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2014

Sri Lanka – Country Report

Labour Law, the Business Environment and Growth of Micro and Small Enterprises

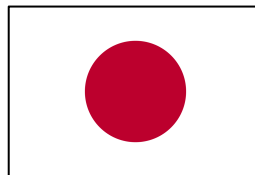


Labour Law, the Business Environment and Growth of Micro and Small Enterprises

Sri Lanka - Country Report



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Labour Law, the Business Environment and Growth of Micro and Small Enterprises – Sri Lanka: Country Report / Sudharshan Senaratne and Dr. Manitha Weerasuriya; International Labour Organization, ILO DWT for South Asia and Country Office for India. – New Delhi: ILO, 2014

ISBN: 978-92-2-129445-0 (print)

ISBN: 978-92-2-129446-7 (web pdf)

ILO Cataloguing in Publication Data

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Printed in India

Foreword

Enterprises, in particular micro- and small enterprises or MSEs, are considered the growth engine for creating productive jobs. They play a crucial role in enabling countries achieve the goal of decent work for all. However, enterprises often face significant obstacles in the forms of red tape, lack of access to financing and markets. These challenges are among the contributing reasons why entrepreneurs decide to operate in the informal economy.

The International Labour Organization (ILO) has identified the informal economy as representing a significant obstacle to achieving decent work for all. Entrepreneurs who operate in the informal economy are less productive and unlikely to achieve the full growth potential of their enterprise. Furthermore, workers employed in informal enterprises generally receive lower salaries and enjoy fewer, if any, of the benefits that formal economy workers do. Enterprises operating in the informal economy, at times, also contribute to unfair competition by avoiding taxation and the costs associated with compliance with labour laws and other regulations. Facilitating the formalization of enterprises and workers is a key priority guiding the work of the ILO.

This study was conducted to support the ongoing policy dialogue in Sri Lanka on strategies to support the formalization of the informal economy. While informal economy issues affect entrepreneurs and workers alike, this study focuses on the enterprise side of informality. It is part of a series of four country studies commissioned by the ILO, to research the impact of labour laws and the cost of regularization on entrepreneurs' decisions to formalize their businesses. The countries covered by this research are India, Nepal, Bangladesh, and Sri Lanka. In Sri Lanka, the research has focused on four sectors: agro processing, textiles and garments, woodworking, and hospitality. The first part of this study was completed in 2007. In the second part of the study, which was completed in 2011, the research was expanded with a large-scale survey targeting 576 enterprises.

The research was conducted by EML Consultants. Sudarshan was the team leader for the first part of the research and Dr Manitha Weerasuriya was the team leader for the second research part. They were assisted by Neomal Gunewardene, Shyamali Ranaraja, Roy Jayasinghe, Ramani Gunatilake, Fuard Marikar, Uma Muthukumarana and Chaminda Jayasundara. Professor T.S. Papola of the Institute for Studies in Industrial Development, New Delhi, has provided valuable comments and has been responsible for guiding the four country studies. Additional support was received from Gopal Joshi (ILO, Geneva), Paul Vandenburg (consultant), Debi Prasad Mondal (regional expert, Statistical Information and Monitoring Programme on Child Labour), Bandana Sen (statistical specialist) and Rasika Somaweera (ILO, Colombo). Mridusmita Bodoloi (consultant) analysed and incorporated additional data. Hideki Kagohashi (Senior Enterprise Specialist) of the ILO's Decent Work Team for South Asia has been responsible for conceptualizing and overseeing the research. Thomas Kring (Chief Technical Advisor, 'Way Out of Informality' project) oversaw and managed the finalization of the study.

This project was made possible through support from the Norwegian Agency for Development Cooperation, with additional support from the Japanese Government provided under the "Way Out Of Informality: Facilitating Formalization of Informal Economy in South Asia sub-regional project.

Tine Staermose
ILO Decent Work Team for South Asia and
Country Office for India
New Delhi

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II. Executive Summary

This study is based on a survey of micro- and small enterprises (MSEs) in Sri Lanka and provides a better understanding of the legal and regulatory factors that can aid or inhibit growth, quality of jobs and employment creation in MSEs in the country. It is part of the four country studies conducted in South Asia, covering Bangladesh, India, Nepal, and Sri Lanka. These countries broadly share the same approach towards the application of labour and labour-related laws in MSEs: generic or partial exemptions for enterprises below certain threshold sizes. The work in South Asia is, in turn, part of a larger effort by the Small Enterprise Development Unit (SEED) in the Enterprise Department at the ILO headquarters in Geneva to conduct research, engage in dialogue, develop the best practices, and generate tools for its constituents. An overview of current ILO thinking on the topic is available in the Governing Body paper entitled *Business environment, labour law and micro and small enterprises* (ILO, 2006), which was used as a baseline document in this study.

The objectives of the study were to research and to find answers to the following:

- Whether the exemption thresholds in legislation, both of labour as well as other business regulations, would incentivize certain types of avoidance behaviour by firms and, if so, to what degree.
- Whether regulations without such exemptions would also incentivize certain types of avoidance behaviour and, if so, to what degree.
- What are the important variables that affect such behaviour (e.g. inspection coverage).
- Whether these findings support the perception-based rating of factors that affect the growth of MSEs.

The study first reviewed and prioritized those laws and regulations from labour and other regulatory issues that are perceived to have a high probability of becoming growth traps (e.g. incentivizing businesses to stay smaller than the set threshold or remain unregistered). Sri Lankan labour law generally applies to enterprises of all sizes. Those labour-related laws that apply to all cover the core areas of labour regulations such as minimum wages and employees' provident fund (EPF)/employees' trust fund (ETF).

The two major exceptions are the Termination of Employment of Workmen Act of 1971 (TEWA) and the Payment of Gratuity Act 12 of 1983, which are applicable only to enterprises which employ more than 15 workmen. The formation of a trade union requires seven regular employees but can include those working in other businesses; hence this is not a binding threshold in practice. Besides the labour laws, the laws on income tax and value added tax (VAT) have thresholds for exemption and lower rates, but these are set on the basis of the annual turnover, not on number of employees. Besides the original assumption of firms staying below the threshold level, several other

avoidance strategies were presumed and the survey questionnaire was designed to capture them.

The survey collected data from the sample of 576 enterprises, covering four sectors (agro processing, textiles and garments, woodworking, and hospitality) with five to seventy employees. Given the importance of 15 workers as the threshold level, the survey stratified enterprises into those employing less than 15 workers and those employing 15 or more workers. It asked the owners/managers of these businesses about their knowledge of and actual compliance with each of the labour and business regulations perceived important in Sri Lanka. It also asked for the transaction cost of compliance and, if applicable, reasons for non-compliance. Regarding the legal requirements of a threshold, the survey had different sets of questions for those below the threshold level and for those above it in order to precisely identify avoidance and non-compliance behaviour and the reasons behind both. The questionnaire also captured information on registration, licensing, precise knowledge of the obligations and penalties of the labour regulations as well as the frequency of inspection, access to incentives and informal payments. The survey brought out several findings that can contribute to policy dialogue and development.

The main survey findings are as follows:

- The survey verified that *“staying below the threshold level”* to avoid compliance with labour laws was not a popular strategy in Sri Lanka. Around two per cent of MSEs tried to stay below the income tax threshold; around one per cent below the VAT threshold; less than one per cent below the gratuity threshold; and one per cent below the retrenchment threshold.
- To avoid retrenchment regulations, the most frequently cited reason was *“The separation was voluntary”* (42 per cent). A considerable number of MSEs provided reasons that can be considered direct *“avoidance by choice”* behaviour such as *“It has not been demanded”* (24 per cent).
- Being aware and still avoiding compliance with minimum wage regulations was observed among five per cent of MSEs in Sri Lanka (although this is not a *“growth trap”*).
- *“Making informal payments”* was identified as a popular avoidance strategy on the basis of the *“have heard of”* question. Informal payments were most prevalent in relation to income tax (58 per cent), followed by EPF (37 per cent), VAT (27 per cent), minimum wage (14 per cent), and gratuity (10 per cent). The hospitality sector demonstrated the highest ratio of awareness on informal payments, followed by agro processing, when compared to other sectors. These two sectors demonstrated higher coverage by tax inspectors and public health inspectors of the local authority, which might explain the sectoral difference in awareness on informal payments. While substantially smaller in percentage than those MSEs that were aware of informal payments being made, some MSEs

actually made such informal payments in relation to income tax (10 per cent), EPF/ETF (5 per cent) and VAT (1 per cent).

- “*Avoiding registration/staying informal*” to avoid tax obligations was exercised by a small number of MSEs, but overall only two per cent of the surveyed firms were unregistered. Around 97 per cent of the total MSEs surveyed had at least one of the seven popular types of registration.
- Whether “*casualizing of labour*” is a popular avoidance strategy in Sri Lanka is uncertain. Overall, 25 per cent of the employees of the surveyed MSEs were casual labour at the time of the survey (2011), down from 27 per cent from two years earlier. Over 90 per cent of the casual employees worked less than five years (beyond which gratuity must be paid at the time of separation) at the interviewed firms while the figure declines to over two-thirds for full-time and part-time employees. These evidences are inconclusive though. The perception-based ratings tended to overstate the impact of positive factors and understate the impact of negative factors when compared to the actual behaviour of firms.

Finally, this report offers a context within which to engage in a policy dialogue towards a legal and regulatory framework that will provide balance between the protection of workers and the incentives to growth and employment generation in the context of the emerging and responsive regulation debate.

List of abbreviations

AIA	Archaeological Impact Assessment
BOI	The Board of Investment
BDS	Business Development Services
CGL	Commissioner General of Labour
DQC	Department of Quality Control
ECS	Economic service charge
EDB	Export Development Board
EIA	Environmental Impact Assessment
EPF	Employees' Provident Fund
ETF	Employees' Trust Fund
EPZ	Export Promotion Zones
FTZs	Free Trade Zones
FDI	Foreign Direct Investment
H.S.C	Harmonized System Codes
IE s	Industrial Estates
IEE	Initial Environment Examination
IDA	Industrial Disputes Act No. 43 of 1950
IDB	The Industrial Development Board
LPAs	Labour Policy Areas
JAAF	Joint Apparel Association Forum
JICA	Japan International Cooperation Agency
LA	Local Authority
NDB	National Development Bank
MSE	Micro and Small Enterprises
MID	Ministry of Industrial Development
MRI	Ministry of Rural Industries
MSME	Micro, Small and Medium Enterprise Sector
NORAD	Norwegian Agency for Development Cooperation
NGOs	Non-governmental Organizations
OHS	Occupational Health and Safety Standards
QLFS	Quarterly Labour Force Survey
SEED	Small Enterprise Development Unit
SLIS	Sri Lanka Integrated Survey 1999/2000
SME	Small and Medium-sized Enterprises
SMI	Small and Medium Industries
TEWA	Termination of Employment of Workmen (Special Provisions) Act
TIN	Tax Identification Number
UNIDO	United Nations Industrial Development Organization
TU	Trade Union
TUO	Trade Union Ordinance No.14 of 1935
USAID	United States Agency for International Development
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WBO	Wages Boards Ordinance

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CHAPTER 1: Introduction

The International Labour Organization (ILO), along with its constituents, aims to develop a better understanding of the factors that can aid or inhibit growth, quality of jobs and employment creation in micro- and small enterprises (MSEs) in South Asia. The ILO is currently engaged in a research and policy dialogue process, supported by the Norwegian Agency for Development Cooperation (NORAD), on the manner in which labour laws in the context of the overall business environment affect the development of MSEs. In this context, the “labour laws and business environment” include labour and labour-related laws and regulations, other laws and regulations, and non-regulatory aspects of the business environment, such as non-labour law related cost-of-doing business, as a part of the overall study.

1.1 Objectives of the study

The objectives of the research were to find answers to the following:

- ✓ The impact of labour laws in the context of the overall business environment, if any, on the size profile of enterprises in Sri Lanka.
- ✓ Whether an MSE labour law growth trap exists and whether enterprises tend not to grow in a normal manner to avoid compliance with laws at above the threshold.
- ✓ Whether it is mostly the labour laws (or labour-related laws) that create the perceived growth trap – whether it is (a) the tax code, subsidy schemes or accounting regime that confines enterprises to a small size; (b) the business registration and licensing process that inhibits micro-enterprises from growing into formal small businesses; or (c) the non-regulatory business environments that create the growth trap.
- ✓ The practices that enterprises undertake to avoid labour laws and state-level data on the nature of these practices
 - **Expanding horizontally:** an entrepreneur sets up an additional enterprise; neither of the two enterprises breaches the size threshold.
 - **Hiding workers:** an enterprise expands beyond the threshold level but does not report the additional workers.
 - **Casualizing labour:** an enterprise contracts workers who are not considered part of the regular workforce of the enterprise.
 - **Making unofficial payments:** an entrepreneur pays officials not to enforce the law
 - **Investigate changes,** if any, to labour law and the impact that this had on MSEs, including the level of employment and the nature of the employment relationship.

The research study in Sri Lanka was planned to be completed in two stages:

- **Study I:** Reviews the impact (direct and indirect) of labour laws in the context of the overall business environment on MSEs.
- **Study II:** Surveys the costs and benefits of doing business (business environment with focus on labour laws and other regulations) on MSEs.

Study I was completed in 2007 with the intention of integrating the results of Study II (which is a large-scale survey targeting 500 enterprises to improve on study I) to provide a comprehensive report with the latest field information. The intention of this survey is to test the hypotheses developed during the first study. The research focused on four selected sectors, namely: agro processing, textiles and garments; woodworking; and hospitality.

This country report includes findings of both studies and is updated with current scenarios relating to the MSE sector in the country.

CHAPTER 2: Overview of the MSE sector, labour laws and business regulations

2.1 Overview of the MSE sector

The micro- and small enterprises (MSEs) sector has been identified as an important strategic sector for promoting growth and social development in Sri Lanka. Sri Lanka's micro, small and medium sector consisted of 121,426 enterprises in 2003 (Kozak, 2007). This sector is considered to be a major source of employment, income generation, poverty alleviation, and regional development. Although the MSEs are spread across all the major sectors of the economy – in agriculture, mining, manufacturing, construction and services – reliable data are not available except for the industrial, some services and manufacturing sectors. Within the manufacturing sector, small and medium scale industries (SMI) account for about 96 per cent of industrial units and 36 per cent of industrial employment and 20 per cent of value added (white Paper, 2002). However, it is difficult to estimate the total contribution of MSEs to the national economy due to the lack of reliable information.

In 1997, in Sri Lanka, there were about 25,000 small and medium-sized enterprises (SMEs) and more than 100,000 micro-enterprises, ranging from those in the industrial sector, which made up about 20 per cent of all businesses, to those in the services sector. SMEs and micro-enterprises employed 70 per cent of all workers in the private industrial sector and accounted for 55 per cent of its added value (Sonoda, 2008).

The geographical distribution of MSEs is somewhat skewed with 30 per cent of industries concentrated in the Western Province, where the capital city is located, and 20 per cent of industries in the adjoining North Western Province. Thus the majority of MSEs are located in these two provinces while the remaining 50 per cent of industries are spread out among the other seven provinces. The MSEs comprise a heterogeneous group of over 26 industry sub-sectors, with a high degree of variation in terms of size, type of entrepreneur, type of activity, variety of products, and level of economic sustainability. The government's role is expected to be one of facilitation rather than intervention. However, the regulatory environment has stifled expansion of this sector due to unnecessary delays in approval procedures – a complex system of documentation, lengthy procedures, and outdated rules and regulation.

Despite several incentives offered by successive governments, with assistance from donor agencies, the MSE sector enterprises have shown only marginal growth when compared to large-scale enterprises in the national economy. The growth and expansion of MSEs are said to be constrained by problems relating to both product and factor markets. Lack of institutional and policy support has further reduced the potential contribution of MSEs to the national economy. Major constraints identified include high interest rates and collateral requirements by lending institutions; low level of technology; lack of technical and managerial skills; lack of market information and marketing skills; lack of adequate infrastructure such as water, electricity, communication and road access; pro-worker labour legislation; competition from low-priced substandard goods; and the overly bureaucratic and regulatory role of the government.

2.1.1 Labour law in Sri Lanka in the context of MSE growth

Sri Lanka's labour legislation and its possible negative impact on employment growth have been much discussed in the literature. The Sri Lankan labour market is governed by several legislative enactments that make it difficult for enterprises to adjust the size of the workforce to meet changing conditions (IFC, 2006/2007). In particular, it has long been argued that the high dismissal costs of Sri Lanka's Termination of Employment of Workmen Act (TEWA) reduces job creation rates in firms with more than 15 workers which are covered by it and which are unable to evade the law due to high visibility and related monitoring by the authorities and unions (Abidoye, Orazem and Vodopivec, 2007; Heltberg and Vodopivec, 2004; Rama, 1994; 2003; Ranaraja, 2005). Consequently, the majority of workers are forced into informal employment at low wages and poor conditions of work (Heltberg and Vodopivec, 2004). This issue has attracted considerable research interest and controversy in recent years. This research study is an attempt to throw light on the impact of Sri Lanka's labour regulations, non-labour regulations and the business environment on the growth and survival of MSEs. This chapter presents the regulatory and non-regulatory environment in Sri Lanka, thus opening up factual scenarios for research and discussion.

Sri Lankan labour law generally applies to all enterprises regardless of the size of the enterprise, the two exceptions being the Termination of Employment of Workmen (Special Provisions) Act of 1971 (TEWA) and the Payment of Gratuity Act 12 of 1983, which are applicable only to enterprises which employ more than 15 workmen. All statutes apply to the private sector (both formal and informal), state-owned commercial enterprises and public companies, and public corporations and statutory boards or authorities. However, they do not apply to employees of central and local governments (ministries and government departments). A few other regulations formulated under specific statutes provide for minor requirements based on enterprise size, but these do not relate to significant aspects of employment or workers' rights.¹

Coverage under Sri Lankan law arises from the definition of workman in the main statute pertaining to labour and working conditions, namely the Industrial Disputes Act (IDA) No. 43 of 1950.² Other statutes, such as the employees' provident fund (EPF), employees' trust fund (ETF), workmen's compensation, etc., contain the same definition, and therefore any person who is defined as a workman is covered under these laws and regulations, regardless of the size of the enterprise in which the person is employed. Some differentiation does occur on the basis of the nature of the business

¹ Many of the regulations have been formulated under the Factories Ordinance and provide for sanitary conveniences such as the provision of toilets based on number of workers.

² Article 48 of the IDA interprets workman as being "any person who has entered into or works under a contract with an employer in any capacity, whether the contract is expressed or implied, oral or in writing, and whether it is a contract of service or of apprenticeship, or a contract personally to execute any work or labour, and includes any person ordinarily employed under any such contract whether such person is or is not in employment at any particular time, and includes any person whose services have been terminated."

of the enterprise (for instance, occupational safety and health regulations applicable to industrial undertakings are not applicable to shops and offices), but all enterprises are covered by all labour legislation with the exception of TEWA and Payment of Gratuity Act.

The main legislative provisions applicable to the sectors in this study, namely, textiles and garments, woodworking, hospitality, and agro processing, are summarized in Appendix I.

2.1.2 Legislation in relation to specific labour policy areas (LPAs)

2.1.2a Collective bargaining and freedom of association

The legislation which forms the basis of freedom of association, and thus of social dialogue, in Sri Lanka is twofold. First, the second Republican Constitution enacted in 1978 recognizes the fundamental right and freedom of every citizen to form associations (Article 14(1)(c)), the freedom to form and join a trade union (Article 14(1)(d)), and the freedom to engage by himself or in association with others in a lawful occupation, profession, trade, business or enterprise (Article 14(1)(g)). The right to freedom of speech and expression (Article 14(1)(a)) gives voice to the fundamental right to organize as citizens who exercise the right to associate and to form and join a trade union and also enjoy a concomitant right to receive and impart information. Although these rights could be abridged in the national interest, unlike in previous Constitutions, a direct complaint to the Supreme Court, the highest judicial body in the country, was also provided for in the event of violation of these rights by executive or administrative action. The application and scope of these rights and the remedial action available have been expanded by judicial action beyond the legislative bare-bones.

Second, the Trade Union Ordinance (TUO) No. 14 of 1935 provides the means to enjoy the constitutional right to freedom of association, by enabling seven members, and not necessarily workers or those employed in a particular enterprise or trade, to register a trade union to enjoy the legal rights and immunities conferred by the TUO.

Thus, the right to form and join a trade union is now a core right of every citizen and it is not dependent on a citizen being employed. In addition, the status of trade unions was enhanced further by an amendment to the IDA in December 1999, which compelled the mandatory recognition of a union that commanded a representation of 40 per cent of the workforce, by defining a refusal by the employer to bargain with such a union as an unfair labour practice punishable by a fine of 20,000 Sri Lankan rupees (LKR) or a term of imprisonment of six months.

In practice, however, especially given that many MSEs operate in the informal sector, it is unlikely that workers in these MSEs would be able to exercise their right to freedom of association. While there has been no survey of trade union membership based on size of enterprise, the responses to the industry survey by the focus groups appear to indicate that it is extremely unlikely that workers in MSEs are unionized or represented to a meaningful extent.

Collective bargaining: In Sri Lanka, collective bargaining as a dispute resolution process is favoured by urban commercial/mercantile sector worker organizations, such as bank employees, and by estate workers in resolving disputes with employers who are mainly in the membership of the Employers' Federation of Ceylon. Although the legal recognition of the right of association and the immunities and privileges statutorily afforded to unions were intended to redress the unequal bargaining power between employers and trade unions and thus create an environment conducive to collective bargaining, collective agreements are more the exception than the rule, even in formal, large-scale enterprises in Sri Lanka. There are very few instances of collective bargaining or collective agreements in MSEs, and these are especially unlikely in informal sector MSEs.

2.1.2b Anti-discrimination/equal opportunity

Despite the principle that “equals should be treated alike”, discrimination, especially in relation to different rates of payment based on gender, has been reported in some sectors. In the agriculture sector, until the revision of such provisions recently, some Wages Boards sanctioned different rates of pay for men and women even though the work performed was the same. While men and women may seem to congregate in different occupations (for instance, machine operators in the apparel sector are almost exclusively young, single females), this seems to be more a matter of preference of the workers rather than design by the employer. This is irrespective of whether employment is in MSEs or otherwise. Female workers are also protected by legislation from arbitrary termination due to reasons of pregnancy and childbirth, although this protection may not be available in MSEs due to the nature of employment in many of these enterprises, where workers may be unable to compel enforcement of legislation due to various reasons.

2.1.2c Prohibition on forced labour/child labour

Unlike many of its neighbours in South Asia, Sri Lanka does not have widespread child labour or forced/bonded labour. The employment of any child below the age of 14 is prohibited by law, and school attendance is also compulsory until that age. Child labour, where reported, has mainly been in instances where children are employed as domestic labour. However, child labour in the MSE sector, especially in family-based economic activity, is likely to be unreported and invisible; child labour in agriculture, where members of the same family are engaged in production, is likely to be the most serious manifestation of child labour in the MSE sector, although no firm data is available.

2.1.2d Minimum wage

Minimum wages are stipulated in relation to specific trades for which Wages Boards have been set up under the Wages Boards Ordinance (WBO). Although these Wages Boards determine minimum wages in these trades through a tripartite mechanism from time to time, in reality in many sectors real wages would be substantially higher due to the operation of market forces. Especially in sectors such as hospitality and construction, wages paid could be several times higher than the stipulated wage.

However, wages are generally a matter for individual negotiation based on relative bargaining strengths of employer and worker, and would be unlikely to be set as a result of collective bargaining.

2.1.2e Overtime/working time

The Wages Boards for different trades established under the WBO provide for the working hours and rates of pay for overtime work for workers in those trades. Generally, male workers work nine hours a day, 45 hours a week, and there are no restrictions on the amount of overtime work that can be performed by them. Working hours for women are given in table 2.1.

Table 2.1. Wages Boards provisions on hours of work and rates of pay for women

Normal working hours	Overtime work	Night work
<p>Nine hours in any one day excluding intervals or not more than 45 hours a week, provided:</p> <ul style="list-style-type: none"> * The employee is over 16 years old. * Total hours worked (including overtime) does not exceed ten in any one day. 	<p>Should not exceed 60 hours in a calendar month.</p>	<p>Night work permitted, provided:</p> <ul style="list-style-type: none"> * The employee consents to night work. * The Commissioner of Labour grants permission in writing. * The employee has not been employed on the same day between 6.00 a.m. and 6.00 p.m. * Female wardens, restrooms, and refreshments, are available. * No female shall be employed on night work on more than ten days a month.
Rates of pay		
<p>Minimum wages stipulated by Wages Boards if applicable</p>	<p>1½ x hourly rate for every hour of overtime work, and double the hourly rate if employed on holidays declared by the Wages Board.</p>	<p>1½ x the hourly rate</p>

It is also noteworthy that Sri Lanka, which had in 1966 ratified the Night Work (Women) Convention (No. 89), which prohibited night work for women between the hours of 10.00 p.m. and 5.00 a.m., denounced Convention No. 89 in 1984 purely to enable women to be employed at night in factories and industrial establishments in the fledgling export processing zones. Although preconditions for night work, such as employee consent, and the permission of the Commissioner of Labour, were stipulated as safeguards against women being forced to work at night, these provisions are largely observed in the breach, and, in any case, are virtually unenforceable. Given the lack of compliance even in large, formal sector establishments, the level of adherence to these provisions by MSEs, especially those located in the informal sector, is likely to be extremely low.

2.1.2f Paid time off

Sri Lanka has without doubt one of the most generous public holiday structures in the world, in addition to statutorily imposed paid leave for various categories of employees, as indicated in table 2.2.

Table 2.2. Holiday and leave provisions in Sri Lanka

Types of holiday & leave	Employees covered by Shop & Office Employees Act	Trades covered by the wages boards			Public sector
		Plantations (83% of workforce in these trades)	Other trades (13% of workforce)	Workers affected by 1972 extension (4% of workforce)	
Holidays (per annum)					
Weekly	78	52	52	52	104
Statutory	8	3	8	8	13
Poya (full moon)	12	12	12	12	12
	98	67	72	72	129
Leave (per annum)					
Annual	14	14	14	14	24
Sick/casual	7	0	0	28	21
	21	14	14	42	45
TOTAL (per annum)					
Non-working days	119	81	86	114	174
Working days	246	284	279	251	191

Source: Compiled from relevant statutes.

However, this liberal structure does not apply in the manufacturing sector, where there is no requirement to provide paid leave for illness, even where employees are engaged in regular, permanent work. As medical leave is not a legal requirement, employers do not provide any paid leave to many workers in MSEs, with the result that employees report for work even when sick, as any absence will be unpaid, and may even attract disciplinary measures.

A paid weekly holiday must be provided to most trades covered by a Wages Board but this too is very often observed in the breach. If an employee has to be employed on the day of the week designated as the weekly holiday, s/he is entitled to the following: (a) 1½ x the hourly rate of pay during normal working hours; (b) double the hourly rate for work beyond normal working hours; (c) a holiday with pay within the next six years in lieu of the holiday on which the employee was required to work.

Although an employer must provide 14 days of paid leave annually, very often workers are unaware of these provisions, or cannot avail themselves of these privileges due to non-compliance by employers. Enforcement levels are extremely low in the MSE sector, and as such these terms are not available to many workers.

2.1.2g Social security, unemployment insurance and workers' compensation

There is no system of unemployment insurance available to workers in Sri Lanka, other than the ETF Act of 1980, which requires employers to contribute a sum equal to three per cent of the basic wage of every employee to a central fund, the benefit of which can be claimed by an employee if s/he ceases to be employed for any reason; the withdrawal of benefits is permitted only once in five years. However, compliance is very low, and many workers are unaware, both of the liability of the employer to make such contributions and the manner of withdrawal of such contributions.

Workers in the private sector, in general, are not entitled to regular pension payments on retirement. Currently, a pension scheme for private sector employees has been proposed but not finalized. Legislation provides for a contributory scheme of superannuation where the employee contributes a minimum of eight per cent of monthly wages, while the employer contributes an additional amount equal to a minimum of 12 per cent of the wage, to the employees' provident fund (EPF) which is administered by the Department of Labour. The entire amount available to the credit of an employee in the EPF can be obtained on retirement or, in the case of a female, upon marriage, if she is giving up employment permanently. In addition, any employee who has been employed for more than five years in any employment is entitled to the payment of half a month's wages for every year of completed employment as gratuity, at any time when the services of the employee come to an end thereafter. However, none of these provisions provide a long-term social security system, as the entire amount lying to the credit of an employee can be withdrawn when s/he qualifies for such benefits. Very often the employee is not aware of the importance of investing these benefits in a secure manner to provide a regular source of income for old age or infirmity, and the benefits are used for conspicuous consumption.

Many workers and employers are unaware of the provisions of the Workmen's Compensation Ordinance, and very often injuries/accidents remain unreported and uncompensated, especially in the informal sector. Compensation, if any, is usually at the discretion of the employer and few employees would be able to compel the enforcement of such legislation.

2.1.2h Protection against unjust dismissal

The Department of Labour has jurisdiction over all workplaces in the country in respect of the administration and enforcement of all labour legislation. The IDA provides for several mechanisms for dispute resolution, including that of termination of employment/unjust dismissal: (a) arbitration (both voluntary and compulsory, where parties are required to restore the status quo pending a decision); (b) conciliation (by the Commissioner of Labour between parties to an industrial dispute); (c) adjudication by Labour Tribunals (in matters relating to termination of employment for disciplinary reasons) wherein the IDA empowers the Labour Tribunal to make an order in an application challenging the termination, notwithstanding any provision in the contract of employment between the employer and employee; and (d) by entering into collective agreements between the employer and workers' organizations or trade unions (especially in relation to wages and terms of employment). The collective agreements are registered by the Commissioner of Labour to give legal effect to the terms of such agreement.

These mechanisms are intended to operate efficiently and expeditiously in order to minimize the disturbances to industrial relations, but this is no longer a reality due to the deficiencies that have arisen within these systems. For instance, although the IDA contains a provision which indicates that an application made by a workman against the termination of his services to the Labour Tribunal should be decided within four months, the average duration of such an inquiry at present is about three years. Similar delays and inefficiencies plague the systems of arbitration, conciliation and inquiries conducted by the Commissioner of Labour, affecting the ability of a worker to compel the enforcement of applicable legislation.

Where a worker claims that his/her services were unjustly terminated for non-disciplinary reasons, TEWA provides for a direct complaint to the Commissioner General of Labour (CGL); however, this relief is available only to workers in enterprises employing more than 15 workers.

2.1.2i Occupational safety and health

In considering the above statistics, it must be noted that the Factories Ordinance applies only to factories as defined under the Ordinance, and covers approximately 30 per cent of the working population of about eight million in the country. A further 37 per cent of the workforce engaged in agricultural activities, including plantation workers, is not covered by any health, safety and welfare legislation. Even workers employed in shops and offices are not covered by specific occupational safety and health (OSH) legislation. While there are some threshold-based requirements to provide for sanitation, washing

facilities, etc., these provisions are rarely complied with, nor are they enforced due to practical difficulties.

2.1.2j Advance notice (for large-scale lay-offs)

Please refer to the discussion on TEWA ahead.

2.1.2k Parental/family leave

Maternity benefits are provided for all female workers under the Maternity Benefits Ordinance, which applies to workers in industrial undertakings. However, there is no provision for paternity leave, either paid or unpaid.

2.1.2l Employee consultation

There are no specific legal provisions for employee consultation other than those relating to collective bargaining and freedom of association discussed above.

2.1.2m Protection of rights on transfer of undertaking

There is no provision to ensure the rights of workers on the transfer of undertaking in the private sector. However, both the Department of Labour and the Labour Tribunal have proceeded to substitute successors-in-interest, where the enterprise has undergone a transfer of ownership, in litigation involving workers.

2.1.3 Compliance gap

It has been found that a large portion of workers in MSEs in countries across the world do not enjoy the protection of labour laws, even though they may be legally covered (ILO, 2006). The decent work deficit in MSEs relates to employment and income security, social protection and rights at work, and workers in these enterprises typically cannot, in reality, access many rights guaranteed by law. The situation in Sri Lanka is similar, and the available research indicates that the low levels of compliance with labour laws by MSEs and the difficulty of enforcement of such laws against them by the relevant authorities arise from the fact that many of these MSEs operate in the informal sector.

The National Policy for Decent Work in Sri Lanka estimates that up to 80 per cent of MSEs operate in the informal sector (defined as a group of usually small and micro-enterprises spread across many sectors of the economy but not having a formalized status or without any type of registration or approval of controlling authorities), and that about 70 per cent of the labour force in Sri Lanka is employed therein (MLRFE, 2006). Sandaratne (2003) states that “small informal enterprises employ a few workers and their wages are determined by the relative bargaining strength of the parties...” Those with hardly any skills would be paid the prevailing unskilled wage rate in the area. This differs considerably from place to place. It is not determined by the prevailing minimum wage rates specified by the Labour Department Wages Board for the industry (even if it is covered by a Wages Board). These workers rarely contribute to the EPF, or the ETF. Both the employer and the employee in these small enterprises are reluctant to

be involved in contributing to these funds. The employer views it as an additional financial cost and unnecessary work and expense in sending remittances. In addition, the employer views such an involvement as entailing risks of being entangled with new labour legislation and other authorities at a later date, including tax authorities. Therefore, to a certain extent, employers avoid being drawn into labour regulations.

Even where MSEs are visible or operate with some degree of formality, compliance with labour laws is incomplete. Sandaratne (2001) found that MSEs often register only some employees for the purpose of coverage of labour laws; resort to casual employment, with employees being discontinued periodically to evade compliance; and find ways and means to minimize the involvement of the MSE with authorities, often by means of bribery of the inspecting officials. Although a written contract of employment is not a legal requirement in Sri Lanka, under several legislative provisions (e.g. the Shop and Office Employees Act) there is a duty to provide a written record of relevant terms such as wages, deductions from wages, period of payment of wages, etc. This is more often than not observed in the breach in MSEs. Thus, workers will find it more difficult to establish an employment relationship for the purpose of enforcing compliance with legislation.

It is therefore likely that MSEs find labour laws to be less restrictive to their operations than do their larger counterparts. This conclusion is supported by the findings of a survey by the World Bank on what businesses see as constraints. In a recent survey of the urban and rural investment climate in Sri Lanka, urban entrepreneurs rated labour regulations as the fifth most significant constraint to investment, while rural entrepreneurs appeared to consider the impact of labour regulations to be less restrictive (World Bank and ADB, 2005) (see table 2.3).

Table 2.3. Constraints to investment, and their ranking by urban and rural entrepreneurs

Constraint	Urban ranking	Rural ranking
Electricity	1	5
Policy uncertainty	2	10
Macro instability	3	n.a.
Finance (cost)	4	2
Labour regulations	5	15
Transport	9	1
Finance (access)	12	3
Demand	n.a.	4

Source: World Bank and ADB, 2005.

The survey also found that urban enterprises, on average, employed 105 workers, while their rural counterparts employed only 2.4 workers. Using this data as a proxy, it is not unlikely that most rural enterprises could be categorized as MSEs³ and that they did not find labour regulations to be a significant constraint due to the compliance gap.

2.1.4 Impact of threshold-based legislation: TEWA in Sri Lanka

TEWA has achieved a degree of notoriety as being an extremely restrictive piece of legislation. However, much of the discussion on TEWA has considered its impact as a disincentive to foreign investment,⁴ and there has been no systematic survey on the impact of TEWA on enterprise and employment growth. If TEWA is creating adverse consequence for firms, they are likely to try to avoid this from happening. One method by which this could be done is by keeping their workforce below 15, which will enable them to benefit from TEWA exclusion. However, these types of evasive strategies have been recognized as creating “growth traps” which prevent firms from growing, even where conditions are conducive to growth beyond that threshold size (ILO, 2006).

Due to the absence of reliable size-based data on enterprises, some proxy data has been used by a team of researchers to form a reasonable hypothesis of the impact of TEWA. Based on the data from returns filed by employers when forwarding contributions under the EPF Act, this does provide some support for the theory that “bunching” appears to take place at the threshold level of 15 workers.⁵

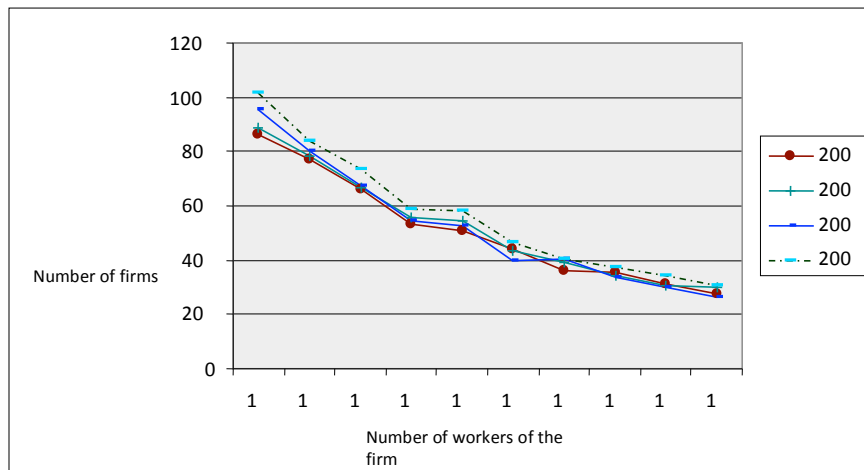
³ This is supported by the findings of the Survey of Industries of the Department of Census and Statistics (DCS, 2003) which found that over 96 per cent of rural enterprises employed less than 15 workers.

⁴ TEWA affects investors by creating:

- (a) uncertainty as to their ability to restructure their labour force in response to changed future market conditions or technological change; employers estimate that at least 10 per cent of the current private-sector workforce continues to be employed because TEWA makes it impossible or too expensive to retrench them;
- (b) Uncertainty when planning their investments, as to the true cost of labour (a significant operating cost in most sectors), because restructuring and exit costs are unknown and may be very high. Moreover, there are usually substantial delays in obtaining the necessary government decisions (UNCTAD, 2004).

⁵ While EPF provides an extremely rich database on the firm-level number of workers – all registered firms are required to pay contributions for their permanent workers – the data is not free of problems. Above all, firms report only workers for whom EPF contributions are paid. If, for whatever reason, such contributions are not paid, the true number of workers of the firm deviates from the number reported to the EPF – the deviation which figures prominently, particularly when computing growth rates. To improve reliability of the data, in the analysis of the growth of firms we therefore excluded firms with less than 10 workers (either in current or previous year), as well as firms with growth rates in the current year (positive or negative) exceeding 20 per cent, as such large changes almost certainly reflected reporting inaccuracies (and firms going out of business not being of particular interest for the current analysis).

Figure 2.2. Number of firms contributing to EPF by size, 2000–03



Source: Vodopivec and Ranaraja (2006); computation based on EPF data, 1995–2003 (based on the panel of firms consisting of 34,655 firms in 1995 and 50,748 firms in 2003).

The EPF data indicates that each distribution of firms in 2000–03 has “a kink” at size 14. While the number of firms falls monotonically with the size of the firm for firms larger than 10, there is an irregularity at size 14, with the number of firms of this size being about the same as the number of firms of size 13, followed again with a reduced number of firms of size 15. In other words, firm size of 15 is found to be particularly “unstable” compared with firm size of 14 which shows better stability.

It is therefore likely that MSEs that employ less than 15 workers opt to remain below that threshold in order to avoid coverage under TEWA. However, since the larger part of MSEs operate in the informal sector and are unlikely even to pay EPF and ETF, caution must be exercised in extending the findings of the above analysis to MSEs in the informal sector. Due to the ease of avoidance, it is possible that even TEWA is not a constraint to growth of informal sector MSEs.

2.1.5 Cost of compliance with TEWA

2.1.5a Cost of compensation

Compliance with TEWA has become increasingly more costly, and the incentive to employers to remain below the 15-worker threshold has never been stronger. In March 2005, the CGL published a new formula which would form the basis for compensation awarded under TEWA (table 2.4).

Table 2.4. Formula for payment of compensation (2005)

No. of years' service concluded at the date of termination	No. of months' salary to be paid as compensation for each year of service	Maximum compensation (cumulative)
1–5	2.5	12.5
6–14	2.0	30.5
15–19	1.5	38.0
20–24	1.0	43.0
25–35	0.5	48.0

Source: Gazette Extraordinary No.1384/07 of 15 March 2005.

The compensation payable was subject to the following conditions:

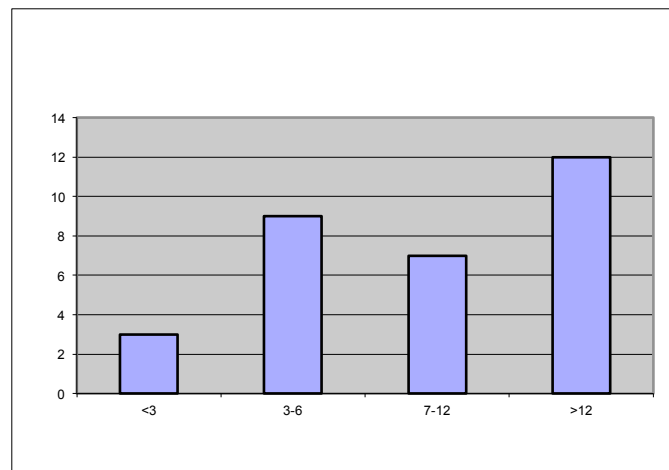
- (1) If at the time of the termination of his services a workman has less than four years left of his services, he shall be paid either the aggregate salary for the period of denied service or compensation computed according to the above formula, whichever is less.
- (2) The maximum amount payable as compensation is limited to LKR1,250,000. Under this system, a worker with two years' salary would be entitled to five months' salary, while a worker with 25 years of service would be entitled to 43.5 months' salary as compensation. Compensation payable under the formula is in addition to other benefits available to a worker on termination such as gratuity and ETF. Such a financial burden is very often beyond the capacity of an MSE, and would provide a strong incentive for an MSE to limit expansion in order to benefit from the exclusion available under TEWA.

2.1.6 Cost of litigation where TEWA is applicable

The TEWA system is costly to both employers and workers, and it generates different costs at several points of the procedure. Direct costs arise from fees to lawyers or legal representatives and may be considerable depending on the number of workers and the duration of the proceedings. Although parties in a TEWA hearing need not be represented by an attorney-at-law, most employers retain legal counsel and workers may be represented by legal counsel, a trade union or any other person, who are usually practitioners in law (as it is not imperative that a representative before the TEWA unit should have a legal qualification). A trade union representing workers would generally bear the legal costs of TEWA proceedings, but if a worker is not so represented s/he would have to bear the legal costs personally. Even where the CGL awards compensation to the workman, the commissioner is not authorized to order the employer to pay the costs of litigation, and the worker must bear such expense.

There is uncertainty as to the legal cost of litigation, as the legal fees payable for litigation are not specified in Sri Lanka, and lawyers/legal representatives' charge for their services at their discretion. As there is no practice of billing by time utilized, some lawyers may charge for each appearance at a hearing and for all written submissions, opinions and consultations, while others may charge a single fee for the entire proceedings. Generally, the fees charged by an attorney-at-law would be higher than the fees of an informal practitioner, and the fees would also vary based on the experience of the lawyer or representative, but this is not regulated in any way.

