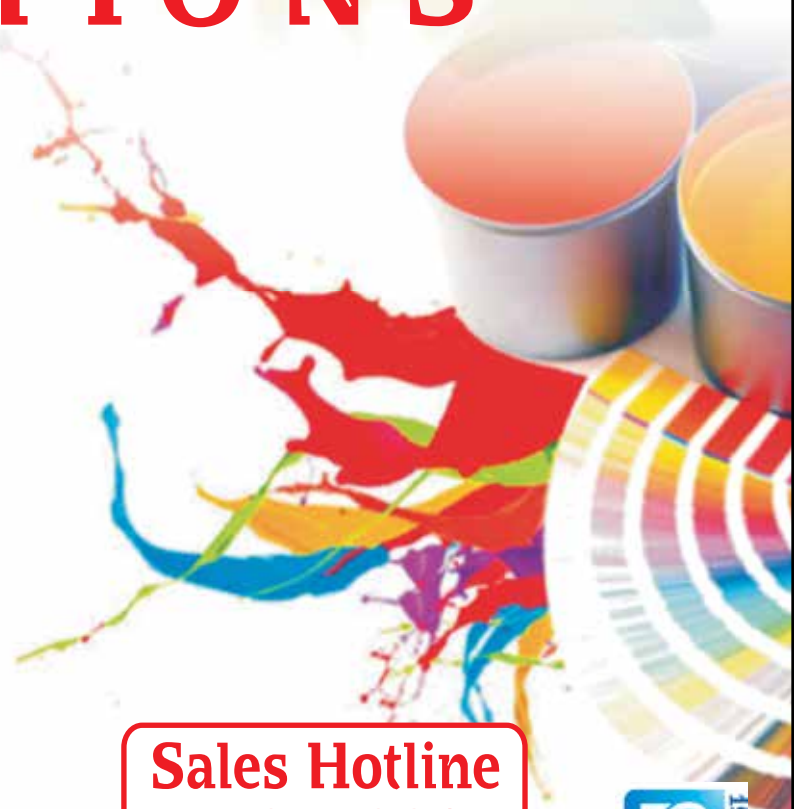
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The Practice of Integrated **Reporting in the Public Municipality Sector**

“It’s great to have an absolutely rigorous reporting framework. The only problem is they’re useless unless somebody uses them.” – Civil servant, Dublin City Council

Introduction

Most city governments/municipal councils in the world, as part of their reporting practices produce an annual report, together with a sustainable report that may be either voluntary or required by law. In the European Union, an accounting directive applies to all large public interest entities to disclose ‘non-financial and diversity information’ in their annual reports from 2018 onwards. In France, it has been mandatory for all municipalities with more than 50,000 inhabitants, to periodically produce sustainability reports along with their financial reports (Niemann and Hoppe, 2018, pp. 201-23).

Integrated reporting <IR> is a recent development in corporate reporting with a focus on conciseness, strategic relevance and future orientation. The guidelines for <IR> is given in the International <IR> Framework issued by the International Integrated Reporting Council (IIRC).

<IR> is gaining momentum around the world and with it creating interest in the public sector as well. Therefore, it is timely to review the present practise of Sustainability Reporting under the guidelines of the Global Reporting Initiative(GRI), that is followed by most city government/ government municipalities by comparing it with <IR> to evaluate the benefits that <IR> will bring to these entities.

Sustainable Reporting versus Integrated Reporting

The contents of a Sustainability Report consists mainly of non-financial data. It includes information on aspects such as employee satisfaction and corporate awareness of the local community through to recycling and carbon reduction initiatives. A narrative description of the risks and benefits to the social and natural environment posed by the company’s operations

and a statement about the management of any risks also form part of the Report. It may also contain a description of how the data demonstrates successful implementation of corporate values. Sustainable Reporting is aimed at a wide circle of stakeholders such as employees, customers, the general community, investors, and business suppliers and looks to the near past, present and near future. Materiality is a relevance filter that helps to decide whether information should be included in the Sustainability Report, based on it being important enough to the various interests of the stakeholders covered.

An Integrated Report contains both financial and non-financial data linked by a narrative explaining what the data means for future corporate profitability, as well as how the company can derive profit from programs that benefit the social and natural environment. <IR> is aimed at equity investors,

stockbrokers, and providers of debt finance. Materiality is a relevance filter to help decide whether information should be included based on whether it could influence the providers of finance capital in the short, medium or long-term.

(view from the Corporate Box Blog-18.4.2016, <http://www.integratereport.com/>)

outcomes such as information overload (de Villiers, Rinaldi and Unerman, 2014) remains ignored.

Advocates of <IR> suggest it as an effective approach to increase the relevance of sustainability information for decision making. The aim is to promote integrated thinking and to overcome duplications and thinking in silos by integrating information systems

(Flower, 2015). Yet it is increasingly popular among companies and has influenced the public sector (Bartocci and Picciaia, 2013). Sustainability reporting as promoted by the GRI recommends the participation and targeting of a wide stakeholder audience, while



Relevance of Practicing <IR> as a Further Development of Sustainable Reporting in Government Municipalities/City Governments Globally

Sustainability Reporting is at a risk of merely exacerbating the already overwhelming amount of disclosures provided without adding further insight (Adams and Simnett, 2011, p.294), if negative

of internal and external reporting (Stacchezzini, Melloni and Lai, 2016). Early discussions included the idea for an organization's integrated report to be a high-level overview, yet the current <IR> framework proposes replacing other forms of reporting (de Villiers, Rinaldi and Unerman, 2014). Critics ironically dub <IR> as the new holy grail (Milne and Gray, 2013) and talk of capture by the accounting profession

<IR> has a narrower focus on its stakeholders of providers of financial capital (Adams C.A., 2015). The latter may be inappropriate for the public sector (Bartocci and Picciaia, 2013).

