



## THEME: ACCESS TO FINANCE

## CBC: Micro-Case Study of Job Creation Effects

*IFC has supported Sri Lanka's largest private bank, the Commercial Bank of Ceylon (CBC), since 2003. IFC has provided equity, advisory services, and support for loans to small and medium-size enterprises. Interviews with a sample of 100 micro, small, and medium-size enterprises (MSMEs) that obtained loans from CBC in 2009 found that the firms created 2,650 permanent jobs between 2009 and 2012, with annual job growth of 12 percent—more than twice the country's job growth. Job creation was equal for men and women and the companies also increased labor productivity. The rapid job growth coincides with companies starting and expanding operations using financial resources from CBC and taking advantage of a better investment climate. Extrapolating the sample results to CBC's portfolio of MSMEs that received loans in 2009, we estimate that they may have created between 140,000 and 330,000 jobs over three years, which represents about 1.8–4.3 percent of employment in Sri Lanka in 2011. But, these jobs cannot be exclusively attributed to the financing and there are some other caveats.*

This is the first case study covering financial markets for the IFC Job Study, which estimates the employment effects on MSMEs of access to finance provided by CBC, IFC's financial intermediary client. The study is based on interviews with a representative sample of 100 MSMEs that received loans from CBC in 2009.

### Methodology

To choose the firms, the portfolio was split in three groups according to the size of the loan, based on the assumption that loan size is a proxy for firm size.<sup>1</sup> Then, samples of at least 30 firms were chosen for each loan size to have large enough samples to do an extrapolation to the portfolio.<sup>2</sup> Firms were asked about employment in 2009 and 2012. The period of about three years was chosen to measure the employment effects on firms of having capital to start and expand operations but limit the effect of external factors on turnover and job growth that could result over a longer period of time.

The sectors covered, for their relevance to Sri Lanka's economy, were tourism, agribusiness, infrastructure, and manufacturing. Of the 100 selected MSMEs, 92 were in the western, southern, and central parts of the country. The other eight were from northern and eastern (post conflict) areas (box 1). Based on the sample, a conservative extrapolation was done on the total portfolio of loans provided by CBC in 2009.<sup>3</sup> The estimates consider loans provided by CBC to companies in 2009, adjusting for nonperforming loans in the portfolio, but not correcting for the fact that some companies could have received more than one loan in 2009.

### IFC and CBC

CBC is the country's largest private bank, accounting for about 12 percent of the Sri Lankan market.<sup>4</sup> For banks that make loans to SMEs, CBC estimates that it currently holds about 20 percent of this market. It is among IFC's longest-standing

investment clients in Sri Lanka. IFC's equity investment in CBC started in 2003 and currently holds nearly 8 percent of its shares.

Between 2006 and 2009, as part of its advisory services, IFC helped CBC develop an integrated SME, retail, and corporate strategy—creating a new loan product for SMEs. CBC has since increased its focus on SMEs and enlarged its SME portfolio, increasing the number of MSME loans (with sizes from \$1,000 to \$1,000,000) more than three times from 2009 to 2011. IFC has also been involved in the development of internal systems and the improvement of risk management and credit scoring models. CBC is expected to continue supporting Sri Lanka's growth and development, especially in infrastructure, tourism, and agriculture, in addition to retail financing in the northern and eastern regions. In 2012, IFC supported CBC providing \$65–70 million to expand its SME portfolio and its credit support to 20,000 firms.

### Direct Employment in CBC

CBC's solid financial performance is reflected in its growth in business volumes and increased profits before taxation. Profits grew 18 percent in 2010 and 10 percent in 2011.<sup>5</sup> Employment in CBC also increased between 2009 and 2011, with full-time employment up nearly 6 percent a year and outsourced workers<sup>6</sup> by about 3 percent per year.<sup>7</sup> Between 2009 and 2011 almost 470 positions were created and the gender mix of employees remained stable, with three-quarters accounted for by men. Male and female participation is similar among outsourced workers.

<sup>1</sup> IFC uses loan size as a firm size proxy. Firms are defined as micro (\$1,000–10,000), small (\$10,001–100,000), or medium-size (\$100,001–1,000,000), depending on the loan size received in 2009. In 2009 Sri Lanka did not have a uniform nationally accepted definition of SMEs but part of classifications based on employment, asset value, or investment criterion depending on the institution (i.e. Sri Lanka Standards Institution, Industrial Development Board, Department of Census and Statistics, and the Ministry of Small and Rural Industries).