Figure 2.2. Number of TEWA cases by duration of application processing time, 2003 (in months)



The other costs of the system arise from the lengthy hearings as inquiries made by the employer to terminate the services of an employee or employees are seldom concluded in the two months. On average, each hearing may last between one and two hours, and an application may require about ten to 12 such hearings. In addition, the employer must grant paid leave to any worker who has to be present at an inquiry into a pre-termination application made by the employer. The representative of the employer will also have to be present at consultations that may be required by the legal counsel prior to hearings which may take up a considerable amount of time.

These features of the TEWA system combine to create a cost structure that would be well-nigh impossible for an MSE to sustain. For instance, an MSE with more than 15 workers would have to apply to the CGL to terminate the services of a single worker for a reason such as medical incapacity due to a non-work related illness; the in-built costs of the system and the uncertainty as to the amount of compensation that would be ordered by the CGL would mean that it is not viable for the MSE to make or maintain such an application, and that it is more than likely that some avoidance strategy or some negotiation between parties would be resorted to as an alternative.

A long-term cost of TEWA proceedings may also damage the relationship between the parties. Due to the adversarial nature of the proceedings, the breakdown of the understanding or goodwill between the workers/trade union and the MSE may be

harmful to both parties in other areas where cooperation is essential, such as in improving productivity or worker safety.

2.1.7 Costs of post-termination litigation

Where an employer terminates the services of a worker in breach of TEWA, a worker must make an application for relief to the CGL. Although the CGL can order that the workers be reinstated with wages for the period of unemployment, the worker must bear the cost of legal representation. However, as the worker does not receive wages while the inquiry is pending (unlike in an application made by the employer for termination), the worker may be unable to sustain the litigation as s/he would be unable to pay legal fees. The employer, similarly, would have to retain legal counsel in order to establish, with evidence, on a balance of probability, that the termination is justified in order to avoid compensation or reinstatement of the employee. Such a standard of evidence is also difficult to establish as an MSE probably may not have sufficient record-keeping or documentation to provide acceptable evidence by the very nature of its business, and so may find that the termination is determined to be unjustified. It may, therefore, be likely that TEWA is especially prohibitive to the growth of MSEs over the threshold of 15 workers due to the compliance cost involved.

2.1.8 Cost of compliance with other litigation

Cost of litigation in Labour Tribunals under the IDA: Much of the costs associated with Labour Tribunal litigation is caused by the time taken to dispose of applications. Although there are now about 40 Labour Tribunals in operation throughout the island, the number of applications outstanding has remained almost constant, as indicated by data in table 2.5.

Table 2.5. Applications pending before Labour Tribunals

Year	Brought forward	New applications	Disposals
1999	15 200	6 800	6 700
2000	15 300	6 800	6 800
2001	15 300	7 800	6 700
2002	15 899	3 900	5 500
2003 (Jan-Aug)	15 435	4 820	4 260

Source: www.justiceministry.gov.lk.

Applications filed by a workman or a trade union on behalf of a workman against a termination make up almost the entirety of the caseload before the Labour Tribunals. The procedure to be followed in inquiring into applications can be determined by each Labour Tribunal, and there is no uniform or specified procedure. However, the general procedure is a lengthy one, due to the following reasons: (a) the cases being refixed for

inquiry with a time lapse of about three months; (b) the practice of legal representatives requesting baseless postponements and the inability of the Labour Tribunal presidents to refuse the same; (c) the large number of partly heard cases in the system; and (d) lack of resources to improve recording of proceedings, administration and documentation. A case would typically be fixed for inquiry once every two to three months; each hearing may last from between one to three hours, including time spent while other (older) cases are disposed of. After the conclusion of evidence, the parties would be given three to four months to file written submissions, together with all documentary evidence produced at the hearing. The preparation of such submissions would typically require eight to ten work hours.

As in TEWA cases, legal representatives in the Labour Tribunal are unlikely to charge by the hour, and would either charge for each hearing or for the entire matter. There would be additional charges for preparation of written submissions, and for consultations with witnesses to prepare for hearings. Lawyers and legal counsel would typically charge more than an informal legal representative, with charges also varying with the seniority of the representative.

These costs would make it prohibitive for both employer and worker in an MSE should such a worker make an application to a Labour Tribunal. There is also a provision for two levels of appeal from the decision of a Labour Tribunal, and if resorted to, this may add heavily to the monetary cost of the litigation and double the time taken to conclude proceedings. MSEs may adopt avoidance strategies such as maintaining informality in the status of the employee by not providing letters of contract, in order to create the impression in the mind of the employee that her/his services can be terminated at will, or that s/he has no recourse in the event of termination as there is no document to establish employment.

Cost of compliance under EPF/ETF legislation: The EPF is the sole social security provision for workers in the private sector and covers all those in employment regardless of the sector or level of employment. An MSE is, therefore, required to contribute on a monthly basis an amount equal to 12 per cent of the basic salary of each workman to the EPF (the employee contributes an amount equal to eight per cent of the monthly salary, which is deducted and forwarded by the employer at the same time). In addition, the employer must contribute an amount equivalent to three per cent of the monthly basic salary to the ETF, which the employee is entitled to withdraw once in every five years upon ceasing to be employed for any reason. Thus, the cost of social security payment alone is 15 per cent of the monthly wage bill, which could amount to a significant payment for an MSE, and could affect its ability to compete profitably in the sector. To circumvent this situation many maintain low wages in order to offset the additional 12 per cent and three per cent required to be paid as social security costs, or may employ workers on an informal basis without documentation or records to establish employment in the event of inspection by the labour inspectorate. Both low wages and the undocumented nature of employment is likely to be a disincentive for better qualified and trained employees to join such MSEs and can cause low morale in employees who do join, which probably results in lower productivity.

Cost of compliance with other regulations: The law relating to maternity benefits requires the employer to provide maternity leave with pay to a female worker upon childbirth (which is 84 working days for first and second childbirths and 42 working days for any subsequent childbirths) and in MSEs this can make it necessary to employ a temporary worker to cover the work usually done by the worker on leave. The need to provide maternity leave also discourages the employment of women, but in rural areas where the available labour is largely female, provision of maternity leave creates a higher cost for MSEs.

Holiday and leave regulations under the Shop and Office Employees Act or the WBO requires employers to provide paid leave (both weekly and annual leave) as well as casual leave in the case of the Shop and Office Employees Act. In addition, there are up to eight public holidays and 12 Poya holidays annually, which are paid holidays to all employees. There may be up to two or three additional days where a paid holiday must be provided under the Shop and Office Employees Act due to a requirement that an additional day's leave should be granted where a public holiday falls on a weekly holiday (e.g. Saturday or Sunday). Where an employer requests an employee to work on such a public holiday, the employee is entitled to be paid at a premium rate for work on that day as well as an additional day off before the end of the year. This system of leave and holidays can both add to the cost of labour as well as reduce productivity due to less time worked.

The Factories Ordinance provides for requirements on space, lighting, ventilation, sanitation, etc., which are impractical given the limited space and resources available to most MSEs.

While the Payment of Gratuity Act also applies to workers in enterprises where more than 15 workers are employed, its provisions do not constitute an excessive regulatory burden as the payment is relatively moderate (two weeks' pay for every completed year of service). However, even a worker employed in an enterprise with less than 15 workers can apply to the Labour Tribunal for the payment of a gratuity and, therefore, every employee may become entitled to gratuity on completion of the threshold service period; this uncertainty creates difficulty in managing cash flow and maintaining accounts, as the MSE might proceed on the basis that it is not bound to pay gratuity, only to have gratuity imposed subsequently by a Labour Tribunal.

2.1.9 Avoidance strategies

Although the labour law regime in Sri Lanka is considered to be more rigid in comparison with many other countries *Doing Business in 2006*,⁶ many surveys examine

⁶ A joint survey of the World Bank and the International Finance Corporation, *Doing Business in 2006*, is one of a series of annual reports on the scope and manner of regulations that enhance business activity and those that constrain it. Comparing 145 countries, the report ranked them on starting a business, hiring and firing workers, enforcing contracts, getting credit, closing a business, registering property, and protecting investors. In general, poorer countries had a uniformly more regulated business environment than richer countries; Sri Lanka ranked as being particularly rigid on employment-related factors, and, in particular, on firing of workers due to the impact of TEWA.

legislation from the perspective of foreign investment. Existing enterprises, particularly MSEs, contrive to make labour laws less restrictive, due to several avoidance strategies. This is possible because MSEs in Sri Lanka, as in other countries, operate largely in the informal sector. The *World Employment Report 2004-05* finds that most SMEs (mainly micro-firms) in developing countries are operating in the informal economy and thus are not recorded in official data. Larger firms find it impossible to operate in the informal economy because of their visibility and size. The SME sector and the informal economy are thus closely linked (ILO, 2005). This low visibility, and lack of registration or inclusion in official data, makes avoidance of legislation possible.

In Sri Lanka, MSEs follow several strategies to avoid compliance with most labour laws, and TEWA in particular. These include the following: (a) not maintaining a record of employment, such as letters of appointment; (b) concealing the employment relationship; (c) employing workers on non-formal, temporary arrangements; (d) ensuring that the firm has less than fifteen workers; and (e) maintaining a low basic wage rate.

No record of employment: MSEs, typically, do not issue formal letters of appointment or contracts of employment which prevent an employee from establishing the fact or period of employment. Moreover, the entire business may be operated on a “paper-less” basis, no invoices, no receipts and no registration. In the event of a dispute, for instance on the non-payment of EPF/ETF contributions, the employer can either deny that the worker was ever employed in the MSE, or dispute other details which would prevent the worker from proving entitlement to legal benefits.

Concealing the employment relationship: A more common method of side-stepping legislation is to employ workers as “casual” workers.⁷ Workers find it difficult to establish the employment relationship as they are not given letters of appointment or any other form of identification, and are usually not paid through the common payroll records. Where the worker wishes to make any employment-related complaint it is not possible to establish the employment relationship in order to benefit from legislative protection.

Subcontracting of specific functions is an increasingly common system of avoiding legislative coverage. This arrangement is particularly common in the apparel sector where employee strength is dictated by the work in hand, and a single order for a category of garments may move between the main factory and several subcontractors prior to being exported. Especially in the case of SMEs, the employer would have the advantage of not having to comply with legislative protection for additional workers who would be employed by the subcontractor. An employer could also create several MSEs of smaller sizes, instead of a continuous growth pattern of the primary enterprise.

⁷ The definition in Sri Lanka is of a person who is engaged in *work* of a casual nature, someone who is under no obligation to report for work and who is employed only if there is work to be offered. The classic example is that of a window cleaner employed periodically, or a gardener hired to do a specific job. In practice, the term is more commonly used to identify a category of workers without the status of permanent employment, for instance, a group of workers being used in a factory to overcome high levels of absenteeism.

Closure of a business: Very often the least costly strategy of avoidance is the closure of the MSE. In larger establishments, closure very often amounts to a notice at the entrance to the premises that the establishment is no longer in operation, with entry refused to workers. As there is no access to any member of the senior management, with most managerial staff also being in the same position, very often the workers cannot proceed against the employer due to lack of information. Where an MSE closes down, even liquidation proceedings are unlikely to be followed, as the entire operation is likely to be on a very informal basis.

Maintaining a low basic wage rate: Many of the financial benefits of employment, (such as EPF/ETF, overtime payments, payment for work on holidays, gratuity, workmen's compensation payments, and compensation for loss of employment or severance pay), are based on the basic wage rate. Employers, therefore, often maintain an artificially low basic wage, or pay the minimum stipulated wage despite a high industry wage, and provide additional remuneration as allowances, reimbursements, incentives, and bonuses. The employee would very often be unaware of the composition of their remuneration as they do not receive any payslips or records. Therefore, even where an employer complies with legislated payments, the amount paid would be lower than the actual entitlement based on the gross wage, of which the employee would be unaware or unable to take any type of action.

Therefore, in general practice, avoidance of labour legislation is a relatively risk-free strategy for most employers, and especially for MSEs, which mainly operate in the informal sector. This is clear from records maintained by the EPF department, where compliance with legislation, that is mandatory in respect of all workers, is estimated to be as low as 50 per cent.

2.1.10 The implementation levels of labour policy areas (LPAs)

Table 2.6 sets out the implementation levels for different labour standards and labour policy areas (LPAs). It is to be noted that implementation through enforcement of existing laws and regulations is primarily in the formal sector, as enforcement is inefficient in the informal sector. Applicability of these standards is uniform across the sectors examined in this study for the most part, while implementation differs based on the formal or informal nature of activity in each sector.

Table 2.6. Implementation levels of LPAs in Sri Lanka

Labour Policy Areas	Implementation level				
	1 Not implem ented	2	3 Somew hat implem ented	4	5 Fully implem ented
Collective bargaining and freedom of association				✓	
Anti-discrimination/equal employment opportunity					✓
Prohibitions on forced labour/child labour					✓
Minimum wage			✓		
Overtime/working time limits			✓		
Paid time off			✓		
Social security (retirement, disability, death sickness and health benefits)			✓		
Unemployment insurance	✓				
Workers' compensation				✓	
Protection against unjust dismissal					✓
Occupational health and safety standards			✓		
Advance notice and consultation (for large-scale lay-offs) placement after dismissal				✓	
Parental/family leave			✓		
Employee consultation			✓		
Protection of rights and entitlements on transfer of undertaking			✓		

Source: Based on own judgement and some discussion with both employers and workers in MSEs.

Collective bargaining and freedom of association: The relevant legislation applies across all selected sectors, but implementation is patchy, for instance, in the agriculture

sector. There are pockets of evasion/non-compliance in some enterprises located within export processing zones due to restrictions on access to unauthorized persons, but this does not directly impact the MSE sector. There have also been complaints of non-enforcement by the CGL by both employers and trade unions: that trade unions are not penalized for acting in breach of registered collective agreements (by the former), and that employers are not penalized for resorting to unfair labour practices and non-recognition of trade unions (by the latter). However, in general, freedom of association is widely recognized and implemented, while collective agreements are less widely in use.

Anti-discrimination/equal employment opportunity: Discrimination in employment is not common in any of these sectors, unless due to social norms or cultural reasons. For instance, despite the demand for skills in masonry, plumbing or electrical wiring, very few women either opt to follow courses in these fields, and even if they do, find it difficult to obtain work in occupations which are traditionally considered as being a male prerogative. However, there is very little opportunity for direct implementation as anti-discrimination litigation is minimal.

Prohibitions on forced labour/child labour: Sri Lanka has one of the lowest incidences of child labour in the Asian region, and has very little, if any, forced labour of any sort. Enforcement is stringent, especially due to public awareness campaigns under the direction of the National Child Protection Authority, where high-profile prosecutions have added weight to legislation.

Minimum wage: Even in sectors where the minimum wage has been stipulated, it has been found that market forces ensure that wages are very much higher at all levels. The construction sector is an example, where wages in the informal construction sector were nearly double than those stipulated by the relevant Wages Board. Enforcement is, therefore, hardly necessary, but is carried out if a complaint is received.

Overtime/working time limits and paid time off: The applicable regulations are mostly followed in the breach due to the lack of awareness on the part of workers as well as the difficulty in accessing records relating to hours worked. Available data indicates that these regulations would be only partially implemented in the MSE sector.

Social security (retirement, disability, death, sickness, and health benefits): The EPF provisions are uniformly applicable to all private sector workers, whether formal or informal, but compliance is recognized to be about 50 per cent to 60 per cent of all employed. Many workers in the MSE sector also prefer employers to refrain from deducting compulsory EPF contributions from their wages, given the age limit of 55 years for males (and 50 years for females) to access benefits. Benefits on disability and death arising from employment exist in the form of workmen's compensation but are insufficiently utilized and implemented. Sickness and health benefits do not arise from employment due to the availability of universal free health care.

Unemployment insurance: Sri Lanka has no system of unemployment insurance in place at present.

2.2 Business regulations in Sri Lanka in the context of MSE growth

This section focuses on the non-labour regulatory framework and the impact of regulations on the general operations of MSEs. It seeks to draw certain generalizations with regard to the constraints experienced by MSEs in complying with the regulations. The analysis is based on following;

- a) It focuses on small and medium industries and seeks to determine in a general way factors which impede growth.
- b) It focuses on regulatory aspects within certain local authority areas and the time and ease of compliance as a basis of comparing local authorities.
- c) It focuses on a specific piece of legislation, e.g. business registration, and seeks to determine the degree of compliance and the reasons for non-compliance.

Based on the literature review, regulatory impediments and bottlenecks do not seem to exist amongst the more prominent factors listed by the MSE sector as being constraints to growth.

In the above context, the more relevant factor could be that there are specific regulations which have a major impact on specific industries. Furthermore, the ease and cost of compliance with such regulations could vary substantially between medium- and large-scale industries and MSEs, and the studies in the past have not focused on such aspects. See, for example, The Asia Foundation (2007), ILO (2007a), Ranasinghe (2002) and Rydberg (2007).

Based on the above, a study with a sectoral emphasis of particular regulatory aspects which have been identified to have a major impact on such a sector would be of use very specially if the study has also considered the size of the firm as an important variant.

The available studies on this subject have extensively analysed the non-labour regulatory environment and identified the key impediments that hinder the growth process of businesses in general; the focus of the studies is on small and medium-sized enterprises (SMEs) and MSEs. Some of these studies have to be extended to identify specifics in MSEs where impact is expected to be different or to affect the MSEs more seriously. In certain areas the same strategies could be employed for fact-finding and analysing the problems, while different strategies would be required for others. A comparison of impact and cost of transactions as against those of labour laws and the regulatory framework that affect the growth progress of MSEs have not been covered in these studies.

According to a survey that was carried out among MSEs to ascertain the reason for not registering businesses, 37 per cent reported that it is not necessary to register in order to run the business and a further 26 per cent was of the opinion that the business is too small to register. The other reasons were that they do not know how to register the business (8 per cent), that they prefer not to have contact with the authorities (7 per

cent) and that registering their business is both time-consuming and costly (5 per cent). Another important finding was that, of those surveyed, about 37 per cent of the entrepreneurs plan to register their businesses within 12 months, while about 53 per cent do not. The main reasons for considering registering of their business in the future was to expand the business and increase profits (25 per cent), to obtain loans (15 per cent), because it is required by law (4 per cent) (ILO/Enter Growth, 2007).

A study carried out to measure the local enabling environment for private enterprise in Sri Lanka indicates that the regulatory environment, compliance and costs with regard to businesses in the Western Province (most industrialized area of Sri Lanka including the business capital, Colombo) has an advantage over the rural business community. This advantage may be explained by the fact that the business community of the Western Province of Sri Lanka has ready access to a range of services offered by a variety of government institutions, whereas compliance becomes a hindrance in other provinces in Sri Lanka, due to the inadequacy of such services (The Asia Foundation, 2007). *Doing Business 2008* indicates that the introduction of the new Companies Act No. 7 of 2007 has significantly reduced the number of steps required to register an enterprise as a legal entity. However, after the approval of the registration, the introduction of mandatory publishing of details of the new company in the newspapers (in all three official languages) and introduction of the mandatory gazette notification are more costly and time-consuming for the entrepreneur (table 2.7).

Table 2.7. Comparison of registration under the Companies Act No. 17 of 1982 (Old Act) and the Companies Act No. 7 of 2007 (New Act)

Procedure	Cost (LKR) and time to complete	
	Old	New
Total minimum cost	LKR16 692.25	LKR23 293.44
Total minimum time	10 days	21 ays

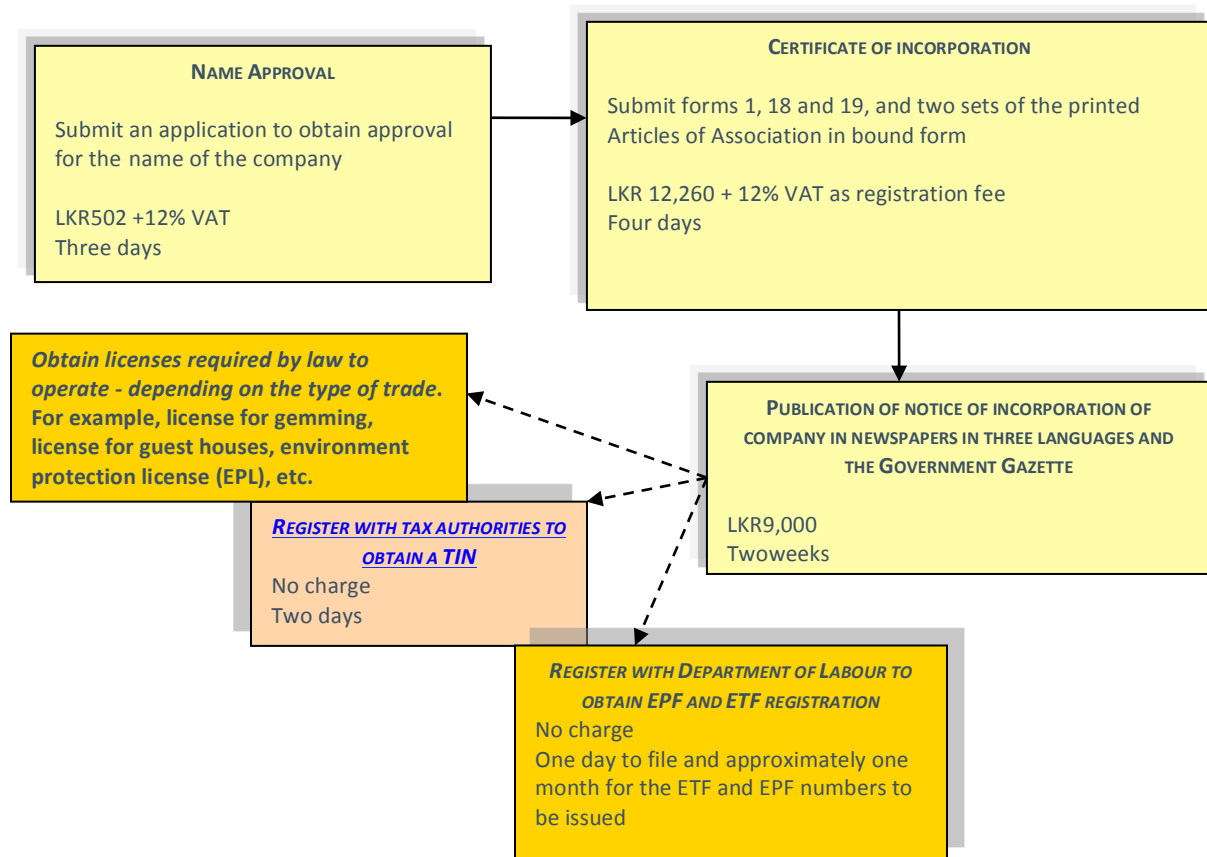
2.2.1 Business registration and licensing requirements in Sri Lanka

2.2.1a Business registration

Private limited liability Company: According to *Doing Business 2008*, Sri Lanka has made the most progress in South Asia. The new Companies Act No. 07 of 2007 eliminated burdensome approvals and introduced a flat registration fee. Company seals and notaries were made optional. Procedures were reduced from eight to five, and the time for start-up from 50 days to 39.

The procedure, time and costs involved for registering a business under the new Companies Act No. 07 of Sri Lanka are outlined in Figure 2.3

Figure 2.3. Registration procedure of a private limited liability company, time taken and costs involved



Proprietorships/partnerships: Sole proprietorships and partnerships can carry on business under a business name registered in terms of the provisions of the Business Names Ordinance. Registration is not, however, required in instances where the business name comprises the true full names without any addition of the individual (in the case of a sole proprietorship) or partners (in the case of a partnership). Registration is essential, as sole proprietorships or partnerships which do not register their business names will be unable to enforce any contract entered into in the name of that business unless they are able to satisfy the relevant court of law the reasons for such default.

In the case of partnerships, a further requirement is established by the Prevention of Frauds Ordinance, which requires the agreement for establishing a partnership to be in writing if the capital of the partnership exceeds LKR 1,000.

Procedure for registration of business name: Submission to the Registrar of the Province in which the business is situated, a statement in writing giving the particulars required in the prescribed application form, which includes, inter alia, the business

name; the general nature of the business; the principal place of business; full name, nationality and the usual residence of the individual/partners; and the date of commencement of business.

2.2.1b Licensing requirements

There are no general licensing requirements for a business other than the business registration requirements set out above. In most local authority areas there would also be a trade tax, depending on the activity which is being carried on. This sum in normal businesses ranges from LKR1,000 to LKR5,000 per annum. However, some industrial activities require licenses to operate. Appendix II sets out the legislative provisions for licensing requirements in Sri Lanka.

2.3 Non-labour regulatory laws affecting the MSE sector in Sri Lanka

The literature review conducted on non-labour regulatory laws and statutes revealed that non-labour regulatory laws affecting the MSE sector in Sri Lanka could be identified as follows:

2.3.1 Laws and statutes with threshold levels

1. The Inland Revenue Act No. 10 of 2006 and Amendment Act No. 10 of 2007

This regulates the payment of income tax. At present, an individual is liable only if his taxable income for the year is in excess of LKR300,000 per annum (micro). In the case of companies, there is a differentiation between companies which have taxable income less than LKR5,000,000 (small), which is liable to be taxed at the rate of 15 per cent, and other companies which are liable to be taxed at 35 per cent (medium to large). The construction and tourism industry are also liable to be taxed at the concessionary rate of 15 per cent.

2. Value Added Tax Act No 14 of 2002 and Amendment Acts No. 7 of 2003, No. 13 of 2004, No. 6 of 2005, No. 8 of 2006 and No. 14 of 2007

There is no liability to register for Value added tax (VAT) unless the turnover of the business does not exceed LKR1,800,000 per annum – or LKR5,000,000 per quarter. The VAT threshold of LKR1,800,000 is likely to be applicable only at small-scale enterprise level.

3. Economic Service Charge Act No. 13 of 2006 and Amendment Act No. 15 of 2007

This Act imposes an economic service charge (ESC) at rates which range from 0.25 per cent to 1.0 per cent of the turnover of a business. The ESC is deductible from any income tax payable. The ESC threshold is LKR 30,000,000 per annum and such a threshold is only likely to be achieved by a medium-scale enterprise.

4. The Board of Investment Law No. 4 of 1978

This law provides for the granting of certain Board of Investment (BOI) concessions for export-oriented industries with a minimum investment of USD250,000. The minimum investment of USD250,000 would make the enterprise something beyond a medium-scale enterprise.

5. National Environmental Authority Act No. 47 of 1980

This Act regulates the emission of waste and requires an Environmental Impact Assessment (EIA) or an Initial Environment Examination (IEE) to be carried out by certain business activities which includes tanneries, saw mills with a milling capacity in excess of 50 cubic metre and guesthouses with 20 or more rooms, which are considered small to medium-scale enterprises.

6. The Municipal Councils Ordinance/Urban Councils Ordinance/Pradeshiya Sabha Act

These local authority enactments require approval for carrying out certain industrial and trading activities within the local authority area and also require the payment of trade taxes. The amounts would differ from area to area and depend on the trade or activity being carried on.

2.3.2 Laws and statutes with no threshold levels

1. Antiquities Ordinance No. 9 of 1940 and Amendment Act No. 24 of 1998

The regulations under these Acts require that any person who is involved in the clearing of any land in excess of one hectare furnish an Archaeological Impact Assessment (AIA).

2. Coast Conservation Act No. 57 of 1981 and Amendment Act No. 64 of 1988

Any person who is involved in any development activity within 300 metres of the mean high-water line is required to obtain a permit from the Director of Coast Conservation.

3. Fauna and Flora Protection Ordinance No. 2 of 1937

No person shall, within one kilometre of a natural reserve, carry out any development activity except under the authority of a license issued under the Ordinance. The Ordinance also provides for restrictions on the removal of sand for construction purposes in certain specified areas except under the authority of a license. There is no threshold.

4. Forest Ordinance No. 16 of 1907 and Amendment Acts No. 84 of 1998 and No. 23 of 1995

This provides for restrictions on the cutting and transporting of timber and the establishment of saw mills and conversion of timber within specified areas. It also provides that no timber could be exported except under the authority of a license issued by the Conservator of Forests. There is no threshold.

5. Mines and Minerals Act No. 33 of 1992

Any exploration, mining, processing, trade, transport, and export of minerals could only be carried out under the authority of a license issued by the Geological Survey and Mines Bureau.

6. National Gem and Jewellery Authority Act No. 50 of 1993

This regulates the mining, processing and selling of gems, which can only be carried on under the authority of a license issued by the National Gem and Jewellery Authority. All premises where the trade is been carried out need to be registered with the authority. There is no threshold.

7. Tourist Development Act No. 14 of 1968 and Amendment Acts No. 2 of 1987 and No. 33 of 1991

This provides for the licensing and grading of tourist guesthouses, tourist restaurants, tourist shops and tourist recreational and entertainment sectors. There is no threshold.

8. Companies Act No. 7 of 2007

This provides for the establishment and regulation of companies. There is no threshold.

9. Business Names Act No. 7 of 1987

This requires every sole trader and partnership to seek registration. There is no threshold.

The cost and time estimates for compliance by the identified sectors with respect to some of the laws mentioned above would necessarily depend on the nature and scale of activity which is proposed to be carried out. Based on initial assessment, our estimation of cost and time is given in table 2.8.

Table 2.8. Cost and time taken for compliance in selected sectors

	Cost low	Cost high
Time high	Forest Ordinance No. 16 Mines and Minerals Act No. 33 The Municipal Councils Ordinance/Urban Councils Ordinance/Pradeshiya Sabha Act	National Environmental Authority Act No. 47 Coast Conservation Act No. 57
Time low	Antiquities Ordinance No. 9 Fauna and Flora Protection Ordinance No. 2 Business Names Act No. 7	National Gem and Jewellery Authority Act No. 50 Tourist Development Act No. 14 Companies Act No. 7

The Board of Investment Law No. 4 of 1978 contains certain thresholds which are based on quantum of investment and, in some exceptional situations, the number of employees. However, these thresholds begin at approximately 100 workers and, therefore, are not applicable to MSEs.

The *Economic Governance Index Report of 2007* (The Asia Foundation, 2007) has measured the general impact of local authority registration, permits and licenses for selected local authority areas. It has noted that the Western Province performs relatively better than other areas in this regard. It has not studied the impact of such regulations in relation to specific industries.

The cost of compliance with the laws and regulations set out above in relation to the specific industries would need further study. The study would also identify any avoidance strategies which are adopted by enterprises in this regard.

The legislative provisions applicable to the sectors selected and their potential to create a growth trap is set out in Appendix III.

2.4 Incentive schemes in Sri Lanka in the context of MSE growth

Traditionally, incentive schemes and subsidies have been a common practice in Sri Lanka's economy. Most common subsidy schemes were for agricultural inputs such as seed (planting) material and fertilizer. During one period, even petroleum was subsidized to enhance economic development. Currently this situation has changed and the degree of subsidization has greatly reduced. However, in order to identify the potential of the MSE sector in Sri Lanka's economic development, the Sri Lankan government has introduced incentive schemes through tax and other benefits which vary between industries. Appendix IV provides a list of some of the incentive schemes operational in Sri Lanka.

2.5 MSE statistics in Sri Lanka and the interpretation of the growth trap potential

This section analyses a new data set that enables the identification of informal *employment and the impact of the size class of firms on earnings and the probability of employment in formal and informal enterprises*. (Detailed methodology analysis is given in Appendix VI.)

A latest set of available statistical data was analysed to examine the impact of TEWA - in some of its hitherto unexplored manifestations, the theoretical reasoning of which we set out above. In particular, this analysis draws on the findings of a study on informal employment undertaken for ILO Colombo by the same author on the extent of informal employment in Sri Lanka (Gunatilaka, 2008). This study also looks for evidence of clustering of employees in firms with employment levels below the size threshold of 15 employees and investigates the extent and probability of informalization of employment in formal and informal sector enterprises in different size classes of firms. Finally, this study follows Heltberg and Vodopivec (2004) and investigates possible wage premia between workers in formal and informal employment and the impact of firm size on earnings in both types of enterprises.

The analysis draws data from the Quarterly Labour Force Survey (QLFS) of 2006, conducted by the Department of Census and Statistics (DCS), Sri Lanka. QLFS 2006 does not include data from the Northern and Eastern Provinces as the conflict situation precluded data collection in these areas. Hence the present analysis relates only to the seven provinces outside the Northern and Eastern Provinces. This population accounts for about 85 per cent of Sri Lanka's population of roughly 19 million people. The total sample of 22,000 households of QLFS 2006 was selected using a two-step stratified sampling procedure. The full sample was distributed into 12 months, covering January to December 2006. Details of the survey can be found in the *Annual Report of the Sri Lanka Labour Force Survey 2007* (see DCS, 2007).

While the survey includes information on demographic characteristics, education, occupation, and industry for all employed persons, information on size of production unit, earnings and hours of work is available only for employees in the private sector. Therefore, the data analysis to follow distinguishes between the full sample of employed persons and the sample of employees. The spatial information available in the survey is related to the sector or administrative district of residence and not of employment. Therefore, we cannot draw inferences about jobs and earnings in relation to the geographic area in which both are generated, but only in relation to the area in which workers live.

The definition for employment used is the standard one used by DCS. Accordingly, a person is considered employed if he or she has worked as a paid employee, employer, own account worker or unpaid family worker in the week preceding the week of the survey. The definition includes those with a job but not at work during the previous week.

According to this definition, a total of 27,747 individuals in the sample were found to be employed. However, only 23,424 individuals of this sample could be identified as being engaged in formal or informal employment using the criteria to be discussed in the following subsection. The nature of employment in terms of formal or informal for the remainder could not be identified as the necessary information was missing for these observations. Of this number amounting to 16 per cent of the entire sample, the large majority – some 4,228 individuals - were employees. Rather than drop the missing observations of employees which would have skewed the representativeness of the sample, we imputed values for them using Royston's (2004) user-written Stata ado programme, ICE, or Imputation by Chained Equations. This left us with a total sample of 27,724 observations of employed persons of whom 15,483 were employees.

In addition to descriptive statistics about the extent of informal employment and evidence of clustering of employees below the 15-employee size threshold, we deploy regression analyses to look at two specific issues: (a) the role of firm size in determining the probability of informal employment; and (b) the impact of informal employment and firm size in determining wages.

2.6 Overview of findings

The extent of informal employment in Sri Lanka, the evidence of clustering of enterprises below the TEWA-related size threshold, and the impact of firm size on the probability of employment and the determinants of wages were analysed.

The analysis found informality to be the predominant characteristic of employment in Sri Lanka. Even three decades after economic liberalization, informal employment accounts for a little more than two-thirds of total employment, and formal employment, excluding public sector employment, accounts for a little less than a fifth of total employment. The predominance of informality raises serious questions about the quality of Sri Lanka's structural transformation and points to very low formal job creation rates. Thus, the findings of this study are in line with Vodopivec and Ranaraja's (2006) finding that formal job creation and job destruction rates are abnormally low in Sri Lanka. The study also found evidence of informalization of employment in formal enterprises, with smaller firms more likely than larger firms to have informal work arrangements, probably because they are less likely to have unions and could count on being more invisible to the law enforcement authorities. This again points to serious impediments to formal job creation, with evidence of informalization in formal firms, in particular, hinting that job security regulations may be a factor.

Job security regulations can dampen formal job creation rates in two ways. Either through an enterprise growth trap at the threshold size where the legislation kicks in, or by dampening job creation rates even beyond the growth trap through very high compensation formulae for lay-off. In this study we looked for evidence of the size threshold of 15 employees acting as a formal job growth trap and failed to find any. We found informal employment bunching at the micro-enterprise level which accounted for roughly a third of all employment, and we did not find any evidence that employees in firms with less than 15 employees were more likely to be informally employed. Here, again, the job growth trap, if any, was at the micro-enterprise level with employees in such organizations significantly more likely than employees of any other size class to be informally employed.

However, our failure to find a growth trap at the size threshold of 15 employees could also be due to the imprecise variable we used – firm size 10–15 workers- the only one allowed by the data. Besides, neither our data nor our methodology is suited to an analysis of growth, which is about dynamics that are hard to capture with cross-section data. Thus, we were unable to add much to the findings of Vodopivec and Ranaraja (2006) and Abidoye, Orazem and Vodopivec (2007) on the existence of a TEWA-induced growth trap at the size 15 threshold.

Substantial and significant wage premium for formal employees was identified in the analysis. However, we could not find a significant wage premium for employees in firms above the TEWA threshold, even when informality was dropped as an explanatory variable. The only significant result to emerge from the wage analysis is that employees in micro-enterprises earn, on average, more than employees in all other size classes and this result is driven almost entirely by the earnings of employees in informal micro-enterprises. Here, again, we could not find any evidence of a TEWA-induced wage

premium. This is in contrast to Heltberg and Vodopivec (2004) who found a TEWA-related wage premium of around 12 per cent.

While the 15-employee size threshold may be working as a growth trap for firms, any impact the regulations may have for the setting up or expansion of firms already above this threshold will depend on the effect of the high compensation formulae for retrenchment. In fact, the 15-employee growth trap would be relevant largely for small domestic enterprises looking to expand. In contrast, the 15-employee size threshold is likely to be irrelevant for the growth of firms already larger than the critical threshold or for firms looking to set up with an initial workforce larger than 15 employees. Thus, for the majority of foreign investors who are encouraged by BOI incentives to begin operations on a large scale, it is how punitive the compensation formula is likely to be, rather than the coverage threshold of the legislation that must be the critical factor. Unfortunately, we are unable to throw any light on this aspect of job security regulations given the limitations of our data, but the embarrassing predominance of informal employment that the present study reveals leaves open the possibility that the compensation formula of TEWA, in addition to the requirement that approval be obtained for retrenchment, may be dampening formal job growth. However, at this level of the macroeconomy, factors such as the availability of infrastructure, the conflict, and the law and order situation must also be taking their toll.

2.7 Major hypotheses of the study

We have derived the following hypotheses from the foregoing synthesis and analysis of the Sri Lankan scenario on labour and non-labour regulations and business environment for MSEs. The hypotheses derive from the possible impact of labour laws and other factors on the growth of MSEs. The impact of labour and other regulations depends not only on the coverage of the laws – that is the size threshold at which they apply – but also on their monitoring and enforcement. The size of the enterprise has a bearing on both these factors: size in terms of coverage and size in terms of greater visibility and hence vulnerability to monitoring and enforcement. Hence, possible growth-inhibiting effects of the laws can be expected to produce distorting effects which can be tested as hypotheses as follows:

- (1) The 15-worker size threshold at which a firm comes under the coverage of TEWA and the Payment of Gratuities Act will act as a growth trap and both formal and non-formal MSEs will tend to bunch below the threshold of 15 workers in order to evade coming under the law.
- (2) Employment expansion in formal enterprises beyond the 15-worker size threshold will take the form of informal work arrangements and temporary and casual workers.
- (3) Horizontal expansion of industries to avoid compliance with labour laws.
- (4) Labour laws (such as EPF, gratuity, minimum wages) and non-labour regulations (for example, the Forestry Ordinance No. 16 of 1970 and the National

Environmental Authority Act No. 47 of 1980, taxes, etc.) can also constrain the growth of certain industries.

- (5) Lack of infrastructure such as electricity and transport, credit facilities, the impact of the law and order situation on business confidence, lack of skilled labour and competition from imports can also inhibit the growth of MSEs.

CHAPTER 3: The MSE survey

The purpose of the survey is to test the hypothesis given in the previous chapter that because different pieces of national (and possibly regional) legislation apply to different sizes of enterprises with particular thresholds this could create a growth trap. Thus, there is a possibility that a *growth trap* exists in which enterprises seek to avoid labour legislation by (officially) staying small. Micro- and small enterprises (MSEs) or establishments are defined as business units involved in the production of a specific type of product or service. MSEs have been classified into two categories according to the number of employees: category one of micro-enterprises – Worker Group one (enterprises with 5–14 employees), and category two of Small Enterprises – Worker Group two (enterprises with 15–70 employees). All enterprises with one or more employees are required to contribute to the employees’ provident fund (EPF) and employees’ trust fund (ETF), while enterprises with 15 or more employees are required to pay gratuity and retrenchment payments. The labour law pertaining to gratuity and retrenchment is the only one that may have an impact on business expansion and therefore the categorization has been done accordingly, in order to capture this impact through the survey.

The hypothesis was researched primarily through a sample survey of MSEs to test the hypotheses developed under Study one in Sri Lanka. The study focused on determining the actual costs of doing business in terms of both labour laws and other non-labour related laws. The study also identified non-legal and non-regulatory factors that have had a significant impact on constraining the growth of MSEs, employment expansion and the promotion of decent work. The scope and coverage of the survey included, among others, the following: business characteristics; the workforce and its trend; business registration and its cost; employment records and inspections; contracts, wages and hours; social security and workers’ compensation; termination procedures and benefits; maternity benefits; payment of bonus acts; unionization; business growth and regulation; incentive schemes; barriers to business growth; and the effect of labour and other regulations.

3.1 Survey methodology

Four sectors, comprising 70 per cent of the total number of MSEs in the country, about 142,000 enterprises (2007 census data), were selected for the survey, which was conducted in three out of the 25 districts in the country. These four sectors were selected on the basis of their importance in contributing to value added, employment creation and spatial distribution. The “sector” definition adopted in the study is based on the ISIC Revision 4 classification and the four sectors selected are:

- **Agro processing** (Manufacture of Food Products ISIC-10, Beverages ISIC-11, and Tobacco Products ISIC-12)
- **Woodworking** (ISIC Manufacture of Wood and of Products of Wood and Cork except Furniture ISIC-16, Manufacture of Articles of Straw and Plaiting Materials ISIC-17 and Manufacture of Furniture ISIC-31)

- **Textiles and Garments** (Manufacture of Textiles ISIC-13 and Manufacture of Wearing Apparel ISIC-14)
- **Hospitality** (Accommodation ISCI- 55 and Food and beverages service activities ISIC-56)

The number MSEs as a percentage of the total in the four sectors are as follows: agro processing (27 per cent), woodworking (18 per cent), textiles and garments (13 per cent), and hospitality (12 per cent). The number of MSEs in each of the sectors varies considerably in the different provinces, with the majority of over 50 per cent of the industries located in the five districts of the Western and North Western Provinces. Details of the distribution of MSEs in the selected sectors by the administrative hierarchy of districts, divisional secretariats (DS) and Grama Niladhari (GN) divisions are presented in Table 3.1. Each district is geographically demarcated into smaller DS divisions and each DS division further subdivided into a smaller GN division (as shown in Table 3.1). The highlighted districts were selected for the survey.