Practice of <IR> by Local Municipalities/City Governments

<IR> is not presently practised by Sri Lankan local government municipalities. However, the



international view is that <IR> definitely helps in planning and identifying areas that enables local municipalities/city governments to draw joint partnership with the private sector and other similar cities globally. There have been recent instances of Sri Lankan local municipalities joining in partnership with foreign cities in the area of developing sustainable cities.

The Concept of a Sustainable City

According to a World Bank report (November 2016):

- The world is urbanizing at a rapid pace. Already more than half of the global population lives in cities, and this number is expected to increase to two thirds of the global population by 2050. The vast majority of

this growth will be concentrated in developing countries, with nearly 90% increase occurring in Asian or African cities.

- In addition, cities are responsible for two-thirds of the world's overall energy consumption and an estimated 70% of all greenhouse gas emissions. With developing countries experiencing unprecedented urban growth, efforts to build liveable and sustainable cities are hampered by mounting challenges in areas like water supply and sanitation, waste management, transport infrastructure and services, energy supply, as well as climate change.
- Cities around the world are in urgent need of effective planning and financing strategies to meet these challenges. Integrated urban planning offers a unique opportunity for cities to realign their growth trajectories onto a more sustainable, resilient, and inclusive path.

Led by the World Bank, the Global Platform for Sustainable Cities (GPSC) is a forum for knowledge sharing and partnership to achieve urban sustainability. GPSC supports the following activities:

- Using geospatial data and tools to support integrated urban planning;
- Developing GPSC national planforms to enable public access to reliable and accurate location-based information;
- Establishing and enhancing urban sustainability indicators in close alignment with the UN Sustainable Development Goal 11;

- Implementing a diagnostic process to assess cities' sustainability status;
- Preparing and implementing action plans to facilitate planning for sustainable urban growth;
- Providing capacity building opportunities to improve municipal finances and city

creditworthiness, as well as to identify priorities for urban investment

- Delivering workshops and trainings at regional and national levels to share knowledge and experience among client cities.

“Linking knowledge to finance is critical to directing investment flows to quality and sustainability. We see this platform as a great opportunity to connect cities not only to cutting-edge knowledge, but also to development banks and financial institutions. “

Practice

“If planned and managed well, compact, resilient, inclusive, and resource-efficient cities can drive development, growth, and the creation of jobs, while also contributing to a healthier, better quality of life for residents and the long-term protection of the global environment. “

Ede Ijjasz-Vasquez
Senior Director of the World Bank's
Social, Urban,
Rural, and Resilience Global

NAOKO ISHII
Global Environment Facility
CEO and Chairperson

Developing an <IR> system in Local Government Municipalities in Sri Lanka

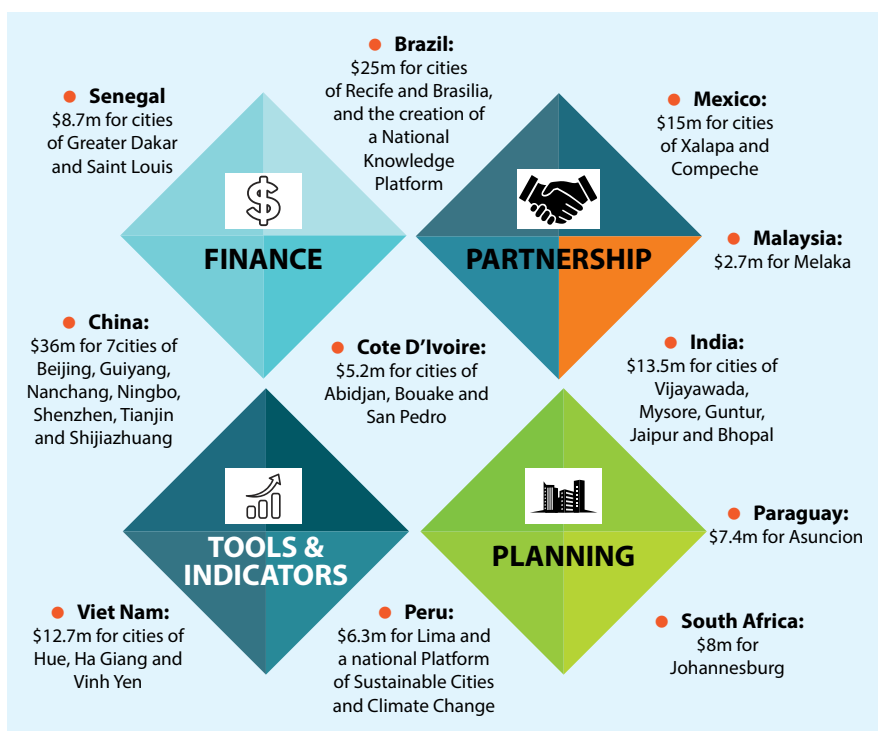
Having had opportunities to partner with global cities, how can local government municipalities achieve a sustainable development plan to provide an effective service? How can the use of <IR> help?

When developing an <IR> system it will be necessary to identify the core activities and issues of the local government municipality. The co-operation of those heading the main activities will also be key to ensure the availability of required information. Thereafter, an effective <IR> process can be implemented.