<sup>2</sup> For more details on the methodology please go to [www.ifc.org/jobcreation](http://www.ifc.org/jobcreation).

<sup>3</sup> The approach used the 25th percentile and the median to extrapolate the results, instead of using the average, in order to eliminate the effects of outliers. The 25th percentile is the value below which 25 percent observations in each loan group can be found and the median is the value below 50 percent of the observations can be found.

<sup>4</sup> Commercial Bank of Ceylon. 2011. Miles Ahead. Annual Report 2011. 43rd issue

<sup>5</sup> Commercial Bank of Ceylon. 2011. Miles Ahead. Annual Report 2011. 43rd issue

<sup>6</sup> Defined as employees hired by agencies to perform certain activities for the bank but are not directly employed by CBC

<sup>7</sup> Commercial Bank of Ceylon. 2011. Miles Ahead. Annual Report 2011. 43rd issue



CBC provides competitive compensation based on market surveys and collective agreements. It promotes equal pay at the same employee levels regardless of gender—in 2010 and 2011 the male to female wage ratios at each level were close to one. Employees receive significant training and education, with an average of 23.8 training hours per worker a year from 2009 to 2011. CBC increased spending on training by 28 percent between 2011 and 2012, with 446 training programs.

### CBC's Strategy for Small and Medium-Size Enterprises

CBC plays an important role in developing SMEs, as one of the two main private banks serving them in Sri Lanka. Actually, about two-thirds of the SME sample to which CBC provided loans in 2009 obtained them solely from CBC. Why is this? The most common reasons cited for getting loans from CBC were its efficient services, convenient locations, and established relationships. CBC also has competitive rates and has provided valuable advice on loans and other financial products, according to firms interviewed.

### Micro, Small, and Medium-Size Enterprises Need Access to Finance

A significant proportion (40 percent) of firms interviewed mentioned that insufficient access to finance had been a main obstacle either when starting or expanding their business. Lack of access to finance represented the top constraint for three reasons: firms did not have enough resources to start at a bigger scale or expand rapidly, interest rates were too high to obtain loans, and business slowdown increased financial needs or made it difficult to repay. For example, one-quarter of the companies mentioned difficulties repaying loans as a result of the Euro crisis, higher loan costs, competition, delayed client payments, or macroeconomic conditions. This confirms the notion that during crises, MSMEs are more vulnerable to shocks and suffer more from access to finance constraints than larger firms.

#### BOX 1. EXPANDING FINANCIAL SERVICES IN POST CONFLICT AREAS

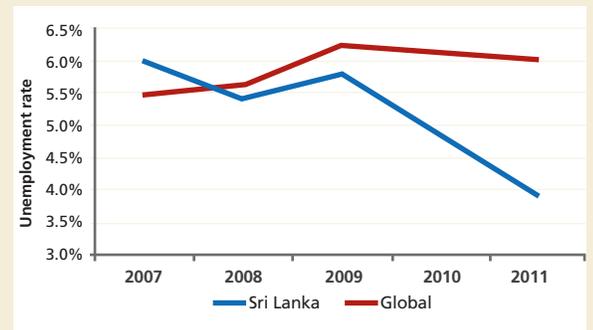
*CBC decided to open more branches in post conflict areas of Sri Lanka—eastern and northern areas—from 9 to 21 new branches opened between 2009 and 2011. In fact, it was the first bank to open a branch in Kilinochchi, the most affected area of the country in the north.*

*To stimulate livelihoods for people in the north, mainly in agriculture and fishery, CBC committed more than 1,500 unsecured loans.*

*In the east—not as economically paralyzed as the north—people look to develop businesses and mainly need working capital. Here, CBC opened branches for convenience and to create opportunities.*

Firms operating in the infrastructure sector mainly face financial constraints because they often have liquidity and working capital needs due to delayed payments from customers and high project costs. These firms said that another main constraint for their operations was the unavailability of skilled

**FIGURE 1: UNEMPLOYMENT RATE IN SRI LANKA HAS BEEN DECREASING SINCE 2007**



Source: Department of Census and Statistics in Sri Lanka and ILO 2012.

workers. In addition, wages for machine operators tended to be high compared to the minimum wage in Sri Lanka. These firms usually had the lowest share of female employees, and when women participated they held administrative positions.