Table 3.1. Distribution of MSEs by districts, DS and GN divisions

District	No. of DS divisions	No. of GN divisions	Approx. no. of MSEs in four selected sectors
Kurunegala	30	1 610	13 000
Colombo	13	557	11 000
Gampaha	13	1 177	10 000
Kandy	20	1 188	6 500
Anuradhapura	22	694	4 500
Galle	18	895	4 500
Kalutara	14	762	4 500
Matara	16	650	4 000
Kegalle	11	573	4 000
Puttalam	16	548	3 900
Hambantota	12	572	3 500
Matale	11	545	3 400
Ampara	20	508	3 200
Ratnapura	17	575	3 200
Polonnaruwa	7	295	2 900
Badulla	15	567	2 400
Jaffna	14	435	2 400
Nuwara-Eliya	5	491	2 100
Batticaloa	14	348	2 000
Moneragala	11	319	2 000
Trincomalee	11	230	2 000
Vavunia	4	102	900
Mannar	5	153	700
Mullativu	5	127	600
Killinochchi	4	95	500
All districts	328	14 016	97 700

3.2 Sampling procedure

Sampling was undertaken in three stages. The first stage was the selection of the districts; the second stage was the selection of primary sampling units (PSUs); and the third stage, the selection of sample MSEs in the four sectors. Each selected PSU was stratified according to four activity sectors. This was followed by stratification of each sector according to worker groups. For the first stage of sampling, the Proportionate Probability Sampling (without replacement) method or PPS (WOR) method was utilized to select the districts using the total number of industries in all four sectors as the basis. A stratified random sampling procedure was utilized for selecting the samples. Initially, the population was stratified by district and three districts out of a total of 25 districts were selected. According to this method, each district will have proportional probability of being selected, with districts with larger numbers of industries having a higher probability of selection. Utilizing this methodology, the following three districts were selected for the survey: Kurunegala, Kalutara and Gampaha.

Each district is divided into administrative units, the DS divisions. The PSU for the second stage of selection was the DS division. It was proposed to select a total of 50 PSUs for the second stage of selection using the PPS (WOR) method from the three districts selected at the first stage. The three selected districts had a total of 57 DS divisions. It was proposed to have an equal number of PSUs in each of the selected districts or approximately 16–17 DS divisions per district for a total of 50 PSUs and 12 samples from each PSU to obtain a total of 600 samples for the survey. However, due to the small number of PSUs in two selected districts, Kalutara (14 PSUs) and Gampaha (13 PSUs), and on the advice of the consultant statistician of the ILO, all PSUs were selected from these two districts with below average number of PSUs and the balance PSUs made up from the district with a larger number of PSUs (Kurunegala). Utilizing this methodology, the following numbers of PSUs were identified from the three districts selected for the survey: Kurunegala (23 DS divisions), Gampaha (13 DS divisions) and Kalutara (14 DS divisions). Details are in given in table 3.2.

Table 3.2. Districts and PSUs selected for survey

District	Total no. of PSUs (DS divisions)	No. of PSUs selected for survey	Approx. total no. of enterprises in four selected sectors
Kurunegala	30	23	13 000
Kalutara	14	14	4 500
Gampaha	13	13	10 000
Total	57	50	27 500

The break-up of total and sample enterprises by the four selected sectors and the two worker groups is presented in table 3.3.

Table 3.3. Break-up of total and sample enterprises

Worker group	Sector 1- agro processing	Sector 2- textiles & garments	Sector 3- woodworking	Sector 4- hospitality	Total
Total number & percentage of enterprises					
Worker group 5–14 (no.)	958	1 148	824	683	3 613
Worker group 5–14 (%)	26.5	31.8	22.8	18.9	100
Worker group 15–70 (no.)	175	279	72	192	718
Worker group 15–70 (%)	24.4	38.9	10.0	26.7	100
Total no. of enterprises	1 133	1 427	896	875	4 331
Total no. of enterprises (%)	26.2	32.9	20.7	20.2	100
Total number & percentages of samples					
Worker group 5–14 (no.)	132	159	115	95	501
Worker group 5–14 (%)	26.3	31.7	23.0	19.0	100
Worker group 15–70 (no.)	24	39	10	26	99
Worker group 15–70 (%)	24.2	39.4	10.1	26.3	100.0
Total sample enterprises	156	198	125	121	600
Total sample enterprises (%)	26.0	33.0	20.8	20.2	100

Table 3.4 provides the sample categorized by district, sector and worker group.

Table 3.4. Sample number of enterprises, by district, sector and worker group

District	Sector 1- agro processing	Sector 2- textiles & garments	Sector 3- woodworking	Sector 4- hospitality	Worker group 5–14	Worker group 15–70	Total
Gampaha	83	79	55	70	233	54	287
Kalutara	18	33	29	27	86	21	107
Kurunegala	55	86	41	24	182	24	206
Total	156	198	125	121	501	99	600

CHAPTER 4: Survey findings

4.1 Location, parallel units and duration of operation of MSEs

4.1.1 Location

The micro- and small enterprises (MSEs) are located more or less equally between urban and rural areas. Kurunegala district had the highest percentage of urban enterprises (57 per cent), while Kalutara district had the highest percentage of MSEs in rural areas. The variations with respect to location of MSEs between districts were marginal, while variations between sectors were more pronounced, particularly with respect to the hospitality sector, where over 80 per cent of the MSEs were located in the rural sector (table 4.1). This is probably due to the fact that hospitality sector enterprises are more widespread with most enterprises located in rural areas due to intrinsic characteristics of the industry. The distribution of MSEs by worker group by urban or rural location does not vary much with MSEs in both worker groups spread more or less equally between these two locations.

Table 4.1. Location of MSEs by sector and by district (percentage)

District	Gampaha		Kalutara		Kurunegala		Total	
Sector	Rural %	Urban %	Rural %	Urban %	Rural %	Urban %	Rural %	Urban %
Agro processing	48.0	53.0	41.0	59.0	33.0	67.0	41.7	58.3
Textiles and garments	43.0	57.0	41.0	59.0	51.0	49.0	46.4	53.6
Woodworking	40.0	60.0	57.0	43.0	21.0	79.0	37.5	62.5
Hospitality	85.0	15.0	79.0	21.0	75.0	25.0	81.4	18.6
Total	53.6	46.4	54.5	45.5	43.3	56.7	50.2	49.8

4.1.2 Parallel units

About 95 per cent of the enterprises reported that they had no other similar businesses operating in any other location. About four per cent had one other business, while only about two per cent reported having two or more businesses. Ownership of MSEs is biased towards males who owned 83 per cent of the enterprises (table 4.2). In the case of male-headed enterprises, 94 per cent had no other similar businesses. In the case of female-headed businesses, 97 per cent had no other parallel businesses. The hypothesis that enterprises tend to expand laterally through establishment of similar enterprises to

avoid compliance with labour laws or business legislation cannot be strongly validated based on the above data.

Table 4.2. Ownership of other similar businesses

Businesses in other locations	Male		Female		Total	
	No.	%	No.	%	No.	%
No other businesses	453	94.4	93	96.9	546	94.8
One other business	18	3.8	3	3.1	21	3.6
Two other businesses	3	0.6	0	0	3	.5
Three or more other businesses	6	1.3	0	0	6	1.0
Total	480	100	96	100	576	100.0

However, an analysis of the 30 owners (5 per cent of MSEs), who had parallel units in the same or neighbouring district, showed that 22 businesses had smaller number of employees than the threshold size of 15 employees (table 4.3). These firms with parallel units formed five per cent of the total MSEs below the threshold level. There is a likelihood that they might have created parallel units as part of “*staying below the threshold level*” strategy.

Table 4.3. Percentage of MSEs in Sri Lanka with more than one parallel business unit, by business sector and worker group

Business sector/worker group	No. of MSEs managing more than one similar business in the same and/or neighbouring district	% of MSEs managing more than one similar business in the same and/or neighbouring district	Base (no. of MSEs)
Enterprise with 5–14 workers	22	5%	480
Enterprise with 15–70 workers	8	8%	96
Agro processing	12	8%	151

Textiles & garments	7	4%	192
Woodworking	2	2%	120
Hospitality	9	8%	113
All	30	5%	576

4.1.3 Number of employees and duration of operation of MSEs

An analysis of the distribution of MSEs by number of employees shows that 80 per cent of MSEs in the smaller worker group (< 15 employees) had less than ten employees; more than 30 per cent of MSEs in the larger worker group (15–70 employees) had between 15–19 employees, and 22 per cent of the enterprises in this group had between 20–24 employees. In each of the worker groups employing from 10 to 14 employees, the proportion of MSEs ranged from 3.2 per cent to 5.1 per cent, as shown in table 4.4. The 14 and 13 employee worker groups comprised only 3.4 per cent each of the total number of MSEs in Worker Group one (< 15 employees). While “bunching” of enterprises just below 15 employees was not evident from the data, when charted against the period of operation the data provides a better basis for analysis.

Table 4.4. Number of MSEs according to number of employees

Worker Group 1 (5–14 employees)			Worker Group 2 (15–70 employees)		
No. of employees	No. of MSEs	% of WG 1	No. of employees	No. of MSEs	% of WG 2
14	16	3.4	15–19	31	32.3
13	17	3.4	20–24	21	21.9
12	16	3.2	25–29	10	10.4
11	19	3.8	30–39	12	12.5
10	25	5.1	40–49	10	10.4
9	32	6.6	50–59	8	8.3
8	60	12.5	60–70	4	4.2
7	74	15.5			
6	100	21.0			
5	121	25.5			
Total	480	100		96	100

Over 70 per cent of the MSEs interviewed had been in operation for more than eight years. Thus a larger proportion of the more traditional MSEs, such as those in the agro processing, woodworking and hospitality sectors, have been in operation longer than the newly introduced garment and textile sector MSEs. A greater proportion (72 per cent) of MSEs in the smaller worker group (5–14 employees) have been in operation for more than eight years than the proportion (64 per cent) of MSEs in the larger worker group (15–70 employees).

Charts (figures 4.1 and 4.2) showing number of employees and the number of years of operation for the two worker groups of 5–14 and 15–70 employees, show that a large number of MSEs have been operating for up to 20 years just above and below the threshold of 15 workers. There is some bunching in the 5–9 worker groups and in the 15–20 groups, but not much bunching just below the threshold of 15 workers.

Figure 4.1. Number of employees v. years of operation of MSEs (worker group 5–14)

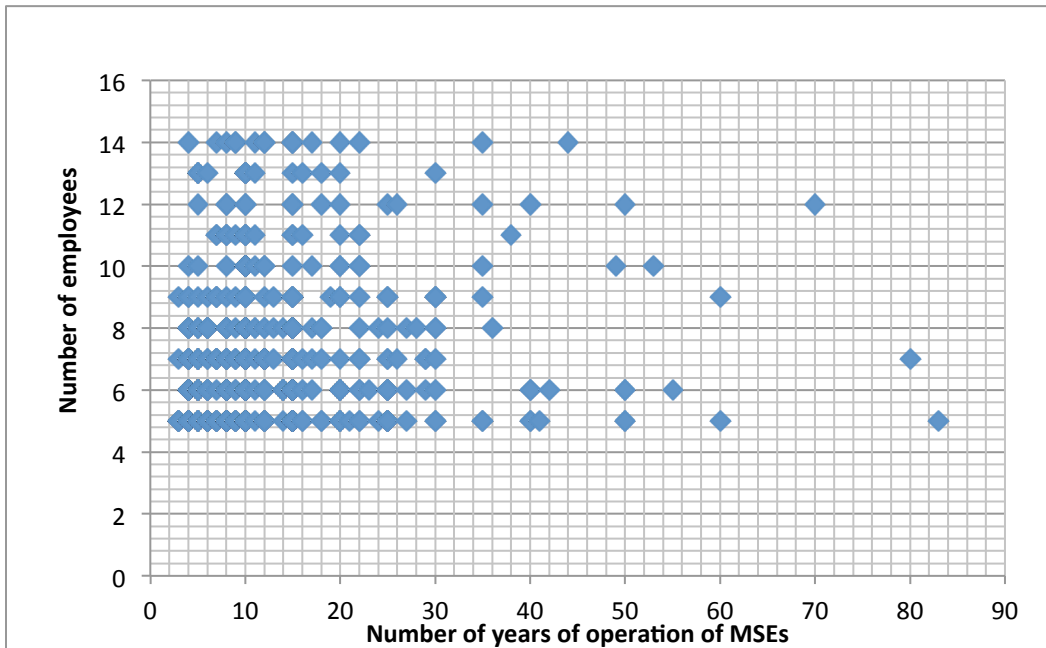
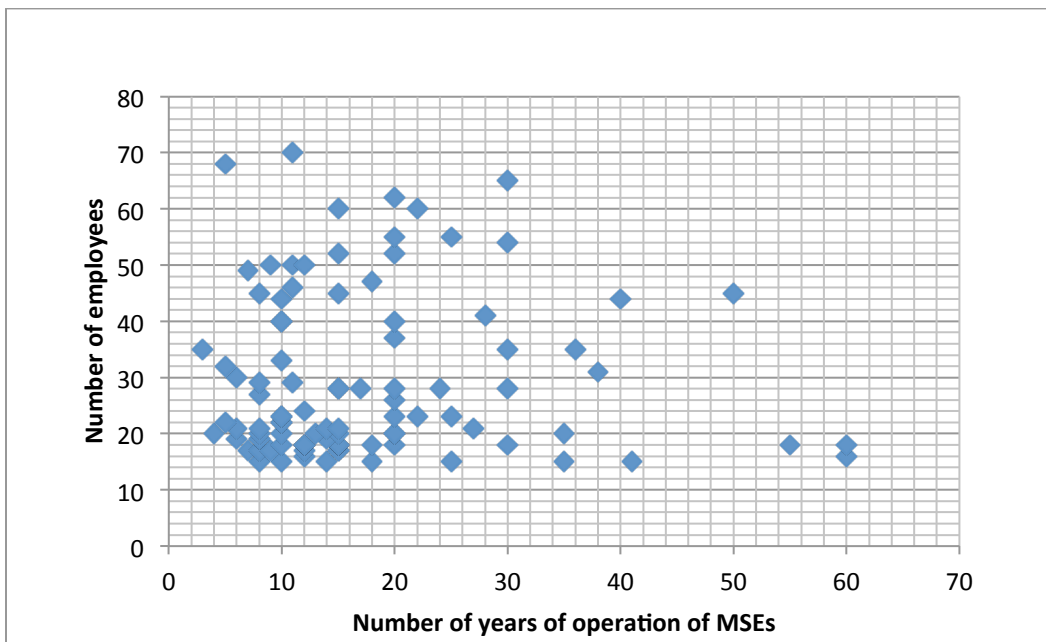


Figure 4.2. Number of employees v. years of operation of MSEs (worker group 15–70)

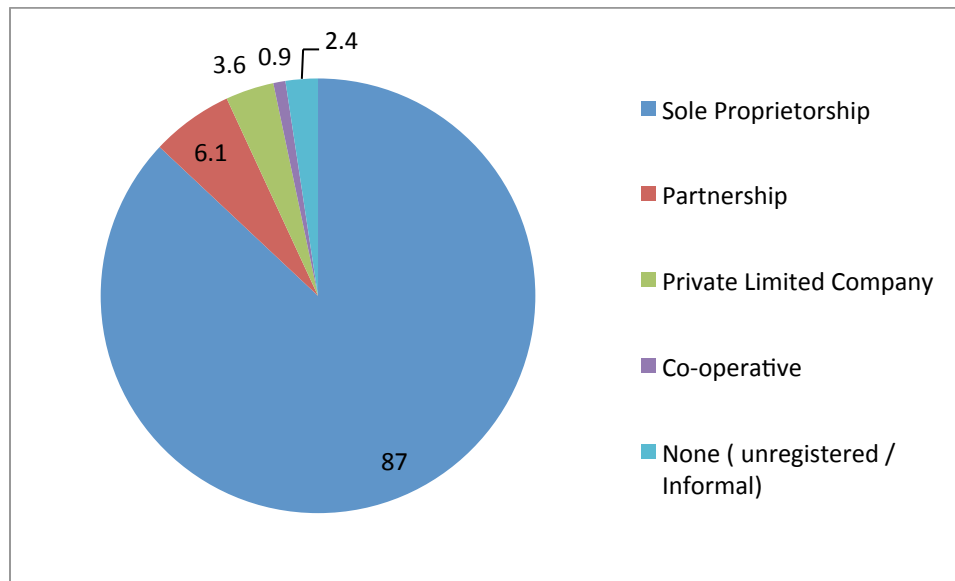


There is a possibility, therefore, that MSEs with smaller worker groups may be maintaining the number of employees below 15 over a long period of time due to the growth trap created by restrictive legislation in relation to ease of termination and payment of gratuity. Since the survey was not designed to capture information about the reasons for keeping the employee numbers at a relatively low level, this feature may require more information to be collected in a subsequent exercise to enable a better analysis.

4.2 Ownership structure

Sole proprietorship is observed to be the most significant type of business structure in both the smaller as well as the larger enterprises in Sri Lanka. Around 87 per cent of the total surveyed MSEs are sole proprietorships (figure 4.3), followed by partnerships (6.1 per cent), private limited companies (3.6 per cent) and unregistered or informal businesses (2.4 per cent).

Figure 4.3. Type of business structure (percentage)



Among businesses with 5–14 employees, over 88 per cent are sole proprietorships. Even among businesses with 15 or more employees, around 80 per cent are sole proprietorships (table 4.5).

Table 4.5. Type of structure of enterprises

Type of registration	Work group (5–14)		Work group (15–70)		Total	
	No	%	No	%	No	%
Sole proprietorship	424	88.3	77	80.2	501	87.0
Partnership	26	5.4	9	9.4	35	6.1
Private limited Company	15	3.1	6	6.3	21	3.6
Co-operative	4	0.8	1	1.0	5	0.9
None (unregistered/informal)	11	2.3	3	3.1	14	2.4
Total	480	100.0	96	100.0	576	100.0

The above ownership structure observed suggests that this structure is not a growth trap for expanding their businesses and that operating as a sole proprietorship is not a barrier in expanding to over 15 employees.

Table 4.6. Percentage distribution of MSEs in different business sectors according to type of legal structure in Sri Lanka

Legal structure	Agro processing	Textiles & garments	Wood-working	Hospitality	All
					87.0
Sole proprietorship	89%	88%	86%	85%	%
Partnership	7%	4%	4%	11%	6.1%
Private limited company	4%	3%	5%	3%	3.6%
Cooperatives/associations	0%	2%	1%	0%	0.9%
None (unregistered/informal)	1%	3%	4%	2%	2.4%
Total MSEs	100%	100%	100%	100%	100%
Base (Total no. of MSEs)	151	192	120	113	576

The sectoral difference of this feature is minimal, and there is not much difference in legal structure of MSEs across business sectors (table 4.6). In the woodworking sector, the share of private limited companies (5 per cent) and unregistered businesses (4 per cent) is comparatively higher than in the other sectors. Among MSEs working in the hospitality sector, the share of partnership businesses is relatively higher (11 per cent).

4.3 Registration or licensing patterns of MSEs

The number of registrations among sectors varied. Overall, 3.3 per cent of enterprises reported not having any registration and, across sectors, only a small percentage of enterprises (2–4 per cent) were without any registration. About 12 per cent had one registration. It ranged from four per cent to 18 per cent among the four sectors and worker groups. About 70 per cent of the enterprises had obtained two to four registrations, ranging from 65 per cent (textiles and garments) to 74 per cent (hospitality) (table 4.7) and 68 per cent to 69 per cent in the worker groups. Overall, the level of registration was slightly lower in female-owned enterprises.

Table 4.7. Number of registrations, by sector

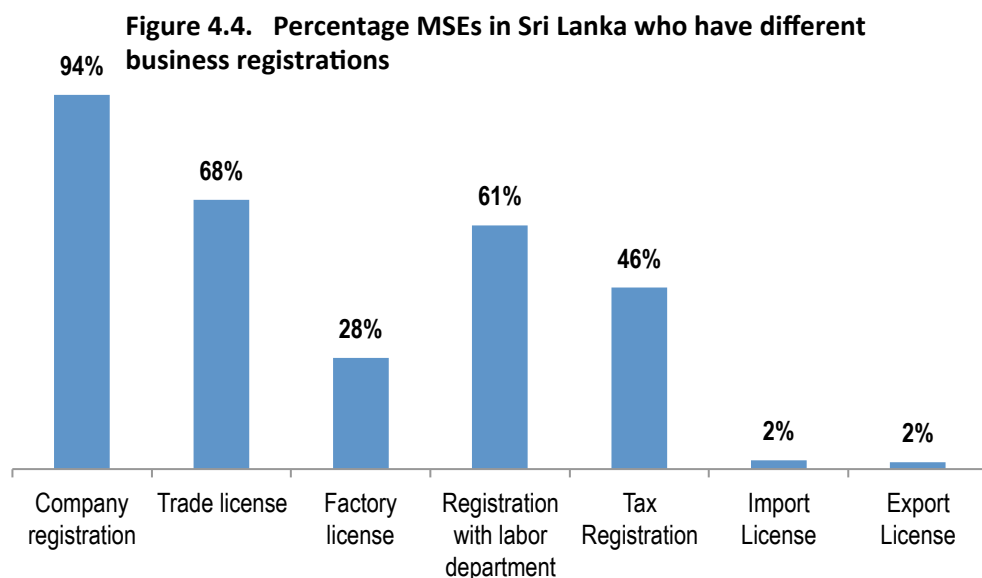
Registration Status	Agro processing		Textiles & garments		Woodworking		Hospitality		All	
	No	%	No	%	No	%	No	%	No	%
No registration	6	4.0	9	4.7	2	1.7	2	1.8	19	3.3
One registration	14	9.3	35	18.2	13	10.8	10	8.8	72	12.5
Two registrations	27	17.9	38	19.8	25	20.8	23	20.4	113	19.6
Three registrations	34	22.5	57	29.7	36	30.0	22	19.5	149	25.9
Four registrations	44	29.1	29	15.1	24	20.0	39	34.5	136	23.6
Five registrations or more	26	17.2	24	12.5	20	16.7	17	15.0	87	15.1
Total	151	100	192	100	120	100	113	100	576	100

Thus 95 per cent to 98 per cent of MSEs had at least one registration, suggesting that some form of registration is undertaken by the enterprise, as this would facilitate the operation of their businesses. “Staying informal” is not a popular strategy; only 2.4 per cent (tables 4.5 and 4.6) of the surveyed firms were unregistered, but how many of them intentionally tried staying informal is unknown. Around 97 per cent of the total MSEs surveyed had at least one of the seven popular types of registration (table 4.7 and figure 4.4). It is to be noted that while three per cent of MSEs are not registered with any of the seven pre-identified categories recorded here, the actual proportion of unregistered/informal as reported under “type of legal structure” was marginally lower at 2.4 per cent (tables 4.5 and 4.6).

The discrepancy between the numbers without registration, as indicated in tables 4.5 and 4.6 (2.4 per cent) compared with table 4.7 (3.3 per cent), is probably due to the non-response of the respondent, either due to lack of understanding or not remembering whether registered or not. The correct figure for non-registered enterprises is probably as given in tables 4.5 and 4.6 (14 enterprises or 2.4 per cent not registered). The figure given in table 4.7 is probably an overestimation due to the reasons stated above. Also, question 6.1 in the questionnaire from which table 4.7 has been derived, did not specifically ask the respondent whether they were unregistered or not. It only listed the different types of licenses obtained. What is recorded as no registration in table 4.7 is the balance number of those respondents who had not obtained any of the listed licenses.

Table 4.8. Percentage of MSEs in Sri Lanka that have the different licences

Licences	% MSEs who have the licences
Company registration	94
Trade license	68
Factory license	28
Registration with labour department	61
Tax registration	46
Import license	02
Export license	02



Company registration is the most frequent type of registration undertaken by enterprises in all sectors, with 94 per cent of MSEs having this type of registration. The next most popular one is the trade license (68 per cent), followed by registration with the labour department (61 per cent), tax registration (46 per cent) (table 4.8 and figure 4.4).

Around 80 per cent of MSEs in the hospitality sector have trade licenses, whereas the share of MSEs with trade licenses is much less (56 per cent) in the textiles and garments sector (table 4.9). Tax registration is lowest in textiles and garments, with only one-third of firms having this registration.

Table 4.9. Percentage of MSEs in Sri Lanka that have different licenses, by business sector

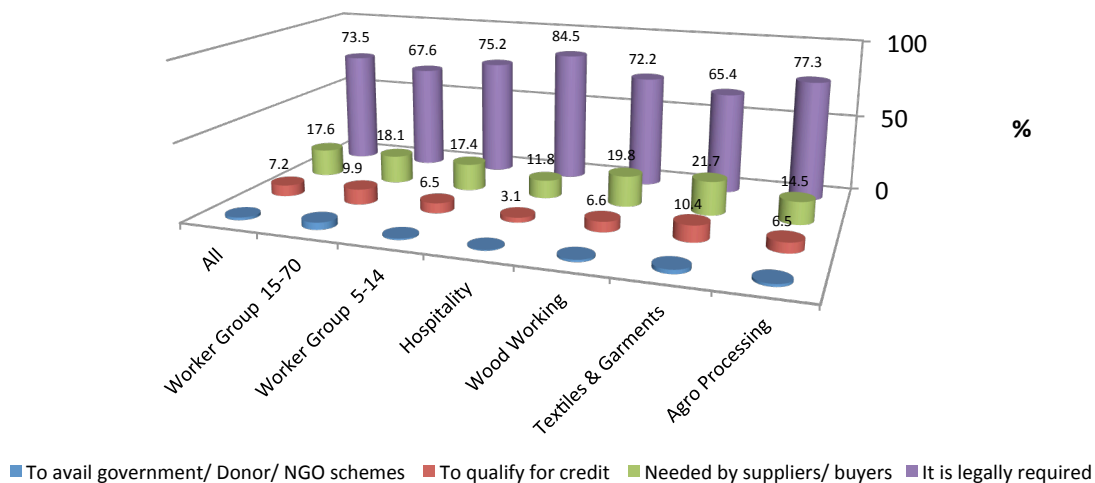
Licences	Agro processing	Textiles & garments	Woodworking	Hospitality	All
Company registration	95%	92%	94%	97%	94%
Trade license	75%	56%	67%	80%	68%
Factory license	26%	25%	45%	17%	28%
Registration with labour department	64%	61%	53%	67%	61%
Tax registration	52%	34%	44%	58%	46%
Import license	3%	3%	3%	0%	2%
Export license	3%	3%	1%	0%	2%
Base (total no. of MSEs)	151	192	120	113	576

Legal requirement seems to be the most important reason for getting any type of license by the MSEs. More than 95 per cent of MSEs who acquired each of the licenses reported getting the license because it is legally required (table 4.10 and figure 4.5). Another reason provided by 21–46 per cent of MSEs who had each registration/license was that they acquired the license because suppliers and buyers needed it. The third most frequently quoted reason for acquiring licenses (8–20 per cent) was that lenders needed it for qualifying for credit. About 2–20 per cent obtained licenses in order to avail government, donor or NGO assistance.

Table 4.10. Reasons for having each licence (percentage of MSEs)

Licences	It is legally required	To qualify for credit	To avail government/donor/ NGO schemes	Needed by suppliers/ buyers	Base (MSEs with a particular licence)
Company registration	95%	10%	2%	21%	543
Trade license	95%	10%	2%	25%	391
Factory license	100%	8%	2%	24%	161
Registration with labour department	95%	8%	2%	23%	354
Tax registration	99%	8%	2%	21%	263
Import license	100%	15%	15%	46%	13
Export license	100%	20%	20%	40%	10

Figure 4.5. Reasons for licensing/registering businesses (percentage of MSEs)



The major reason stated for not registering businesses was that it was not legally required. In the case of company registration, 38 per cent said that it was not legally required; in the case of other licenses, 74–97 per cent also stated this reason (table 4.11). This may be due to the lack of awareness among those unregistered, although, overall, only five per cent had specifically stated that they were unaware of the requirement.

Table 4.11. Distribution of MSEs in Sri Lanka who have not acquired different licenses across reasons

Licences	It is not legally required	It is legal, but not enforced	Takes too much time	Complicated/do not see the benefit	Don't want to pay the required fees	Don't want to become taxable	Not aware of requirement	Others
Company registration	38%	28%	3%	9%	0%	6%	16%	0%
Trade license	80%	8%	1%	4%	1%	3%	6%	0%
Factory license	94%	2%	0%	1%	0%	2%	1%	0%
Registration with labour department	74%	11%	1%	7%	0%	3%	8%	0%
Tax registration	82%	5%	0%	2%	1%	6%	7%	0%
Import license	97%	2%	0%	1%	0%	1%	1%	0%
Export license	97%	2%	0%	1%	0%	1%	1%	0%

Table 4.12. Average number of days taken by MSEs in Sri Lanka to complete the registration/acquire license

Licences	Average number of days actually taken	Officially defined duration (no. of days)	Difference (actual–official)
Company registration	4.7	20	-15.3
Trade license	4.2	1	3.2
Factory license	12.0	1–6 months	6–11 months
Registration with labour department	1.9	1	0.9
Tax registration	4.2	2	2.2
Import license	33.5	Depends on the nature of business	
Export license	25.6	Depends on the nature of business	

Table 4.13. Average official government fees paid by MSEs for initial registration/licensing in Sri Lanka

Licences	Average amount actually paid (LKR)	Officially set fee (LKR)	Difference (actual–official) (LKR)
Company registration	1 923	23,293	-21 370
Trade license	4 233	Local Authority fee 1000-5000	3 233 to -767
Factory license	3 275	No Direct fee but incur compliance cost	3 275
*Registration with labour department	2	No Charge	2
Tax registration	53 787	No Charge	53 787
*Import license	32 400	Depends on the nature of business	NA
*Export license	33 000	Depends on the nature of business	NA

Note: * Only two enterprises answered this question for these three licences. Thus, the average is based on only two sampled MSEs each.

Table 4.14. Average annual renewal fee paid by MSEs for registration/licensing in Sri Lanka (LKR)

Licences	Average amount actually paid (LKR)	Officially set fee (LKR)	Difference (actual–official) (LKR)
Company registration	4178	5 600	-1 422
Trade license	4 111	1000–5000	3 111 to -889
Factory license	3 179	No direct fee	3 179
* Registration with labour department	n.a.	No charge	0
Tax registration	18 928	No charge	18 928

* Import license	120 000	Depends on the nature of business	n.a.
* Export license	64 500	Depends on the nature of business	n.a.

Note: * n.a.: None of the MSEs reported this.
 **: Import license is based on only one MSE, Export license is based on two MSEs.

The number of days taken to obtain company registration, trade or factory licenses varied from two to 12 days, while import and export licenses required about a month or more to obtain. Company registration was obtained much faster than the official period, but it was slower in the case of other licenses (table 4.12).

Fees paid for initial registration for company registration, trade and factory licenses varied from 2000 Sri Lankan rupees (LKR) to LKR4,000, compared to the fees for tax registration and export or import licenses, which ranges from LKR30,000 to over LKR50,000 (table 4.13). The official charge was much higher for company registration than actual, and was much lower (free) for tax registration.

Amounts actually paid for renewal of import and export licenses ranged from LKR60,000 to over LKR120,000 and were ten to 30 times higher than that paid for company registration or trade and factory licenses (table 4.14). Actual amount paid for renewal charges for company registration was slightly lower and within range for trade licenses, but was much higher for factory license and tax registration.

In the case of tax registration, it is possible that the respondents may be quoting the amount paid as tax rather than tax registration cost, because it is well known that there is no charge for tax registration in Sri Lanka.

4.4 Employee structure

4.4.1 Paid and unpaid employment

About 88 per cent of the labour force was made up of paid employees, of whom four per cent came from within the household (table 4.15). The balance 12 per cent were unpaid workers, ten per cent were household members and two per cent non-household members such as trainees or relatives/friends working to get experience.

Table 4.15. Paid and unpaid employees in MSEs

Employment	Male No	%	Female No	%	Total No	%
Total paid HH employees	226	5.5	57	2.1	283	4.1
Total paid non-HH employees	3 260	79.3	2 484	89.4	5 744	83.4
Total paid employees	3 486	84.8	2 541	91.5	6 027	87.5
Total unpaid HH employees	499	12.1	175	6.3	674	9.8
Total unpaid non-HH employees	126	3.1	61	2.2	187	2.7
Total unpaid employees	625	15.2	236	8.5	861	12.5
Total no. of HH employees	725	17.6	232	8.4	957	13.9
Total no. of non-HH employees	3 386	82.4	2 545	91.6	5 931	86.1
Total no. of employees	4 111	100	2 777	100	6888	100.0

4.4.2 Structure of employment, 2009–11

Employment registers were not maintained by 30 per cent of enterprises, but despite this shortcoming nearly all enterprises were able to recall the number of workers employed two years previously (2009) through other records maintained by the enterprises. The data obtained appeared to be reasonably accurate and shows there is no increasing trend in casualization of labour. This suggests that a majority of the enterprises may not be adopting this strategy of casualization to avoid compliance with labour laws. Hypotheses tests undertaken also confirm that there is no statistically significant increase or decrease either in the mean or proportion of casual labour, and no trend in increased casualization of labour during the two-year period 2009–11. However, over 90 per cent of casual/temporary workers have been in employment for less than five years, which raises the possibility that these employees may be maintained below the five-year threshold to avoid payment of gratuity, or that such workers are more easily terminated to maintain the number of employees at a level which does not attract the Termination of Employment of Workmen Act (TEWA).

About 50 per cent of paid household members and over 95 per cent of unpaid workers were employed full time in both worker groups and in all sectors (*Sri Lanka Survey Report*, 2011). The high level of full-time employment of unpaid household workers may be due to the high proportion of sole proprietorship which results in greater commitment of household members to improve their own business enterprises.

In the surveyed MSEs in Sri Lanka, casualization/informalization of labour has been observed as a significant percentage in 2011. Overall, around one-fourth (25 per cent) of paid workers are observed to be casual workers in 2011, down from 27 per cent from two years earlier (tables 4.16 and 4.17). The conversion from casual to full-time work has happened among two per cent of the labour force in the surveyed firms.

Table 4.16. Distribution of employees across type of employment for different worker group, 2011

Nature of employment	Enterprise with 5–14 workers	Enterprise with 15–70 workers	All enterprises
Paid workers			
Full time	68%	67%	67%
Part time	7%	10%	8%
Casual/temporary	25%	23%	25%
Total	100%	100%	100%
Base (paid workers)	4 155	1 909	6 064
Unpaid workers			
Full time	91%	90%	91%
Part time	2%	1%	2%
Casual/temporary	6%	9%	7%
Total	100%	100%	100%
Base (Unpaid workers)	711	115	826

Table 4.17. Distribution of employees across type of employment for different worker group, 2009

Nature of employment	Enterprise with 5–14 workers	Enterprise with 15–70 workers	All enterprises
Paid workers			
Full time	65%	65%	65%
Part time	8%	9%	8%
Casual/temporary	27%	25%	27%
Total	100%	100%	100%
Base (paid workers)	4 179	1 833	6 012
Unpaid workers			
Full time	93%	71%	89%
Part time	2%	8%	3%
Casual/temporary	5%	21%	8%
Total	100%	100%	100%
Base (Unpaid workers)	602	131	733

The agro processing and textiles and garments sectors had more casual labour at the time of the survey (34 per cent and 29 per cent, respectively) than the woodworking and hospitality sectors (20 per cent and 18 per cent). In 2009, this was 34 per cent and 32 per cent for the agro processing and textiles and garments sectors and 19 per cent and 15 per cent for the woodworking and hospitality sectors, respectively (Table 4.18).

Table 4.18. Distribution of casual/temporary employment across sectors

Casual / Temporary Employment	2011		2009	
	No	%	No	%
Agro processing	529	34	567	34
Textiles & garments	448	29	541	32
Woodworking	304	20	312	19
Hospitality	276	18	246	15
Total	1 557	100	1 666	100

Most of the unpaid workers tend to be working full time (91 per cent) in 2011. Around seven per cent of unpaid workers had casual employment, marginally down from eight per cent in 2009. There is not much difference in composition type of the unpaid workers between large and small enterprises in 2011. However, in 2009, the share of unpaid workers working as full time was much smaller in larger enterprises (71 per cent) than in smaller enterprises (93 per cent).

4.4.3 Gender and employment structure, 2009–11

About 60 per cent of all employees were males, with 80 per cent of paid non-household employees and 57 per cent of paid household employees being males. The majority of paid as well as unpaid employees both within and outside the household were males. The majority (60–65 per cent) of the casual/temporary employees were males, with a decline of female casual/temporary employees observed between 2009 and 2011.

The highest proportion of female employment was in the textile and garment sector and that of male employment in the woodworking sector. More females are being hired on a full-time basis compared to males, while, at the same time, casual employment is declining rapidly for females, which may be due to female casual employees being upgraded to full-time employees. Employment registers and other labour laws, such as EPF payments, were followed more by male owners, while compliance with payment of minimum wages was higher among female owners of MSEs.

Of the total workers (including unpaid workers) in the surveyed MSEs, 60 per cent were male in 2011 (table B.1). The scenario was similar in 2009 as well, when 59 per cent of total workers were male (table B.2). The proportion of females was comparatively lower in the case of casual workers. In fact, the proportion of female casual workers has reduced slightly

from 39 per cent in 2009 to 36 per cent in 2011. It should be noted that the proportion of female workers, whether total or paid, has had either no change or marginal change between the years 2009 and 2011.

A gender analysis of employment by sector shows that there is a heavy bias towards hiring of male employees in all sectors except the textile and garment sector. Among the four surveyed sectors, the share of male workers was highest in woodworking (84 per cent) and lowest in textiles and garments (36 per cent) (table B.3). The pattern of employment has not changed much since 2009, with the woodworking sector having 85 per cent male workers, and the textiles and garment sector having 35 per cent male workers (Table B.4). The high proportion of male workers in the woodworking sector is probably due to the strenuous work involved in this sector. Part-time and casual/temporary employment declined and was compensated by an increase in full-time employment between 2009 and 2011.

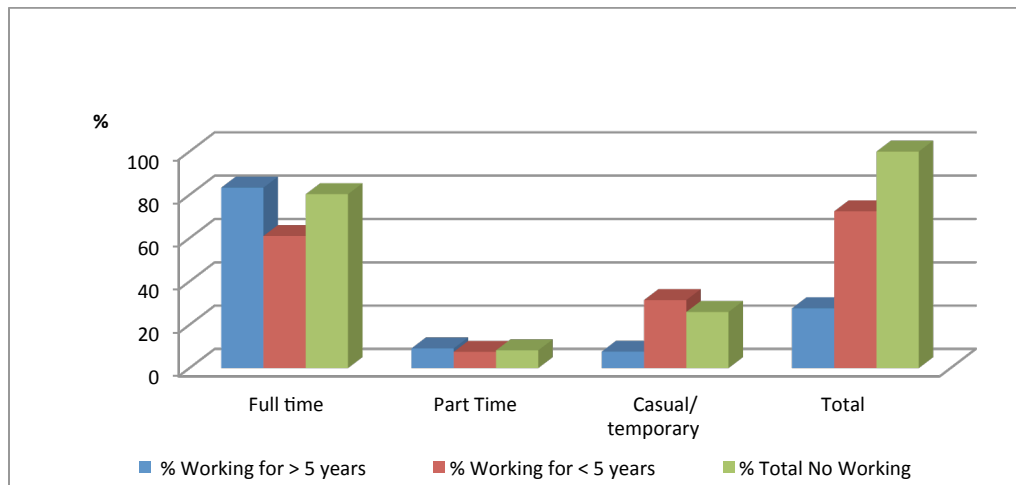
4.4.4 Duration of employment

The majority of workers (72 per cent) have worked for less than five years, while about 28 per cent have worked for more than five years. More than two-thirds of those employed full time and part time and over 90 per cent of the casual employees have worked less than five years. Thus, most employees in both worker groups have been recruited within the last five-year period, which may also indicate a fluctuating workforce which may make it possible to limit employee numbers to below the threshold level.

Table 4.19. Duration of employment of hired workers, by nature of employment

Nature of employment	Working for > 5 years		Working for < 5 years		Total no. working	
	Total No.	%	Total No.	%	Total No	%
Full time	1 385	34.2	2 663	65.8	4 048	100
Part time	151	31.5	329	68.5	480	100
Casual/temporary	127	8.5	1 372	91.5	1 499	100
Total	1 663	27.6	4 364	72.4	6 027	100

Figure 4.6. Duration of employment by percentage of hired workers, by nature of employment

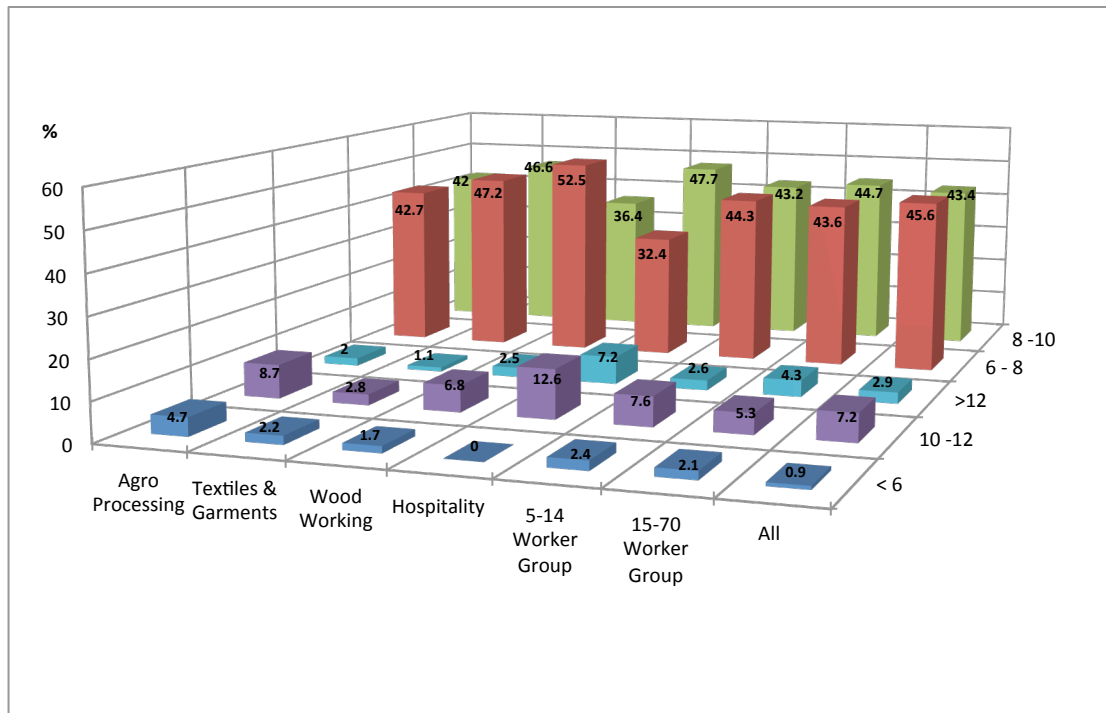


In the case of those who had worked over five years, 83 per cent were full-time workers, and in the case of those who have worked for less than five years, 60 per cent have been full-time workers and the rest were either part time or casual/temporary workers (figure 4.6). Thus a substantial proportion (40 per cent) of newer employees has worked on a casual or temporary basis. However, casual employment has declined between 2009 and 2011, thus the above data may not indicate a trend in increase of casual worker, but more likely that workers are hired on a casual/temporary basis initially but later on become full-time or permanent employees.