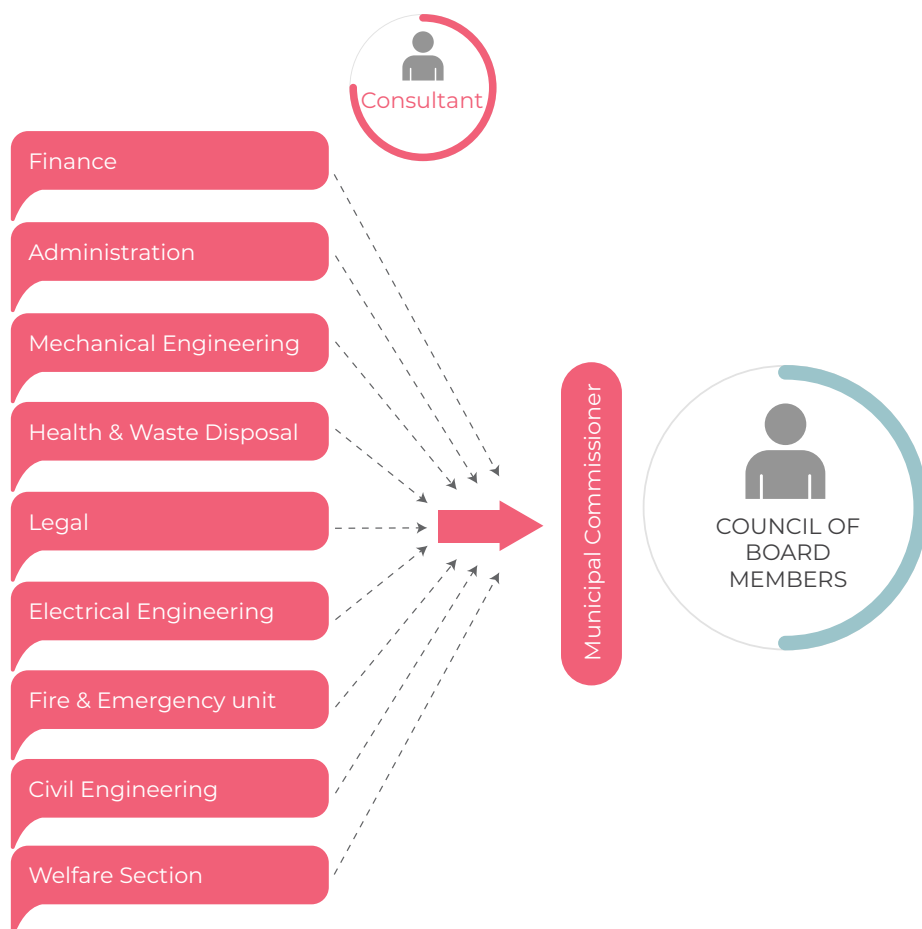
Steps to Implementing <IR> in a Local Government Municipality:

1. Establish an <IR> team with an effective reporting structure. The Municipal Commissioner as head of the team could be assisted by the functional heads with their comprehensive knowledge of the municipality activities and also obtain the services of a consultant.

GPSC Support to Participating Cities with Partnership Organizations

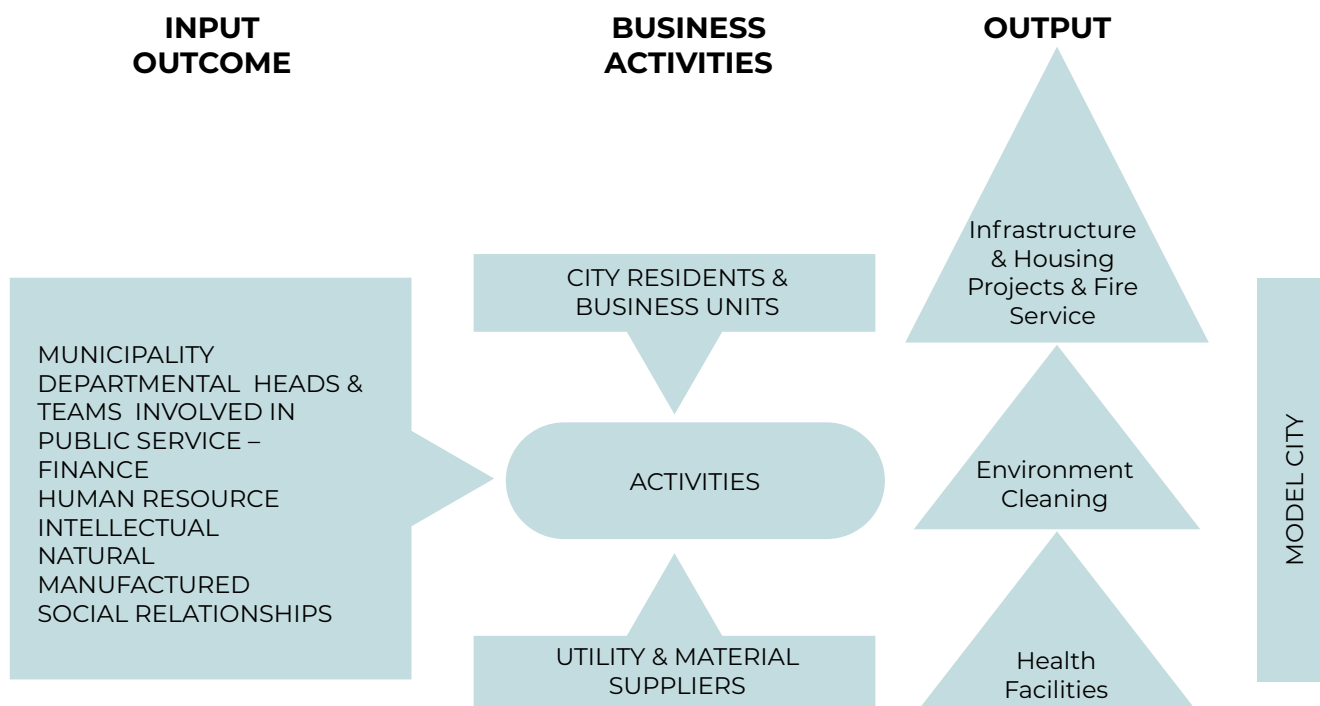


An <IR> Team Organization Flow chart as follows-



2. Comparison of <IR> with the present reporting practises of the municipality. Clearly recognise the differences and apply the guiding principles of <IR> to the six capitals – financial, manufactured, intellectual, human, natural and social & relationship.
3. How relevant is the municipality's vision & mission to its activities and outcomes? Linking the vision and mission to the integrated report.
4. Creation of a Business Model and how it serves.