### Sri Lankan Fast Employment Growth after Conflict

The Sri Lankan economy is going through a positive phase, as employment figures show. This is surprising given the global economic climate. While the global unemployment rate has been increasing since 2007, for Sri Lanka it has decreased to levels below 4 percent in the third quarter of 2011 (figure 1).<sup>8,9</sup> Annual employment growth for Sri Lanka was 4.8 percent up to the third quarter of 2011, showing an accelerating trend.<sup>10</sup> The services sector employed 43 percent of the workforce in the third quarter of 2011, showing the fastest compounded annual growth since 2009 of about 3.5 percent.

Regarding GDP, the Sri Lankan economy grew by 8 percent in 2010 and 2011 and the country's development continued in 2012 with similar GDP growth in the first quarter.<sup>11</sup>

### Fast Annual Employment Growth of MSMEs Served by CBC between 2009 and 2012

The sample of CBC client MSMEs showed annual job growth of 12 percent between 2009 and 2012, with equal job creation for women and men—more than twice the most recent annual growth for which Sri Lanka has data. The firms surveyed created 2,650 positions, with half going to women. But by 2012, female participation rate was lagging behind male participation rate in the sample, accounting for about 40 percent of employment overall. In addition 15 companies interviewed did not have any female employees.

The study estimated that 10 – 31 jobs were created for every \$100,000 of loans provided to MSMEs.<sup>12</sup> However, more than 80 percent of the firms surveyed also got other loans before or after 2009, which could have also contributed to their expansion and the impact on job creation during the period. This could, in turn, overestimate the number of jobs created per \$100,000 of loans. Other factors could also have affected job growth, and the variation in the estimate varies significantly.<sup>13</sup>

The sales turnover in the sample increased 19 percent a year because of the significant expansion of activities, a faster rate

<sup>8</sup> Excluding the north. <http://www.statistics.gov.lk>.

<sup>9</sup> International Labour Organization. 2012. Global Employment Trends 2012. Geneva.

<sup>10</sup> The most recent annual employment (2010 – 2011). Excluding the north. <http://www.statistics.gov.lk>.

<sup>11</sup> <http://www.statistics.gov.lk>.

<sup>12</sup> Based on an exchange rate of 114 Sri Lankan rupees to \$1. The range of the multiplier is based on all industries considered and was calculated using the 25th percentile and the median.

<sup>13</sup> Even excluding outliers - the 10 percent smallest and largest job creation figures per \$100,000 - the range is 2-145.

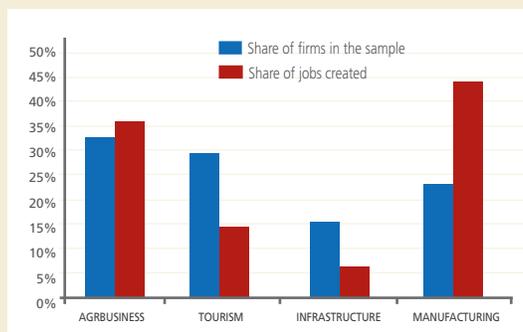


than job growth.<sup>14</sup> Firms in tourism and agribusiness had the highest sales turnover increases, while infrastructure did not perform as well. Two factors affecting firm sales turnover performance in infrastructure were higher competition and more expensive imports, in part due to Sri Lankan rupee depreciation. Average annual labor productivity (sales relative to employees) growth in the sample was 10 percent from 2009 to 2012, showing a positive association of job growth and productivity. That could be, to some extent, due to investments in technology: about 20 percent of firms interviewed mentioned that they used loans to acquire more productive machinery or additional technology. The result of job growth, accompanied with increases in labor productivity, is in line with the IFC Job Study's finding: there is a positive association between labor productivity and job growth for firms in developing countries.<sup>15</sup>

### Manufacturing Firms Created More Than 40 Percent of Jobs

In Sri Lanka, manufacturing firms created the most jobs, accounting for 44 percent of jobs, with an average of 51 positions per firm (figure 2). Agribusiness created about 36 percent of jobs, and accounted for 33 percent of firms. Manufacturing and agribusiness firms had the highest annual job growth between 2009 and 2012 (16 percent). Infrastructure firms had the lowest annual job growth, at 3 percent, and also had the lowest share of jobs created (7 percent). According to the surveyed firms, low job growth in infrastructure is the result of higher competition and slowdown of construction business. In addition, direct employment for infrastructure firms is low compared to the other sectors. Even in case of tourism, which is a labor intensive sector, employment effects were low, which might be a consequence of the higher incidence of temporary workers and the stagnating business trend due to the Euro crisis. This makes sense as European tourists accounted for half of the share of tourism arrivals to Sri Lanka in 2011.<sup>16</sup>