Enterprises probably do not want to recruit workers on a full-time basis due to the economic and other situation prevailing in the country and perhaps to avoid gratuity payments. There appears to be a greater bias towards males in the group who had worked over five years compared to those who had worked for less than five years. More females have been newly recruited (below five years) than males. Overall, the percentage of female workers in all three categories was higher in the less than five-year category, suggesting that the proportion of female workers declined with the increase in the duration of employment, or that MSEs appear to have higher proportion of male employees over the longer term of operation. This could be due to the fact that female employees are voluntarily leaving their jobs or that employers prefer males to females when the enterprise is stabilized and operating over a longer period. The need to provide maternity benefits, nursing intervals, etc., to female employees may also serve as a disincentive to employ females for over longer periods, although no firm conclusion can be drawn without more detailed information,

Overall, about 90 per cent of workers follow a six to ten hour working day and ten per cent work for more than ten hours. The hospitality sector is the sector with the longest working hours, with over 70 per cent working more than eight hours a day (figure 4.7). This sector works longer hours due to its service nature.

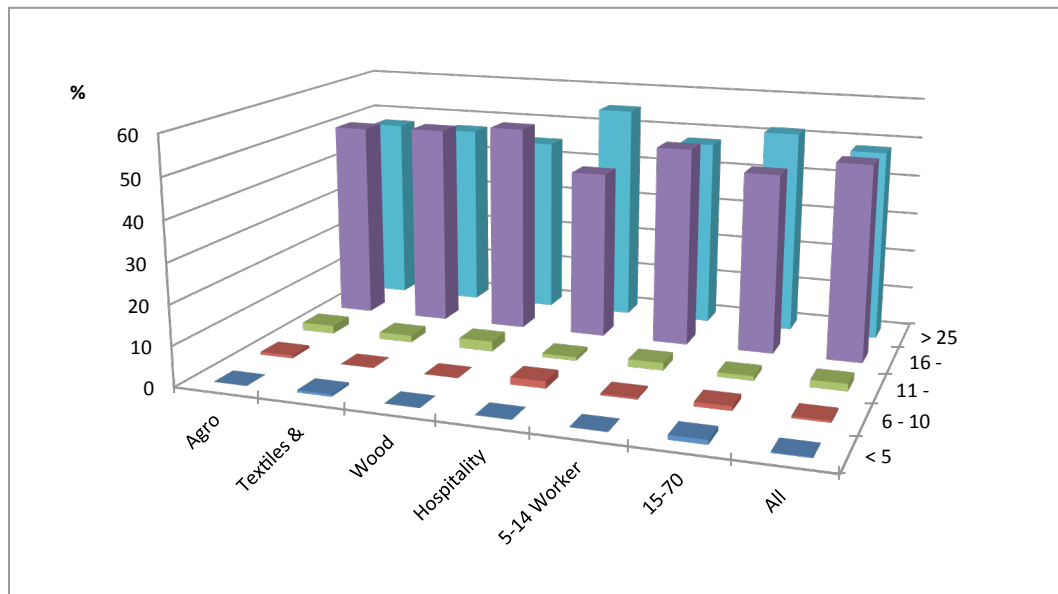
Figure 4.7. Average number of working hours in a day



4.4.5 Number of working days in a month

Just over 50 per cent worked 16–25 days in a month in all sectors, except the hospitality sector and the 15–70 worker group where the proportions were 42 per cent and 45 per cent, respectively. About 45 per cent to 47 per cent worked for over 25 days in a month in all sectors, except in the hospitality sector and the 15–70 worker group where the proportions were 55 per cent and 52 per cent, respectively (figure 4.8). Thus in the larger enterprises and in the hospitality sector, there was a higher proportion of employees working a greater number of days in a month than in the other sectors and smaller enterprises.

Figure 4.8. Average number of working days in a month



4.4.6 Basis of payment of wages

A little higher than half (56 per cent) of the workers were paid on a monthly basis (table B.5). The next popular mode of payment was price rate (18 per cent), followed by payment on a daily basis (16.1 per cent). Lump-sum and hourly basis of payment are two least popular methods with less than one per cent of workers being paid through these two modes. Monthly basis of payment is most popular in the hospitality sector, where more than three-fourth (78 per cent) of employees are paid on a monthly basis. In the woodworking sector, a large section of employees is paid on a piece-rate basis (28 per cent), indicating relatively higher incidence of casual employment.

In the hospitality sector, food preparation and services may be obtained on piece-rate. In the Sri Lankan context, even daily paid employees are categorized as full-time employees, provided that they work for a full month. Full-time employment amounted to about 66 per cent of total hired employment, which is close to the total proportion paid on a monthly and daily basis (72 per cent).

4.5 Maintenance of employment registers

Overall, 74 per cent of MSEs stated that they maintained employment registers. A higher percentage of MSEs maintained registers in the larger worker group (15–70 employees) in all sectors except in the hospitality sector. The variations were minor, with sector variations ranging from 70 per cent in the woodworking sector, 74 per cent in the textiles and garments sector, to 75 per cent in the hospitality sector and 76 per cent in the agro processing sector. Thus a majority of MSEs maintain employment registers and comply with the legal requirements of businesses. Even those MSEs not maintaining employment registers provided information on hired/unpaid workers from the other records maintained by them.

Overall, 26 per cent of MSEs reported that they did not maintain employment registers for their workers (table 4.20). However, in firms with 15–70 employees, this percentage was much lower (16 per cent). Even though there is not much variation in maintenance of employment registers across the four surveyed business sectors, the share of MSEs not maintaining registers was relatively higher in the woodworking sector (30 per cent).

Table 4.20. Percentage of MSEs in Sri Lanka that maintain official employment registers across different business sectors and worker groups

Sector \ worker group	Enterprises with 5–14 workers		Enterprises with 15–70 workers		All	
	% MSEs	Base (total no. of MSEs)	% MSEs	Base (total no. of MSEs)	% MSEs	Base (total no. of MSEs)
Agro processing	74%	127	88%	24	76%	151
Textiles & garments	70%	155	92%	37	74%	192
Woodworking	69%	109	82%	11	70%	120
Hospitality	76%	89	71%	24	75%	113
All	72%	480	84%	96	74%	576

When MSEs not keeping the employment register were enquired about their reasons for non-compliance, more than half (62 per cent) of them reported that the employment register was not necessary as wages were paid on a daily basis. Around 27 per cent also said that it was not legally required (table B.6). There were reasons cited by relatively smaller proportions of MSEs that reflect “*avoidance by choice*” behaviour such as “It is legally required, but not enforced” (11 per cent), and “Unnecessarily complicated (do not see the benefit)” (seven per cent), “Takes too much time” (three per cent) and “Too costly” (three per cent).

A higher proportion of male-headed enterprises maintained employment registers and obtained environmental licenses such as the Initial Environment Examination (IEE), Environmental Impact Assessment (EIA), while a higher proportion of female-headed enterprises obtained the Environmental Protection License (EPL).

The type of registration was cross tabulated with maintenance of employment registers and the results showed that 90 per cent of those with business registration maintained employment registers. The proportion maintaining employment registers declined to 68 per cent for those MSEs with trade licenses, 62 per cent for those with labour department registration, 46 per cent for those with tax registration, and 28 per cent for those with factory licenses. Thus business registration can be considered a key factor influencing the maintenance of employment registers.

The relatively lower proportion maintaining employment registers where the business is itself registered with the labour department is also of some interest, as this may be a method to avoid the application of labour legislation in the event of labour inspections, as

the absence of employee registers may make it possible to “conceal” some categories of employees such as casual or temporary workers.

In all worker groups and sectors, except the worker group with 15–70 workers in the agro processing sector, the perception of the respondents is that the employment register is not necessary as wages are paid on a daily basis. In the agro Processing sector and the 15–70 worker group, the other reasons given by respondents included that it was not legally required, and if legally required, it was not enforced in order to hide information from tax officers. Thus it appears that 60 per cent of the industries that do not maintain registers do so because their workers are generally paid on a daily basis.

4.6 Business inspection

4.6.1 Frequency of inspections

Among the districts, the highest frequency of inspections was in Gampaha district, closely followed by Kalutara district. Kurunegala district had the lowest level of inspections, probably due to the larger number of industries and lack of officials to meet the inspection needs. The highest reported frequency of inspections was once or twice a year in all districts, except in Kurunegala, where no inspections were reported by the highest proportion of respondents (50 per cent). The highest proportion of respondents reporting three to five visits was in Gampaha district.

Of all the MSEs being surveyed, 27 per cent were never inspected by any government official or department during the year prior to the survey (table 4.21). While 46 per cent were inspected once or twice, another 21 per cent were inspected three to five times. The share of MSEs that went through inspections three to five times was observed to be highest in the hospitality sector (29 per cent) and lowest in the textiles and garments sector (12 per cent).

Table 4.21. Percentage distribution of MSEs in Sri Lanka across frequency of official inspection in different business sectors

Frequency of government inspection	Agro processing	Textiles & garments	Woodworking	Hospitality	All
Not once	21%	40%	26%	12%	27%
1–2 times	50%	42%	41%	51%	46%
3–5 times	22%	12%	27%	29%	21%
5–10 times	6%	5%	7%	4%	6%
10 or more times	1%	1%	0%	3%	1%
Total	100%	100%	100%	100%	100%
Base (no. of MSEs)	151	192	120	113	576

In the agro processing sector, 50 per cent reported one or two inspection visits, 21 per cent reported no visits and 22 per cent reported three to five visits. In the textiles and garments sector, 42 per cent reported one to two inspection visits, 40 per cent reported no visits and 12 per cent reported three to five visits. In the woodworking sector, 41 per cent reported

one to two inspection visits, 27 per cent reported three to five visits and 26 per cent reported no visits. In the hospitality sector, 51 per cent reported one to two inspection visits, 29 per cent reported three to five visits and 12 per cent reported no visits. Thus, among the four sectors, textiles and garments reported the highest percentage of no visits, probably because this sector is abiding by the rules more than the other sectors, being more organized for export and local market trading. The hospitality sector had the highest frequency of one to two and three to five visits compared to the rest of the sectors and also the lowest percentage of no visits suggesting that this sector, dealing with food sales and local and foreign tourism, is subject to a higher-level inspection regime, to ensure health and environmental standards and also improve and promote tourism.

4.6.2 Types of inspections

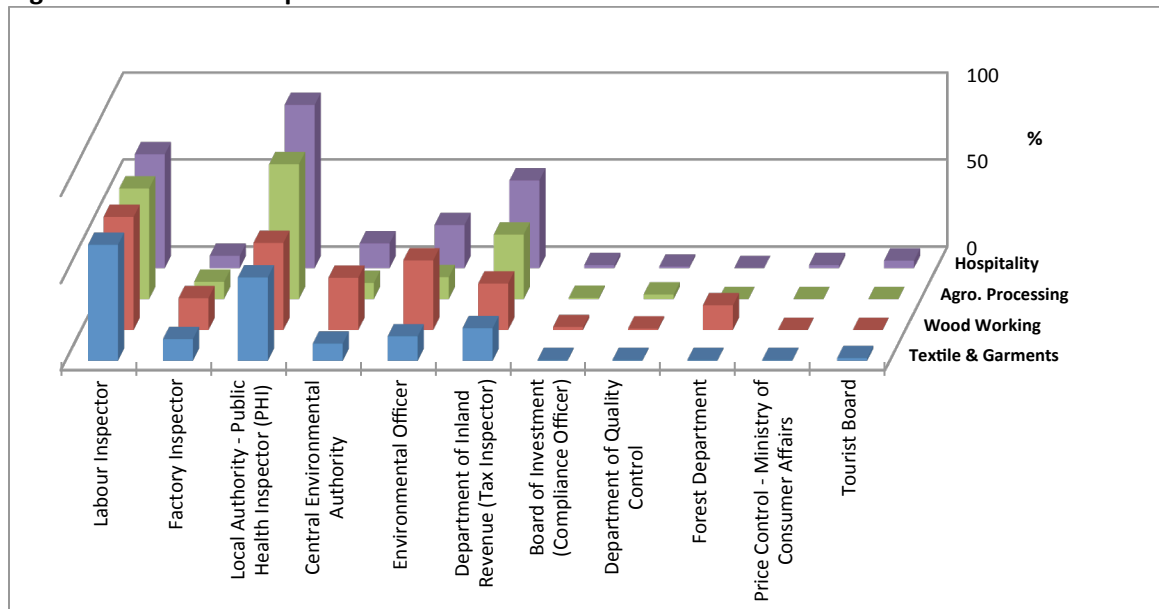
The most reported inspecting officials in all four sectors were the labour inspector (LI), local authority–public health inspector (PHI) and the tax inspector from the Inland Revenue Department (TI-IRD). Less frequently visiting officials include the Central Environmental Authority (CEA) personnel and the factory inspector (FI). Personnel visiting rarely include forest department (FD) and tourist board (TB) officials, police officers (POs) and officials from the Board of Investment (BOI) and the Department of Quality Control (DQC).

Of the seven different types of inspection that were enquired during the survey, inspection by LI and PHI had relatively better coverage (table B.7 and figure 4.9). Around 65 per cent of the sample firms reported that over the past one year they were visited by an LI as well as a PHI of the local authority.

While there were little sectoral differences observed among the percentage of firms visited by the LI, the PHI inspection was found to be almost universal (94 per cent) for the hospitality sector, while in the case of the textiles and garments sector it was found to be only 48 per cent. Other important inspections were conducted by the TI (31 per cent), the environmental officer (EO) (21 per cent) and the CEA personnel (15 per cent). In the agro processing sector, the most reported inspector is the PHI, followed by the LI and the TI-IRD. Less reported personnel include the EO, FI and DQC. In the textiles and garments sector, the most reported official is the LI, followed by the PHI. Less reported officials include the TI-IRD, EO, FI and the CEA. In the woodworking sector, the most reported officials include the LI, PHI, EO and the TI-IRD. Less reported officials include the FD and the PO. In this sector, the forest department and police officials get more involved in order to prevent illegal felling in state forests. In the hospitality sector, the most reported inspecting official was the PHI, as this official has to ensure cleanliness in food preparation and waste disposal. The other most reported officials include the LI, TI-IRD, EO and the CEA. The less reported officials include, FI, TB, PO, BOI and officers of the Price Control of the Ministry of Consumer Affairs (PC-MCA).

Some of the other departments that conducted inspections include the tourist board, which inspected four per cent of the MSEs in the hospitality sector, and the forest department, which inspected around 14 per cent of MSEs in the woodworking sector.

Figure 4.9. Official inspections of businesses



Overall, the main officials conducting inspections are the LIs, PHIs, environment-related officials, TI-IRDs, and, to a lesser extent, the FIs, particularly in industries with factories. Cross tabulation of official inspection with the type of registration or license shows that the highest level of inspection is undertaken by labour and local authority inspectors in MSEs with any type of registration or license, with about two-thirds and up to 90 per cent of MSEs being covered by these inspectors. Tax inspectors and environmental inspectors cover between 30 per cent and 65 per cent of MSEs with different types of registration. A high percentage of MSEs with import and export licenses are visited by most inspectors, probably because of the small number who have such licenses. Only 33 per cent of MSEs with factory licenses are visited by the FI, suggesting that factory inspection is not enforced properly.

There was a higher level of no inspections in the smaller worker group, probably because of the larger number of industries in this group and because the inspectors target the bigger enterprises due to lack of staff. The same situation prevails in each district as well.

Cross tabulation of frequency of official inspection with type of registration showed that over 60 per cent of MSEs are visited between one and five times in a year in the case of those MSEs with company registration, trade license, and tax and labour department registration. In the case of other types of registration, the frequency of inspections of one to five times a year is less prevalent with about 40 per cent to 50 per cent of the MSEs being inspected. The least frequency of visits is for MSEs with factory licenses.

4.7 Regulation on minimum wages

The legal obligation of minimum wage applies to businesses of all sizes in Sri Lanka.

Around 64 per cent of MSEs in the three sectors of agro processing, textiles and garments, and hospitality reported being aware of minimum wages in their sector of business. These figures are approximately in line with the percentage of businesses which answered “Aware

of the minimum wage obligations” in the earlier section. This perceived awareness was highest in the hospitality sector (72 per cent) among all (table 4.22). The reported minimum wage of a majority of 55 per cent of those MSEs who reported to be aware of the minimum wage was observed to be falling within the official range.

Table 4.22. Percentage of MSEs in Sri Lanka who reported awareness of the minimum wage for their sector of business

Business sector/worker group	% of MSEs aware of national minimum wage	Base (Total No. of MSEs)
Agro processing	61%	151
Textile & garments	61%	192
Hospitality	72%	113
Enterprise with 5–14 workers	62%	371
Enterprise with 15–70 workers	72%	85
All except the woodworking sector	64%	456

Only five per cent of MSEs were aware of government-specified minimum wage obligations but still avoided paying minimum wage to their workers (table B.8) and (table B.9). This behaviour was more widely observed in the textiles and garments sector (ten per cent). Again, avoidance behaviour is slightly higher in firms with 5–14 workers (six per cent) than in those with 10–70 workers (four per cent). While 26 per cent of MSEs were not aware of this requirement, more than two-thirds (69 per cent) reported being aware and did pay by following the minimum wage regulations.

There are huge sectoral differences observed in compliance with payment of minimum wage obligations. Agro processing, textiles and garments, and hospitality sectors demonstrated a high rate of awareness and compliance with the minimum wage obligations (74 per cent, 64 per cent and 72 per cent, respectively).

The reasons for non-compliance with regulations on minimum wage given by maximum number of MSEs were other than those five options listed during the survey (table B.10).

Of all the MSEs in the three sectors, except woodworking, 60 per cent were aware of the existence of penalties if businesses did not comply with regulations on minimum wage (table 4.23). Of those who were aware, 59 per cent knew at least the category of penalty, which is a higher number than those who could not specify exactly what the penalties were (40 per cent).

Table 4.23. Percentage of MSEs in Sri Lanka aware of labour laws related to minimum wage, across knowledge of category and quantum of penalty

Worker group/business sector	Know the category and quantum	Know category but not the quantum	Do not know	Unable to specify the penalties	Base (no. of MSEs who have heard about existence of penalties)
Enterprises with 5–14 workers	1%	58%	41%	1%	367

Enterprises with 15–70 workers	0%	62%	39%	0%	84
Agro processing	1%	66%	34%	1%	148
Textiles & garments	1%	54%	45%	1%	191
Hospitality	1%	57%	42%	1%	112
Total	1%	59%	40%	1%	451

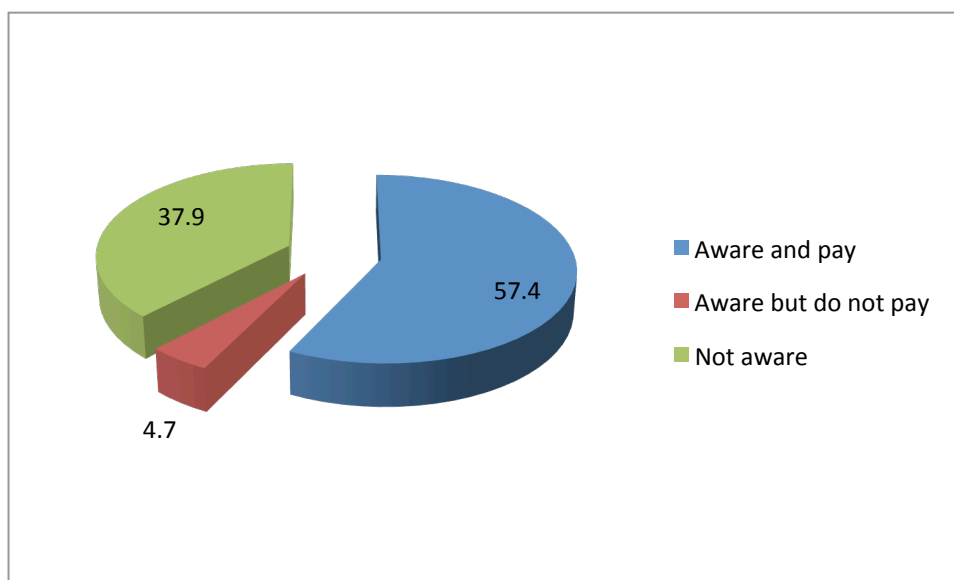
These figures are approximately in line with the percentage of businesses which answered they were aware of the minimum wage obligations in the earlier section and those who had knowledge of minimum wage rates. This consistency indicates that the respondents were largely honest about their awareness and knowledge on the minimum wage.

Overall, 14 per cent of MSEs reported having heard about informal payments being made in order to avoid compliance with minimum wage regulations (table B.11). Out of which, six per cent reported making such payments to avoid compliance with the regulations. The share of MSEs who had reportedly made informal payments was highest in the textiles and garments sector (11 per cent) and almost negligible in the hospitality sector (0 per cent).

4.7.1 Awareness of minimum wages without unions

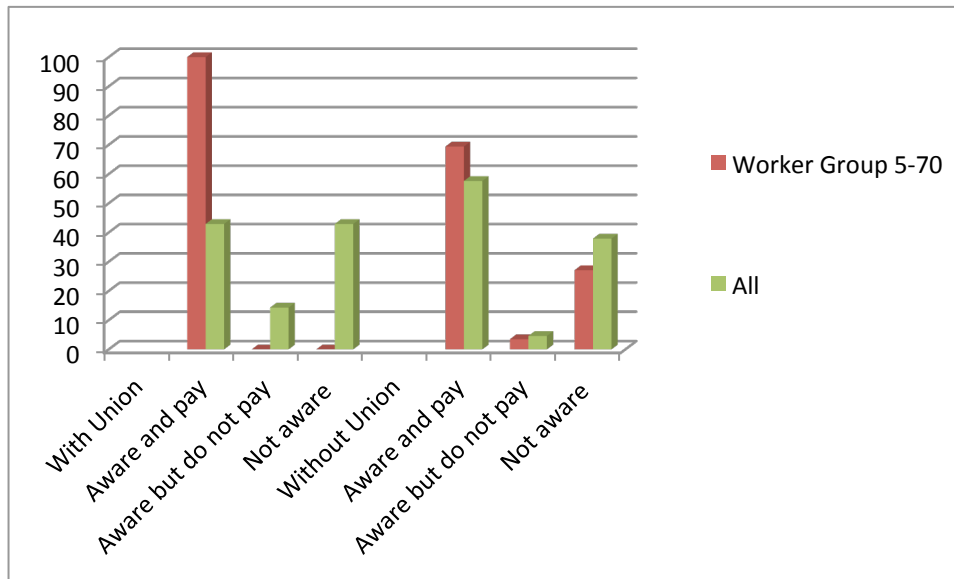
A higher percentage of MSEs are aware and pay minimum wages (57.4 per cent), and a lower percentage are aware but do not pay minimum wages (4.7 per cent) without unions; 37.9 per cent was not aware (figure 4.10). Minimum wages are high without unions than with unions. Thus unionization appears not to have improved awareness, or payment of minimum wages.

Figure 4.10. Awareness and payment of minimum wages, by sector without unions



In the larger worker group (15–70), there is a greater level of awareness and payment of minimum wages compared to the smaller worker group (5–14). This is true for situations with and without unions. However, the differences do not appear to be significant and, therefore, payment of minimum wage may not be a growth trap for MSEs (figure 4.11).

Figure 4.11. Status of awareness and payment of minimum wages, enterprises with and without unions



Awareness and payment of minimum wage is high among female-headed MSEs, compared to male-headed MSEs. About 59 per cent of male-owned MSEs and 69 per cent of female-owned MSEs were aware of minimum wage regulations. Of this proportion, 56 per cent of male-owned MSEs and 58 per cent of female-owned MSEs actually paid minimum wages to their employees. The rest were unaware or did not pay minimum wages.

Cross tabulation of awareness and payment of minimum wages by sector and worker group with type of registration or license showed that in all sectors and worker groups, except the woodworking sector, a substantial majority of MSEs are aware and pay minimum wages, whatever the type of registration or license of the MSE concerned. Data on minimum wages was not obtained for woodworking as such minimum wages do not exist for the woodworking industry. In the case of the woodworking sector, much of the labour is hired on piece-rate basis, rather than daily or monthly payment systems.

4.8 Employees' provident fund (EPF)/Employees' trust fund (ETF)

The EPF/ETF applies to all businesses in Sri Lanka. The strategy of "staying below the threshold level" in order to avoid compliance with EPF/ETF regulations was not at all observed among the surveyed MSEs in Sri Lanka. It was observed that 64 per cent of MSEs were aware of the regulations on EPF/ETF payments and they all made EPF/ETF

contributions (table 4.24). Overall, the proportion of MSEs who were unaware of EPF/ETF obligations was 36 per cent, with not much variation across the four business sectors.

Table 4.24. Percentage distribution of MSEs in Sri Lanka across awareness and payment status of EPF/ETF, by business sector

Status of awareness and payment	Agro processing	Textiles & garments	Woodworking	Hospitality	All
Aware and pay	61%	47%	48%	62%	54%
Aware but do not pay	3%	15%	12%	8%	10%
Not aware	36%	38%	40%	30%	36%
Total	100%	100%	100%	100%	100%
Base (no. of MSEs)	151	192	120	113	576

4.8.1 Reasons for non-payment of EPF by non-payers

About ten per cent of respondents do not pay EPF and 36 per cent were not aware that they have to pay EPF/ETF. The main reasons for not paying EPF, according to those responding, were that workers have not demanded it and that employees prefer to receive a higher take-home pay. This was the case in all sectors. No regular staff was the third most important reason in all sectors, except the hospitality sector. Other reasons reported by a minority of respondents were that “It is legally required, but not enforced”, “Too costly”, and “Unnecessarily complicated”.

Of the MSEs who made EPF/ETF payments, 44 per cent reported that they took half an hour to one hour to file monthly EPF returns (table B.12), while 31 per cent of MSEs mentioned they took one to two hours every month. It can be observed that larger enterprises with 15–70 workers took relatively more time to file EPF/ETF returns. Of the total MSEs with 15–70 employees, around one-third (33 per cent) reported that they took more than two hours every month to file EPF/ETF returns, whereas the overall proportion was only 15 per cent.

Overall, 74 per cent of MSEs in Sri Lanka reported that they heard about the existence of penalties if businesses do not comply with regulations on EPF/ETF. Of these, 73 per cent of MSEs were able to describe at least the category of penalty correctly (table B.13). However, there were only one per cent of MSEs that could describe both the quantum and category of penalty.

Overall, 37 per cent of MSEs reported that hearing about informal payments being made to avoid compliance with regulations on EPF in their sector of business (table B.14). Out of these, 13 per cent were honest enough to report having made such payments to avoid compliance with the EPF regulations.

A higher proportion of MSEs contributed to ETF without unions than with unions in both worker groups and in the four sub-sectors (table 4.25 and figures 4.12 & 4.13)

Table 4.25. Contribution to ETF with and without unions, by sector and worker group

Sector	Worker group 5–14	Worker group 5–70	All
Agro processing	%	%	%
With union	0.8	0.0	0.7
Without union	58.3	70.8	60.3
Not contributing EPF	40.9	29.2	39.1
Total	100.0	100.0	100.0
Textiles & garments			
With union	0.6	2.7	1.0
Without union	55.5	67.6	57.8
Not contributing EPF	43.9	29.7	41.1
Total	100.0	100.0	100.0
Woodworking			
With union	0.9	0.0	0.8
Without union	57.8	27.3	55.0
Not contributing EPF	41.3	72.7	44.2
Total	100.0	100.0	100.0
Hospitality			
With union	0.0	0.0	0.0
Without union	66.3	66.7	66.4
Not contributing EPF	33.7	33.3	33.6
Total	100.0	100.0	100.0
All			
With union	0.6	1.0	0.7
Without union	58.8	63.5	59.5
Not contributing EPF	40.6	35.4	39.8
Total	100.0	100.0	100.0

Figure 4.12. Contributions to EPF with and without unions, by sector and worker group (enterprises with union)

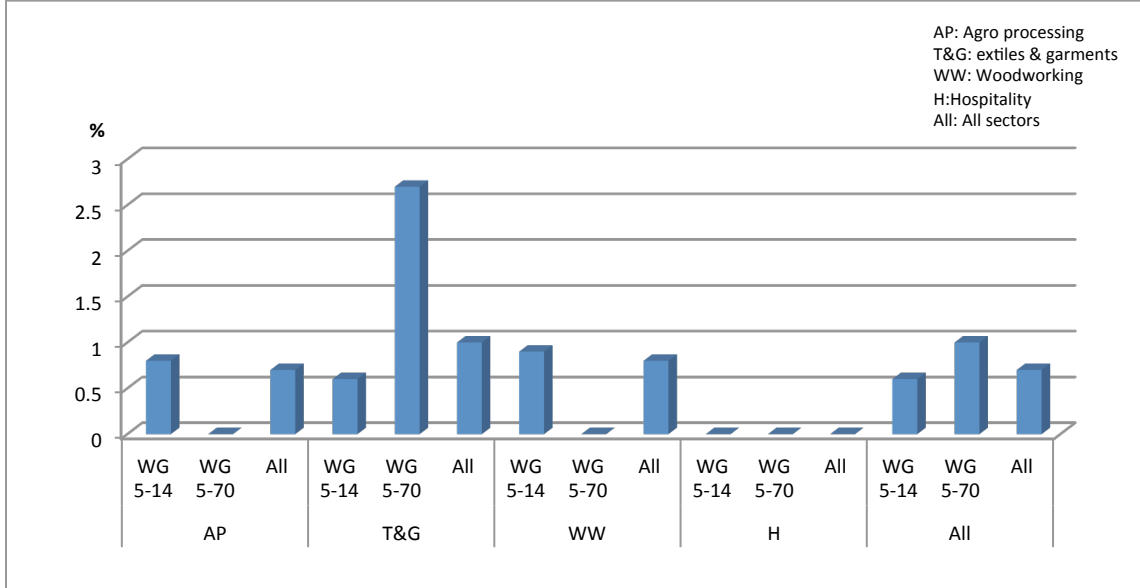
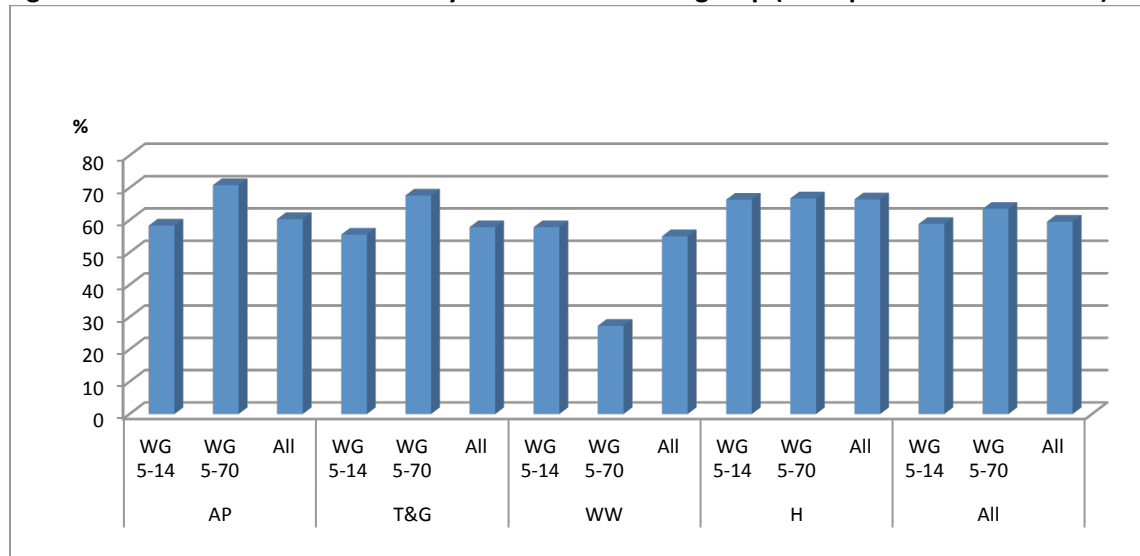


Figure 4.13. Contributions to EPF by sector and worker group (enterprises without union)



In the agro processing sector, a higher percentage (58–70 per cent) is paying EPF without unions in both worker groups and less than one per cent is paying with unions. About 40 per cent of the enterprises do not contribute to EPF in the smaller working group, while 30 per cent of enterprises contribute in the larger worker group. Thus both worker groups are paying without unionization, which is not apparently having any impact on EPF payments. There is also a greater percentage paying EPF in the larger worker group compared to the smaller worker group.

In the textiles and garments sector, a higher percentage (55–68 per cent) is paying EPF without unions in both worker groups and less than three per cent paying with unions. About 44 per cent of enterprises are not contributing to EPF in the smaller working group, while 30 per cent of enterprises are not contributing in the larger worker group. Thus both worker groups are paying without unionization, which is not apparently having any impact on EPF payments. There is also greater percentage paying EPF in the larger worker group compared to the smaller worker group.

In the woodworking sector, a higher percentage (27–58 per cent) is paying EPF without unions in both worker groups and less than one per cent is paying with unions. About 41 per cent of enterprises are not contributing to EPF in the smaller working group, while 72 per cent of enterprises are not contributing in the larger worker group. Thus both worker groups are paying without unionization, which is not apparently having any impact on EPF payments. There is also a much greater percentage paying EPF in the smaller worker group compared to the larger worker group. It is possible that the larger worker group enterprises are employing largely casual workers or workers on piece-rate system resulting in high level of non-payment of EPF.

In the hospitality sector, a higher percentage (66 per cent) is paying EPF without unions in both worker groups and 0 per cent is paying with unions. About 33 per cent of enterprises are not contributing to EPF in both worker groups. Thus both worker groups are paying without unionization, which is not apparently having any impact on EPF payments. In this sector, about two-thirds of enterprises in both worker groups are paying EPF and the entire sector is not unionized. Overall, 60 per cent of enterprises are paying EPF, while about 40 per cent are not paying EPF and less than one per cent are paying with unions, suggesting that there is very little unionization and that unionization probably does not have any impact on EPF payment. Awareness and payment of EPF by gender showed that over 67 per cent of the male-headed enterprises are aware and pay EPF, compared to 47 per cent of female-headed MSEs who are aware and pay EPF. Thus over 50 per cent of the female-headed MSEs do not pay EPF compared to only 33 per cent in the case of male-headed MSEs.

4.9 Gratuity

4.9.1 Threshold for gratuity

In Sri Lanka, businesses with 15 or more workers have to make gratuity payments at the time of separation for those who have completed at least five years of service. In the surveyed MSEs as a whole, a majority of paid workers (72 per cent) have worked for less than five years, while about 28 per cent have worked for more than five years. Around two-thirds of those employed full time (65 per cent) and a little higher than two-thirds of those employed part time (69 per cent) have worked less than five years (table 4.26). This practice is even more prevalent in the case of casual workers. In the case of casual workers, around 90 per cent have worked for less than five years.

Table 4.26. Distribution of paid workers in MSEs across duration of employment, by nature of employment, 2011

Nature of Employment	Working for > = 5 years	Working for <5 years	Total
Full time	35%	65%	100%
Part time	31%	69%	100%
Casual/temporary	10%	90%	100%
Total	28%	72%	100%
Base (Total paid workers)	1 721	4 343	6 064

Only two out of the 480 surveyed MSEs (0.4 per cent) with less than 15 workers reported that they tried to stay below the threshold in order to avoid gratuity payments, either by employing less than 15 workers or by limiting the duration of employment within five years (i.e. “staying below the threshold” strategy in order to avoid compliance is almost negligible) (table B.15). There were 68 per cent of MSEs below the threshold who were not aware of gratuity payment obligations.

Of the total MSEs above the threshold level, 84 per cent reported that they had never made gratuity payment to their workers (table B.16). Among the four surveyed sectors, the share of MSEs not complying with gratuity obligations was observed to be highest in the woodworking sector (91 per cent) and lowest in the hospitality sector (75 per cent).

Cross tabulation of gratuity payment with type of registration showed that the majority of MSEs do not pay gratuity, in the case of all type of registration. The highest percentage of MSEs not paying gratuity are those MSEs with company registration, followed by trade license and labour registration. The lowest percentage was observed for import and export licenses. Thus registration has not influenced payment of gratuity.

When MSEs above the threshold level, who did not make gratuity payments, were enquired about the reasons, 27 per cent reported that there was no resignation/retirement in their corresponding enterprise (table B.17). Around 14 per cent of MSEs also reported that it was not legally required for them. However, there were some MSEs who gave reasons that can be considered “avoidance by choice” behaviour such as “Workers have not demanded it” (64 per cent), and “It is legally required, but not enforced” (32 per cent) (table B.17).

Of the total MSEs being surveyed, 31 per cent claimed that they knew the amount of gratuity payment that businesses above the threshold level are required to make for those who had completed a minimum of five years of services (table B.18). This perceived awareness was highest in the hospitality sector (42 per cent) and lowest in the woodworking sector (28 per cent). Of the 31 per cent who claimed that they knew the amount of gratuity payment, 18 per cent knew the correct rate of half a month’s salary for each month of service. The other 13 per cent gave incorrect answers (answer mismatched).

Overall, 99 per cent of MSEs had reported that they were aware of the penalties of not complying with the gratuity regulation (table B.19). Out of those who were aware, 30 per cent knew at least category of penalty, which is much lower than those who could not specify what the exact penalty was (70 per cent) (table B.20).

Overall, ten per cent of MSEs reported that they had heard of informal payments being made to avoid compliance with regulations on gratuity in their sector of business (table B.21). Out of this, only four per cent were honest enough to report that they made such payments to avoid compliance with gratuity payments. The proportion who reported making made informal payments was relatively higher in firms working in the woodworking sector (10 per cent) compared to firms working in the hospitality and textiles and garments sector, where the share of those making informal payments was almost negligible.

4.10 Trade unions

A little over one per cent of enterprises had trade unions (table 4.27) in all sectors and worker groups, but the reasons for the lack of such trade unions may need further information gathering from the employees. The reasons for lack of trade unions could be due to several reasons such as the employees having no interest in forming or joining trade unions; the fact that many of the MSEs operate in the informal sector where trade union formation is found to be less prevalent; the nature of employment, such as in the agro processing industry, where a transient labour force may not encourage the establishment of trade unions; or the discouragement/prevention of the formation of trade unions by employers.

Table 4.27. Unionization status

Unionization	No	%
Have trade union	7	1.2
No trade union	523	90.8
No response	46	8.0
Total	576	100

Overall, 25 per cent of the surveyed MSEs reported that even though they were aware of the regulation on trade unions, none of them had a trade union in their business (table 4.28). Only one per cent of the total surveyed MSEs reported that they had a trade union.

Table 4.28. Percentage of MSEs in Sri Lanka across their awareness about trade union formation, by business sector

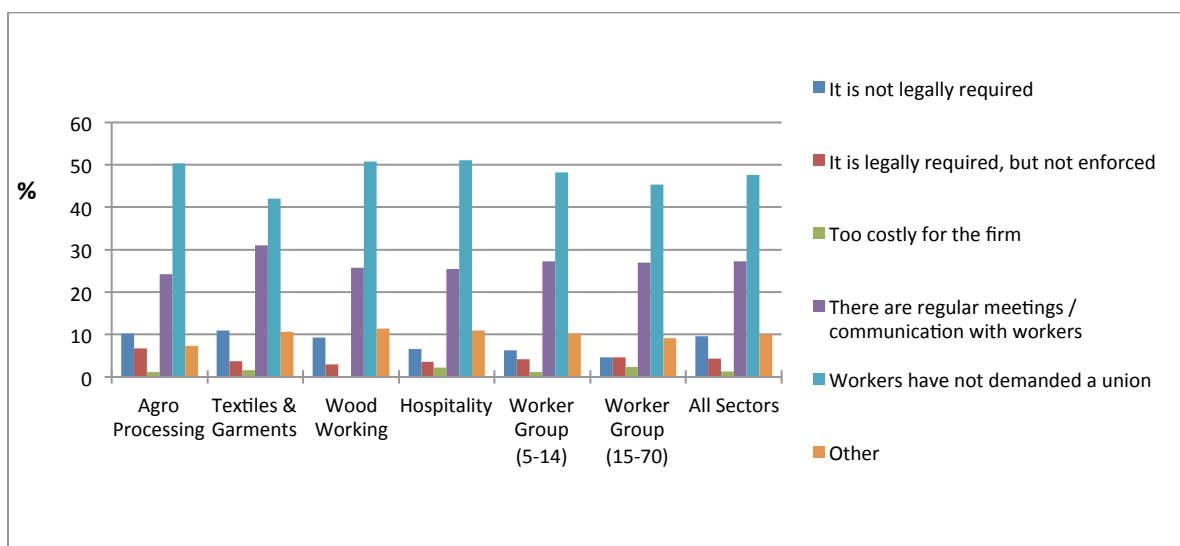
Status of awareness about trade union	Agro processing	Textiles & garments	Woodworking	Hospitality	All
Aware, and have a trade union at their business	1%	2%	1%	0%	1%

Aware, but do not have a trade union at their business	24%	30%	23%	19%	25%
Not aware	75%	68%	77%	81%	74%
Total	100%	100%	100%	100%	100%
Base (no. of MSEs)	151	192	120	113	576

Around 74 per cent of MSEs were unaware of the legal condition that it requires seven regular employees (including those from other businesses) to form a trade union (table 4.28). Lack of awareness regarding regulations on trade unions seems to be highest in the hospitality sector (81 per cent) and lowest in the textiles and garments sector (68 per cent).

Many of the MSEs who were aware of regulations on trade unions, but never formed any, provided reasons that looked legitimate such as “Workers have not demanded it” (65 per cent) and “There are regular meetings/communication with workers” (around 39 per cent MSEs cited this reason), which did not look so legitimate, and “It is not legally required” (20 per cent) (table B22). A relatively smaller proportion of firms provided reasons that reflect “avoidance by choice” behaviour such as “It is legally required but not enforced” (2.6 per cent) and “Too costly” (2 per cent). The pattern is similar in all sectors. According to the responses, union formation appears to be dependent on worker demand, and not so much on legal requirements, and also on whether workers and management had regular meetings and good communication between them.

Figure 4.14. Reasons for the non-existence of trade unions, by sector/worker groups



The major reason for the non-existence of trade unions in enterprises among sectors and worker groups (about 40–50 per cent of the response) is that that the workers have not demanded a union (figure 4.14). About 20–27 per cent indicated that there were regular meetings and communications with workers and there was no need for a union. The highest

proportion was in the textiles and garments sector but the proportions were more or less equal. About six to ten per cent believe that it is not legally required, while another two to five per cent believe that it is legally required but not enforced. Less than two per cent indicated that it would be too costly for the firm. The pattern is similar in all groups. Thus union formation appears to be largely dependent on worker demand, and, to some extent, on the level of communications between the workers and the employers and not so much on legal requirements or enforcement. However, as stated previously, it may be necessary to gather more information from employees on the low level of trade union formation, as the perception of employers may not be accurate in this context.

Only those MSEs who had a trade union federation were enquired about the number of working days lost in the year prior to the interview due to labour disputes. Overall, none of the firms who had a trade union reported that they had lost working days due to labour disputes.

Overall, 57 per cent of MSEs in Sri Lanka reported that there was an overall wage increase for their employees during the one year prior to the survey (table B.23). The proportion of firms who had increased wages was considerably higher in the agro processing sector (65 per cent) compared to the other three sectors.