BUSINESS MODEL



5. Identification of stakeholders, their needs and the services provided.
 - a. The finance division obtains the necessary funding from internal & external sources -Financial Capital
 - b. Human resource department will obtain the required resource personnel- Human Capital
 - c. Planning & research department will encourage innovation in city planning, licencing, systems - Intellectual Capital
 - d. The solid waste disposal department coming under the Health Department will ensure clean environment, awareness programs utilizing all renewable & non-renewable resources – Natural Capital
 - e. The engineering department will ensure all assets are in proper use - Manufactured Capital.
 - f. Relationships with all stakeholders such as resident & business customers, utility providers & suppliers and furthering global city partnerships are maintained cordially by the public relations units - Social & Relationship Capital
6. Identifying both internal and external material issues and encouraging integrated thinking in the team to find solutions to the issues
7. Each project undertaken by the municipal council will be reviewed to ensure value is created taking into consideration the funds allocated and spent .
8. Finally, the outcome of a safe, clean and a model city under municipality control is achieved.



Many participating cities will pursue transit-oriented development (TOD) initiatives.

Conclusion

<IR> is gaining momentum in both the public and private sectors. Although initially <IR> was designed for the private sector, the public sector has accepted the relevance of key concepts underpinning <IR> such as integrated thinking and overcoming silos. Local authorities

like municipal and urban councils in Sri Lanka do not practice <IR>. They continue to provide a short sustainable report with their annual financial report. However, the guidelines laid down in the International <IR> Framework could be useful for local government municipalities in instilling a sense of value

creation on each and every activity undertaken. Adopting <IR> with its emphasis on value creation could help to achieve transparency in reporting for local government municipalities along with an ideal model city that is clean, environmentally sustainable and healthy.



Mr. Janaka Heenkenda
BBA in Entrepreneurship
(sp.) (RUH), M.Sc. (SJP)

Lecturer

Department of
Management Studies
The Open University of
Sri Lanka



Mrs. Jayani Hapugoda
B.Sc. Statistics with
Computer Science (UOC),
CIMA (UK)

Lecturer

Department of
Management Studies
The Open University of
Sri Lanka



Mr. Asanka Senevirathne
B.Sc. Accountancy &
Business Finance (sp.)
(WUSL), MBA (WUSL)

Lecturer

Department of
Management Studies
The Open University of
Sri Lanka



Mr. Chanaka Weerasekara
Management (sp.) (SUSL),
M.Sc. (SJP)

Lecturer

Department of
Management Studies
The Open University of
Sri Lanka

ASSESSMENT OF BUSINESS INNOVATION CAPABILITY: A CASE OF MICRO, SMALL AND MEDIUM-SIZE ENTERPRISES IN SRI LANKA

¹²³⁴Department of Management Studies, Faculty of Humanities and Social Sciences,
The Open University of Sri Lanka, Nawala, Sri Lanka

Corresponding author: hmhee@ou.ac.lk

Abstract

Micro, small and medium-size enterprises (MSMEs) make a significant contribution to business innovation and economic growth in a country. This study attempts to assess the ability and competencies of micro, small and medium-size enterprises to innovate. A self-administered structured Likert scale questionnaire was distributed among a sample of 292 MSME owners to collect primary data. This study adopted a quantitative research approach and the data

was analyzed utilizing statistical methods. The exploratory factor analysis revealed six capabilities of business innovation applicable to MSME owners: knowledge and competence capability (KCC), participatory leadership capability (PLC), networking capability (NC), technology capability (TC), product and services capability (PSC) and marketing capability (MC). According to the descriptive analysis, the business innovation capability of MSME owners

was of a relatively high level. The findings of this study will be useful for MSME owners, MSME-based stakeholders and policy makers for MSME development thereby contributing to both enterprise and national economic development.

Keywords: Business Innovation Capability, Micro, Small and Medium size enterprises (MSMEs)

INTRODUCTION

Micro, small and medium size enterprises (MSME) play an important role in the economic growth of both developed and developing economies by contributing not only to Gross Domestic Production (GDP) but also to employment creation (Abor & Quartey, 2010). MSMEs have contributed significantly to the socio-economic development of both developed and developing economies through employment creation, provision of goods and services, and tax and export revenue generation, in addition to supporting economic growth, livelihoods in developing countries, social stability, and economic diversity. MSMEs are the engine of

growth essential for developing competitive and efficient markets and reducing poverty, particularly in developing countries (Fan, 2003).

Business innovation is recognized as a key driver of economic development (Prajogo et al. 2013; Raymond et al. 2013) in many studies on how best to nurture and maximize business innovation capabilities for sustainable economic development. However, measuring innovation capabilities is complex. Multi-dimensional difficulties arise in the innovation process. Innovation involves a broad and dynamic spectrum of activities related to markets, new

products, redesigning, production and so on. Successful innovation comes from the integration of a set of capabilities rather than a single type of capability (Zhang, Garrett-Jones, & Ricky, 2013).

The SME sector is recognized as an important strategic sector in Sri Lanka for generating high economic growth and for reducing unemployment, inequity, and poverty. It contributes to 30% of GDP, 30% of manufacturing value added, 35% of the national labour force, and 20% of total export values according to the Asia SME Finance Monitoring Report (2014). Most of the enterprises established in Sri Lanka belong to Micro, Small and Medium size categories.

Table 1: Sri Lankan Economic Senses

Enterprise category	Micro	SMEs	Large
Number of Enterprises	880,066	132,483	4931
Number of Employment	1,160,138	930,889	915883

Source: Asia SME Finance Monitoring Report (2014)

Globalization has changed the business environment and increased competition especially in developing countries, according to Kassim et al. (2003), because of which MSMEs have not only to struggle among themselves but also with larger manufacturing firms. In addition, unlike large companies, small firms lack resources, expertise and impact on the marketplace (Talib, Ali and Idris, 2014). In recent years, business innovation capability has become one of the important factors of success in modern economies affecting the development of entrepreneurial ability and competency among micro, small and medium size enterprises. Accordingly, this study

attempts to assess the ability and competencies of the micro, small and medium size enterprises to business innovate in Sri Lanka.