**FIGURE 2. MANUFACTURING FIRMS CREATED THE LARGEST SHARE OF JOBS**



### Firms in Central Sri Lanka Created the Most Jobs per Firm

Firms in the center of Sri Lanka created the most jobs (averaging 44 positions), and rapid annual job growth of 17 percent. But those results are magnified by outliers that created many

jobs between 2009 and 2012. In the north and east the average 15 jobs created per firm were enlarged by an infrastructure firm that almost doubled its turnover. The west (including southwest) had the slowest annual job growth rate in the sample, at 8.8 percent.

### Women Accounted for a Third of Employees of Female-Owned Small and Medium-Size Enterprises<sup>17</sup>

There was significant participation of females in SMEs ownership. Forty percent of the firms surveyed had at least one woman participating in their ownership. The most common form was in partnerships with their husbands. In Sri Lanka, women and men have equal property ownership and inheritance rights. This gives women in Sri Lanka better access to land and property than in other countries in South Asia.<sup>18</sup> Their property can be used with their husbands' to obtain better loan conditions and/or higher loan amounts. Hence, the high proportion of husband and wife business partnerships can be indicative of people taking advantage of this option.

Higher female employment is associated with the sectors that firms operate in rather than with female ownership. Women-owned companies employed 34 percent of women, less than the average female employment ratio of 40 percent in the sample, but similar to the national employment share distribution (35 percent).<sup>19</sup> For the sample, the participation of women in ownership did not seem to increase female employment. On the other hand, when focusing analysis on the sector, firms operating in the agribusiness sector tend to have the highest shares of employment of women, followed by textile and manufacturing companies. Among agribusinesses, 40 percent of firms employ more women than men. In tourism and infrastructure there is very low participation of women, and they usually hold administrative positions. In tourism, one in five companies did not have female employees. Female participation is the lowest among infrastructure firms, with one in three employing no women.

### Jobs Created in CBC's Portfolio of Micro, Small, and Medium-Size Enterprises

The sample showed significant job creation effects supported by business expansion and technology investment—more than 80 percent of firms used loans obtained in 2009 for these purposes. CBC's development credit department provided more than 30,000 loans to MSMEs in 2009 worth \$1,000–1 million.<sup>20</sup> An extrapolation of sample results to the CBC's whole MSME loan portfolio in 2009 showed that the companies created about 140,000 to 330,000 jobs between 2009 and 2012. The range might represent about 1.8–4.3 percent of total employment figures in the third quarter of 2011.<sup>21</sup>

Employment data showed a positive relationship between firm size and number of jobs created (figure 3). Medium-size firms created the most jobs per firm, but small firms had the fastest annual job growth rate. Medium-size firms had average job growth of 39 positions per firm, small firms created 30, and micro firms had 11.

<sup>14</sup> Turnover data was available for 98 percent of the sample

<sup>15</sup> IFC Forthcoming ([www.ifc.org/jobcreation](http://www.ifc.org/jobcreation)). For the analysis, World Bank Group Enterprise Surveys were used and data from IFC clients.

<sup>16</sup> Sri Lanka Tourism Development Authority. 2011. Annual Statistical Report.

<sup>17</sup> Women-owned definition is based on the fact that at least one of the owners is female.

<sup>18</sup> International Center for Research on Women. 2006. Property Ownership & Inheritance Rights of Women for Social Protection – The South Asia Experience (Synthesis report of three studies).

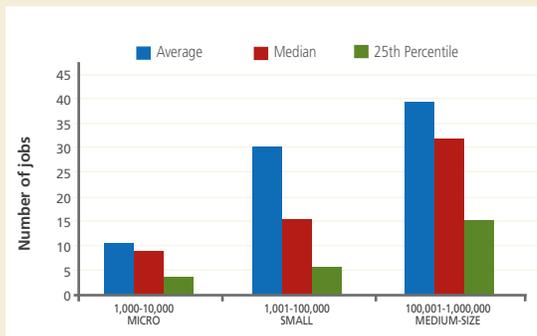
<sup>19</sup> <http://www.statistics.gov.lk>.