Of the MSEs whose employees had an overall wage increase, 35 per cent had an increase of ten per cent, while 28 per cent had wage increase at a rate less than or equal to five per cent only. About 17 per cent had a wage increase between 5–9 per cent, while 14 per cent had a wage increase of 11–14 per cent (table B.24). A smaller share of six per cent of MSEs reported that they had an overall wage increase at a rate higher than 15 per cent among their employees.

Overall, 99 per cent of MSEs had reported that they had heard about the existence of penalties for not complying with the regulations on trade unions (table B.25).

Out of those who had heard, 16 per cent knew at least category of penalty, which is much lower than those who could not specify what the penalties were (83 per cent) (table B.26).

Overall, ten per cent of MSEs reported that they had heard of informal payments being made to avoid compliance with regulations on trade union formation in their sector of business (table B.27). Out of which only five per cent were honest enough to report making such payments to avoid compliance with gratuity payment regulations. The Proportion of firms who made informal payments was highest in the woodworking sector (13 per cent) and lowest (almost negligible) in the textiles and garments sector (zero per cent).

4.11 Income tax

In the case of income tax in Sri Lanka, the threshold level is not related to number of employees, but to annual income level. For sole proprietorships and unregistered businesses, one is required to pay income tax if one earns over LKR500,000 a year; and for partnerships and private limited companies, one is required to pay 35 per cent of earnings if the business earns over LKR5 million against 15 per cent for those earning less).

Overall, 57 per cent of MSEs in Sri Lanka reported that they did not pay income tax (table 4.29). The proportion of MSEs who did not pay income tax was observed to be relatively higher in the textiles and garments sector (62 per cent) compared to the other three sectors.

When all districts are combined, about 43 per cent of the MSEs pay income tax, with about 34 per cent paying at a rate greater than 20 per cent, varying from about 28 per cent to 42 per cent among the sectors and worker groups, and about eight per cent pay at a rate less than 20 per cent.

Table 4.29. Percentage of MSEs in Sri Lanka who pay income tax, by business sector and worker group

Status of awareness and impact on growth	Enterprises with 5–14 workers	Enterprises with 15–70 workers	Agro processing	Textiles & garments	Woodworking	Hospitality	All
MSEs that pay income tax	41%	54%	48%	38%	42%	48%	43%
MSEs that do not pay income tax	59%	46%	52%	62%	58%	52%	57%
Total	100%	100%	100%	100%	100%	100%	100%
Base (total no. of MSEs)	480	96	151	192	120	113	576

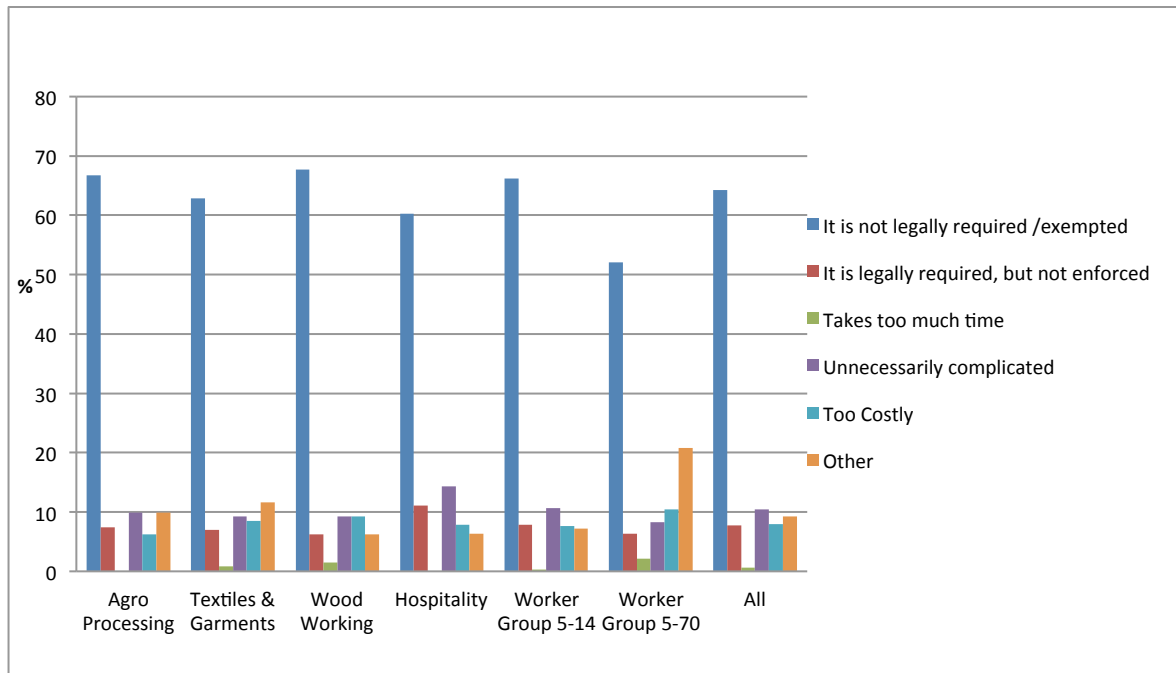
A higher percentage (54 per cent) of MSEs in the larger worker group pay income tax compared to the smaller worker group (41 per cent). Thus the larger enterprises, which may be more organized and making more profits, appear to comply with tax regulations, compared to the less organized and perhaps less profitable smaller enterprises.

Overall, there is a high proportion (57 per cent) of enterprises not paying income tax with about one-third of enterprises paying taxes above the rate of 20 per cent.

The highest level of payment of income tax was by MSEs registered with the income tax department, and import and export license-holders. The lowest levels of income tax payments were made by MSEs with company registration and trade licenses.

The reason stated by most MSEs (66 per cent) for not paying income tax was that they were legally exempted from income tax payment (table B.28). However, since data on annual turnover of MSEs was not collected during the survey, it was uncertain whether all of these 66 per cent firms not paying income tax were legitimately exempted because their earning was actually less than the threshold or not. Though relatively smaller in percentage, some MSEs provided reasons for non-compliance that can be considered “avoidance by choice” strategy such as “Unnecessarily complicated (do not see the benefit)” (11 per cent), “It is legally required, but not enforced” (8 per cent), “Too costly” (8 per cent) and “Takes too much time” (1 per cent). It is to be noted that a considerable proportion of MSEs (17 per cent) did not specify any reason for not paying income tax.

Figure 4.15. Reasons for not paying income tax, by sector and worker group



The major reason in all sectors (66 per cent reporting) and the smaller worker group (66 per cent reporting) and larger worker groups (52 per cent reporting) for not paying income tax was that it was not legally required or that such payment was exempted. Other reasons include “It is legally required but not enforced” (8 per cent), “Unnecessarily complicated” (11 per cent) and “Too costly” (8 per cent). For MSEs with all types of registration and licenses, the majority indicated that the reason for non-payment was that it was not legally required (figure 4.15).

Of all the firms who reportedly paid income tax, 33 per cent stated that they paid it at the rate of 15 per cent, while 18 per cent paid it at the rate of ten per cent, followed by another 18 per cent who paid it at a rate less than equal to five per cent (table B.29).

More than one-third (37 per cent) of MSEs, who reportedly paid income tax, mentioned the transaction cost (time required) for filing and paying income tax to be three to eight days on an average (table B.30), followed by 17 per cent who mentioned the average time required to be two days. While 16 per cent of MSEs reported that the average transaction cost income tax was one day, a considerable share of MSEs (18 per cent) did not provided any information on this. There was not much difference among business sectors in the distribution pattern of MSEs across transaction cost for income tax payment, except the hospitality sector, where a relatively larger proportion of firms (22 per cent) reported that they took only one day to file and pay income tax.

Around 73 per cent of MSEs in Sri Lanka reported that they heard about the existence of penalties for evading payment of income tax. Of these, 69 per cent were able to describe at

least the category of penalty correctly (table B.31). However, only four per cent of MSEs could describe both the quantum and the category of penalty.

Only 65 per cent of the textiles and garments sector firms surveyed were aware (“have heard of”) of the penalties for not complying with the income tax regulation, while the other three sectors demonstrated the awareness ratio between 75 per cent and 80 per cent (table B.32). This knowledge gap with regard to penalties could indicate that it would be psychologically easier for MSEs in the textiles and garments sector not to comply with income tax regulations than those in other sectors. The lowest ratio of tax inspection in the textiles and garments sector may explain this knowledge gap.

Only two per cent of MSEs among those that are either sole proprietorships or unregistered businesses in Sri Lanka reported that they were aware of income tax regulations and still tried to avoid compliance by keeping their income below threshold level, thereby following the “staying below the threshold level” strategy (table B.33). On the other hand, 64 per cent of all sole proprietorships and unregistered businesses reported that they were not aware of income tax regulations that if they earn more than LKR500,000 they are required to pay income tax. There was little sectoral variation in the proportion of such firms who are not aware of income tax regulations.

Only two per cent of MSEs among those that are either partnership businesses or private limited companies in Sri Lanka reported that they were aware of income tax regulations and still tried to avoid compliance by keeping their income below the threshold level, thereby following the “staying below the threshold level” strategy (table B.34). On the other hand, 59 per cent of all partnership businesses or private limited companies reported that they were not aware of income tax regulations that if they earn between LKR1 million and LKR5 million they were liable for an income tax of 15 per cent, whereas if they earn over LKR5 million, they are liable for an income tax of 35 per cent. Among the four surveyed sectors, the proportion of firms who were not aware of income tax regulations was highest in textiles and garments (71 per cent) and lowest in agro processing (50 per cent).

More than half of the surveyed MSEs (58 per cent) reported that they had heard of informal payments being made to avoid compliance with regulations on income tax (table B.35); out of which, 17 per cent reported that they have actually made such informal payments to avoid compliance. In the case of enterprises with 15–70 workers, the proportion who admitted making such informal payments went up to 23 per cent.

4.12 Value added tax (VAT)

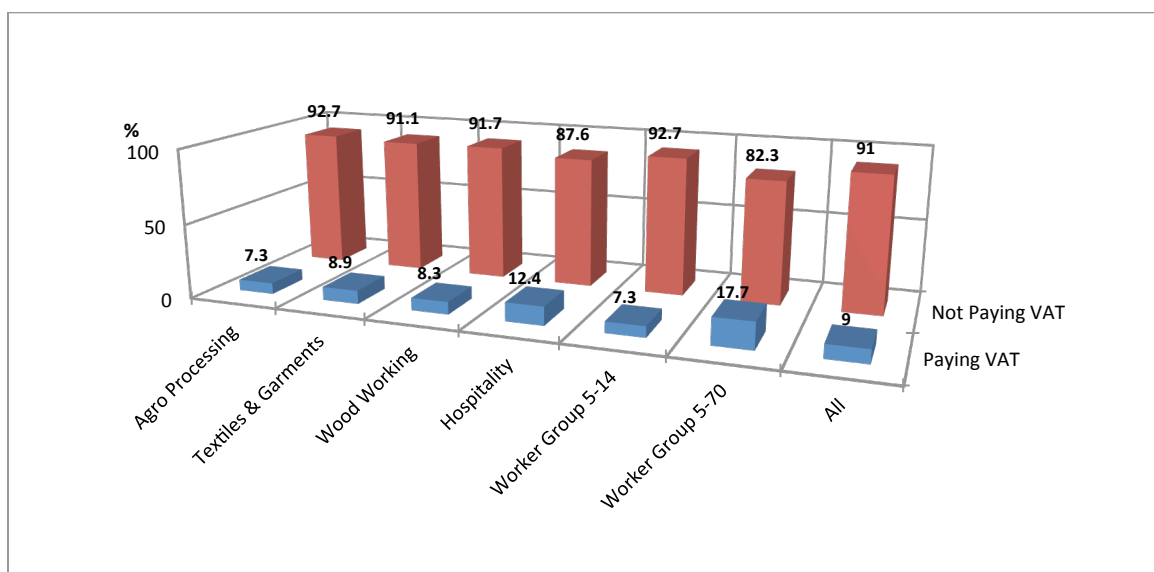
In Sri Lanka, the threshold for VAT is not related to number of employees of an enterprise. VAT payment is required if a business has an annual turnover of LKR2.5 million. Only one per cent of the surveyed MSEs reportedly followed the “staying below the threshold level” strategy to avoid compliance with VAT regulations by keeping their income below the exemption threshold of LKR2.5 million or by not registering (table B.36). A *considerable* proportion of 64 per cent of MSEs claimed that they were not aware of the VAT regulations. The share of MSEs who were not aware of the VAT obligations was similar across all the four surveyed sectors.

A large majority of MSEs (91 per cent) reported that they *did not pay VAT* (but how many of them are below the threshold cannot be specified). About eight per cent of MSEs claimed that they paid VAT in the range of 12–15 per cent and one per cent paid VAT at a rate less than 12 per cent (table 4.30). A higher percentage of VAT payments were made by the larger worker group of 15–70 workers (18 per cent) compared to firms with 5–14 workers (7 per cent).

Table 4.30. Percentage distribution of MSEs in Sri Lanka by status of VAT payment, by business sector and worker group

Status of VAT payment	Enterprises with 5–14 workers	Enterprises with 15–70 workers	Agro processing	Textiles & garments	Woodworking	Hospitality	All
% Paying VAT							
@ Less than 12%	0%	5%	1%	2%	0%	1%	1%
@ 12%	4%	9%	2%	5%	6%	6%	5%
@ 12%–15%	3%	3%	4%	2%	3%	5%	3%
MSEs that pay VAT	7%	18%	7%	9%	8%	12%	9%
MSEs that do not pay VAT	93%	82%	93%	91%	92%	88%	91%
Base (total no. of MSEs)	480	96	151	192	120	113	576

Figure 4.16. Status of VAT payments, by business sector and worker group

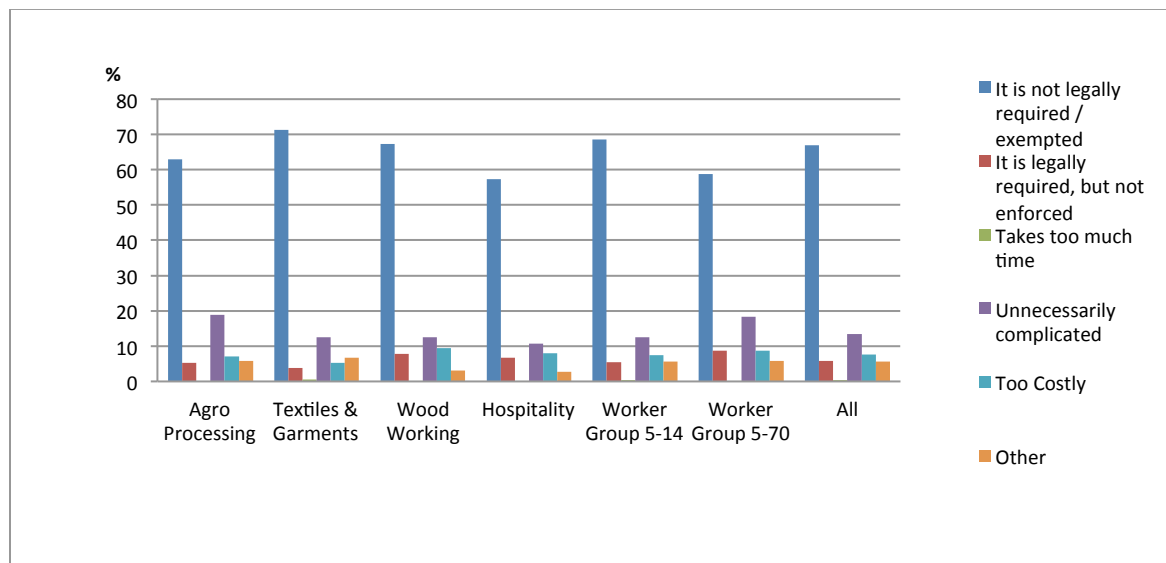


A higher percentage of VAT payments at ten per cent as well as 20 per cent are made by the larger worker group (figure 4.16). This group also has a lower percentage of enterprises not paying VAT compared to the smaller worker group, suggesting that the more organized larger enterprises are probably complying with these laws compared to the smaller worker groups which may be avoiding such payments.

A majority of MSEs registered with the tax department and those with import or export licenses pay VAT; the lowest level of payments were made by those MSEs with company registration, and trade and labour department registrations. The major reason, as indicated by all MSEs with the various types of registrations or licenses, was that it was not legally required. “Unnecessarily complicated” was the other reason quoted by all MSEs.

More than three-fourth of MSEs (79 per cent) who did not pay VAT had stated that they did so because it was not legally required or because they were exempted from VAT payments (table B.37). Some of the other reasons stated for non-compliance by MSEs reflected the “avoidance by choice” strategy such as “Unnecessarily complicated (do not see the benefit)” (16 per cent), “It is legally required, but not enforced” (7 per cent), and “Too costly” (9 per cent). It is to be noted that a considerable proportion of MSEs (8 per cent) did not specify any reason for not paying income tax.

Figure 4.17. Reasons for not paying VAT



The majority of respondents (58–68 per cent) in all sectors and worker groups reported that VAT is not legally required or that it was exempted. About ten per cent to 20 per cent reported that it was “Unnecessarily complicated”, while 5–10 per cent reported that it was “Too costly”. About 5–9 per cent reported that although VAT was legally required, the regulation was not enforced (figure 4.17). The differences between the two worker groups were marginal, with the smaller worker group (smaller enterprises) reporting a higher

percentage of enterprises legally not required to pay VAT or exempt from VAT compared to the larger worker group.

Around 86 per cent of those paying VAT reported that they collected and paid VAT within a week (seven days). In the case of businesses with 5–14 workers, while 79 per cent took one to seven days, another 21 per cent needed eight days to make the VAT payment. The average time spent on making VAT payment by all MSEs is estimated to be four days (table B.38). Among the four surveyed sectors, the average time spent by the agro processing sector in making the VAT payment was observed to be relatively higher (six days) compared to the other three sectors.

Around 47 per cent of MSEs in Sri Lanka reportedly heard about the existence of penalties for evading collection and payment of VAT (table B.39). Out of these, 46 per cent of MSEs were able to describe at least the category of penalty correctly (table B.40), while 52 per cent were unable to specify what the penalties were.

Overall, 27 per cent of MSEs reported that they had heard of informal payments being made to avoid compliance with regulations on VAT (table B.41), out of which, only five per cent reported having actually made such informal payments to avoid compliance. The proportion of firms who reportedly heard of informal payments being made to avoid VAT compliance was highest in the hospitality sector (36 per cent) and lowest in textiles and garments (19 per cent).

4.13 Incentive programmes

Of the total MSEs being surveyed, a negligible share of eight per cent (46 MSEs from the total sample of 576 MSEs) reported that they had started their businesses with support from the government, a donor or a non-governmental organization (NGO) (table 4.31). Among the four business sectors, the percentage of MSEs who availed the support of such incentive programmes was highest in the textiles and garments sector (12 per cent) and lowest in the woodworking sector (three per cent).

Table 4.31. Percentage of MSEs in Sri Lanka whose businesses started with support from a government donor or NGO, by business sector

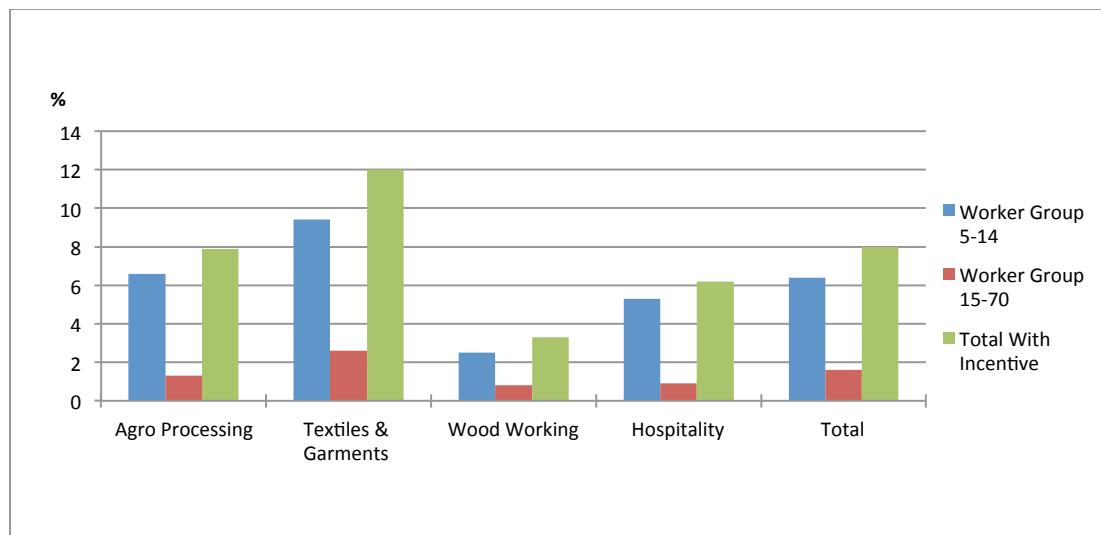
Business sector	% MSEs who received support	Base (total no. of MSEs)
Agro processing	8%	151
Textiles & garments	12%	192
Woodworking	3%	120
Hospitality	6%	113
All	8%	576

Around 92 per cent of enterprises started without availing any incentives. The main reason appears to be the lack of information on incentive schemes and support programmes as 97 per cent of the respondents were not aware of the presently available incentives.

It was observed that the incentive programmes in Sri Lanka did not create a growth trap. Over 99 per cent of MSEs reported that the incentive scheme threshold did not affect growth or expansion (i.e. they were not concerned about losing benefits if the business grew beyond the maximum threshold).

Over 95 per cent of enterprises were not informed of any incentive schemes; they did not avail any incentive schemes nor were they aware of the threshold level for incentive schemes. Over 99 per cent reported that the incentive scheme threshold did not affect growth or expansion. Around 2–5 per cent of respondents indicated that they were informed and had availed of incentive schemes and were also aware of the threshold of one incentive scheme. The highest proportion of such MSEs was observed in the agro processing and textiles and garments sectors and in the larger worker group. Less than one per cent indicated that the incentive scheme threshold level affected growth. The results show an almost total lack of awareness regarding incentive schemes and that a very few have availed of one scheme, resulting in no impact of any incentive scheme threshold on growth.

Figure 4.18. Percentage of enterprises which were started with incentive schemes



Over 90 per cent of enterprises were started without any incentives. The highest level of incentives was in the textiles and garments sector followed by agro processing and hospitality. Greater numbers of enterprises were started with incentives in the smaller worker group than the larger worker group (enterprises). This suggests that incentives have played only a minor role in assisting the establishment of enterprises, with a greater proportion of smaller enterprises and enterprises in the textiles and garments and agro processing sectors being established with incentives.

4.14 Retrenchment

The threshold for application of regulations on retrenchment in Sri Lanka is 15 or more employees in an enterprise. Businesses with 15 or more workmen have to obtain government permission to retrench workers and also need to make retrenchment payments to workers.

Of the total MSEs with 5–14 workers, only one per cent tried to stay below the threshold level in order to avoid compliance with regulations on retrenchment payments (i.e. they follow the “staying below the threshold level” strategy of avoidance) (table B.44). Of the total number of MSEs with 5–14 workers, around 79 per cent were not aware that they needed to obtain government permission to retrench workers and also make retrenchment payments to workers.

Of the total MSEs with 15 or more workers, only eight per cent reported that they had ever taken government permission to retrench workers and provided retrenchment payments (table B.45). The proportion of such firms who have ever undergone the formal retrenchment process according to regulations was relatively higher in the hospitality sector (21 per cent) and almost negligible in the woodworking sector (0 per cent).

For businesses with 15–70 workers, which did not seek government permission nor make any retrenchment payments, the most frequently cited reason was that “The separation was voluntary” (42 per cent) (table B.46). These are grey cases and may not be interpreted as defiance to legal obligations, but could indicate that “*seeking voluntary separation*” might be a popular avoidance strategy of enterprises for retrenchment regulations. A considerable number of MSEs provided reasons that can be considered direct “avoidance by choice” behaviour such as “It has not been demanded” (24 per cent), “It has not been necessary” (6 per cent), “It is legally required, but not enforced” (3 per cent), and “Too costly” (1 per cent). Around 18 per cent of MSEs also reported that they were legally exempted. It is to be noted that a significant proportion of enterprises (32 per cent) that did not make any retrenchment payment did not specify any reason for not paying.

Those who claimed to know the monetary and transaction cost of the retrenchment regulations were few (table B.47): from four per cent in the textiles and garments sector to 11 per cent in agro processing for monetary cost, and from four per cent in textiles and garments to ten per cent in agro processing for transaction cost. These figures are in line with the small percentage of firms that have ever undergone the retrenchment process.

Out of the total number of MSEs in Sri Lanka only 18 per cent knew that there were penalties for non-compliance with the retrenchment regulation, 82 per cent did not know about the penalties or what the penalties were.

Overall, ten per cent of MSEs reported that they had heard of informal payments being made to avoid compliance with regulations on retrenchment payments (table B.48); out of which, only two per cent reported that they have actually made such informal payments to avoid compliance. The proportion of firms who reported to have heard of informal

payments being made to avoid compliance was highest in the agro processing sector (15 per cent) and lowest in the textiles and garments sector (7 per cent).

4.15 Awareness of labour laws and informal payments

4.15.1 Informal payments to avoid compliance with laws/regulations

Table 4.32. Percentage of MSEs in Sri Lanka across different business sectors who have heard of informal payments being made to avoid compliance with regulations in their business

List of regulations	Agro processing	Textiles & garments	Woodworking	Hospitality	Enterprises with 5–14 workers	Enterprises with 15–70 workers	All
Environmental regulations	32%	25%	41%	43%	34%	33%	34%
Minimum wages	15.2%	14%	11%	17%	14%	14%	14%
EPF/ETF	38%	34%	34%	42%	36%	42%	37%
Gratuity	13%	8%	8%	12%	10%	9%	10%
Trade unions	13%	9%	7%	10%	10%	7%	10%
Income tax	60%	52%	58%	65%	58%	59%	58%
VAT	31%	19%	26%	36%	28%	25%	27%
Retrenchment payments	15%	7%	8%	11%	10%	8%	10%
Base (no. of total MSEs)	151	192	120	113	480	96	576

In terms of awareness (“have heard of”), informal payments related to income tax were the most prevalent ones (58 per cent), followed by EPF (37 per cent), environmental regulations (34 per cent), VAT (27 per cent), minimum wage (14 per cent) and gratuity (ten per cent). The hospitality sector demonstrated the highest ratio of awareness on informal payments against each labour and other legal obligation followed by the agro processing sector (gratuity is the only case where the agro Processing sector recorded a higher proportion of MSEs who had heard of informal payments being made than those from the hospitality sector). These two sectors demonstrated higher coverage by the tax inspectors and the PHIs of the local authority, which might explain the sectoral difference of the awareness on informal payments, although the coverage by the LI (which is supposed to address the minimum wage and EPF/ETF) was almost the same across the four sectors). Thus it appears informal payments to avoid income tax are the most prevalent, followed by payments to avoid EPF, environmental regulations and VAT (table 4.32).

Out of those who heard of informal payments being made, 21 per cent actually made informal payments to avoid compliance with environmental regulations, 17 per cent on income tax, 13 per cent on EPF/ETF, six per cent on minimum wage, five per cent each on trade unions and VAT, four per cent on gratuity and two per cent on retrenchment payments (table 4.80). Interestingly, there were fewer firms from the Hospitality and the

agro-processing sectors which honestly disclosed their informal payments than other sectors.

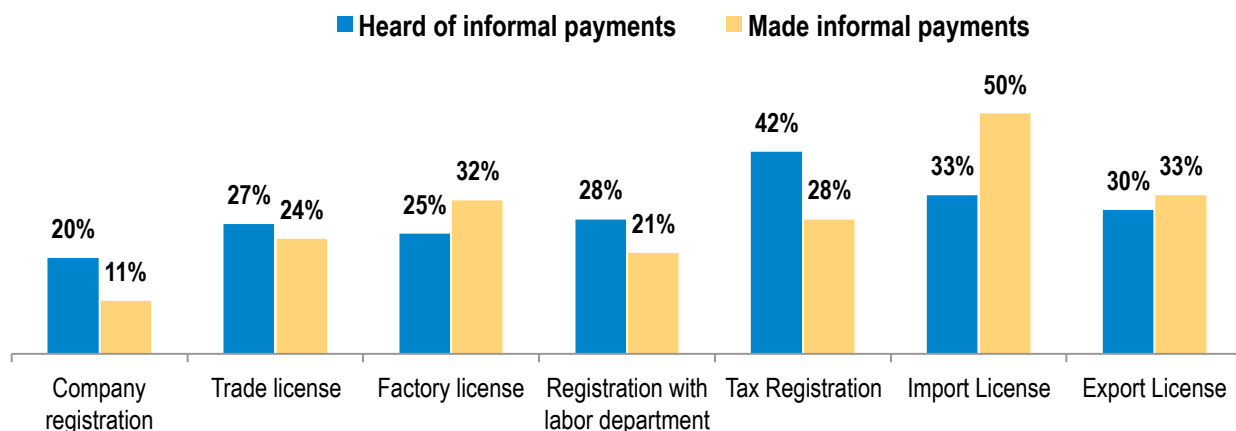
Table 4.33. Percentage share of MSEs in Sri Lanka who have made informal payments to avoid compliance with regulations in their business, by business sector and worker group

List of regulations	Agro processing	Textiles & garments	Woodworking	Hospitality	Enterprises with 5–14 workers	Enterprises with 15–70 workers	All
Environmental regulations	15%	10%	35%	24%	21%	22%	21%
Minimum wages	4%	11%	8%	0%	4%	15%	6%
EPF/ETF	9%	17%	15%	11%	12%	18%	13%
Gratuity	5%	0%	10%	0%	4%	0%	4%
Trade unions	5%	0%	13%	9%	6%	0%	5%
Income tax	14%	19%	19%	14%	15%	23%	17%
VAT	6%	3%	6%	5%	5%	4%	5%
Retrenchment payments	0%	0%	10%	0%	2%	0%	2%

4.15.2 Informal payments to acquire license or registration

The MSEs were asked whether they had heard of or made informal payments in order to acquire each of the different types of registration or licenses (figure 4.19). Around 44 per cent of MSEs who had tax registration had heard that businesses have to pay for the services of agents or make informal payments to government officers to get this registration, followed by 33per cent of MSEs who have an import license. Knowledge of informal payments was comparatively lower among those who had company registration (20 per cent).

Figure 4.19. Percentage of MSEs in Sri Lanka with different licenses who have heard of or made informal payments to acquire that licence/registration

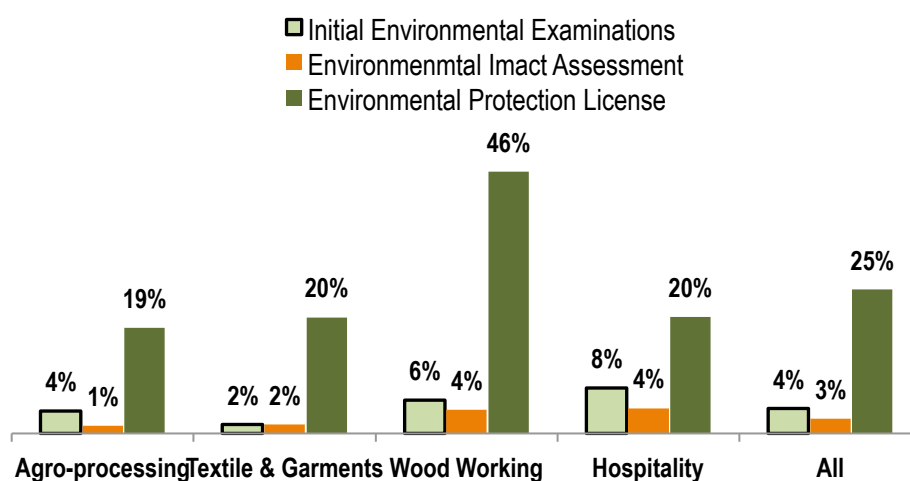


Of the MSEs who had different types of license/registration, the proportion who admitted to making informal payments to acquire those licenses/registration was highest among those who had an import license (50 per cent). On the other hand, a considerably smaller share of MSEs reported that they had to make informal payments in order to get company registration (11 per cent) and registration with the labour department (21 per cent) (table B.49).

4.16 Environmental regulations

Among all the MSEs surveyed, 25 per cent were reported to have the EPL. However, the share of MSEs that went through IEE (4 per cent) and EIA (3 per cent) were significantly lower. The share of MSEs with EPL is highest in the woodworking sector (46 per cent) and lowest in the agro processing sector (19 per cent). The share of MSEs that went through IEE is relatively higher in the hospitality sector compared to the other three sectors (figure 4.20).

Figure 4.20. Percentage of MSEs in Sri Lanka that comply with different environmental regulations, by business sector



Legal requirement is observed to be the key reason why MSEs comply with different environmental regulations (table 4.34). Of the 25 per cent of MSEs in Sri Lanka that have EPL, around three per cent reported that they acquired such a license to also avail the donor or NGO schemes apart from it being a legal requirement.

Table 4.34. MSEs in Sri Lanka with different reasons for compliance as a share of all those MSEs that comply with environmental regulations

Environmental license/regulation	It is legally required	To avail donor/ NGO schemes	Base (no. of MSEs that comply with each regulation)
Initial Environmental Examinations (IEE)	100%	4%	25
Environmental Impact Assessment (EIA)	100%	13%	15
Environmental Protection License (EPL)	99%	3%	145

When asked for the reasons for not complying with the three environmental regulations, more than 90 per cent of MSEs each in case of IEE and EIA, and 80 per cent of MSEs in the case of EPL reported that they did so because it is not legally required (table B.50). Among those who did not have an EPL, around 15 per cent reported that they were simply not aware of the legal obligation of having such a license. Although small in number, there were some MSEs who provided reasons that can be considered “avoidance by choice” strategy such as “It is legally required, but not enforced” (3–6 per cent), “Unnecessarily complicated/do not see the benefit” (1–2 per cent) and “Don’t want to pay the required fees” (2 per cent each).

The average transaction cost was found to be 24 days to prepare reports for IEE compliance and 30 days for its government approval, which is similar to the officially defined period of 15–45 days and 15–180 days, respectively (tables B.51 and B.52). However, the average time taken was reported to be much less for preparation of reports for EIA compliance (12 days on an average) and its approval by government (15 days), which is similar to the officially defined period of 15–180 days. The In case of EPL, even though the average time required to prepare compliance reports was found to be 18 days, it took much longer (193 days) to get them approved by the government, compared to the official duration of 15–45 days and 30–365 days, respectively. For each of the three environmental regulations the transaction time was significantly higher for enterprises with 15–70 workers compared to those with 5–15 workers.

The average fees paid by the surveyed MSEs to the government for initial licensing was observed to be highest for IEE (LKR20,208), followed by EIA (LKR9,800). However, the official fees are dependent on the nature of the project which can be much lower or higher than the officially defined fees (table B.53). Again, the official government licensing fee for EPL, as reported by the surveyed MSEs, was found to be LKR5,455 on average, which is similar to the official fee which ranges from LKR4,000 to LKR7,500, the difference ranging from LKR1,500 to LKR2,000

While only six per cent of MSEs in Sri Lanka reported that they were aware that penalties exist if they do not comply with EIA or IEE, as high as 97 per cent of MSEs were aware of the existence of penalties for not acquiring the EPL. Of those MSEs who had heard about penalties for non-compliance with EIA/IEE, 24 per cent were observed to have accurate knowledge of the category as well the amount of penalties, which is significantly higher than six per cent of MSEs in the case of EPL. Likewise, 64 per cent of MSEs know the category of the penalty on EPL is also high (table B.54). This is interesting since the coverage by environmental inspectors is not particularly high in comparison to others (e.g. labour inspection).

Overall, 34 per cent of MSEs reported that they had heard about informal payments being made in order to avoid compliance with environmental regulations (table B.55). Out of which, 21 per cent reported that they had made such payments to avoid compliance with environmental regulations. The share of MSEs who had reportedly made informal payments was highest in the woodworking sector (35 per cent) and lowest in the textiles and garments sector (10 per cent).

4.17 Perception-based ranking of factors

- When compared to the level of awareness, compliance and avoidance confirmed through the survey, the general tendency is that perception-based rating overstates the impact of positive factors and understates the impact of negative factors.
 - While 78 per cent of MSEs perceived that compliance with environmental and sanitary regulations positively affects business growth, the proportion of MSEs actually following these regulations was much smaller. However, among all MSEs being surveyed, 25 per cent reported having the EPL. The share of MSEs that went through the IEE (four per cent) and EIA (three per cent) were significantly lower.
 - The 89 per cent who viewed paying the minimum wage as positively affecting the growth of business is not in line with only 69 per cent of surveyed MSEs who claimed to be aware of the minimum wage obligations and claimed paying the minimum wage.
 - The 84 per cent who viewed maintaining an employment register as positively affecting the growth of business is not in line with the outcome that only 74 per cent of MSEs maintained the employment register. However, a significant proportion claimed that they did not maintain registers because they had daily wage employment.
 - While 62 per cent of MSEs perceived making EPF contributions as positively affecting the growth of business, 64 per cent of the surveyed MSEs were aware of the obligations and did contribute to EPF/ETF.
 - Having a trade union and collective bargaining process is perceived to be not applicable to the growth process of businesses by half of the MSEs (47 per cent) and is perceived to have no influence by 33 per cent of MSEs. While ten per cent

of MSEs believed that having a trade union positively influences business growth, only one per cent of the surveyed businesses had actually joined or formed a trade union.

4.17.1 Factors influencing business growth (business climate)

- How do MSEs in Sri Lanka view regulations and inspection (including labour, taxation, registration, licensing and so on) among the other factors that can influence business growth? When asked “To what extent do you believe any of the following factors encourage or hinder the growth of your business?”, the views were split (table 4.35). Around 53 per cent considered regulations and inspections as having a strongly positive or positive influence on growth, while 34 per cent considered them to have a strongly negative or negative influence. The 53 per cent positive view was not very high, with other factors scoring better, e.g. market demand for your products or services (85 per cent), water and sanitation facilities (this is related to the working conditions, though) (83 per cent), availability of electricity (81 per cent), transport infrastructure (80 per cent), the cost of labour (70 per cent) and availability of raw materials (59 per cent). The 34 per cent negative view was not that high either when other factors collected more negative votes: cost of electricity (69 per cent), access to appropriately skilled workers (62 per cent), cost of land and premises for business (57 per cent), cost of financing (e.g. interest rates) (47 per cent), availability of land and premises for business (46 per cent) and government corruption (40 per cent). Except for the top three factors rated positive (market demand for your products or services, water and sanitation facilities and availability of electricity), most of the factors have split views into positive and negative sides.

Table 4.35. Distribution of MSEs in Sri Lanka across factors influencing business growth (business climate), all sectors

Factors of influence	Strong positive influence	Positive influence	No influence	Negative influence	Strongly negative influence	Does not apply	Total
Market demand for your products or services	34%	51%	0%	13%	2%	0%	100%
The cost of labour	12%	59%	1%	23%	5%	1%	100%
The level of taxation	8%	41%	9%	26%	6%	10%	100%
Regulations and inspections (labour, taxation, registration, licensing, etc.)	9%	44%	8%	27%	7%	6%	100%
The cost of finance (eg. interest rates)	3%	38%	8%	40%	7%	5%	100%
Access to credit (procedural)	12%	37%	8%	30%	8%	5%	100%
Access to appropriately skilled workers	7%	30%	1%	43%	18%	1%	100%
Transport infrastructure	19%	61%	3%	13%	2%	1%	100%
Effectiveness of courts	3%	19%	38%	11%	6%	23%	100%

Dealing with disputes							
Government corruption	5%	23%	18%	28%	12%	14%	100%
Non-payment by customers	12%	37%	8%	24%	8%	11%	100%
Availability of land and premises for business	7%	35%	5%	34%	11%	7%	100%
Cost of land and premises for business	6%	28%	2%	39%	18%	7%	100%
Availability of electricity	22%	59%	1%	13%	3%	1%	100%
Cost of electricity	3%	26%	1%	44%	24%	2%	100%
Water and sanitation Facilities	32%	51%	2%	10%	3%	2%	100%
Availability of raw materials	23%	36%	1%	23%	16%	1%	100%
Industrial security (extortion, threat to life for business persons)	21%	18%	8%	4%	4%	45%	100%
Other	0%	0%	0%	0%	0%	100%	100%

In the agro processing sector, 65 per cent to 95 per cent of the respondents indicated either positive or strongly positive influence on business expansion due to labour laws such as maintaining an employment register, paying the minimum wage, provident fund contributions, and workers' injury compensation. This suggests these laws generally assist or do not hamper business expansion in this sector. About 30 per cent to 55 per cent of the respondents indicated positive as well as strongly positive influence on business due to labour laws such as limits on working time, insurance, complying with health and safety standards of workers as well as procedures for dismissals and disputes, and severance payments, suggesting an average level of positive influence of these factors on business development. In other words, these laws may be either assisting or not hampering business expansion to some extent. In the case of laws such as limits on working time, insurance and compliance with procedures for dismissals and disputes, 10–20 per cent of the respondents reported that these laws had a strongly negative or negative influence on business expansion and these laws may be partly hampering business expansion. A majority or a substantial proportion of the respondents indicated that many laws either had no influence or were not applicable for business expansion. These include laws such as unions and collective bargaining (87 per cent), paying for annual leave (68 per cent), procedures for dismissals and disputes (60 per cent), complying with health and safety standards of workers (54 per cent), severance payments, retrenchment and gratuity (48 per cent) and insurance (46 per cent) as well as workers' injury compensation (34 per cent) and limits on working time (27 per cent). Thus the majority of the labour laws appear to have either a positive impact on business or have no influence or are not applicable to business expansion in this sector.

In the textiles and garments sector, 55–90 per cent of the respondents indicated either positive or strongly positive influence on business expansion due to labour laws such as maintaining an employment register, paying the minimum wage, provident fund contributions, and workers' injury compensation. This suggests these laws generally assist or do not hamper business expansion in this sector. About 25 per cent to 45 per cent of the

respondents indicated positive as well as strongly positive influence on business due to labour laws such as limits on working time, insurance, complying with health and safety standards of workers, severance payments, insurance, paying for annual leave as well as procedures for dismissals and disputes, suggesting an average level of positive influence of these factors on business development. In other words, these laws may be either assisting or not hampering business expansion to some extent. In the case of laws such as limits on working time (28 per cent), severance payments and provident fund contributions, and compliance with health and safety standards and procedures for dismissals and disputes, 10–28 per cent of the respondents reported that these laws had a strongly negative or negative influence on business expansion and these laws may be partly hampering business expansion. A majority or a substantial proportion of the respondents indicated that many laws either had no influence or were not applicable for business expansion. These include laws such as unions and collective bargaining (76 per cent), paying for annual leave (68 per cent), compliance with procedures for dismissals and disputes (60 per cent), complying with health and safety standards of workers (48 per cent), severance payments, retrenchment and gratuity (45 per cent) and insurance (52 per cent) as well as workers' injury compensation (25 per cent) and limits on working time (27 per cent). Thus the majority of labour laws appears to have either a positive impact on business or have no influence or are not applicable to business expansion in this sector.