RESEARCH OBJECTIVES

- To identify the dimensions of business innovation capability pertaining to the micro, small and medium sized enterprises owners of Sri Lanka;
- To examine the existing level of business innovation capability of micro, small and medium size enterprise owners of Sri Lanka; and
- To study the influence of demographic factors on business innovation capability of micro, small and medium

size enterprise owners of Sri Lanka.

LITERATURE REVIEW

In the competitive, complex and intellectual environment of today, the literature claims that business innovation is the most fundamental determinant of a firm's success and survival (Adams et al., 2006). There are several definitions of business innovation capability in the literature. Innovation capability is an important factor that facilitates an innovative organizational culture, the characteristics of internal promoting activities, and the capabilities of understanding and responding appropriately to the external environment.

According to Romijn & Albaladejo (2002), innovation capability can be defined as the knowledge and skills required to absorb and develop existing technologies efficiently, in addition to producing new ones. Numerous dimensions have been identified in the literature pertaining to innovation capability, viz. knowledge and competence, participants' leadership culture, business networking, technology capability, product and service capability, the market of the business, risk-taking capability, vision & mission, capability development, collaboration, strategic planning and individual activities.

Knowledge, competencies and skills are fundamental to innovation as they provide the basis for new ideas and their successful development (Hull & Coombs, 2000). Therefore, goal-oriented development and application are extremely important for improving innovation capability (Nonaka & Akeuchi, 1995). Participatory leadership culture refers to the overall atmosphere of the organization that supports and motivates innovation and the leadership that facilitates innovation. The ability to lead, direct, and support the creation and sustenance of innovation behaviours is important for a firm (Bessant, 2003). Leadership that fosters innovation enables setting task boundaries, sharing information, obtaining resources, instilling a positive attitude, and a leadership style that keeps the employees challenged and focused (McDonough, 2000). Another dimension of innovation capability is technology capability. Technology is a prerequisite for new products and production processes; it addresses planning, management

and controlling. In this context the capability to identify new technologies, to assess their value and to successfully exploit them are invaluable. Several technological characteristics of an innovation would affect its adoption, including complexity, compatibility, and relative advantage, ease of use, perceived usefulness, information intensity and uncertainty (Tornatzky, & Klein, 1982).

Networking capability, another important dimension of IC, can be defined as the interactions with suppliers, customers, industry associations, and competitors, which provide entrepreneurs with the missing external inputs (Lawson & Samson, 2001). Barney (1986) and Teece & Pisano (1994) consider networking initiatives as essential for innovation, for they act as a vehicle for importing external knowledge. This vehicle is crucial for many sources of innovation do not reside exclusively within an individual firm. Often the bulk of these networking initiatives are informal. Innovative firms rely on both informal and formal

networks for their innovations. Previous research on small firms has emphasized the importance of networking for innovativeness (Adams et al., 2006). According to Weerawardena (2003), marketing capabilities are an indispensable factor based on the innovative capabilities of a company that can generate growth and profit via distinctive innovation capabilities. According to Li et al., (2007), tangible and intangible resources and capabilities are important for marketing operations, including brand, sales, channel and service to provide various marketing services. Saunila et al., (2014) mention that demographic characteristics (such as age, gender, educational level, and experience) influence the business innovation capability which was considered as a dimension of the dynamic capabilities.

METHODOLOGY

The conceptual framework of this study was designed based on the above identified relationships, the following conceptual framework is proposed which is subject to empirical validation.

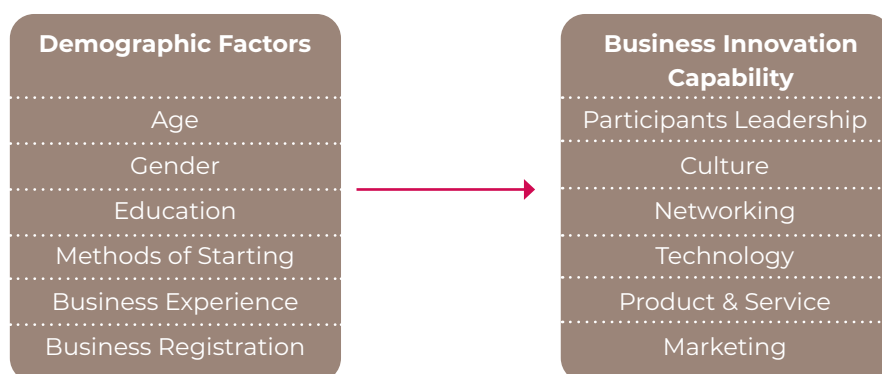


Figure 1: Conceptual Framework

In order to measure the level of innovation capability six main dimensions were identified based on the literature, namely, Knowledge and Competence, Participants Leadership Culture, Networking, Technology, Product and Services, and Marketing. Accordingly, business innovation capability was considered the dependent variable and demographic factors of the learners the independent variable.

This study adopted a quantitative research approach and statistical

methods to analyze the data. Data was collected with structured Likert scale questionnaires. The sample consisted of three hundred thirty six (336) respondents who are members of the Small Enterprise Development Divisions from three (03) districts in the Western Province in Sri Lanka. The study was limited to MSME firms registered under SEDD and operating in Colombo, Kalutara & Gampaha districts covering 42 divisional secretariats in the Western province. Two

hundred and ninety-two (292) questionnaires were received, representing a retrieval rate of 87%. Cronbach's Alpha coefficient test indicated that the questionnaires were reliable since the coefficient was above 0.5 ($\alpha=0.903$). Respondents were selected based on simple random sampling to arrive at the desired sample of the owners of SMEs in three districts in Western province. Statistical techniques were used to test the hypotheses.