<sup>20</sup> Comes from MIS data

<sup>21</sup> The employment figure for Sri Lanka does not include the north as the information is not available. The percentage is a rough estimate, and there are some caveats on the calculation. Hence it should not be considered as an accurate estimation of employment impact in the country.



**FIGURE 3. LARGER FIRMS CREATED THE MOST JOBS**



### Some Caveats

The sample showed considerable job growth from 2009 to 2012. However, job losses that competitors could have experienced due to MSMEs expansion are not measured in the study. The sample of firms interviewed did not include firms with nonperforming loans, which could have experienced job losses in the period. Even when the portfolio was adjusted for nonperforming loans and the extrapolation was done using a conservative approach of the 25th percentile and the median, the job growth can be an overestimation.

CBC supported MSMEs by providing loans efficiently and advising them on financial opportunities to help firms with their operations and expansion plans. But, banks pick winners, in the sense that they select high performing MSMEs to provide loans to, which are expected to grow faster than other MSMEs not eligible for loans. Therefore, the high job growth results can be related to CBC choosing highly profitable MSMEs that are willing to risk collateral to fund their business plans. Nearly all (99 percent) of the firms surveyed that got loans in 2009 used land and property as collateral for loans. Only one firm got a loan without providing collateral—but used guarantees instead.

Access to finance likely played an important role in business growth, but it is difficult to attribute job creation effects just to the loans provided by CBC in 2009. Several firms obtained loans from CBC and other banks before and after 2009, and other relevant events occurred in the period considered in Sri Lanka; both could have supported job creation. In 2009 the conflict in Sri Lanka ended and the economy benefited from macroeconomic and political stability. Firms that started operations or expanded in 2009 relied on the better business environment. In contrast, most firms that participated in the study said that current macroeconomic conditions made it harder to expand their operations, mainly due to high interest rates in the country (over 14 percent).

### Job Creation Analysis: Opportunities for Financial Institutions

This study is the first of IFC Job Study's micro-case studies conducted in partnership with a financial institution to understand and estimate job creation effects of providing access

to finance to MSMEs. Banks can benefit when making and informing strategic decisions: 1) on products, regions, and sectors that are associated with high growth, 2) identifying MSMEs with high job creation results that can be potential clients for other financial services, 3) understanding their reach and impact on firms and in the market in terms of employment, and 4) as an additional tool linked to responsible finance and corporate social responsibility, given the impact of job creation on development and poverty reduction.

The study helps understand the impact of access to finance to MSMEs and the channels through which this can create jobs. From a sectoral perspective, the study collects information to build job creation multipliers that can be used to estimate the impact of providing financing to MSMEs in specific ways. These multipliers can be used to establish benchmarks and compare the effects across sectors, but evidence from additional studies is needed to further confirm these findings.

### Conclusions and Lessons

Sri Lanka, in contrast to global trends, has been experiencing fast economic growth and unemployment reduction in recent years. This study shows that firms have been expanding operations and increasing their workforce. CBC, the bank around which this discussion has revolved, had employment growth of 6 percent in the past two years while MSMEs surveyed registered an annual 12 percent employment growth since 2009.

The jobs created by productive MSMEs in Sri Lanka show that access to finance can have significant effects. Other factors, such as macroeconomic stability, have also contributed to business expansion and employment effects. Firms have reported that limited access to finance is a major constraint to business creation and expansion. In addition, crises can exacerbate the impact of financial constraints on MSMEs. Employment growth in MSMEs has been complemented by higher labor productivity, likely supported by technology investments. There was significant share of women owned enterprises in the sample. However, it is interesting that female owned firms were not associated with higher female employment. Higher levels of female employment, in fact, were associated with the sector in which firms operated.

#### THE STUDY PROVIDES SEVERAL LESSONS:

- Providing loans to MSMEs has a significant potential to create jobs—but there are other relevant elements such as improving skills of workers and the investment climate in the country that can contribute to it.
- By supporting local banks, IFC can help firms create jobs and raise labor productivity.
- The study estimated that 10 - 31 jobs were created per \$100,000 of credit provided, but there was a lot of variation, and the job creation cannot be exclusively attributed to the financing. Hence, more studies are needed to confirm these findings.

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