In the woodworking sector, 75–82 per cent of the respondents indicated either positive or strongly positive influence on business expansion due to labour laws such as maintaining an employment register, paying the minimum wage and workers' injury compensation. This suggests these laws generally assist or do not hamper business expansion in this sector. About 30–55 per cent of the respondents indicated positive as well as strongly positive influence on business due to labour laws such as provident fund contributions, limits on working time, insurance, complying with health and safety standards of workers, severance payments, paying for annual leave as well as compliance with procedures for dismissals and disputes, suggesting an average level of positive influence on business development. In other words, these laws may be either assisting or not hampering business expansion to some extent. A small proportion of the respondents reported that the following laws had a strongly negative or negative influence on business expansion, limits on working time (22 per cent), and severance payments (ten per cent) suggesting that these laws may be having only a minor negative impact on business expansion. A majority or a substantial proportion of the respondents indicated that many laws either had no influence or were not applicable for business expansion. These include laws such as unions and collective bargaining (78 per cent), paying for annual leave (68 per cent), compliance with procedures for dismissals and disputes (63 per cent), complying with health and safety standards of workers (56 per cent), severance payments, retrenchment and gratuity (45 per cent) and insurance (41 per cent) as well as workers' injury compensation (22 per cent) and limits on working time (27 per cent). Thus the majority of the labour laws appears to have either a positive impact on business or have no influence or are not applicable to business expansion in this sector.

In the hospitality sector, 60–90 per cent of the respondents indicated either positive or strongly positive influence on business expansion due to labour laws such as maintaining an

employment register, paying the minimum wage, paying provident funds and workers' injury compensation. This suggests that these laws generally assist or do not hamper business expansion in this sector. About 35–55 per cent of the respondents indicated positive as well as strongly positive influence on business due to labour laws such as limits on working time, insurance, complying with health and safety standards of workers, severance payments, paying for annual leave as well as compliance with procedures for dismissals and disputes, suggesting an average level of positive influence on business development. In other words, these laws may be either assisting or not hampering business expansion to some extent. A small proportion of the respondents reported that the following laws had a strongly negative or negative influence on business expansion: severance payments (23 per cent), compliance with health and safety standards and limits on working time (13 per cent). This suggests that these laws may be having only a minor negative impact on business expansion. A majority or a substantial proportion of the respondents indicated that many laws either had no influence on, or were not applicable for, business expansion. These include laws such as unions and collective bargaining (83 per cent), paying for annual leave (57 per cent), compliance with procedures for dismissals and disputes (53 per cent), complying with health and safety standards of workers (43 per cent), severance payments, retrenchment and gratuity (47 per cent) and insurance (53 per cent) as well as workers' injury compensation (35 per cent) and limits on working time (34 per cent). Thus the majority of the labour laws appear to have either a positive impact on business or have no influence or are not applicable to business expansion in this sector.

In general, the results show that many of the labour laws and regulations which have strongly positive or positive impact on business were the same in all four sectors. These include, for example, maintaining an employment register or paying minimum wages, workers' injury compensation, provident fund contributions, limits on working time, insurance, complying with health standards or procedures for dismissals or disputes, and paying for annual leave. Only a small proportion of respondents reported that some laws had strongly negative or negative impacts on business growth. These include limits on working time, complying with procedures for dismissals and disputes and, to some extent, severance and provident fund payments and complying with health and safety standards. A high proportion of respondents indicated that many laws either had no influence or were not applicable to business expansion. These include such laws as unions and collective bargaining, paying for annual leave, compliance with procedures for dismissals and disputes, complying with health and safety standards of workers, severance payments, retrenchment and gratuity, insurance as well as workers' injury compensation, and limits on working time. As many of these labour laws (other than those on severance payments) are applicable to all enterprises regardless of size, this perception of a considerable proportion of MSEs that there was no influence on the business by these labour laws or that they were inapplicable may indicate that they are more easily evaded or that the application of enforcement mechanisms in the MSE sector are weak. However, given the findings regarding the high rate of inspections of MSEs by the Department of Labour, both evasion and lack of inspection appear to be unlikely (unless the inspections are not stringent), and thus this aspect may justify further study.

Hypothesis testing showed that statistically significant greater positive influences were obtained in the case of factors such as maintaining employment registers, paying minimum wages, complying with health and safety standards for workers, workers' injury compensation and insurance. Statistically significant equal or lower negative influence on business expansion was obtained for factors such as dismissal procedures, severance payments, provident fund contributions, payment for annual leave, unions, and limits on working time. Thus these latter factors may have a negative impact on business expansion with the test confirming the results of the survey analysed.

Table 4.36. Results of statistical tests of influence of labour laws and regulations on business expansion

Labour regulations/laws influencing business expansion	
Factors of influence	Results of statistical test
Maintaining an employment register	Strongly positive or positive influence
Paying the minimum wage	Strongly positive or positive influence
Complying with health and safety standards for workers	Strongly positive or positive influence
Dismissal procedures and disputes	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Severance payments (retrenchment, gratuity, ETF)	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Provident fund contributions	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Paying for annual leave	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Unions and collective bargaining	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Workers' injury compensation	Strongly positive or positive influence
Limits on working time (per day, week, etc.)	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Insurance	Strongly positive or positive influence

4.17.2 Factors influencing business growth (business laws and regulations)

Within the legal and regulatory issues (table 4.37), labour regulation and inspections come sixth as the positive factor at 65 per cent while the top five are: maintaining minimum product standards and certification (85 per cent), cost or time required to register a business (83 per cent), cost and time required to obtain a business license (78 per cent), complying with environment and sanitary standards (78 per cent) and complying with food and health standards (66 per cent). Complying with labour regulations and inspections come sixth as the negative factor (19 per cent) after time required to complete tax administration (22 per cent), registering land and other property (25 per cent), cost and time required to register for taxation (25 per cent), complying with banking and credit

regulations (28 per cent) and cost of taxation (37 per cent). It is notable that the three out of top five negative factors mentioned were of tax issues. Nonetheless, all top five negative factors had more votes as positive factors.

Table 4.37. Distribution of MSEs in Sri Lanka across factors influencing business growth (laws and regulations), all sectors

Factors of Influence	Strongly positive influence	Positive influence	No influence	Negative influence	Strongly negative influence	Does not apply	Total
Cost or time required to register a business	18%	65%	5%	9%	1%	2%	100%
Cost and time required to obtain a business license	11%	68%	4%	13%	2%	2%	100%
Complying with banking and credit regulations	3%	41%	15%	26%	2%	13%	100%
Cost and time required to register for taxation	5%	41%	18%	23%	2%	11%	100%
Cost of taxation (income tax, sales tax/VAT)	2%	26%	17%	30%	8%	17%	100%
Time required to complete tax administration	3%	30%	22%	20%	3%	23%	100%
Complying with labour regulation and inspections (health and safety, social security, hiring and firing, leave and other benefits)	13%	52%	10%	16%	3%	6%	100%
Complying with environment and sanitary standards (regulations)	24%	54%	5%	9%	2%	6%	100%
Maintaining minimum product standards and certification	36%	49%	5%	2%	0%	8%	100%
Complying with food and health standards (for products)	29%	37%	6%	2%	0%	25%	100%
Obtaining patents and copyrights	0%	2%	10%	1%	0%	86%	100%
Complying with import and export regulations	1%	7%	9%	3%	1%	78%	100%
Registering land and other property	6%	33%	16%	19%	6%	20%	100%
Other	0%	0%	0%	0%	0%	100%	100%

In the agro processing sector, over 80 per cent of the respondents indicated either positive or strongly positive influence on regulatory issues such as cost or time required to register or obtain a business license for their business, as well as complying with food and health or environment and sanitary standards and in maintaining minimum product standards and certification. This suggests that these regulatory issues do not hamper business expansion in this sector.

Positive as well as strongly positive influence indicated by 45–65 per cent of the respondents on business for factors such as complying with banking and credit regulations, registering land and other property, and cost and time required to register for taxation suggests an average level of positive influence on business development. In other words, these factors are not overly affecting business expansion or are at reasonable levels. In the case of issues such as cost of taxation, cost and time required for taxation, complying with banking and credit regulations, and time required to complete tax administration, 25–40 per cent of the respondents indicated either strongly negative or negative influence on business expansion, while 15–25 per cent felt that these factors, as well factors such as registering land and other property, had no influence on business expansion. A majority (70–80 per cent) also felt that obtaining patent rights and complying with import regulations was not applicable to business expansion. About 15–25 per cent also felt that registering land or property, time required to complete tax administration, and cost of taxation were not applicable to business expansion.

In the textiles and garments sector, 75–90 per cent of the respondents indicated either positive or strongly positive influence on regulatory issues such as cost or time required to register or obtain a business license for their business, as well complying with environment and sanitary standards and in maintaining minimum product standards and certification. This suggests that these regulatory issues do not hamper business expansion in this sector. About 40–65 per cent of the respondents indicated positive as well as strongly positive influence on business for factors such as complying with labour regulations and inspections, food and health standards, as well as banking and credit regulations and registering land and other property, and cost and time required to register for taxation. This suggests an average level of positive influence of these factors on business development. In other words, these factors are not overly affecting business expansion or are at reasonable levels. In the case of issues such as cost of taxation, cost and time required for taxation, complying with banking and credit regulations, and registering land and other property, 25–36 per cent of the respondents indicated either strongly negative or negative influence on business expansion, while 12–22 per cent felt that these factors, as well factors such as time required to complete tax administration, had no influence on business expansion. A majority (70–90 per cent) felt that obtaining patent rights and complying with import regulations was not applicable to business expansion. About 15–40 per cent felt that registering land or property, complying with banking and credit regulations, cost and time required for registering for taxation, time required to complete tax administration, cost of taxation, and complying with food and health standards were not applicable to business expansion.

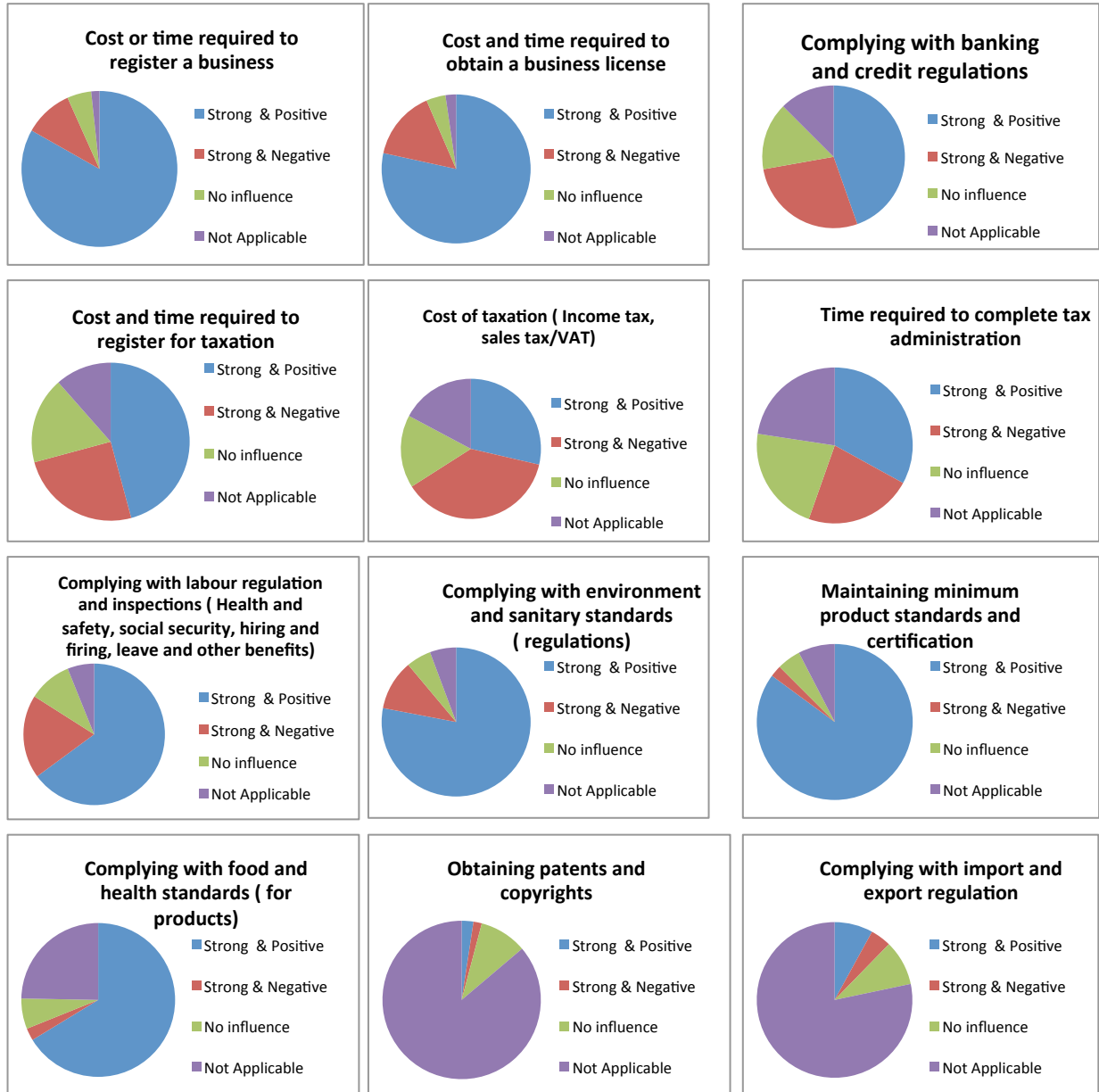
In the woodworking sector, 65–75 per cent of the respondents indicated either positive or strongly positive influence on regulatory issues such as cost or time required to register or

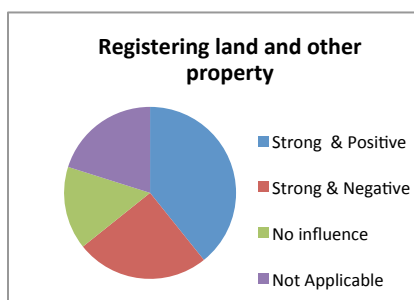
obtain a business license for their business, as well as complying with environment and sanitary standards, maintaining minimum product standards and certification, and in complying with labour regulations. This suggests that these regulatory issues do not greatly hamper business expansion in this sector. About 35–45 per cent of the respondents indicated positive as well as strongly positive influence on business for factors such as complying with food and health standards as well as banking and credit regulations, registering land and other property, cost and time required to register for taxation, and time required to complete tax administration, suggesting a moderate level of positive influence on business development. In other words, these factors are not overly affecting business expansion or are at reasonable levels. In the case of issues such as cost of taxation, cost and time required to register for taxation and to obtain a business license, complying with banking and credit regulations, and registering land and other property, 20–30 per cent of the respondents indicated either strongly negative or negative influence on business expansion. For 10–26 per cent of respondents, all factors, except cost and time required to register a business or to obtain a business license, complying with environmental and sanitary standards and maintaining product standards and certification, had no influence on business expansion. A majority (75–85 per cent) felt that obtaining patent rights and complying with import regulations were not applicable to business expansion. About 15–40 per cent felt that cost of taxation and time required to register for taxation, time required to complete tax administration, maintaining product standards and certification, and complying with food and health standards (42 per cent) were not applicable to business expansion.

In the hospitality sector, 65–90 per cent of the respondents indicated either positive or strongly positive influence on regulatory issues such as cost or time required to register or obtain a business license for their business, as well as complying with labour regulations or environment and sanitary standards, in maintaining minimum product standards and certification, and in complying with food and health standards. This suggests that these regulatory issues do not greatly hamper business expansion in this sector. About 30–50 per cent of the respondents indicated positive as well as strongly positive influence on business for factors such as complying with banking and credit regulations, and registering land and other property and cost of taxation and cost and time required to register for taxation and time required to complete tax administration, suggesting a moderate level of positive influence on business development. In other words, these factors are not overly affecting business expansion or are at reasonable levels. In the case of issues such as cost of taxation (45 per cent), cost and time required to register for taxation, complying with banking and credit regulations, and time required to complete tax administration and registering land and other property, 20–45 per cent of the respondents indicated either strongly negative or negative influence on business expansion. Around 12–18 per cent felt that registering land and other property, time required to complete tax administration, cost and time required for registering for taxation, and cost of taxation had no influence on business expansion. A majority (85–90 per cent) felt that obtaining patent rights and complying with import regulations were not applicable to business expansion. About 10–22 per cent felt that cost of taxation and time required to register for taxation, time required to complete tax

administration and registering land and other property (22 per cent) were not applicable to business expansion.

Figure 4.21 Influence of business regulation on business expansion





In general, the results show that many of the major laws and regulations that have a strongly positive or positive impact on business were the same in all the four sectors, e.g. cost or time required to register or obtain a business license, as well as compliance with labour regulations or environment and sanitary standards, maintenance of minimum product standards and certification, and compliance with food and health standards. Several regulations having a strongly negative or negative impact such as cost of taxation, time required to complete tax administration, cost and time required to register for taxation, complying with banking and credit regulations, complying with labour regulations, and registering land and property. These influence business expansion to a moderate level and were common to all the four sectors. Other common negative influences influencing business expansion at a low level include cost and time required to register a business, compliance with environmental and sanitation standards, and obtaining a business license. Obtaining patent rights and complying with import and export regulations were considered to be not applicable by a large majority in all sectors. Other regulations considered to have no influence on business expansion, as commonly stated by a small percentage of respondents in all sectors, include regulations such as complying with banking and credit regulations, cost and time required to register for taxation, cost of taxation, and time required to complete tax administration and register land and other property.

Table 4.38. Results of statistical tests of influence of business regulations on business expansion

Business regulations influencing business expansion	
Factors of influence	Results of statistical test
Cost or time required to register a business	Strongly positive or positive influence
Cost and time required to obtain a business license	Strongly positive or positive influence
Complying with banking and credit regulations	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Cost and time required to register for taxation	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Cost of taxation (income tax, sales tax/VAT)	Strongly positive or positive influence less than or equal to strongly negative or negative influence

Time required to complete tax administration	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Complying with labour regulation and inspections	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Complying with environment and sanitary standards	Strongly positive or positive influence
Maintaining minimum product standards & certification	Strongly positive or positive influence
Complying with food and health standards	Strongly positive or positive influence
Obtaining patents and copyrights	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Complying with import and export regulations	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Registering land and other property	Strongly positive or positive influence less than or equal to strongly negative or negative influence

Hypothesis tests showed the factors that have a statistically significant higher positive influence: cost or time required to register a business or to obtain a business license; compliance with environment, sanitation, food and health standards; maintaining minimum production standards; and certification. In the case of all the other factors there was no significant difference between positive and negative influences, suggesting that business factors such as compliance with banking regulations, taxation and labour laws may have an equal negative as well as positive influence on business growth.

4.17.3 Labour laws and regulations influencing business growth

Within the boundary of labour laws and regulations (table 4.39), the top five positive factors were: paying the minimum wage (89 per cent), maintaining an employment register (84 per cent), workers' injury compensation (69 per cent), EPF contributions (62 per cent) and limits on working time (50 per cent). The top five negative factors were: limits on working time (22 per cent), complying with procedures for dismissals and disputes (13 per cent), severance payments (retrenchment, gratuity, ETF) (11 per cent), EPF contributions (11 per cent) and complying with health and safety standards for workers (ten per cent).

Table 4.39. Distribution of MSEs in Sri Lanka across elements of labour law and regulation influencing business growth, all sectors

Regulations/laws	Strongly positive influence	Positive influence	No influence	Negative influence	Strongly negative influence	Does not apply	Total
Maintaining an employment register	32%	52%	8%	2%	1%	5%	100%
Paying the minimum wage	39%	50%	5%	1%	0%	5%	100%
Complying with health and safety	9%	30%	31%	8%	2%	20%	100%

dismissal procedures and disputes	6%	22%	37%	10%	2%	23%	100%
Severance payments	13%	30%	28%	7%	5%	19%	100%
EPF contributions	26%	36%	14%	7%	4%	14%	100%
Paying for annual leave	11%	21%	35%	5%	2%	26%	100%
Unions and collective bargaining	2%	8%	33%	7%	2%	47%	100%
Workers' injury compensation	15%	55%	19%	1%	1%	9%	100%
Limits on working times	5%	45%	19%	15%	7%	9%	100%
Insurance	14%	28%	23%	9%	1%	26%	100%
Others	0%	0%	0%	0%	0%	100%	100%

4.18 Labour law and growth in MSEs

Agro processing sector: Over 80 per cent of respondents indicated either positive or strongly positive influence on business for factors such as market demand, transport infrastructure, and availability of electricity, water and sanitation services. Over 50 per cent of respondents indicated positive as well as strongly positive influence on business for factors such as cost of labour, level of taxation, regulations and inspections, non-payment by customers, access to credit, availability of raw materials, suggesting above average positive influence on business development. In other words, these factors are not overly affecting business expansion or are at reasonable levels. In the case of factors such as cost of electricity, cost of land and premises, and availability of land and premises to some extent, access to skilled workers, cost of finance and government corruption, over 40 per cent and up to 75 per cent of the respondents indicated either strongly negative or negative influence on business expansion. A majority felt that the effectiveness of courts in dealing with disputes and, to a small extent (21 per cent), government corruption did not have any influence on business expansion. A majority (45 per cent) also felt that industrial security was not applicable while about 40 per cent felt that it had either a strongly positive or positive influence on business expansion.

Textiles and garment sector: Around 70–90 per cent of the respondents indicated either positive or strongly positive influence on business for factors such as market demand, transport infrastructure, cost of labour, and availability of electricity, water and sanitation services. Around 40–52 per cent of the respondents indicated positive as well as strongly positive influence on business for factors such as level of taxation, regulations and inspections, cost of finance, non-payment by customers, access to credit, availability of raw materials and availability of land and premises, suggesting above average positive influence on business development. In other words, these factors are not overly affecting business expansion or are at reasonable levels. In the case of factors such as cost of electricity, cost of land and premises and availability of land and premises (to some extent), access to skilled workers, cost of finance, and government corruption, over 40 per cent and up to 70 per cent of respondents indicated either strongly negative or negative influence on business

expansion. A majority felt that the effectiveness of courts in dealing with disputes did not have any influence or was not applicable for business expansion. A majority (53 per cent) also felt that industrial security was not applicable while about 34 per cent felt that it had either a strongly positive or positive influence on business expansion.

Woodworking sector: Around 60–85 per cent of respondents indicated either positive or strongly positive influence on business for factors such as market demand, transport infrastructure, cost of labour, and availability of electricity, water and sanitation services. Around 45–51 per cent of respondents indicated positive as well as strongly positive influence on business for factors such as level of taxation, regulations and inspections, cost of finance and non-payment by customers, suggesting above average positive influence on business development. In other words, these factors are not overly affecting business expansion or are at reasonable levels. Strongly negative or negative influence was reported by over two-thirds in the case of factors such as access to skilled workers, availability of raw materials and cost of land and premises, while factors such as cost of electricity, availability of land and premises, cost of finance, and regulations (to some extent), and government corruption were reported to have strongly negative or negative impact on business expansion by 40 per cent and up to 53 per cent of the respondents. A majority (over 60 per cent) felt that the effectiveness of courts in dealing with disputes did not have any influence or was not applicable for business expansion. A majority (43 per cent) also felt that industrial security was either positive or strongly positive, while about 36 per cent felt that it was not applicable to business expansion.

Hospitality sector: Over 80 per cent of respondents indicated either positive or strongly positive influence on business for factors such as market demand, availability of raw materials, transport infrastructure and availability of electricity, water and sanitation services. Around 50–65 per cent of respondents indicated positive as well as strongly positive influence on business for factors such as cost of labour, regulations and inspections, level of taxation, and non-payment by customers, suggesting above average positive influence on business development. In other words, these factors are not overly affecting business expansion or are at reasonable levels. Strongly negative or negative influence was reported by over two-thirds in the case of factors such as access to skilled workers and cost of electricity. Other factors such as availability and cost of land and premises, cost of finance and government corruption were reported to have strongly negative or negative impact on business expansion, by 45 per cent and up to 58 per cent of respondents. A majority (over 60 per cent) felt that the effectiveness of courts in dealing with disputes did not have any influence or was not applicable for business expansion. A majority (43 per cent) also felt that industrial security was not applicable, while 40 per cent felt that it had either positive or strongly positive impact on business expansion.

When data for all sectors were combined, the major positive factors were market demand, cost of labour, transport infrastructure, and availability of electricity, water and sanitation. Factors that had average levels of positive or strongly positive influence and equal or slightly lower strongly negative or negative influences were cost of finance,

availability of land and premises, availability of raw materials, regulations and inspections, level of taxation, access to credit, cost of labour, and non-payment by customers. A higher proportion of strongly negative or negative influence was reported for access to skilled workers, cost of electricity, cost of land and premises, and government corruption, which may be hindering expansion and act as a growth trap for MSEs. A majority considered factors such as effectiveness of courts in dealing with disputes, industrial safety and, to some extent, government corruption to be not applicable or with no influence on growth.

Table 4.40 Results of statistical tests of business environment-related issues on business expansion

Business environment-related issues influencing business expansion	
Factors of influence	Results of statistical test
Market demand for your products or services	Strongly positive or positive influence
Cost of labour	Strongly positive or positive influence
Level of taxation	Strongly positive or positive influence
Regulations and inspections (labour, taxation, registration, licensing, etc.)	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Cost of finance (e.g. interest rates)	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Access to credit (procedural)	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Access to appropriately skilled workers	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Transport infrastructure	Strongly positive or positive influence
Effectiveness of courts in dealing with disputes	Strongly positive or positive influence
Government corruption	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Non-payment by customers	Strongly positive or positive influence
Availability of land and premises for business	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Cost of land and premises for business	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Availability of electricity	Strongly positive or positive influence
Cost of electricity	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Water and sanitation facilities	Strongly positive or positive influence
Availability of raw materials	Strongly positive or positive influence less than or equal to strongly negative or negative influence
Industrial security (extortion, threat to life for business persons)	Strongly positive or positive influence

Testing of hypothesis showed that the following issues had a statistically significant greater positive influence on business-related issues: market demand, cost of labour, transport infrastructure, availability of electricity and water and sanitation services, and industrial security. All the other factors, such as level of taxation, regulations and inspections, cost of finance and electricity, access to skilled workers, availability of raw materials, etc., have an equal or lower level of negative influence on business expansion, statistically confirming the results of the analysis based on proportions described in previous chapters.

CHAPTER 5: Summary, conclusions and recommendations

5.1 Summary of findings

The first section of this chapter summarizes the conclusions of the survey based on the analysis of results relating to current status of MSEs with respect to location, number of years in operation, legal structure, registration, employment, including duration of employment, working hours and number of working days in a month, as well as maintenance of employment registers and payment modalities. The second section summarizes the views, perceptions and practices with respect to factors influencing growth or expansion of MSEs, regulatory and legal issues, compliance with labour laws and unionization and payment of taxes, as well as awareness and knowledge regarding laws and regulations. The third section summarizes the conclusions with respect to gender analysis and statistical testing of survey results.

5.2 Current status of MSEs

The micro- and small enterprises (MSEs) are located more or less equally between urban and rural areas. The variations with respect to location of MSEs between districts were marginal, while variations between sectors were more pronounced, particularly with respect to the hospitality sector, where over 80 per cent of the MSEs were located in the rural sector. This is probably due to the fact that the hospitality sector enterprises are more widespread, with most enterprises located in rural areas.

The majority (95 per cent) of enterprises reported that they did not own a similar business in any other location. Thus, expansion of business to other locations in order to avoid compliance with labour laws or business regulations is probably not a strategy being adopted by MSEs in Sri Lanka.

Over 70 per cent of MSEs interviewed had been in operation for more than eight years. The more traditional MSEs, such as those in the agro processing, woodworking and hospitality sectors, have been in operation longer than the newly introduced garment and textile sector MSEs. The MSEs in the smaller worker group have been in operation for more than those in the larger worker group. Information on the number of workers at the time of establishment of the enterprises in Worker Group two (15–70 employees) may throw more light on whether these firms expanded from a smaller workforce to a larger one or were established initially with a larger workforce.

Avoidance behaviour of not expanding beyond the 14-worker threshold is not apparent from the data from the survey, as only 16 per cent of the total MSEs were in the 10–14 worker group, while there were seven per cent of total MSEs in the 15–20 worker group. Graphical analysis also shows some bunching in the 5–9 worker group and in the 15–20 group, but not much bunching just below the threshold of 15 workers, suggesting that the Termination of Employment of Workmen Act (TEWA) and payment of gratuity are not a hindrance to expansion. However, there are several MSEs that have operated for a long

period of time with less than 15 workers, and this may merit further study to ascertain the reasons for such MSEs not expanding over time.

Sole proprietorship is the most significant type of business structure in both the smaller as well as the larger enterprises with 87 per cent reporting, suggesting that sole proprietorship is not a growth trap for expanding their businesses.

Over 90 per cent of MSEs in all sectors and worker groups have completed at least one registration for their businesses. More than 60 per cent of MSEs have completed three or more registrations in all sectors and worker groups, with a slightly higher proportion of registration in the larger worker group. However, registration per se may not be a growth trap for expansion. The most frequent registration in the case of all sectors and worker groups was company registration.

The most frequent registration was business registration and the most frequently stated reason (75 per cent reporting) for registering in all sectors and worker groups was that it was legally required. Other reasons include that it was needed by suppliers/buyers to qualify for credit and avail of donor/NGO incentive schemes. The major reason for not registering businesses was that it was not required according to over 80 per cent of respondents. This may be due to the lack of awareness among those unregistered, although only five per cent had specifically stated that they were unaware of the requirement. A slightly higher level (five per cent) of no registration can be generally observed among female-headed enterprises compared with the male-headed ones (3 per cent).

“Staying informal” is not observed to be a popular strategy. Only two per cent of the surveyed firms were unregistered, and how many of them intentionally tried staying informal is unknown. Around 97 per cent of the total MSEs surveyed had at least one of the seven popular types of registration. Of the total MSEs, 87 per cent were sole proprietorships.

About 88 per cent of the labour force was hired, of which four per cent came from within the household. The balance 12 per cent were unpaid workers, ten per cent were household members and two per cent non-household members such as trainees or relatives/friends working to gain experience. The employment is biased towards males in all sectors, except the textiles and garments sector, where two-thirds of the employed workforce is female. In the woodworking sector, over 80 per cent of the workers are male, probably due to the strenuous work involved. The pattern of employment has not changed much since 2009. Part-time and casual/temporary employment declined and was compensated by an increase in full-time employment between 2009 and 2011. About 50 per cent of the paid household members and over 95 per cent of the unpaid workers were employed full time in both worker groups and in all sectors. The high level of full-time employment of unpaid household workers may be due to the high proportion of sole proprietorship which results in greater commitment of household members to improve their own business enterprises.

In the surveyed MSEs in Sri Lanka, casualization/informalization of labour has been observed as a significant percentage in 2011. Overall, around one-fourth (25 per cent) of the paid workers are observed to be casual workers in 2011, down from 27 per cent from

two years earlier. The conversion from casual to full-time work has happened among two per cent of the labour force in the surveyed firms. The agro processing and woodworking sectors had more casual labour at the time of the survey (34 per cent and 28 per cent, respectively) than the hospitality (21 per cent) and textiles and garments (19 per cent) sectors.

The majority of workers (72 per cent) have worked for more than five years and over 83 per cent of those who have worked for more than five years were full-time workers. In the case of those who have worked for less than five years, 60 per cent have been full-time workers and the rest were either part-time or casual/ temporary workers. Thus a substantial proportion of newer employees have worked on a casual or temporary basis. Enterprises probably do not want to recruit workers on a full-time basis due to the economic and other situation prevailing in the country, and perhaps to avoid gratuity payments. There appears to be a greater bias towards males in the group who had worked over five years compared to those who had worked for less than five years. More females have worked less than five years than males. This may be due to the fact that female employees may be voluntarily leaving their jobs or that employers prefer males to females when the enterprise is stabilized and operating over a longer period of time.

Part-time and casual employment declined and full-time employment increased for both males and females between the period 2009 and 2011. Casual and temporary employment declined overall by 7.2 per cent but declined substantially by 17 per cent for females and only marginally (1.2 per cent) for males. Thus, overall, there is an increasing trend in full-time employment, particularly among female employees, and a decline in casual/temporary employment (largely females) and part-time employment (largely males). Casualization of workers as a strategy to avoid compliance with labour laws cannot be validated with this data. Statistical testing also shows no increased casualization of labour. The two-year picture is slightly different from the analysis made using duration of employment of less than five years versus more than five years, which shows a higher proportion of casual workers with less than five years of employment, but does not take into account the total number of workers.

The hospitality sector has the longest working hours, with over 70 per cent working more than eight hours a day. This sector works longer hours due to its service nature. In the larger enterprises and in the hospitality sector, a higher proportion of employees worked a greater number of days in a month than in the other sectors and smaller enterprises.

Overall, about 70 per cent of MSEs stated that they maintained employment registers. A higher percentage of MSEs maintained registers in the smaller worker group (5–14 employees) in all sectors except in the woodworking sector.

A higher proportion of male-headed enterprises maintained employment registers, and obtained Environmental Impact Assessment (EIA) and Initial Environment Examination (IEE) licenses, while a higher proportion of Environmental Protection Licenses (EPLs) were obtained by females-headed enterprises.

Overall, 26 per cent of MSEs reported that they did not maintain employment registers for their workers. However, in firms with 15–70 employees, this percentage was much lower (16 per cent). Even though there is not much variation in maintenance of employment registers across the four surveyed business sectors, the share of MSEs not maintaining registers was relatively higher in the woodworking sector (30 per cent).

When MSEs not keeping an employment register were asked their reasons for non-compliance, around one more than half (62 per cent) reported that the employment register was not necessary as wages were paid on a daily basis. Around 27 per cent also said that it was not legally required. There were reasons cited by relatively smaller proportions of MSEs that reflect “avoidance by choice” behaviour.

In general, a majority of those MSEs with business registration (94 per cent), trade licenses (68 per cent), registration with the labour department (62 per cent) and tax registration (46 per cent) tend to maintain employment registers. A higher proportion of larger businesses appear to adhere to the laws pertaining to maintenance of employment registers and a large majority of those with business registration maintain employment registers. Business registration can be considered a key factor influencing the maintenance of employment registers.

The most frequent mode of payment is on a monthly basis (37 per cent), followed by payment on a daily basis (27 per cent), payment by piece-rate system (25 per cent), and payment on a weekly basis (10 per cent). The piece-rate system is common in all sectors, particularly the production sectors. In the hospitality sector, food preparation and services may be obtained on piece-rate basis.

5.3. Perceptions on the impact of labour laws, regulations and economic environment

When compared to the level of awareness, compliance and avoidance confirmed through the survey, the general tendency is that perception-based rating overstates the impact of positive factors and understates the impact of negative factors.

While 78 per cent of MSEs perceived that compliance with environmental and sanitary regulations positively affects business growth, the proportion of MSEs actually following these regulations was much smaller. However, among all the MSEs surveyed, 25 per cent reported having the EPL. The share of MSEs that went through IEE (four per cent) and EIA (three per cent) was significantly lower.

- That 89 per cent of MSEs view paying the minimum wage as positively affecting the growth of business is not in line with the outcome that only 69 per cent of the surveyed MSEs claimed to be aware of the minimum wage obligations and claimed to pay the minimum wage.
- That 84 per cent of MSEs view maintaining of the employment register as positively affecting the growth of business is not in line with the outcome that only 74 per cent of MSEs maintained the employment register. However, a significant proportion claimed that they did not maintain registers because they had daily wage employment.

- While 62 per cent of MSEs perceived that making employees' provident fund (EPF) contributions positively affects the growth of business, 64 per cent of the surveyed MSEs were aware of the obligations and did contribute to either EPF or the employees' trust fund (ETF).
- Having a trade union and collective bargaining process is perceived as not applicable to the growth process of businesses by half of the MSEs (47 per cent) and is perceived to have no influence by 33 per cent of MSEs. While ten per cent of MSEs believed that having a trade union positively influences business growth, only one per cent of the surveyed businesses had actually joined or formed a trade union.

In general, many of the major factors that have a strongly positive or positive impact on business were the same in all four sectors, e.g. market demand, transport infrastructure, availability of electricity, water and sanitation services, and cost of labour to some extent. Several factors that have a strongly negative or negative impact, such as cost of electricity, access to skilled labour and cost of land and premises, were common in all sectors. Many of the respondents may be expressing their opinion on some of the factors and the actual situation in the case of other factors. It appears that demand for the product, good transport infrastructure, availability of electricity, water and sanitation and, to some extent, low cost of labour had a positive influence on their business. Average levels of positive influence and equal or slightly lower negative influence were indicated in the case of availability of raw materials, complying with regulations and inspections, level of taxation, access to credit, non-payment by customers and, to some extent, cost of labour. A higher proportion of strongly negative or negative influence was reported for access to skilled workers, cost of electricity, cost of land and premises, and government corruption, which may be hindering expansion and act as a growth trap for MSEs. A majority considered factors such as effectiveness of courts in dealing with disputes, industrial safety and, to some extent, government corruption as not applicable or as not influencing growth

With respect to regulatory or legal issues, a majority of the respondents indicated either positive or strongly positive influence on issues such as cost or time required to register or obtain a business license for their business, as well as compliance with labour regulations or environment and sanitary standards, and in maintaining minimum product standards and certification and in complying with food and health standards. Thus these regulatory issues do not appear to greatly hamper business expansion. An average proportion of respondents indicated positive as well as strongly positive influence and a slightly lower proportion indicated strongly negative or negative influence on business expansion for factors such as compliance with banking and credit regulations, registering land and other property, cost of taxation and cost and time required to register for taxation, and time required to complete tax administration, suggesting a moderate level of positive/negative influence on business development. In other words, these factors are not overly affecting business expansion or are at reasonable levels. A small proportion felt that registering land and other property, complying with banking and credit regulations, time required to complete tax administration, cost and time required to register for taxation, and cost of taxation had no influence on business expansion. A majority felt that obtaining patent rights and complying

with import regulations was not applicable to business expansion. Strongly negative or negative influences were reported by only a smaller proportion of 30 per cent or less of the respondents, except for cost of taxation. In general, many of the major laws and regulations appear to have a strongly positive or positive impact on business expansion and, therefore, may only marginally impact expansion of businesses.

A majority of respondents indicated either positive or strongly positive influence on business expansion due to labour laws such as maintaining an employment register, paying the minimum wage, paying provident funds and workers' injury compensation. About 50 per cent or a slightly lower proportion of respondents indicated positive as well as strongly positive influence and a minor proportion reported strongly negative or negative influence on business due to labour laws such as limits on working time, severance payments, insurance, compliance with health and safety standards of workers, paying for annual leave, as well as compliance with procedures for dismissals and disputes and insurance, suggesting an average level of positive influence or a minimal level of negative influence on business development. Thus it appears that labour laws largely have a positive influence on business expansion, and that negative effects are minimal.

A majority of MSEs comply with laws such as maintaining employment registers (70 per cent reporting). The main reason for not maintaining employment registers was that the respondents felt that it was not required as the MSEs were paying wages on a daily basis.

With regard to inspections, the most reported inspecting officials were the labour inspector (LI), local authority–public health inspector (PHI), the tax inspector from the Inland Revenue Department (TI-IRD) and, to a lesser extent, the Central Environmental Authority (CEA) personnel and the factory inspector (FI). Other inspectors rarely visited these MSEs. About 25 per cent of MSEs reported no inspections, with a higher percentage of no visits in the lower worker group. About 50 per cent reported one to two annual visits, while 20 per cent reported three to five annual visits. The hospitality sector had the highest frequency of visits compared to the rest of the sectors and also the lowest percentage of no visits, suggesting that this sector, dealing with food sales, local and foreign tourism, is subject to a higher level of inspection, to ensure health and environmental standards and also improve and promote tourism.

Of all the MSEs surveyed, 27 per cent were never inspected by any government official or department during the year prior to the survey. While 46 per cent were inspected once or twice during the 12 months before the survey, another 21 per cent were inspected three to five times.

Of the seven different types of inspection that were asked about during the survey, inspection by LI and PHI had relatively better coverage. Around 65 per cent of the sample firms reported that over year before the interview they were visited by the LI as well as the PHI of the local authority. While there were little sectoral differences observed with regard to the percentage of firms visited by the LI, PHI inspection was found to be almost universal (94 per cent) for the hospitality sector, while only 48 per cent in the case of the textiles and garments sector had it. Other important inspection was conducted by the TI-IRD (31 per cent), the environmental officer (EO) (21 per cent) and the CEA (15 per cent).

A majority of MSEs with business registration, trade and factory license, registrations with the tax and labour departments, and those with import and export licenses were inspected largely by labour inspectors and the local authority PHIs, followed by the TI-IRD, while a moderate proportion was inspected by the CEA and EOs and a small proportion only by FIs. A high level of inspection by almost all inspectors was observed for import/export license holders. Having some sort of registration or license increases the level of inspections by the specific or related inspector. The highest frequency of inspection was once or twice annually (46 per cent). No inspection was reported by 27 per cent of all MSEs and 18 per cent of MSEs in the larger worker group and 28 per cent of MSEs in the smaller worker group. This is probably because of the larger number of industries in this group and the inspectors target the bigger enterprises, due to lack of staff.

The survey results show that only a very few MSEs are unionized (one in the 15–70 worker group and six in the 5–14 worker group) and 530 out of the 537 MSEs (99 per cent) are not unionized. Awareness levels on minimum wages are high without unions than with unions. Contrary to expectations, a higher percentage of MSEs are aware and pay minimum wages, and a lower percentage are aware but do not pay minimum wages without unions than with unions. Since only a few MSEs are unionized, it is difficult to draw conclusions on whether unionization is beneficial or detrimental to expansion. Awareness and payment of minimum wage is high among female-headed MSEs, compared to male-headed MSEs, and among those with company registration and other licenses, except in the woodworking sector where only eight to ten per cent of MSEs pay minimum wages.

With respect to EPF contribution, a majority of the MSEs in all sectors and both worker groups indicated that they are aware of the law and believe that it affects expansion or is a growth trap.

The strategy of “staying below the threshold level” in order to avoid compliance with EPF/ETF regulations was not at all observed among the surveyed MSEs in Sri Lanka. It was observed that 64 per cent of MSEs were aware of regulations on EPF/ETF payments and that all made EPF/ETF contributions. Overall, the proportion of MSEs who were unaware of EPF/ETF obligations was 36 per cent, with not much variation across the four business sectors.

Overall, 37 per cent of MSEs reported that they heard of informal payments being made to avoid compliance with regulations on EPF in their sector of business. Out of these, 14 per cent were honest enough to report making such payments to avoid compliance with the EPF regulations.

About one-third of the respondents were not aware of the EPF regulation in all sectors and worker groups, while only about ten per cent reported being aware of the law but felt that it did not affect growth. About 40 per cent of MSEs did not pay EPF, and 60 per cent paid EPF without any unions, while less than one per cent paid EPF after unionization. In the case of gratuity payments, over 70 per cent stated that they were not aware of this law, while 20 per cent were aware and felt that it affected growth; 13 per cent were aware but felt that it did not affect growth. Due to high unawareness, gratuity payment does not appear to be a growth trap for business expansion. The main reason for non-payment of

EPF is that employees prefer to receive higher take home pay; other reasons include “Workers have not demanded it” and “No regular staff”.