All above variables decided to ensure following indicators and related measures

Table 2: Operationalization

Dimensions	Indicator/(s)	Literature Support
Knowledge & Competence	Understanding own strengths & weaknesses Capability to enhance the knowledge base Systematic knowledge Management	Nonaka, I., Takeuchi, H. (1995), Calantone, R. J., Cavushila, T. S., Zhaob, Y. (2002)
Participate Leadership Culture	Encouragement Feedback	Kallio et al. (2012), Saunila and Ukko, (2014)
Network	Successful external corporation Successful Internal corporation	Romijn, H., Albaladejo, M. (2002), Bullinger, H. J., (Hrsg.) (2006),
Technology	Technology Strategy Technology forecasting Technology evaluation and Sourcing	Bullinger, H.J.(1994), Burgelman, R. A., Christensen, C. M., Wheelwright, S. C. (2004),
Products and Services	Superior of Products and Services Continues improvement of existing products or services Strong customer orientation	Bullinger, H.J., (Hrsg.) (2006), Von Hippel, E. 2005,
Marketing	Market intelligent and industry trends Strong cooperation with suppliers and customer	Bullinger, H.J., (Hrsg.) (2006), Von Hippel, E., Katz, R. (2002)

Source: Author constructed

Table 3: Demographic Characteristics

Characteristic		Frequency	Percentage (%)
Gender	Male	105	35.9
	Female	187	64.1
Age	26-30	78	26.7
	31-35	114	39.0
Education	Primary Education	89	30.4
	Secondary Education	154	52.7
Business Experience	Less than 1 year	64	21.9
	Between 1 to 5 years	148	50.6
Methods of Starting	Inherited from parent	29	9.9
	Started by my self	257	88.0
Business Registration	Sole Proprietorship	263	90.0
	Partnership	18	6.1

Source: Author constructed



Factor Analysis (FA)

The statistical analysis tool SPSS 22 was used to extract the factors using Principle Component Analysis (PCA). FA was done with respect to each construct to test the factor structure of scales using PCA as extraction method and Varimax with Kaiser Normalization as the rotation method (Hair et al, (2009). The Kaiser-Meyer-Olkin (KMO) measure and Bartlett's sphericity test were used to check the adequacy of the sample and correlations between

items respectively, Hair et al (2009) recommend accepting values greater than 0.5 as barely acceptable (values below this should lead you to either collect more data or rethink which variables to include). Furthermore, values between 0.5 and 0.7 are mediocre, values between 0.7 and 0.8 are good, values between 0.8 and 0.9 are great and values above 0.9 are superb. However, in this study the KMO test resulted in 0.760, which is at an acceptable level. The process was limited to a six-factor solution which was

rotated by a Varimax with Kaiser Normalization. As a traditional experiential item with loading 0.5 for any factor was removed. Furthermore, items that revealed cross loadings larger than 0.5 on more than one factor were removed since they do not give perfect measures of a specific construct. Moreover, both Eigen value one standard and Scree test were used to identify the number of factors.

Table 5: Means, Standard deviations and factor loading of the items

Construct and Items	Mean	SD	Construct Factor Loading	CA
Knowledge & Competence Capability(KCC)	4.4024	.47613	0.775	0.751
Participants Leadership Culture (PLC)	4.2397	.46610	0.738	0.716
Networking Capability (NC)	4.3305	.55569	0.757	0.722
Technology Capability (TC)	4.1764	.47774	0.718	0.746
Product & Services Capability (PSC)	4.2740	.48679	0.710	0.742
Marketing Capability (MC)	4.2735	.48852	0.742	0.754

Notes: Scale: Standard Deviation (SD), Factor Loading (FL), Cronbach's Alpha (CA)

The reliability analysis was used to establish both the consistency and stability of the research instrument. Cronbach's Alpha value was calculated to test the internal consistency reliability of the instrument. A rule of thumb suggests that the accepted Cronbach alpha value should exceed 0.7. The Table below gives a summary of the scores of all the responses to the factors related to business innovation capability of MSME owners in Sri Lanka. All factors exhibit a Cronbach's alpha coefficient of 0.70, indicating that the reliability level of the questionnaire is sound. Hence, all the variables are retained.

Hypothesis Testing

In order to obtain more details of the factors influencing the different dimensions of business innovation capability, an analysis was conducted utilizing Generalized Linear Modeling (GLM). The factors considered were age, gender, education level, years of experience, income level, starting status of the business, and registration of the business.

Knowledge and Competence Capability (KCC)

According to the parameter estimates of the obtained model (presented in the Table below), age, marital status and the starting status of the business significantly influence KCC of SME owners. KCC of SME owners whose age is 26-30 years are 0.197 greater and it is 0.189 higher for the owners whose age is 36-45 years than that of MSMEs owners of 46 years and above. An owner of a business inherited from parents has 1.04 lower KCC than a person who takes over a company from another person legally.

Participatory Leadership Capability (PLC)

The results depict that the significant factors influencing the PLC of MSME owners are gender, business experience, starting status of the business and registration of the business. The estimate values (presented in the Table below) can be interpreted in the same way as for KCC.

Networking Capability (NC)

According to the analysis, the significant factors influencing NC are age and starting status of the business. The estimate values (presented in the Table below)

can be interpreted in the same way as for KCC.

Technological Capability (TC)

The results reveal that the significant factors influencing the TC of MSME owners are education level and business experience. The estimate values (presented in the Table below) can be interpreted in the same way as for KCC.

Product and Service Capability (PSC)

According to the analysis, the significant factors influencing PSC are gender, age, education level and starting status of the business. The estimate values (presented in the Table below) can be interpreted in the same way as for KCC.

Marketing Capability (MC)

The results depict that the only significant factor influencing the MC of MSME owners is the starting status of the business. The estimate values (presented in the Table below) can be interpreted in the same way as for KCC.



Table 6: Parameter Estimate

	KCC	PLC	NC	TC	PSC	MC
	Parameter Estimate	Parameter Estimate	Parameter Estimate	Parameter Estimate	Parameter Estimate	Parameter Estimate
(Intercept)	6.283	4.115	3.863	4.428	2.987	3.358
[Age=18-25]	.246	.005	.117	.178	-.206	.171
[Age=26-30]	.197	.114	-.185	.096	-.120	-.017
[Age=31-35]	-.081	-.075	-.233	-.159	-.194	-.016
[Age=36-45]	.189	-.055	.044	.091	-.113	.002
[Age=More than 46]	0a	0a	0a	0a	0a	0a
[Gender=Male]	.049	.161	.073	-.036	.132	.106
[Gender=Female]	0a	0a	0a	0a	0a	0a
[Education=No formal education]	.187	-.172	-.078	-.175	-.180	-.138
[Education=Primary education]	-.002	.125	-.025	.052	-.194	-.100
[Education=Secondary education]	-.045	.051	-.075	-.143	.005	.098
[Education=Tertiary education]	0a	0a	0a	0a	0a	0a
[Experience=Less than 1 year]	-.010	-.314	-.137	-.218	-.094	.011
[Experience=1-5 years]	.071	-.269	.042	-.258	-.173	-.099
[Experience=6-10 years]	-.027	-.226	-.018	-.303	-.131	.052
[Experience=More than 10 years]	0a	0a	0a	0a	0a	0a
[Starting=Inherited from parents]	-1.040	1.185	.639	.522	1.651	1.628
[Starting=Self-started]	-.704	1.274	.841	.448	1.635	1.647
[Starting=Acquired from another legally]	0a	0a	0a	0a	0a	0a
[Registration=Sole proprietorship]	-.773	-1.359	-.421	-.533	-.152	-.933
[Registration=Partnership]	-.606	-.862	-.145	-.581	.093	-.732
[Registration=Private Limited Liability]	-.715	-.462	.375	-.162	-.072	-.356
[Registration=Limited Liability Company]	0a	0a	0a	0a	0a	0a

The significant parameter estimates have been highlighted in the above table.

CONCLUSION

This study focused on three objectives all of which were successfully achieved in the study. The first objective of identifying the dimension of business innovation capability was achieved with the exploratory factor analysis. The second objective was to examine the existing level of business innovation capability of micro, small and medium size enterprises (MSMEs) in Sri Lanka. It was observed that knowledge and competence capability recorded the highest mean value (4.4024) with the lowest records of mean

at 4.1764, which is technology capability. The other three variables varied between 4.4024 and 4.1764. The third objective was to study the influence of demographic factors on business innovation capability of micro, small and medium size enterprises (MSMEs) in Sri Lanka. A further analysis was carried out to assess the influence of various demographic and other related variables on business innovation capability of MSME owners. According to the findings, age, marital status, income level and the starting status of the business significantly influence

KCC, while gender, marital status, business experience, income level, starting status of the business and registration of the business significantly influence PLC. Further, age, income level and starting status of the business significantly influence NC, education level and business experience significantly influence TC, age, gender, income level and the starting status of the business significantly influence PSC while gender, income level and starting status of the business significantly influence marketing capability.

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Mr. Ruchira Perera
FCMA, MBA(PIM-USJ) FCMA(UK), CGMA, BSc(Acc)



SME Sector Financing

The Small and Medium Enterprises (SMEs) sector poses unique challenges for banks and other lending institutions requiring a more complicated approach to risk assessment and financing.

Supply side constraints

SME lending is considered highly risky by bankers. It's not just the single person risk. It's also the uncertainty surrounding the business activities, continuity of the business, integrity of the financial records, low capitalization, insufficient assets etc. Banks are likely to experience a high percentage of non-performing loans from the SME sector compared to other sectors.

Providing and following up on loans to SME businesses is costly for banks. Independent information about the SME clients will have to be collected from various sources including the Credit Information Bureau (CRIB) to minimize risks of non-performing loans. The bank will also need to analyze the SME financials to ensure the business is credit worthy. SME lending can erode a lender's margin.

The main challenges in lending to a SME is the lack of financial records, absence of an independent audit conducted by a reputed firm and loopholes in its credit history. Unlike listed companies, SMEs are not required to comply with Sri Lanka Accounting Standards. These organizations can adopt the Sri Lanka Accounting Standard for small and medium entities when preparing financial statements. However,, even the more established SMEs are unable to provide specific information required by lenders due to inadequate reporting and understating profit figures to avoid tax.

The problem is further aggravated as SMEs maintain two or three sets of different financial records for various audiences. This makes it even more difficult for banks to assess the credit worthiness of potential loan applicants. Most banks

are either not willing or lack the technical knowhow to service this important sector that constitutes a large number of organizations, contributes significantly to the national economy and provides a large number of employment opportunities.

Banks require long-term credit lines to fund the SME sector. However, most deposits in the financial sector tend to be short-term and long-term funding on a large scale causes maturity mismatches. This issue has been exacerbated in the recent past by the decrease in credit lines from foreign donor agencies to development financing institutions and several leading development financing institutions (National Development Bank & DFCC Bank) obtaining commercial banking licenses as a measure to aggressively target local funding sources.

SME Financing - Situation in Sri Lanka

1961 marked a landmark year in providing institutional credit to SMEs in Sri Lanka. The People's Bank was established and the Bank of Ceylon was nationalized. Bank of Ceylon through its many branches provided credit facilities under special programs for SMEs. Some of the private banks, with the expansion of their branch network provided special facilities for the SME sector.

Since the late 1970s' there was a concerted effort to provide formal credit for small and medium enterprises with the commencement of an industrial policy promoting labour intensive enterprises.