Awareness and payment of EPF by gender showed that over 67 per cent of the male-headed enterprises were aware and paid EPF, compared to 47 per cent of female-headed MSEs. The highest percentage of MSEs that were aware and paid EPF was those registered with the labour department, followed by MSEs registered for tax and factory license. MSEs with company registration and trade licenses had the highest levels of unawareness and non-payment of EPF.

In the surveyed MSEs as a whole, a majority of paid workers (72 per cent) have worked for less than five years, while about 28 per cent have worked for more than five years. Around two-thirds of those employed full time (65 per cent) and a little higher than two-thirds of those employed part time (69 per cent) worked less than five years. This practice is even more prevalent in the case of casual workers. In the case of casual workers, around 90 per cent worked for less than five years.

Only two out of the 480 surveyed MSEs (0.4 per cent) with less than 15 workers reported trying to stay below the threshold level in order to avoid gratuity payments, either by employing less than 15 workers or by limiting the duration of employment within five years (i.e. “staying below the threshold level” strategy in order to avoid compliance is almost negligible). There were 68 per cent of MSEs below the threshold level who were not aware of gratuity payment obligations.

Overall, only a small minority of about seven per cent of enterprises paid gratuity. This is true in the case of all districts and sectors. A higher level of gratuity payment was observed in the larger worker group. The highest percentage of MSEs not paying gratuity are those MSEs with company registration, followed by trade license and labour registration. The lowest percentage was observed for import and export licenses. Thus registration has not influenced payment of gratuity. The main reasons stated for not paying gratuity by those responding were that there was no resignation or retirement (31 per cent), “It is legally required, but not enforced” (22 per cent), and “Workers have not demanded it” (17 per cent).

Overall, 25 per cent of the surveyed MSEs reported that even though they were aware of the regulation on trade unions, none of them had a trade union in their business. Only one per cent of the total surveyed MSEs reported having a trade union.

Around 74 per cent of MSEs were unaware of the legal condition that it requires seven regular employees (including those from other businesses) to form a trade union. Lack of awareness regarding regulations on trade unions seems to be highest in the hospitality sector (81 per cent) and lowest in the textiles and garments sector (68 per cent).

Overall, the majority is not aware of trade unions. Of those who are aware, the majority feels that trade unions have no impact on growth or expansion of the enterprise. The main reason for the non-existence of trade unions is that workers have not demanded it. Second, the respondents felt that there are regular meetings and consultation/communications with workers which reduced the need for trade unions.

Only two per cent of MSEs among those that are either sole proprietorships or unregistered businesses in Sri Lanka reported that they were aware of income tax regulations and still tried to avoid compliance by keeping their income below the threshold, thereby following the “staying below the threshold level” strategy. On the other hand, 64 per cent of all sole proprietorships and unregistered businesses reported that they were not aware of income tax regulations that if they earn more than 300,000 Sri Lankan rupees (LKR), they are required to pay income tax. Only two per cent of MSEs among those that are either partnership businesses or private limited companies in Sri Lanka reported that they were aware of income tax regulations and still tried to avoid compliance by keeping their income below the threshold, thereby following the “staying below the threshold level” strategy. On the other hand, 59 per cent of all partnership businesses or private limited companies reported that they were not aware of income tax regulations that if they earn between LKR1 to five million they were liable for an income tax of 15 per cent, whereas if they earn over LKR5 million, that earning is liable for an income tax of 35 per cent.

Overall, 57 per cent of MSEs in Sri Lanka reported that did not pay income tax. The proportion of MSEs who did not pay income tax was observed to be relatively higher in the textiles and garments sector (62 per cent) compared to the other three sectors.

Only about 40 per cent of MSEs pay income tax, about eight per cent pay at the rate of 10–20 per cent, and 33 per cent pay at rates higher than 20 per cent. The highest level of payment (80–90 per cent) was by those who had export or import licenses, followed by MSEs registered with the income tax department (60 per cent). The lowest level of payment was by MSEs with company registration (45 per cent) and trade licenses (50 per cent).

Generally, the time taken to file income tax returns was less than one week, according to most of the respondents paying tax. The main reason for not paying income tax was that it is not legally required or that they were exempted from tax. Other reasons stated by seven to ten per cent of respondents include “Unnecessarily complicated”, “Too costly” or “It is legally required, but not enforced”. With regard to awareness and effects of income ceilings, two-thirds of the respondents were not aware of regulations on income tax ceiling. About 20–27 per cent were aware and attributed this to static growth. A further 12–18 per cent were aware but believed that it did not have an effect on growth.

Only one per cent of the surveyed MSEs reported followed the “staying below the threshold level” strategy to avoid compliance with value added tax (VAT) regulations by keeping their income below the exemption threshold of LKR2.5 million or by not registering. A considerable proportion of 64 per cent of MSEs claimed that they were not aware of the VAT regulations. The share of MSEs who were not aware of the VAT obligations was similar across all the four surveyed sectors.

A large majority of MSEs (91 per cent) reported that they did not pay VAT (but how many of them are below the threshold cannot be specified). About eight per cent of MSEs claimed that they paid VAT in the range of 12–15 per cent and one per cent paid VAT at a rate less than 12 per cent. A higher percentage of VAT payments were made by the larger worker group with 15–70 workers (18 per cent) compared to firms with 5–14 workers (7 per cent).

Regarding VAT payments, a large majority or about 90 per cent did not pay VAT, the rest paid VAT at the rate of 10–20 per cent (the current rate for VAT is 12 per cent). A higher proportion of the larger worker group pays VAT. This group also has a lower percentage of enterprises not paying VAT compared to the smaller worker group, suggesting that the more organized larger enterprises are probably complying with these laws compared to the smaller worker groups, which may be avoiding such payments. A majority of MSEs registered with the tax department and those with import or export licenses pay VAT, the lowest level of payments were made by those MSEs with company registration and trade and labour department registrations. Over 80 per cent of those paying VAT reported that they needed less than a week to collect and pay VAT.

The main reason for not paying VAT, as stated by a majority of the respondents in all sectors and worker groups and with all types of licenses and registrations, is that it is not legally required or that it was exempted. Other reasons reported include procedures being unnecessarily complicated, it was too costly and that although VAT was legally required, the regulation is not enforced. A majority of respondents (63 per cent) were not aware of the regulation, particularly those in the smaller worker group. Of those who were aware, a little over half feel that VAT does affect growth and the rest feel that VAT does not affect growth. Overall, VAT does appear to have an impact on growth or expansion of business.

Among all the MSEs surveyed, 25 per cent reported having the EPL. However, the share of MSEs that went through the IEE (four per cent) and EIA (three per cent) was significantly lower. The share of MSEs that had the EPL was highest in the woodworking sector (46 per cent) and lowest in the agro processing sector (19 per cent). The share of MSEs that went through IEE is relatively higher in the hospitality sector compared to the other three sectors.

When asked for the reasons for non-compliance with the three environmental regulations, more than 90 per cent of MSEs each in case of IEE and EIA, and 80 per cent of MSEs in the case of EPL, reported that they did so because it is not legally required. Among those who did not have an EPL, around 15 per cent reported that they were simply not aware of the legal obligation for having such a license. Although small in number, there were some MSEs who provided reasons that can be considered “avoidance by choice” strategy such as “It is legally required, but not enforced” (three to six per cent), “Unnecessarily complicated/do not see the benefit” (one to two per cent) and “Don’t want to pay the required fees” (two per cent).

Around 92 per cent of enterprises started without availing any incentives. The main reason appears to be the lack of information on incentive schemes and support programmes as 97 per cent of the respondents were not aware of the presently available incentives.

It was observed that the incentive programmes in Sri Lanka did not create a growth trap. Over 99 per cent of MSEs reported that the incentive scheme threshold did not affect growth or expansion (i.e. not concerned about losing benefits if their business grows beyond the maximum threshold).

Over 90 per cent of enterprises were started without any incentives. Greater numbers of enterprises were started with incentives in the smaller worker group than the larger worker

group. This suggests that incentives have played only a minor role in assisting the establishment of enterprises.

Over 95 per cent of the enterprises were not informed of any incentive schemes, did not avail the incentive schemes or were aware of the threshold for incentive schemes. Over 99 per cent reported that the incentive scheme threshold did not affect growth or expansion. The results show an almost total lack of awareness regarding incentive schemes and that a very few have availed of one scheme, resulting in no impact of any incentive scheme threshold on growth.

A majority of the MSEs were aware of minimum wage and EPF rates. However, they are less aware of the rates relating to the provision of gratuity. The enterprises in the larger worker group were marginally more aware of the regulations and rates than the smaller worker group. This is probably because of better organization in the enterprises of the larger worker group. However, this may not seriously hamper expansion of business.

While 26 per cent of MSEs were not aware of government-specified minimum wage obligations, more than two-thirds (69 per cent) reported that they were aware and did pay by following the minimum wage regulations. Only five per cent of MSEs were aware of the minimum wage regulations but still avoided paying minimum wage to their workers. This behaviour was more widely observed in the textiles and garments sector (ten per cent). Again, avoidance behaviour is slightly higher in firms with 5–14 workers (six per cent) than in those with 10–70 workers (four per cent).

Of the total MSEs with 5–14 workers, only one per cent tried to stay below the threshold level in order to avoid compliance with regulations on retrenchment payments (i.e. they follow the “staying below the threshold level” strategy of avoidance). Of the total number of MSEs with 5–14 workers, around 79 per cent were not aware that they need to obtain government permission to retrench workers and also make retrenchment payments to workers.

Of the total MSEs with 15 or more workers, only eight per cent reported that they had ever taken government permission to retrench workers and provided retrenchment payments. The proportion of such firms who have ever undergone the formal retrenchment process as per the regulations was relatively higher in the hospitality sector (21 per cent) and almost negligible in the woodworking sector (zero per cent).

In terms of awareness (“have heard of”), informal payments related to income tax were the most prevalent ones (58 per cent), followed by EPF (37 per cent), environmental regulations (34 per cent), VAT (27 per cent), minimum wage (14 per cent) and gratuity (10 per cent). The hospitality sector demonstrated the highest ratio of awareness on informal payments against each labour and other legal obligation followed by agro processing (gratuity is the only case where the agro processing sector recorded a higher proportion of MSEs who had heard of informal payments being made than those from the hospitality sector). These two sectors demonstrated higher coverage by the TIs-IRD and the PHIs of the local authority, which might explain the sectoral difference of the awareness on informal

payments, although the coverage by the LI (which is supposed to address minimum wage and EPF/ETF) was almost the same across the four sectors.

Out of those who had heard of informal payments being made, 21 per cent actually made informal payments to avoid compliance with environmental regulations, 17 per cent on income tax, 13 per cent on EPF/ETF, six per cent on minimum wage, five per cent each on trade unions and VAT, four per cent on gratuity, and two per cent on retrenchment payments. Interestingly, there were fewer firms from the hospitality and agro processing sectors which honestly disclosed their informal payments than other sectors.

The highest level of awareness of informal payments was reported in the case of income tax, followed by EPF contribution and VAT. The highest percentage of awareness was reported by the larger worker group with respect to such payments. A very small percentage of MSEs reported actually making informal payments to avoid labour laws. A higher proportion of MSEs reported making informal payments for EPF, income tax and minimum wages in the larger worker group. There may be considerable under-reporting due to reluctance on the part of the respondents to admit to illegal actions.

The response with respect to awareness and information on penalties for non-compliance with labour laws shows that respondents are generally aware of the penalties for non-compliance, for all major laws, except the provision of gratuity where the level of awareness is low. Penalties for non-compliance with EPF contribution and income tax payment appear to be the best known in all sectors and worker groups. The results indicate average levels of awareness on penalties for non-compliance with minimum wage and VAT regulations, and low levels of awareness with regard to gratuity payments.

Gender aspects: An analysis of the gender aspects of the survey results indicates that ownership of MSEs is significantly biased towards males, but no significant differences were observed with respect to ownership of other similar businesses, while a slightly lower level of registration in female-owned enterprises was observed. In terms of employment, the majority of paid as well as unpaid employees, both within and outside of the household, were males. The majority (60–65 per cent) of the casual/temporary employees were also males, with a decline of female casual/temporary employees observed between 2009 and 2011. The highest proportion of female employment was in the textiles and garments sector and that of male employment in the woodworking sector. More females were being hired on a full-time and part-time basis compared to males, while at the same time casual employment is declining rapidly for females, which may be due to female casual employees being upgraded to full-time employees. Employment registers and other labour laws such as EPF payments were followed more by male owners, while minimum wages payment was higher among female owners of MSEs. Overall, the analysis shows considerable bias towards male ownership and employment with no significant differences with respect to compliance with labour laws and regulations or perceptions on business environment.

Statistical testing: Statistical testing suggests that casualization of labour has not been adopted as an avoidance strategy by MSEs. These tests also reveal that there are many factors that have a positive influence on business expansion and possibly an equal or more

number of factors have an equal or lower level of negative influence on business expansion. This more or less confirms the results obtained by the analysis using proportions, suggesting that more attention should be paid to reducing the impact of factors that have a negative influence on business expansion.

5.4 Conclusions

The majority of MSEs (83 per cent) interviewed was from the 5–14 worker group, according to the proportionate sampling procedure adopted for the survey. Thus the predominant type of MSE in Sri Lanka in the 5–70 employee category is one with 5–14 employees. MSEs in both worker groups and sectors are located more or less equally between rural and urban areas, except in the hospitality sector, where 80 per cent of MSEs are in rural areas. Over 95 per cent of MSEs did not own similar enterprises elsewhere, suggesting that this strategy is not being adopted to avoid compliance with labour laws. Over 70 per cent of MSEs have been in operation for over eight years, of which a majority is from the smaller worker group. Avoidance behaviour of not expanding beyond the 14-worker threshold is not apparent from the data from the survey, as graphical analysis shows some bunching only in the 5–9 worker group and in the 15–20 group but not much just below the threshold of 15 workers. Sole proprietorship is the most significant type of business structure in both the smaller as well as the larger enterprises, with a high level of one to three registrations in both worker groups, suggesting that type of ownership and registration do not hamper expansion. The most frequent type of registration was company/business registration, which was complied with by most MSEs as it was legally required. About 88 per cent of the labour force was hired (4 per cent from household) and the balance 12 per cent were unpaid workers (10 per cent from household), with a bias towards males (60–70 per cent) in all sectors except the textiles and garments sector, where two-thirds of the employed workforce is female.

Over 70 per cent of the workers have worked for over five years with over 80 per cent of them being full time, with a greater bias towards male workers. Of the balance 30 per cent who have worked for less than five years, only 60 per cent are full-time workers, with a lower bias towards male workers. It is possible that female employees may be voluntarily leaving their jobs or that employers prefer males to females due to costs associated with providing paid maternity leave, bans on overtime and night work, etc. New recruits are probably recruited on a casual/temporary basis and later promoted to full-time employees. Casual and temporary employment declined overall by 7.2 per cent, declining substantially (by 17 per cent) for females and only marginally (1.2 per cent) for males between 2009 and 2011. Casualization of workers as a strategy to avoid compliance with labour laws cannot be validated with this data. Statistical testing also shows no increased casualization of labour. However, as casual employment by its nature is less secure, it could be used as an evasion strategy to maintain the number of workers at a lower level as these casual workers can be fired with least liability.

The hospitality sector has the longest working hours due to its service nature. Over 70 per cent of MSEs maintained employment registers, with those with other registrations

tending to maintain such registers. Business registration can be considered a key factor influencing the maintenance of employment registers. The most frequent mode of payment is on a monthly basis (56 per cent), followed by the piece-rate system (18 per cent), payment on daily basis (16 per cent) and weekly payments (nine per cent). Less than one per cent reported lump-sum, hourly or other modes of payment.

Major business environmental factors that have a strongly positive or positive impact on business were the same in all four sectors, e.g. market demand, transport infrastructure, availability of electricity, water and sanitation services, and cost of labour to some extent. Factors with strongly negative or negative impact were cost of electricity, access to skilled labour, cost of land and premises, and government corruption. Average levels of positive influence and equal or slightly lower negative influence were indicated in the case of availability of raw materials, compliance with regulations and inspections, level of taxation, access to credit, non-payment by customers and, to some extent, cost of labour.

With respect to business regulations, positive or strongly positive influence were reported for cost or time required to register or obtain a business license, compliance with labour regulations or environmental and sanitation standards, in maintaining minimum product standards and certification, and in complying with food and health standards. Thus these regulatory issues do not appear to greatly hamper business expansion. Strongly negative or negative influence on business expansion for factors such as complying with banking and credit regulations, registering land and other property, cost of taxation, cost and time required to register for taxation, and time required to complete tax administration were reported by a moderate proportion of respondents. A small proportion felt that these factors had no influence on business expansion.

A majority of the respondents indicated either positive or strongly positive influence on business expansion due to labour laws such as maintaining an employment register, paying the minimum wage, paying provident funds, and workers' injury compensation. A minor proportion reported strongly negative or negative influence on business due to labour laws such as limits on working time, severance payments, insurance, compliance with health and safety standards of workers, paying for annual leave, as well as compliance with procedures for dismissals and disputes and insurance. Thus it appears that labour laws largely have a positive influence on business expansion, and that negative effects are minimal.

The most reported inspecting officials were the LI, local authority PHI, TI-IRD and, to a lesser extent, the CEA personnel and the FI. The survey results show that only a very few (seven out of 537 reporting) MSEs are unionized as very few have demanded it and the majority is not aware of regulations regarding trade unions and feel that trade unions have no impact on growth or expansion. Awareness levels on minimum wages are high, with greater awareness among female-headed MSEs. About 70 per cent of MSEs in all sectors and both worker groups indicated that they are aware of the EPF law, with 40 per cent actually paying EPF and believe that it affects expansion or is a growth trap. Since EPF is required for enterprises with even one employee, it is not a threshold growth trap, but

rather a growth trap due to higher financial commitments as the enterprise gets larger, but with uncertainty with respect to achieving higher profits through expansion. Overall, only a small minority of about seven per cent of the enterprises pay gratuity, with a higher level of payment in the larger worker group.

Only about 40 per cent of MSEs pay income tax, with the highest level of payment (80–90 per cent) by those having export or import licenses, followed by MSEs registered with the income tax department (60 per cent). Generally, the time taken to file income tax returns was less than one week according to most of the respondents paying tax. The main reason for not paying income tax was that it is not legally required or that they were exempted from tax; two-thirds of the respondents are not aware of regulations on income tax ceiling, while about 20–27 per cent are aware and attribute this to static growth. A large majority or about 90 per cent are not paying VAT, with a majority of those registered with the tax department and with import and export licenses paying VAT. The main reasons for non-payment of VAT are it is not legally required, lack of awareness, costly and complicated procedures, and non-enforcement. Most feel that VAT does not affect expansion of the business. Over 90 per cent of the businesses have started without any incentives. The results show an almost total lack of awareness regarding incentive schemes and that a very few have availed of any scheme, resulting in no impact of any incentive scheme threshold on growth.

A majority of MSEs were aware of minimum wage and EPF rates. However, they are less aware of the rates relating to the provision of gratuity. The enterprises in the larger worker group were marginally more aware of the regulations and rates than the smaller worker group. The highest level of awareness of informal payments was reported in the case of income tax, followed by EPF contribution and VAT. A very small percentage of MSEs reported actually making informal payments to avoid labour laws. A higher proportion of MSEs reported making informal payments for EPF, income tax and minimum wages in the larger worker group. Most MSEs are generally aware of the penalties for non-compliance, for all major laws, except the provision of gratuity. Penalties for non-compliance with EPF contribution and income tax payment appear to be the best known, while those for minimum wage and VAT are lesser known.

An analysis of the gender aspects of the survey results indicates that ownership of MSEs is significantly biased towards males, but no significant differences were observed with respect to ownership of other similar businesses, while a slightly lower level of registration in female-owned enterprises was observed. In terms of employment, the majority of paid as well as unpaid employees, both within and outside the household, were males. The majority (60–65 per cent) of the casual/temporary employees were also males, with a decline of female casual/temporary employees observed between 2009 and 2011. More females are being hired on a full-time and part-time basis compared to males, while, at the same time, casual employment is declining rapidly for females, which may be due to female casual employees being upgraded to full-time employees.

The analysis of the results of the survey shows that there is no valid evidence that TEWA and the Payment of Gratuity Act 12 of 1983 are growth traps. There is no significant

bunching below the threshold level of 15 employees. Horizontal expansion of similar enterprises to avoid compliance with labour laws is almost non-existent.

There is no statistically valid evidence to support the hypothesis that there is casualization of labour to avoid compliance with labour laws. The proportion of casual labour is declining and is being replaced by full-time workers once the enterprise is fully established, with overall increases in permanent employment.

Labour laws such as EPF, minimum wages and maintenance of employment registers are generally complied with, but a small proportion of MSEs are not paying EPF as the employees do not want EPF to be deducted from their wages, while some may be making informal payments to avoid payment.

The majority of MSEs do not pay gratuity, with only seven per cent making such payments. The main reasons stated by those not paying gratuity was that there was no resignation or retirement (31 per cent), "It is legally required, but not enforced" (22 per cent), and that workers have not demanded it (17 per cent). The fact that only about 30 per cent of MSEs are aware of the existence of this law and other reasons for non-payment suggests that gratuity payment may not be a growth trap for expansion.

Negative influence of labour laws such as limits on working time, severance payments, insurance, compliance with health and safety standards of workers, paying for annual leave, as well as compliance with procedures for dismissals and disputes and insurance, were reported by a minority of respondents and may have an impact on business expansion.

Business law such as registration is largely complied with. Over 90 per cent of MSEs do not pay VAT, with a large proportion stating that it is neither legally required nor enforced when legally required due to lack of awareness. About 40 per cent of MSEs pay income tax. The main reason for non-payment is that it is not legally required or enforced when legally required.

A moderate proportion of respondents felt that negative influence of the following business-related regulations may hamper business expansion: compliance with banking and credit regulations, registering land and other property, cost of taxation, cost and time required to register for taxation, and time required to complete tax administration.

Business environmental factors that respondents felt would have a negative impact on business are: cost of electricity, access to skilled labour, cost of land and premises, and government corruption. Slightly lower negative influence was indicated in the case of availability of raw materials, compliance with regulations and inspections, level of taxation, access to credit, non-payment by customers and, to some extent, cost of labour. Thus a number of non-labour law related factors may have an impact on expansion.

Thus the survey has identified certain factors, laws and regulations that probably affect the future expansion or growth of MSEs. Economic factors such as cost of electricity, land and premises and availability of skilled labour appear to have a greater impact on expansion than laws and regulations. The unsettled economic environment during the ethnic conflict period appears to have restricted the hiring of new workers. MSEs, particularly those in the larger worker groups, may have resorted to informal payments to avoid compliance with certain laws and regulations. Further, the lack of staff and resources to ensure strict

compliance with laws may have contributed to the easing of some growth traps and facilitating expansion. Informal discussions with enforcing officials and respondents indicate that enforcement officers may not be too strict in enforcing regulations, particularly among the smaller enterprises, due to the fact that small enterprises are generally low-income and livelihood enterprises and strict enforcement may result in loss of income or livelihood of such low-income entrepreneurs. In addition to showing some laxity in enforcement, they have provided more time for compliance.

5.5 Recommendations

1. Some labour laws, such as those which require the payment of EPF and ETF contributions, may be cumbersome for compliance, especially for smaller MSEs due to the formalities required; the payment of such contributions are also costly, especially when combined with other requirements such as the payment of gratuity and severance pay. In these instances, evasion may be an attractive option, and it may well be that such evasion takes place despite inspections by the relevant authorities. Moreover, employees appear to be unaware that such contributions are necessary, and, in the case of EPF, may even prefer that wages be paid without the deductions of such contributions as they are not aware of the long-term benefits of such payments.

Since the non-application or evasion of labour laws is not conducive to providing secure employment, the possibility of relaxing some of these regulations by applying a threshold limit even for EPF contributions should be considered.

2. The MSE sector has considerable potential to provide employment for women, as employees and as entrepreneurs, especially as the labour force participation rate for women is low. It is recommended that providing easier access to credit, technology and skills development, including entrepreneurship skills, for women setting up MSEs or expanding existing MSEs would boost employment opportunities for women.
3. The informal nature of operation of most MSEs creates issues related to employment such as non-compliance or evasion of labour laws, lack of security of employment, lack of skills development opportunities, and low awareness of workers' rights, including the right to form and join trade unions. Therefore, encouraging MSEs to enter the formal sector by making it more advantageous – through access to credit, tax exemptions, social acceptance, etc. – should be considered.
4. Both the nature and the frequency of enforcement and inspection mechanisms, whether by the Department of Labour, the Factories Inspectorate, IRD or any other authority, should be improved by investing in more personnel, by better monitoring of inspections systems, etc. Given the largely informal nature of operations of MSEs, a combined inspection system, where most or many of these inspections are carried out by the officers or various inspectorates at the same time, would make it easier for the MSEs by combining a large number of inspections into one occasion. This will also improve productivity and the aim of such inspections, and make the verification and cross-checking of information possible at the inspection site itself. It would also reduce the opportunity for evasion of compliance with various regulations.

5. Lack of awareness of legal regulations on employment, employment-related benefits, workers' rights, and rights to litigation appears to make evasion or non-compliance possible by MSEs. The inclusion of such information in the education system, at vocational training schools or in the information provided to entrants to the labour market would empower employees to request employers to comply with legal regulations.
 - Provide solutions to ease some of the economic bottlenecks for expansion such as easy credit, training for producing more skilled workers, making available land and premises at reasonable costs for business expansion, improving procedures for registration, and providing greater awareness on laws and regulations to entrepreneurs.
 - Revise some laws, rules and regulations to facilitate enforcement and to update and modernize these laws to facilitate expansion. Remove or revise laws that require high level of resources to enforce and instead replace with procedures that reduces the transactions cost of compliance.
 - Provide more resources for enforcement of laws and regulations.

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Appendix I. Legislative provision applicable to selected sectors in Sri Lanka

Labour policy area	Acts/ordinances/applicability/cost of compliance and non-compliance						Potential to create growth trap
Collective bargaining and freedom of association	<p>Articles 14(1)(c) & (d) of the Constitution of Sri Lanka (1978) guarantees to all citizens the freedom of association, and the freedom to form and join a trade union respectively. However, the Constitution provides that all fundamental rights may be restricted by law in the interests of national security, racial and religious harmony or national economy.</p> <p>The Trade Unions Ordinance No. 14 of 1935 Although a trade union is required to register under this statute to qualify for the privileges and immunities available under the Act, the initial membership requirement of only seven workers provides a reasonably liberal environment for forming and joining a trade union. Without representative status of 40 per cent membership, employer is not obliged to bargain collectively.</p> <p>The Industrial Disputes Act No. 43 of 1950 This Act provides for the entering into and registration of collective agreements, and the amending act of 1999 makes it an unfair labour practice for an employer to refuse to bargain with a trade union having in excess of 40 per cent of those employed in that enterprise in its membership. Results in collective agreement confer superior terms and conditions of employment relating to wages, cost of living payments, enhanced leave benefits and other privileges far in excess of what is laid down in the law.</p>						
Anti-discrimination/equal opportunity	<p>Article 12 of the Constitution of Sri Lanka provides that “all persons are equal before the law and are entitled to the equal protection of the law,” and that “No citizen shall be discriminated against on the grounds of race, religion, language, caste, sex, political opinion, place of birth or any such grounds:”</p>						
Prohibition on forced labour/child labour	<p>Article 14(1)(g) of the Constitution guarantees to every citizen “the freedom to engage by himself or in association with others in any lawful occupation, profession, trade, business or enterprise” and therefore no person can be compelled to engage in any form of labour against his will.</p> <p>The Employment of Women, Young persons, and Children Act No. 47 of 1956 prohibits the employment of a child below the age of 14 years.</p>						
Minimum wage	Stipulated under the Wages Boards Ordinance No. 27 1941 (Wages	No provision	No provision	Stipulated under the Wages Boards Ordinance No. 27 1941	Stipulated under the Wages Boards Ordinance No. 27 1941	Stipulated under the Wages Boards Ordinance No. 27 1941 (Wages boards	

Labour policy area	Acts/ordinances/applicability/cost of compliance and non-compliance						Potential to create growth trap
	Board for the Garment Trade)			(Wages Board for the Building Trade)	(Wages Board for the Hotel and Catering Trade)	for coconut growing, cardamom and pepper, paddy hulling, rubber growing, and tea growing trades)	
Overtime/working time	Stipulated under the Wages Boards Ordinance No. 27 1941 by the relevant Wages Board						
Paid time off	Stipulated under the Wages Boards Ordinance No. 27 1941 by the relevant Wages Board						
Payment of gratuity	Payment of Gratuity Act 12 of 1983 Section 5 upon termination of employment provides for half a month of salary for each year of completed service after five years. This regulation only applies to enterprises with 15 or more employees. In the event of non-compliance, the penalty is a fine not exceeding LKR500 or imprisonment not exceeding six months or both. The amount recovered will be within a surcharge laid down under Section 5(4) of the Act.						
Social security	Employees' Provident Fund Act, No. 15 of 1958 (EPF) provides for a contributory scheme of superannuation for all employees other than those directly employed by the state, with the minimum contribution being 12 per cent of earnings by employer and eight per cent of earnings by employee. Some large private sector organizations operate their own pension funds, but the EPF provides a one-off payment at retirement or permanent cessation of employment. Applies to all sizes of enterprises. Non-compliance: Dues and surcharge plus fine not exceeding LKR1,000 or imprisonment not exceeding six months or both. In addition, liable to a fine not exceeding LKR50 for each day of default.						
Unemployment insurance	Employees' Trust Fund Act, No. 46 of 1980 requires employers to contribute a sum of three per cent of the salary of all employees to this fund, which is intended to enable employees to overcome a period of unemployment; the amount lying to the credit of an employee can be withdrawn once every five years if s/he ceases to be employed for any reason. However, this is not an insurance scheme and only provides a one-off payment and there is no provision for the continuation of benefits during unemployment. Applies to all sizes of enterprises. Non-compliance: Amount defaulted and surcharge plus fine not exceeding LKR1,000 or imprisonment for a term not exceeding six months or both.						
Workers' compensation	The Workmen's Compensation Ordinance, No. 19 of 1934 provides for compensation to any worker in the event of accident/injury sustained in the course of work, or for industrial and occupational diseases contracted whilst						

Labour policy area	Acts/ordinances/applicability/cost of compliance and non-compliance	Potential to create growth trap
	working.	
Protection against unjust dismissal	A worker dismissed for any reason can challenge such termination before a Labour Tribunal under the Industrial Disputes Act (IDA) No. 43 of 1950.	
Advance notice (for large-scale lay-offs)	Termination of Employment (Special Provisions) Act, No. 43 of 1971 prevents any employer from terminating the services of an employee without: (a) the express consent of the employee; or (b) where that consent is not forthcoming, the permission of the Commissioner General of Labour (CGL) (subject to the payment of such compensation as may be ordered by the CGL). Although an employer can request permission to lay-off workers or to terminate workers, the CGL is not required to grant such permission, and may refuse permission, compelling an employer to continue to employ that worker. The publication of a formula for the calculation of compensation has not removed the requirement to apply to the CGL for permission to lay-off workers. <i>However, this Act applies only to workplaces where more than 15 workers have been employed in the 12 months preceding the termination.</i>	
Parental/family leave	The Maternity Benefits Ordinance, No. 32 of 1939 provides for paid maternity leave and other maternity benefits for female workers covered by the Factories Ordinance, and prevent the employment of female workers in hazardous activities in the period before and after confinement. Women workers are entitled to 12 weeks of leave with pay for the first and second live births and six weeks for any subsequent births. There is no provision for paternity leave in the private sector. Applies to enterprises of all sizes. Non-compliance: Magistrate courts fine not exceeding LKR500 and recovery of the amount defaulted. Time spent is about six to 12 months on legal proceedings in magistrate courts.	
Employee consultation	None	
Protection of rights on transfer of undertaking	Guaranteed by law only in relation to public corporations. In the private sector disputes would be settled on a case-by-case basis.	
Installing and maintaining a sanitary bathroom	Factory (Washing Facilities General) Regulation 1965 Section 47 and 105 and Factory (Sanitary Conveniences) Regulation 1965 Section 15 and 105. Only applicable to enterprises with 20 or more employees.	
Provision of proper ventilation	Factories Ordinance Sections 4 and 5 Before the plan is approved, the factory has to be approved by the Chief Inspector of Factories attached to the Department of Labour. No Local authority can issue a license to carry on any trade or business in a factory unless the	

Labour policy area	Acts/ordinances/applicability/cost of compliance and non-compliance	Potential to create growth trap
	premises are registered as a factory under the Factories Ordinance. Shops and offices are exempted. Affects all industries.	
Provision of a fully equipped medical room and/or ambulance	Factories Ordinance Section 105 read with Subsection 50 The regulation is referred to as Factories First Aid Regulation No 1 of 1995 Applies if ten or more persons are employed. In Sri Lanka, first aid kit or cupboard is expected to be installed.	

Source: Compiled from the relevant statutes.

Appendix II. Applicability of non-labour related laws and regulations to the selected sectors

License	Acts/applicability/cost of transaction	Potential to create growth trap
Trade license	<p>The Municipal Council Ordinance/Urban Councils Ordinance/Pradeshiya Sabha Act</p> <p>There are no general licensing requirements for a business other than the business registration. However, certain industries require industry-specific licenses, and approvals are required for carrying out certain industrial and trading activities within the local authority area and would depend on the local authority's by-laws and the type of trade. Also, the cost of the license would differ from area to area and the relevant trade activity, i.e. turnover tax of 0.5 per cent is imposed on the turnover of an enterprise selling gems and jewellery.</p> <p>Time spent for obtaining is approximated to be one day.</p>	
License for manufacture/transport/storage and sale of liquor	<p>Excise ordinance revised 1956 Excise (Amendment) Act No 7 of 1995</p> <p>All industries engaged in any of the components related to handling of liquor should comply.</p>	

<p>Environmental license/Environmental Impact Assessment (EIA) and Initial Environmental Examination (IEE)</p>	<p>National Environmental Authority Act No. 47 of 1980</p> <p>This Act regulates the emission of waste and requires an EIA to be carried out by certain business activities, which includes tanneries, saw mills with a milling capacity in excess of 50 cubic metre and guesthouses with 20 or more rooms.</p> <p>Regulations on large industry are equally applicable to MSEs. Treatment levels and requirements are very costly for MSEs, although level of pollution is low. Small brass foundations in rural areas and traditional craft villages are examples of constrained MSEs. This enactment is of general application and could have an impact on saw mills, gem pits, etc., and, depending on the type of agro processing industry, on waste disposal therefrom. This may be an area which is appropriate for further study.</p> <p>Fauna and Flora Protection Ordinance No. two of 1937</p> <p>No person shall, within one kilometre of a natural reserve, carry out any development activity except under the authority of a license issued under the Ordinance. The Ordinance also provides for restrictions on the removal of sand for construction purposes in certain specified areas, except under the authority of a license. It also includes restrictions on protected fauna and flora. There is no threshold. This enactment is of general application and could have an impact on community-level traditional enterprises using raw materials as the forest reserves are covered by this Ordinance. Enterprises dealing with traditional Ayurvedic medicines are affected by the Ordinance.</p>	
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<p>Environmental Protection License (EPL)</p>	<p>National Environmental Act No. 47 of 1980 amended by Acts No. 56 of 1988 and No. 53 of 2000.</p> <p>Industries and activities which require an EPL are listed in Gazette Notification No. 1533/16 dated 25.01.2008. Industries are classified under three lists, i.e. List “A”, “B” and “C”, depending on their pollution potential. Parts “A” and “B” activities are issued by the Central Environmental Authority (CEA) while part “C” activities are issued by the local authority.</p> <p>“A” – list of 80 significantly high-polluting activities. Cost incurred for obtaining license approximates LKR7,500 + 12 per cent VAT + LKR750 stamp fees. A significantly time-consuming process of anywhere between one and 12 months. The license is valid for only one year.</p> <p>“B” – industries with medium-polluting potential. Cost is LKR6,000 + 12 per cent VAT + LKR750 stamp fees. The license is valid is for up to three years.</p> <p>“C” – industries with low-pollution potential. Cost is LKR4,000 + 12 per cent VAT + stamp fees. License is valid for up to three years.</p>	
<p>License for timber extraction/transportation and sale</p>	<p>Forest Ordinance No. 16 of 1907 and Amendment Acts No. 84 of 1998 and 23 of 1995</p> <p>Provides for restrictions on the cutting and transporting of timber and the establishment of saw mills and conversion of timber within specified areas. It also ensures that no timber could be exported except under the authority of a license issued by the Conservator of Forests. There is no threshold. Jaggery and treacle-making is a micro-level industry in rural areas. The products are made out of sap extracted from palm trees growing mostly in jungles. This is more relevant to Central, Southern and Sabaragamuwa Provinces. Tappers are prohibited to go into the jungle for this purpose. Bamboo tree and creepers are also required for this industry. Felling and transport restrictions have affected the industry.</p> <p>It is difficult to express any view on the above, since agro processing is a wide area and any extraction or usage of state lands without the necessary permits would, in all probability, result in constraints for users, since such an activity would be illegal. It is correct that felling and transport restrictions are a constraint, but this is a wider issue than MSEs. We do not think that a study of this area can result in any meaningful suggestions.</p>	

Factory license in Sri Lanka Factories registration	<p>Factories Ordinance No. 45, 1942 Sections 1 to 5</p> <p>All factories should comply to the set standards and register to obtain a registration certificate. Cost of complying with the set standards under Factories Ordinance may become significant depending on the operation.</p> <p>Time required for the process may range between one and six months.</p>	
Trademark license	<p>This is not mandatory and any entity could apply for one or more trademarks. The cost for obtaining one may approximate to LKR6,000 and the time required for the process may range from 12 months to two years.</p>	
License for mining and mineral industry	<p>Mines and Minerals Act No. 33 of 1992</p> <p>Any exploration, mining, processing, trade, transport, and export of minerals could only be carried out under the authority of a license issued by the Geological Survey and Mines Bureau. The pottery industry and small metal producers (for cement-building blocks and gravestones, etc.) are affected. Restrictions on clay mining and transport for large-scale operations are equally applied to small-scale industries.</p> <p>There is nothing inherent in this Ordinance which has a direct impact on any of the selected industries, other than the gem and jewellery industry.</p> <p>National Gem and Jewellery Authority Act No. 50 of 1993</p> <p>This regulates the mining, processing and selling of gems which can only be carried on under the authority of a license issued by the National Gem and Jewellery Authority. All premises where the trade is carried out need to be registered with the authority. There is no threshold.</p>	

Land use and clearing	<p>Antiquities Ordinance No. 9 of 1940 and Amendment Act No. 24 of 1998</p> <p>The regulations provide that any person who is involved in the clearing of any land in excess of one hectare is required to furnish an Archaeological Impact Assessment (AIA).</p> <p>The AIA has to be carried out with the Department of Archaeology. It is a lengthy and cumbersome procedure when land is outside a declared area. This regulation is equally applied to MSEs. In the absence of declared industrial areas or industrial estates in all parts of the country for MSEs, the MSEs face constraints.</p> <p>However, there is nothing inherent in this Ordinance which has a direct impact on any of the selected sub-sectors. The impact is based on location and, accordingly, is not inherently industry specific. It is unlikely that the Ordinance is pervasive in its applicability either.</p>	
Construction and development activities within proximity of the coast	<p>Coast Conservation Act No. 57 of 1981 and Amendment Act No. 64 of 1988</p> <p>Any person who is involved in any development activity within 300 metres of the mean high water line is required to obtain a permit from the Director of Coast Conservation.</p> <p>The impact of development on the coast is largely applicable to large developments and constructions. It is indiscriminately applied MSEs. The coir industry and small restaurants set up to cater to fishing communities, etc., are affected.</p> <p>This Ordinance does not have a direct impact on any of the selected industries. The impact is based on location and, accordingly, is not inherently industry specific. This was relevant previously in the context of the hospitality industry being included in the study, which would have required the tourist guest houses and restaurants to be evaluated.</p>	
Tourism industry	<p>Tourist Development Act No. 14 of 1968 and Amendment Acts No. 2 of 1987 and No. 33 of 1991</p> <p>This provides for the licensing and grading of tourist guest houses, tourist restaurants, tourist shops and tourist recreational and entertainment sectors. There is no threshold.</p>	

Appendix III. Applicability of non-labour related laws and regulations to the selected sectors

Business regulation	Acts/ordinances/applicability/cost of compliance and non-compliance	Potential to create growth trap
Approvals for trading and industries	<p>The Municipal Councils Ordinance/Urban Councils Ordinance/Pradeshiya Sabha Act</p> <p>These local authority enactments require certain approvals to be obtained for carrying out certain industrial and trading activities within the local authority area and also require the payment of trade taxes. The amounts would differ from area to area and depending on the trade or activity being carried on. Licenses and permits for constructions, building permits, rents and rates have affected the MSEs and increase transaction costs.</p> <p>This is of very general application and in instances such as the construction industry the approvals will be sought by the developer. It is unlikely that based on the industries which have been selected there are significant constraints from local authorities for such industries.</p>	
Establishment, registration and regulation of companies	<p>Companies Act No. 7 of 2007</p> <p>Cost of forming a company, documentation, stamp fees, and procedure are costly for MSEs. Most MSEs will be carried on as sole traders or partnerships and the Companies Act No. 7 of 2007 requirements are not likely to have any great impact.</p> <p>Business Names Act No. 7 of 1987</p> <p>This requires every sole trader and partnership to seek registration. There is no threshold. A previous study carried out by the Enter-Growth Project (ILO) on business registration revealed that about 37 per cent of the entrepreneurs surveyed are considering registration of their businesses while about 53 per cent are not. The most common reasons given by the respondents for considering registering the business are to improve the business and to be eligible for loans. Most of those who do not intend to register believe that either the business is too small to register or registering is not a necessity to run the business.</p>	
Income tax/value added tax (VAT) requirements	<p>Value Added Tax Act No 14 of 2002 and Amendment Acts No. 7 of 2003, No. 13 of 2004, No. 6 of 2005, No. 8 of 2006 and No. 14 of 2007</p> <p>Application of a single rate: 12 per cent</p> <p>Exemptions-</p> <ul style="list-style-type: none"> ✓ Machinery and equipment for bakery products, manufacture of footwear and bags 	

	<ul style="list-style-type: none"> ✓ Locally developed software ✓ Educational services ✓ Unprocessed agriculture and fishing ✓ Leasing for lorries, tractors, and buses for public transportation ✓ Articles for fashion jewellery manufacture ✓ Agricultural machinery and seeds <p>There is no liability to register for VAT if the turnover of the business does not exceed LKR1,800,000 annually or LKR500,000 per quarter. VAT can be reduced if input taxes can be claimed. Many businesses in the informal sector try to avoid paying unless they can claim VAT on inputs. To avoid VAT payments, MSEs try to avoid formal invoicing. This area was highlighted by a few MSE during case study surveys.</p> <p>Optional VAT scheme for the micro-, small and medium enterprise (MSMEs) sector</p> <p>Up to the end of the third year from the date of registration: two per cent</p> <p>From the commencement of the fourth year to the end of the sixth year: four per cent</p> <p>From the commencement of the seventh year to the end of the ninth year: eight per cent</p> <p>From the commencement of the tenth year to the end of the 12th year: 12 per cent</p>	
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Corporate tax rate (%)	<p>The Inland Revenue Act No. 10 of 2006 and Amendment Act No. 10 of 2007</p> <p>Enterprises on sole proprietorship: An individual with taxable income (TI) per annum in excess of LKR300,000 per annum (2010/11) increased to LKR500,000 (2011/12).</p> <p>Year of assessment 2010/11</p> <table><tr><th>Taxable income(LKR)</th><th>Tax rate</th></tr><tr><td>First 400 000</td><td>5%</td></tr><tr><td>Next 400 000</td><td>10%</td></tr><tr><td>Next 400 000</td><td>15%</td></tr><tr><td>Next 500 000</td><td>20%</td></tr><tr><td>Next 500 000</td><td>25%</td></tr><tr><td>Next 500 000</td><td>30%</td></tr><tr><td>Balance</td><td>35%</td></tr><tr><td colspan="2">Tax on TI of LKR2,700,000 ->LKR495,000</td></tr></table> <p>Year of Assessment 2011/12</p> <table><tr><th>Taxable income(LKR)</th><th>Tax rate</th></tr><tr><td>First 500 000</td><td>4%</td></tr><tr><td>Next 500 000</td><td>8%</td></tr><tr><td>Next 500 000</td><td>12%</td></tr><tr><td>Next 500 000</td><td>16%</td></tr><tr><td>Next 1 000 000</td><td>20%</td></tr><tr><td>Balance</td><td>24%</td></tr><tr><td colspan="2">Tax on TI of LKR2 700 000 ->LKR340 000</td></tr></table>	Taxable income(LKR)	Tax rate	First 400 000	5%	Next 400 000	10%	Next 400 000	15%	Next 500 000	20%	Next 500 000	25%	Next 500 000	30%	Balance	35%	Tax on TI of LKR2,700,000 ->LKR495,000		Taxable income(LKR)	Tax rate	First 500 000	4%	Next 500 000	8%	Next 500 000	12%	Next 500 000	16%	Next 1 000 000	20%	Balance	24%	Tax on TI of LKR2 700 000 ->LKR340 000	
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	<p>For companies:</p> <ol style="list-style-type: none"> 1) Tax rate of 15 per cent applicable to companies with taxable income less than LKR5,000,000 (small). The construction and tourism industry are also liable to be taxed at the concessionary rate of 15 per cent. 2) Tax rate of 35 per cent for other medium and large companies. 	
Economic service charge	<p>Economic Service Charge Act No. 13 of 2006 and Amendment Act No. 15 of 2007</p> <p>Rates range from 0.25 per cent to 1.0 per cent of the turnover of a business. Economic service charge threshold is LKR30,000,000 per annum. (This threshold is only likely to be achieved by a medium-scale enterprise and this tax rate ranges from 0.25 per cent to one per cent of the turnover).</p>	
Nation building tax (NBT)	<p>The buying and selling sector is brought under the system. Rate reduced from three per cent (2010/11) to two per cent (2011/12). Liable limit is LKR500,000 per quarter</p> <p>Liability to buying and selling is on 50 per cent of the turnover and for distributors 25 per cent of the turnover.</p> <p>The present threshold of LKR7.5mn (2010/2011) per quarter is increased to LKR25 mn (2011/2012).</p> <p>Manufacturers or service providers are liable unless the exemption is provided.</p> <p>Annual tax returns with quarterly payments expected</p>	

Source: From the relevant statutes.