A credit line called the 'Small Scale Industries (SSI) credit scheme' commenced in 1978. This credit line was operated through the Bank of Ceylon and People's Bank in collaboration with the Industrial Development Board (IDB). In 1979, a new credit line, called SMI Loan Scheme commenced operations. This

scheme aimed at providing finance at a concessionary interest rate to SMIs. At present, there are many other credit lines available to SMEs such as the SMILE credit scheme, SMAP credit scheme, E-Friends credit scheme, SPREAP credit scheme, SMERDP credit scheme, KfW credit scheme, Sahanya credit scheme, Susahana credit scheme and Saubhagya credit scheme.

The share of the SME loan portfolio of the top seven banks in Sri Lanka is shown in Table 1 based on a World Bank study done in 2010. This forms about 75% of total lending to SMEs.

Table 1: Share of SME portfolio of the top seven banks covering SME lending-2009

Bank	Total portfolio (in million \$*)	SME portfolio (in million \$*)	Percentage (%)
Bank of Ceylon	1,865.75	58.83	3.15
People's Bank	2,584.83	40.39	1.56
NDB Bank	485.53	30.73	6.33
DFCC Bank	339.79	140.48	41.34
Hatton National Bank	1,545.28	763.86	49.4
Commercial Bank of Ceylon	1,554.06	468.85	30.17
Wayamba Development Bank	66.73	7.02	10.53
TOTAL	8,441.97	1,510.16	

(*Converted from LKR May 21, 2010)

Source: World Bank, SME Banking Assessment – Sri Lanka, 2010

It's surprising to note that three private commercial banks, i.e. Hatton National Bank, DFCC Bank and Commercial Bank, were actively engaged in SME financing and had the largest SME portfolios. The lowest SME portfolios were held by the two-large state-owned commercial banks, Bank of Ceylon and People's Bank.

Similar information on SME lending by all banks is unavailable for recent years for analysis.

Demand Side Constraints

It's a common practice for Sri Lankan banks to require collateral as a prerequisite to qualify for a loan. Even more than cash flows, financial institutions rely on collateral to minimize the risk of non-performing loans.

Being able to offer a clear title to land can be critical to qualify for a loan. Lack of proper title for land

is an issue that prevents most SMEs from offering land as collateral for loan applications.

SMEs are driven by entrepreneurs who devote most of their time for business activities than on complex loan procedures. They are very sensitive to loan delivery time and lack the skills to prepare detailed business and financial plans required by lenders. This often leads SME owners/managers to look for other avenues, as much

time has to be spent on compiling and obtaining information/ documents and meeting bank officials, which is time spent away from running the business.

Due to uncertainty and high risk associated with SME funding, lenders generally charge high interest rates. Costs such as legal fees, valuation charges, stamp duty, etc., also needs to be borne by the borrower. This is another deterrent for SMEs to obtain funding through financial institutions. The lack of branch networks in rural areas also negatively affect SME financing. Most banks are operational in Colombo and its suburbs. A frequent complaint of many entrepreneurs outside Colombo, is that most financial institutions headquartered in Colombo are not sufficiently knowledgeable about other districts and not able to judge related credit risks sufficiently, resulting in limited financial facilities being made available .

SME operators are also of the opinion that some banks do not have the capacity and/or attitude to support sick enterprises, that their approach to problem loans

is rigid and most apply the provisions of the Loan Recoveries Act without negotiating other workable solutions such as loan restructuring.

Suggestions for Improvement

With the growth of their business, SMEs require funding for expansions and diversions. Banks need to understand the sector and come up with innovative lending facilities that minimises collateral and documentation. Structured financing methods such as leasing, factoring etc., can also be used.

Since SMEs lack financial records and proper business plans, it is recommended that banks maintain all relevant financial and non-financial data relating to SMEs in their computer system. This will help them to regularly review SME operations as published data are often not available.

Organisations such as the Chamber of Commerce and other business associations, can play a key role in assisting their

members to access lending from banks. Banks can cooperate with these organisations to identify credit worthy SME clients and to promote their financial products to SME owner-managers.

SME operators are of the view that loan documentation is a complex process. Therefore, banks and other financial institutions are well advised to expedite the loan review and approval process to encourage more loan disbursements to the sector.

Banks can also advertise various loan products available to the sector and raise awareness of the options available, the costs involved and security required. Regular meetings can be held between the bank and the SME customer to further understand needs and grievances and to offer tailor made products that suit individual businesses.

Bank staff handling SME loan facilities should also be trained to handle the distinct characteristics of this sector bearing in mind the importance of the SME sector in national development.





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IFAC President Ms. Rachael Grimes giving key note address at Integrated Reports Awards 2018



Chief Guest Hon. Speaker Karu Jayasuriya addressing the Integrated Reports Awards 2018

IFAC Presidents Visit



IFAC President Ms. Rachael Grimes meeting with Governor Central Bank of Sri Lanka, Dr. Indrajit Coomaraswamy



Three Professional Accounting Bodies CA Sri Lanka, CMA Sri Lanka and AAT Sri Lanka jointly hosted a welcome dinner in honour of Ms. Rachael Grimes, President of IFAC on 4th July 2018
Three Presidents Mr. Magdon Ismail, Mr. Jagath Perera and Prof. Lakshman R. Watawala presented a plaque of appreciation to IFAC President.



Student recognition – CMA Sri Lanka



Meeting with Security Exchange Commission, Chairman, Mr. Ranel Wijesinha



Presenting of CMA Journal by IFAC President Ms. Rachael Grimes, and CMA President Prof. Lakshman R. Watawala to Hon. Prime Minister Ranil Wickremesinghe

CMA Sri Lanka hosted the SAFA Events and 55th SAFA Board Meeting from 17-19 October 2018 at Hotel Citrus, Waskaduwa, Sri Lanka.



We conducted a Certificate program on 'Forensic Accounting & Financial Frauds' in association with Gujarat Forensic Sciences University, Gujarat, India from 20th – 22nd September 2018 at the Renuka City Hotel, Colombo.



CMA Sri Lanka Apex Level Batch 8 and 9 Group successfully completed the workshop series on Speech Craft, honing the skills of communication and leadership.



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