Appendix IV. Incentive schemes for the MSE sector in Sri Lanka

Incentive	Acts/ordinances/description	Potential to create growth trap
Credit facilities	A new World Bank funded MSME credit programme is launched in 2011 through eight partner banks in Sri Lanka through a World Bank credit facility. This facility allows MSMEs to obtain loans without collateral and the government provides insurance for defaults. The programme also provides funding for training and capacity building credit officers as well as MSMEs at subsidized rates.	
Targeted loan schemes for MSEs	<ol style="list-style-type: none"> 1. Loan Schemes under National Development Trust Fund 2. Agricultural loan schemes 3. Rural Economy Resuscitation Trust Fund 4. Microfinancing to MSEs through registered microfinance institutions (Grass-root lending) 5. Many agricultural loan schemes (capital and recurrent) are available 6. CBO participation in money, labour or material up to ten per cent of the cost of the project is required. 	
Custom duty exemption	Sri Lanka Customs Ordinance Duty exemptions or preferential rates of duty levied under Indo-Sri Lanka, Pakistan–Sri Lanka free trade agreements, Asia Pacific trade agreements, imports for least developed countries, imports for Bangladesh, South Asian Free Trade Area (SAFTA), South Asian Association for Regional Cooperation (SAARC)	
Corporate tax Exemption	The Inland Revenue Act No. 10 of 2006 and Amendment Act No. 10 of 2007 Exceptions are applicable to individuals and partnerships on profits and income earned in foreign currency from any professional service rendered outside Sri Lanka. The profits and income earned in foreign currency by any <i>resident company</i> , from professional services rendered outside Sri Lanka to any person or partnership outside Sri Lanka. Exemption applicable to any person or entity on the export of gold, gems or jewellery.	
VAT exemption	Value Added Tax Act. 14 of 2002 and Amendment Acts No. 7 of 2003, No. 13 of 2004, No. 6 of 2005, No. 8 of 2006 and No. 14 of 2007 There is no liability to register for VAT if the turnover of the business does not exceed LKR1,800,000 per annum or LKR5,000,000 per quarter. VAT can be reduced if input taxes can be claimed. Many businesses in the informal sector try to avoid paying unless they can claim VAT on inputs. To avoid VAT payments, MSEs	

	try to avoid formal invoicing.	
Tax holiday	<p>Section 17A of the Act No. 38 of 2000</p> <p>The five-year tax holiday granted to any person or partnership on profits and income from cultivation of land and sale of produce therefrom has been extended to cover the primary processing of such produce as well.</p> <p>Board of Investment provides tax holidays packaged according to the investment level (especially for foreign investment).</p> <p>A tax holiday is available to a company on trade profits (other than profits from the sale of capital assets) of a “new undertaking” carried on by that company. That undertaking should be located in the area outside Colombo and Gampaha districts. Sum invested in (specified) assets before 1 April 2008 should not be less than LKR30 million.</p> <p>Trade profits (other than the profits from sale of capital assets) of a company from relocated undertaking are exempt for a period of five years, commencing from the year of commercial operations.</p>	
Priority sector lending	<p>Many lending facilities for priority sectors are available, especially for plantation crops and agriculture.</p> <p>Many government-sponsored lending systems are available (mainly through providing low interest loans).</p> <p>SMILE programme funded by JAICA specially targeted MSEs and SMEs. However, it is now completed.</p>	
Access to capital investment subsidy	<p>Capital investment subsidies are provided for the plantation sector on machinery for value addition, etc. This applies to major export sectors such as tea, rubber, coconut and cinnamon to encourage value addition of exports.</p>	

Appendix V. Threshold diagram on labour-related laws for different sizes of enterprises in Sri Lanka

5th threshold	<p>Factory (Sanitary Conveniences)</p> <p>Where more than 500 male workers are employed, one sanitary convenience for every 60 males in excess of 100 males, if sufficient urinal accommodation, is provided.</p>
4th Threshold	<p>Factory (Sanitary Conveniences) Regulations, 1965 Where more than 100 male workers are employed, one sanitary convenience for every 40 males in excess of 100 males, if sufficient urinal accommodation, is provided.</p>
3rd Threshold	<p>Factory (Sanitary Conveniences) Regulations, 1965 One sanitary convenience for every 25 female workers, and for every 25 male workers.</p>
2nd Threshold	<p>Factory (Washing Facilities General) Regulations, 1965 One washbasin/trough for every 20 workers employed.</p>
1st threshold	<p>Termination of Employment (Special Provisions) Act In the event of non-disciplinary termination of a worker, the employer must apply to the Commissioner General of Labour for permission to terminate services.</p> <p>Payment of Gratuity Act Upon termination, for any reason, if the worker has been continuously</p>

	employed for more than five years, the employer must pay a gratuity of half a month's salary for every year of service.				
Workmen's Compensation Ordinance Provides for compensation to a worker in the event of death/partial or temporary disability/injury/illness in the course of and within the scope of his employment.					
Trade Unions Ordinance Rights related to trade union activity assured; any seven members (not necessarily employed in the same workplace) can register a trade union.					
Maternity Benefits Ordinance Provides maximum of 84 days' leave for female workers not covered by the Shop and Office Employees' Act.					
Wages Board Ordinance Stipulates minimum wages, leave, holidays, working hours and overtime for those employed in trades for which a Wages Board has been established.					
Factories Ordinance Provides for occupational safety and health and working conditions for workers in industrial/manufacturing establishments (as defined).					
Industrial Disputes Act Provides dispute resolution mechanisms, including adjudication of claims against termination of services for any reason/non-payment of gratuity (even if employer has less than 15 workers). Also provides for entering into and registering of collective agreements.					
Shop and Office Employees' Act Stipulates leave, holidays, working hours, overtime and some provisions relating to the contract of employment, for those employed in shops and offices (as defined).					
Employment of Women, Young Persons and Children Act Regulates the employment of women, young persons and children in hazardous occupations, working hours and working conditions.					
Employees' Provident Fund Act (EPF) Workers contribute eight per cent and employer contributes 12 per cent of monthly earnings to a state-managed fund; entirety of benefits can be withdrawn upon reaching the age of 55 (men), 50 (women).					
Employees' Trust Fund (ETF) Act Employer contributes three per cent of monthly earnings to ETF; benefits can be withdrawn once every five years, if ceasing to be employed.					
1-15 workers	16 + workers	20+	25+	100+	500+

Appendix VI. Methodology and results - Validation of hypotheses with existing data sets: Econometric analysis of the impact of labour legislation on employment

1. Methodology

In addition to descriptive statistics about the extent of informal employment and evidence of clustering of employees below the 15-employee size threshold, we deploy regression analysis to look at two specific issues: (a) the role of firm size in determining the probability of informal employment; and (b) the impact of informal employment and firm size in determining wages.

To investigate the determinants of the probability of informal employment we estimate two kinds of sector participation choice models using first a maximum-likelihood logistic model and, second, a maximum-likelihood multinomial logistic model, based on the following linear functional form:

$$S_{ij} = \beta_1 x_{1i} + \beta_2 x_{2i} + \dots + \beta_k x_{ki} + \varepsilon_{ij}. \quad (1)$$

The dependent variable S_{ij} denotes the employment outcome j of individual i . Subscript j takes different values with no natural ordering for different employment outcomes.

In the first model we run (the logistic model), the dependent variable S_{ij} is a 0/1 variable, taking one if the individual is informally employed. Therefore, in this specification j takes only one value and denotes only one kind of employment outcome. The independent variables x_{ki} represent personal, labour market and job-related attributes that determine the kind of employment that an individual is likely to be in. We define six groups of such variables: demographic, education occupation, industry, job-related variables and spatial characteristics which will be discussed ahead. Thus, S_{ij} is the outcome of conditions related to personal choice, individual attributes, labour market conditions, and employer preferences that determine the individual's employment. The term ε_{ij} is the error term which has a logistic distribution.

In the second model we apply (the multinomial logistic regression model); the dependent variable S_{ij} is a multinomial variable where j takes different values based on three different employment outcomes: (a) formal employment excluding public sector employment; (b) informal employee in formal enterprise; and (c) employee in informal enterprise or household. The base outcome category is formal employment excluding public employment (a). We exclude the public sector from the analysis of probability because we are looking at the impact of firm size on probability of informal employment and this variable is irrelevant to the public sector.

For the analysis of the determinants of wages, we use Ordinary Least Squares to estimate the following wage function:

$$w_i = \beta_0 + \beta_1 x_{1i} + \beta_2 x_{2i} + \dots + \beta_k x_{ki} + \varepsilon_i. \quad (2)$$

In this equation, the dependent variable W_i is the log of hourly wage of employee i . The independent variables X_{ki} are personal, labour market and job-related attributes that determine the hourly wage that an employee gets. The term ε_i is the error term which is normally distributed.

Variables

The dependent variable for the wage analysis is the log of hourly wages of employee i in the main occupation. Hourly wages were calculated as earnings in the last month from the main occupation divided by the hours usually worked in a month. This worked out as 30/7 times the hours usually worked in a given week as given in Gunewardena (2006).

We define informal employment according to the conceptual framework adopted by the 15th International Conference of Labour Statisticians (henceforth 15th ICLS).⁸ This framework defines informal employment in terms of characteristics of enterprises or production units (sector) as well as in terms of the characteristics of persons employed (jobs). Thus, informal employment includes the total number of informal jobs, whether carried out in formal sector enterprises, informal sector enterprises or households, during a given reference period. Hence, it includes the following types of jobs: (a) own-account workers employed in their own informal sector enterprises; (b) employers working in their own informal sector enterprises; (c) contributing family workers, irrespective of whether they work in formal or informal sector enterprises; (d) employees holding informal jobs in formal sector enterprises, informal sector enterprises or as paid domestic workers employed by households; (e) own-account workers engaged in the production of goods exclusively for own final use by their own household if considered employed. The 15th ICLS's conceptual framework includes work as members of informal producers' cooperatives in informal employment. However, given the data constraints, we have been unable to identify this group for the present study.

Contrary to the recommendations of the 15th ICLS, we include agricultural activities in informal employment as part of the "traditional" sector in Lewis' (1954) model of economic transformation in order to capture the economy's level of structural transformation.

The minimum age threshold for employment was set at ten years of age, in line with that of the Department of Census and Statistics. No upper limit was specified. Registration of the production unit under the Employees' Provident Fund Act or the Inland Revenue Department (IRD), or contribution by employer to a pension scheme or provident fund on the worker's behalf, was deemed as a sufficient criterion to determine whether a production unit was formal or not. Further details about the definition of informal employment can be found in Gunatilaka (2008).

The independent variables X_1, \dots, X_k used in the logistic regression analysis of the probability of employment and in the analysis of the determinants of hourly wages are classed as six groups: demographic, education, occupation, industry, job-related variables and spatial characteristics. The regression analysis of the determinants of hourly wages also includes informal employment as a dummy variable in models using the full sample of employees. The remaining six categories of explanatory variables are defined as follows.

⁸ See the "Resolution concerning statistics of employment in the informal sector", adopted in 1993 by the 15th International Conference of Labour Statisticians, downloadable at: <http://www.ilo.org/public/english/bureau/stat/res/index.htm>.

There are eight demographic variables. *Male* denotes male gender (reference category is female). The dummy *married* takes the value one if the individual is married and 0 if he or she is not. *Age* denotes age in years. There are four ethnic dummies: *Sri Lankan Tamil dummy*, *Indian Tamil dummy*, *Ethnic Moor dummy* and, *Ethnic Other dummy*. The majority Sinhalese ethnic group is the reference group.

The impact of education is captured in terms of five dummy variables: *Grade 5–9*, *GCE O’Level*, *GCE A’Level*, *GAQ/GSQ* and *Degree and above*. The reference category is *Grade 4 or less*.

There are seven occupation variables defined according to the one-digit classification of the International Standard Classification of Occupation: *Managerial*, *Professional*, *Technical*, *Clerical*, *Service*, *Agricultural* and *Elementary*. Product workers and those not classified elsewhere comprise the reference group.

The industrial sector of employment is captured by three dummy variables: *Manufacturing*, *Commerce* and *Services*. *Manufacturing* includes the manufacture of food, beverages and tobacco, textiles, wearing apparel and leather industries, manufacture of wood and wood products, manufacture of paper and paper products, printing and publishing, manufacture of chemicals, petroleum, rubber and plastic products, basic metal industries, and manufacture of fabricated metal products, machinery and equipment. *Commerce* includes wholesale and retail trade, hotels, transport, finance and real estate, and is defined as a separate category to differentiate the sectors in this category from other services. *Services* includes electricity, gas and steam, water works and supply, construction, public administration and defence, sanitary and similar services, social and related community services, recreational and cultural services, personal and household services, and services not adequately defined. The reference category is *Agriculture* which includes all cultivation activities and livestock production, hunting, fishing, forestry and logging, and mining and quarrying.

There are ten job-related variables. Of them seven relate to firm size in terms of the number of employees: *less than five employees*, *between 5 and 9*, *between 10 and 15*, *between 16 and 49*, *between 50 and 99*, *100 plus employees* and *no specific institution*. The reference category for firms in the probability analysis is firms with 10–15 employees – the threshold closest to the TEWA limit. For the analysis of wage determination, the reference category was firms with less than five employees. Of the three remaining job-related variables *Temporary* and *Casual* are related to job tenure and the reference category is permanent tenure. *Public employee* is also a dummy which takes one if the employee is in the public sector, and 0 if not.

Spatial variables consist of sectoral and provincial dummies. There are two sectoral variables *Rural* and *Estates* and the reference category is Urban. The six provincial dummies are: *Central Province*, *Southern Province*, *North Western Province*, *North Central Province*, *Uva Province*, *Sabaragamuwa province*. Western Province is the reference group.

2. RESULTS

In this section we present the results of the analysis along four dimensions: The extent of informal employment in Sri Lanka, evidence of clustering of enterprises below the TEWA-related size threshold, and the impact of firm size on the probability of employment and the determinants of wages.

2.1 Extent of informal employment in Sri Lanka

Informality is the predominant characteristic of employment in Sri Lanka, accounting for 70 per cent of all employment (see table A.1). Agricultural informal employment accounts for 23 per cent,

leaving non-agricultural informal employment making up nearly half of total employment. Conversely, formal employment accounts for a mere 17 per cent while public employment makes up the remaining 13 per cent.

That informal employment should account for so large a share of total employment and formal private employment so small a share 30 years after economic liberalization is alarming and cause for serious concern. It raises disturbing questions about the nature of structural transformation that the country has experienced. It is evident that liberalization and economic growth has not translated into significant job creation in formal employment. Rather, apart from demographic change and emigration, declining unemployment levels seem to owe more to higher rates of informal job creation than to formal job growth.

The results hint at critical impediments to formal job creation. Moreover, note that informal employees in formal enterprises – these are employees of enterprises which are registered with either the Employees' Provident Fund (EPF) or the IRD, but whose employers are not contributing to a provident fund or pension – account for a significant ten per cent of total informal employment. This suggests that even in formal enterprises, there is formalization of employment, in turn signifying the existence of obstacles to formal job growth even within the formal sector. Whether this is a trend may be seen only when we have more years of data that can be analysed.

Pervasive informal employment could be due to many reasons: the impact of labour regulations could be one. The lack of infrastructure in terms of efficient transportation and power generation, lack of access to credit, the law and order situation and the conflict could also depress business confidence and investment in formal production. However, the informalization of employment relations even in formal enterprises is likely to be a symptom of the impact of labour regulations on job creation. In the next section we look for evidence of clustering of employment below the TEWA and Payment of Gratuities Act threshold of 15 employees, suggesting that labour regulations are inhibiting job growth beyond this threshold.

2.2 Clustering of employees below the 15-employee threshold

Recall that the QLFS 2007 survey enumerates households and individuals rather than firms. Hence, the data does not allow us to say much about the clustering of firms by size class as the survey is a representative sample of households rather than of firms. Even so, we can make some inferences about the share of employment by different size classes of firms.

Descriptive statistics on employment shares by size class of formal and informal firms are set out in table A.2 along with the mean hourly wage in each size class. There is little evidence of clustering of employees below the size 15 threshold: 46 per cent of all employees are in firms with less than 15 employees, but the majority (30 per cent) is in firms smaller than five employees. The bulk of employees in such small firms are in informal enterprises, whereas the majority of workers in firms in the largest size class – at least 100 – are formal employees. But note that roughly eight per cent of informal employees are in informal enterprises – that is firms that are not registered under either the Employees' Provident Fund Act or the Inland Revenue Act. Nearly a third of all such employees are residents in Western Province, a fifth in Southern Province and 16 per cent in Sabaragamuwa Province. It is noteworthy that such large enterprises are contriving to remain invisible to the law enforcement authorities.

However, the TEWA-threshold may be having some impact on mean wages around that threshold. Note in table A.2 that mean wages peak at the 10–15 size class in formal enterprises, and at the 16–49 size class in informal enterprises. And while the statistics on mean wages by size class of enterprise reveals that mean wages are lower in the informal enterprises in each size class of

firm, note that the differential is greatest in the 10–15 size class. We will explore this further in our investigation of the impact of informality and firm size class on the determinants of wages in formal and informal enterprises.

2.3 Firm size and the probability of informal employment

In this section we look at the factors that determine the probability of an employee being employed in informal work relative to formal work, excluding the public sector. Among the factors that determine the probability of being an informal employee, we are particularly interested in the impact of firm size.

The marginal effects from the logistic regression and multinomial logistic regression corresponding to equation (1) in section two along with the significance of the coefficients from which they are derived are set out in table A.3. Model (1) shows the marginal effects of the logistic estimates where the dependent variable takes the value one if the individual is an informal employee. The results for the other models are the marginal effects of the multinomial logistic estimates where the base outcome category is formal private employment. The marginal effects denote the effect of a unit change in each variable on the probability of being an employee in the specified category of employment relative to the base category – that is formal private employment – in the case of continuous variables. For dummy variables, marginal effects are discrete changes in the quantities of interest as the dummy variable changes from 0 to 1.

We turn directly to the marginal effects of the job-related variables as they are our variables of particular interest. We set the reference size class as the 10–15 employee category and the marginal effects of the estimates in the table are relative to this size class.

We can discern little evidence of the TEWA-associated size class being a significant determinant of the probability of informal employment. Instead, the critical threshold appears to be firm size less than five or micro-enterprises, whose employees are significantly more likely to be informally employed, whether as informal employees in formal enterprises or as informal employees in informal enterprises. Beyond the micro class of firm, the probability of informal employment declines as firm size increases. Note that the marginal effects decline monotonically, with those in firms with more than 100 employees the least likely to be informally employed. That the micro-enterprise level of employment should emerge as a critical threshold suggests the operation of a growth trap at this level, which is less likely to be due to TEWA and more likely to be due to other factors such as lack of infrastructure and the availability of credit and business development services (see, for example, World Bank and Asian Development Bank, 2005).

Admittedly, our firm size variable is rather crude as our critical threshold includes firms employing between 10 and 15 workers. And in any case, our data is not drawn from a representative sample of firms but from a representative sample of households. In contrast, Vodopivec and Ranaraja (2006) were able to use EPF panel data which permitted a more precise calculation of the critical threshold and an analysis of the dynamics of firm growth. As a result they were able to identify the TEWA-induced threshold as an “unstable” one for firm growth. Nevertheless, the present analysis highlights the existence of yet another critical growth trap operating in informal enterprise at the 5-employee size threshold which seems unrelated to labour regulations, but which still requires further investigation and probably a different set of policies to address. We also highlight some other interesting results before moving on to investigate the impact of firm size on wages.

Other than Moors, those of Sri Lankan and Indian Tamil ethnicity are less likely than Sinhalese to be informally employed. The probability of informal employment declines monotonically with the level of education. Employees in higher skilled occupations are less likely to be in informal

employment than production workers but employees in agricultural and elementary occupations are more likely to be informal employees. Employment in the manufacturing and commerce sectors increases the likelihood of informal employment relative to agriculture. But employment in the service sector increases the likelihood of being an employee in informal enterprises but reduces the likelihood of being an informal employee in a formal enterprise. Residents of rural and estate areas are significantly less likely to be informally employed than urban-based workers, while residents of Central, Southern North Western and Sabaragamuwa provinces are significantly more likely to be employed in informal enterprises than residents of Western Province.

2.4 Impact of informality and firm size on hourly wages

Heltberg and Vodopivec (2004) found that the scarcity of formal jobs had resulted in significant wage premia for public employees and private sector employees covered by TEWA. In this section we extend this analysis with the QLFS 2006 data which allows us to define informal employment as well as look at the impact on wages of different size classes of firms.

Table A.4 sets out the results of the estimation of wage functions. Here again, we first look at the variables of direct relevance to the present analysis. Model (1) sets out the estimates for the entire sample of employees, including public sector employees. It can be seen that the public sector wage premium is around 20 per cent, suggesting that other factors being equal, public sector employees earn around 20 per cent more than private sector employees. Also note the large negative coefficient on informal employees: informal employees earn on average of about 20 per cent less than employees in formal employment.

The sample in Model (2) and Model (3) is restricted to private employees in formal and informal enterprises. Both models include firm size related dummies and the reference category is the smallest size class – less than five employees. However, Model (2) includes a dummy variable for informality whereas Model (3) does not. The results in Model (2) show that formality accounts for an even larger premium once the public sector is excluded from the analysis: informal employees on average earn 25 per cent less than formal employees. Given that the reference size class is the micro-enterprise category, it is surprising to note that employees in all other size classes of firms are likely to earn lower wages than employees in the micro-enterprise class. There does not appear to be any monotonic relationship between firm size class and wage levels and there is nothing noteworthy about the coefficient on the TEWA size class of 10–15 employees. Dropping the dummy for informal employment in Model (3) has little impact on the coefficients of the size class variables either.

In contrast, the sample in Model (4) is confined to formal private employees. Here we see that employees of all size categories earn on average more than employees in micro-enterprises, the reference category. There seems to be a monotonic relationship between size class and firm size other than for the 50–100 size class, with those in firms with more than 100 employees earning the most. Here again, there is nothing noteworthy about the TEWA size class.

The sample of Model (5) is restricted to informal employees in both formal and informal enterprises and it is surprising to note here that informal employees in micro-enterprises – the reference category – earn more than everybody else except those in enterprises with 50–100 workers. Model (7) which is restricted to the sample of informal employees in informal enterprises suggests that these results for informal employees and the results for all private employees in Models (2) and (3) are driven by wage levels among employees in informal micro-enterprises who appear to be earning significantly more than employees in enterprises with 5–15 employees. But note that employees in informal firms with 50–100 workers earn more than employees in micro-enterprises, but the results

are not significant. It is not clear why employees in enterprises above the TEWA threshold should earn more than those in the 5–15 class category. After all, as these employees are in informal enterprises, they are able to evade TEWA anyway.

In contrast, informal employees of formal enterprises of the 5–15 class category (Model 6) earn more than informal employees of formal micro-enterprises, with informal employees of the 100 plus size class earning significantly less. While we cannot discern anything noteworthy about the TEWA size threshold, it is interesting to note that very large formal enterprises appear to have quite exploitative employment arrangements with a part of their workforce, paying them on average an hourly wage that is 25 per cent less than the average paid to informal employees in formal micro-enterprises. This is cause for concern as 61 per cent of all employees in formal enterprises are in firms with more than 100 workers (see table A.2).

Some of the other findings unrelated to firm size and labour regulations but nevertheless interesting are as follows. Note that males earn substantially and significantly more than females, the premium ranging from 25 per cent to 47 per cent. Experience, captured by the age variable, is rewarded, but the negative coefficient on age squared shows a non-linear relationship between age and wages, suggestive of life cycle effects. Ethnicity is not an important determinant of wages – the coefficients are significant only for Moors and the ethnic other group in certain samples. These findings corroborate those of Heltberg and Vodopivec (2004) who found very little or no evidence of ethnic discrimination in wages.

It is a cause for serious concern that education attainment is rewarded in formal employment and is unrewarded in informal employment. If most young people educated at great expense by the state are forced to look for work in informal enterprises where those skills are not rewarded, it throws into question the efficacy of Sri Lanka's education policy in the absence of other effective measures to increase the quality of job opportunities available in the economy at large. Similarly, higher skilled occupations are rewarded only in formal employment. Only technicians earn significantly better wages than production workers (the reference category) in informal employment.

2.5 Overview of findings

The analysis found informality to be the predominant characteristic of employment in Sri Lanka. Even three decades after economic liberalization, informal employment accounts for a little more than two-thirds of total employment, and formal employment excluding public sector employment accounts for a little less than a fifth of total employment. The predominance of informality raises serious questions about the quality of Sri Lanka's structural transformation and points to very low formal job creation rates. Thus, the findings of this study are in line with Vodopivec and Ranaraja's (2006) finding that formal job creation and job destruction rates are abnormally low in Sri Lanka. The study also found evidence of informalization of employment in formal enterprises, with smaller firms more likely than larger firms to have informal work arrangements, probably because they are less likely to have unions and could count on being more invisible to the law enforcing authorities. This again points to serious impediments to formal job creation, with evidence of informalization in formal firms in particular hinting that job security regulations may be a factor.

Job security regulations can dampen formal job creation rates in two ways. Either through an enterprise growth trap at the size where the legislation kicks in, or by dampening job creation rates even beyond the growth trap through very high compensation formulae for lay-off. In this study we looked for evidence of the 15-employee firm size threshold acting as a formal job growth trap and failed to find any. We found informal employment bunching at the micro-enterprise level, which accounted for roughly a third of all employment, and we did not find any evidence that employees

in firms with less than 15 employees were more likely to be informally employed. Here again, the job growth trap, if any, was at the micro-enterprise level with employees in such organizations significantly more likely than employees of any other size class to be informally employed.

However, our failure to find a growth trap at the 15-employee size threshold could also be due to the imprecise variable we used – firm size 10–15 – the only one allowed by the data. Besides, neither our data nor our methodology is suited to an analysis of growth, which is about dynamics that are hard to capture with cross-section data. Thus we were unable to add much to the findings of Vodopivec and Ranaraja (2006) and Abidoye, Orazem and Vodopivec (2007) on the existence of a TEWA-induced growth trap at the size 15 threshold.

We found a substantial and significant wage premium for formal employees. However, we could not find a significant wage premium for employees in firms above the TEWA threshold, even when informality was dropped as an explanatory variable. The only significant result to emerge from the wage analysis is that employees in micro-enterprises earn, on average, more than employees in all other size classes and this result is driven almost entirely by the earnings of employees in informal micro-enterprises. Here again, we could not find any evidence of a TEWA-induced wage premium. This is in contrast to Heltberg and Vodopivec (2004) who found a TEWA-related wage premium of around 12 per cent.

While the 15-employee size threshold may be working as a growth trap for firms, any impact the regulations may have for the setting up of or expansion of firms already above this threshold will depend on the effect of the high compensation formulae for retrenchment. In fact, the 15-employee growth trap would be relevant largely for small domestic enterprises looking to expand. In contrast, the 15-employee size threshold is likely to be irrelevant for the growth of firms already larger than the critical threshold or for firms looking to set up with an initial workforce larger than 15 employees. Thus, for the majority of foreign investors who are encouraged by the Board of Investment (BOI) incentives to begin operations on a large scale, it is how punitive the compensation formula is likely to be, rather than the coverage threshold of the legislation that must be the critical factor. Unfortunately, we are unable to throw any light on this aspect of job security regulations given the limitations of our data, but the embarrassing predominance of informal employment that the present study reveals leaves open the possibility that the compensation formula of TEWA, in addition to the requirement that approval be obtained for retrenchment, may be dampening formal job growth. However, at this level of the macroeconomy, factors such as the availability of infrastructure, the conflict and the law and order situation must also be taking their toll.

Table A.1. Extent of informal employment in Sri Lanka, 2006

	Number of workers	% of total informal employment
Informal employment in formal sector	2 061	10.63
Family worker in formal enterprise	143	0.74
Employee in informal job in formal enterprise	1 918	9.89
Informal employment in informal sector	17 329	89.37
Own-account worker in informal enterprise/household	8 217	42.38
Employer in informal enterprise	548	2.83
Family worker in informal enterprise	2 757	14.22
Employee in informal enterprise/household	5 807	29.95
Total informal employment	19 390	100.00
	Number of workers	%
Total formal employment	8 334	
Public employment as % of total formal employment	3 723	44.67
Total	27 724	
Informal employment as % of total employment		69.94
Agricultural informal employment as % of total employment	6 197	22.35
Non-agricultural informal employment as % of total employment		47.59

Note: Also see Gunatilaka (2008).

Table A.2. Shares of employees and mean hourly wage by size class of firm

Firm size	Share of employees (%)			Mean hourly wage (Rs.)		Ratio: formal/informal
	All	Formal	Informal	Formal	Informal	
< 5	30.46	4.51	44.01	39.79	30.62	130
5–9	8.6	3.97	11.02	45.62	29.94	152
10–15	6.59	5.55	7.13	50.75	31.09	163
16–49	8.54	12.96	6.23	49.81	35.27	141
50–99	6.12	11.62	3.25	44.37	33.57	132
100+	26.16	60.67	8.14	46.30	31.99	145
No specific institution	8.66	0.27	13.04	39.55	33.21	119
No regular employees	4.87	0.45	7.18	37.20	28.75	129
Total	100	100	100	46.40	31.28	148
Total (number)	11760	4035	7725			

Note: “Formal” refers to formal employees in formal private enterprises.

Table A.3. Determinants of probability of different categories of informal employees, marginal effects of logistic and multinomial logistic estimates

Categories of employees	Informal employees	Informal employees in formal enterprises	Employees in informal enterprises
	(1)	(2)	(3)
Log of hourly wage	-0.0143***	-0.0155***	-0.0122***
Demographics			
Male (d)	0.0892***	0.0787***	0.0858***
Married (d)	-0.0120*	-0.0224***	0.0005
Age	0.0014***	0.0009***	0.0016***
Sri Lankan Tamil (d)	-0.0308**	-0.012	-0.0481***
Indian Tamil (d)	-0.0271*	0.0027	-0.0519***
Moor (d)	0.0177	0.0218	0.0163
Other (d)	0.0322	0.0910**	-0.0995
Education			
Grade 5–9	-0.0371***	-0.0252**	-0.0435***
GCE O' Levels	-0.0840***	-0.0307**	-0.1247***
GCE A' Levels	-0.0843***	-0.0362**	-0.1253***
GAQ/GSQ	-0.2093***	-0.1142	-0.2381**
Degree and above	-0.0994***	-0.0247	-0.1902***
Occupation			
Managerial (d)	-0.1770***	-0.0743**	-0.2605***
Professional (d)	-0.1060***	-0.0213	-0.1917***
Technical (d)	-0.1131***	0.0132	-0.2237***
Clerical (d)	-0.1160***	-0.0293	-0.1886***
Service (d)	-0.0627***	-0.0097	-0.1031***
Agricultural (d)	0.0782***	0.0862**	0.0618*
Elementary (d)	0.0305***	0.0442***	0.0125
Industry			
Manufacturing (d)	-0.0573***	-0.0583***	-0.0636***
Commerce (d)	-0.0856***	-0.0680***	-0.1017***
Services (d)	0.0377***	-0.0407**	0.0956***
Job-related variables			
Firm size <5	0.0954***	0.0145	0.1485***
5–9 (d)	-0.0138	-0.0212	-0.0041
16–49 (d)	-0.1806***	-0.0745***	-0.2356***
50–99 (d)	-0.2271***	-0.0881***	-0.2977***
100 + (d)	-0.2633***	-0.0990***	-0.3726***
No specific institution (d)	0.0828***	0.0654**	0.0914***
Temporary (d)	0.1773***	0.1573***	0.1996***

Categories of employees	Informal employees	Informal employees in formal enterprises	Employees in informal enterprises
	(1)	(2)	(3)
Casual (d)	0.1803***	0.1786***	0.1936***
Spatial			
Rural (d)	-0.0416***	-0.0311***	-0.0476***
Estates (d)	-0.2100***	-0.2259***	-0.1530***
Central (d)	0.0360***	-0.01	0.0846***
Southern (d)	0.0618***	0.0243**	0.1015***
North Western (d)	0.0397***	-0.0084	0.0885***
North Central (d)	0.0136	-0.0314	0.0611***
Uva (d)	-0.0077	-0.0600***	0.0497***
Sabaragamuwa (d)	0.0326***	-0.0254**	0.0875***
Pseudo R-squared	0.5577	0.4143	0.4143
Number of observations	11724	11724	11724

Notes:

1. ***, **, and * denote statistical significance at the one per cent, five per cent and ten per cent levels respectively; (d) for discrete change in dummy variable from 0 to 1.
2. Marginal effects of Model (1) estimated using logistic regression where dependent variable takes the value one if individual is an informal employee, 0 if not. Other results are the marginal effects of multinomial logistic estimates where the base category is formal employees in formal enterprises excluding the public sector.
3. Estimation of marginal effects calculated at mean values using Bartus' (2005) Stata ado <margeff>.

Table A.4. Determinants of hourly wages, employees

	All employees	All employees excluding public sector	All employees excluding public sector	All formal employees excluding public sector	All informal employees	Informal employees in formal enterprises	Informal employees in informal enterprises
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Demographics							
Male	0.3142***	0.3816***	0.3573***	0.2436***	0.4457***	0.3748***	0.4749***
Married	0.0822***	0.0464*	0.0470*	-0.011	0.0648*	0.0834	0.0545
Age	0.0380***	0.0356***	0.0368***	0.0489***	0.0305***	0.0575***	0.0208***
Age squared	-0.0004***	-0.0004***	-0.0004***	-0.0005***	-0.0004***	-0.0007***	-0.0003***
Sri Lankan							
Tamil	0.0196	0.0115	0.0184	-0.053	0.0823	0.0717	0.079
Indian Tamil	0.0472	0.0209	0.0291	0.0384	0.0271	-0.0265	0.072
Moor	0.1048**	0.0947*	0.0908*	0.1496	0.0953	0.0807	0.1036
Other	0.0213	-0.0017	-0.0109	0.3531**	-0.4589*	-0.5382	-0.2473
Education							
Grade5–9	0.0673**	0.0268	0.0343	0.082	0.0115	0.1236	-0.017
GCE O' Level	0.1609***	0.0856**	0.1082**	0.1550**	0.0421	0.2469**	-0.0426
GCE A' Level	0.3169***	0.2000***	0.2274***	0.2819***	0.0742	0.2293	0.0074
GAQ	0.5039***	0.4625*	0.5177**	0.5553**	0.2802	0.5995	0.0505
Degree	0.5754***	0.6636***	0.6899***	0.7629***	0.3264	0.1371	0.7051**
Occupation							
Managerial	0.4764***	0.5724***	0.6316***	0.6425***	-0.0818	-0.2131	0.1986
Technician	0.1684***	0.1957***	0.2317***	0.2484***	-0.0015	0.3118	-0.1954
Professional	0.5111***	0.6622***	0.6969***	0.5284***	0.7739***	1.1270***	0.5949***
Clerical	0.1428***	0.2051***	0.2439***	0.1734**	0.1686	0.4905**	-0.0522
Service	-0.1136***	-0.0904*	-0.0793	0.0223	-0.096	0.0773	-0.1609**
Agricultural	-0.1623*	-0.1174	-0.1353	0.2086	-0.2309**	-0.3441	-0.1970*
Elementary	-0.1846***	-0.1530***	-0.1640***	-0.2079***	-0.1328***	-0.0215	-0.1583***
Industry							
Manufacturing	0.1915***	0.1829***	0.1948***	0.2286***	0.1165**	0.094	0.1282**
Commerce	0.1739***	0.1548***	0.1757***	0.3571***	0.04	-0.0201	0.0627
Services	0.1422***	0.0336	0.0248	0.2348**	-0.0348	-0.1536	0.0009
Job-related variables							
Firm size 5–9		-0.1274***	-0.1063**	0.0679	-0.1269***	0.1814	-0.2063***
10–15		-0.0847*	-0.0423	0.1314	-0.0613	0.1043	-0.1158*
16–49		-0.0753*	0.0185	0.1857**	-0.0312	-0.021	0.0367
50–100		-0.1261**	-0.0081	0.0763	0.0484	0.1342	0.0381
100+		-0.0690*	0.0730**	0.2912***	-0.2352***	-0.2519**	-0.0896
No specific		-0.1178**	-0.1102**	-0.0548	-0.1205**	-0.0952	-0.1287**

	All employees (1)	All employees excluding public sector (2)	All employees excluding public sector (3)	All formal employees excluding public sector (4)	All informal employees (5)	Informal employees in formal enterprises (6)	Informal employees in informal enterprises (7)
institution							
Temporary	-0.2377***	-0.1659***	-0.2217***	-0.1940***	-0.0902**	-0.2022**	-0.0464
Casual	-0.2484***	-0.1696***	-0.2280***	-0.1509**	-0.1057**	-0.1711*	-0.0685
Public employee	0.2073***						
Informal employee	-0.2005***	-0.2564***					
Spatial variables							
Rural	-0.0806***	-0.0821**	-0.0730*	-0.0499	-0.0927*	-0.1559	-0.0604
Estates	-0.3098***	-0.2380***	-0.1792***	-0.2025**	-0.0706	-0.0395	-0.0713
Central Province	-0.0363	-0.0514	-0.0617	-0.1419***	0.011	0.1338	-0.0533
Southern Province	0.0556*	0.0648*	0.0441	-0.0174	0.1468***	0.3453***	0.0657
North Western Province	-0.0765**	-0.0916**	-0.1020***	-0.2232***	-0.0222	0.1603	-0.1039**
North Central Province	-0.1058**	-0.0848	-0.0944	-0.2644***	0.0092	0.1854	-0.0726
Uva Province	-0.0332	-0.0678	-0.0667	-0.2028***	0.0883	0.2072	0.0277
Sabaragamuwa Province	-0.1926***	-0.2225***	-0.2320***	-0.2628***	-0.1844***	0.0587	-0.2700***
Constant	2.3860***	2.5357***	2.3075***	1.9382***	2.3277***	1.6679***	2.5349***
R-squared	0.202	0.121	0.117	0.278	0.058	0.072	0.065
N	15447	11724	11724	4032	7692	1912	5780

Appendix VII. Detailed tables for chapter 4

Table B.1. Distribution of employees in MSEs in Sri Lanka across gender for different types of employment, 2011

Nature of employment	Male	Female	Total
Paid workers			
Full time	56%	44%	100%
Part time	58%	43%	100%
Casual/temporary	65%	35%	100%
Total	58%	42%	100%
Base (paid workers)	3 468	2 544	6 012
Unpaid workers			
Full time	74%	26%	100%
Part time	44%	56%	100%
Casual/temporary	50%	50%	100%
Total	72%	28%	100%
Base (unpaid workers)	593	233	826
Total workers (paid + unpaid)			
Full time	58%	42%	100%
Part time	57%	43%	100%
Casual/temporary	64%	36%	100%
Total	60%	40%	100%
Base (total workers)	4 113	2 777	6 890

Table B.2: Distribution of employees in MSEs in Sri Lanka across gender for different types of employment, 2009

Nature of employment	Male	Female	Total
Paid workers			
Full time	56%	44%	100%
Part time	59%	41%	100%
Casual/temporary	61%	39%	100%
Total	58%	42%	100%
Base (paid workers)	3 468	2 544	6 012
Unpaid workers			
Full time	75%	25%	100%

Part time	81%	19%	100%
Casual/temporary	53%	47%	100%
Total	73%	27%	100%
Base (unpaid workers)	537	196	733
Total workers (paid + unpaid)			
Full time	59%	41%	100%
Part time	60%	40%	100%
Casual/temporary	61%	39%	100%
Total	59%	41%	100%
Base (total workers)	4 005	2 740	6 745

Table B.3: Distribution of employees in MSEs in Sri Lanka across gender for different types of employment in each sector, 2011

Paid workers								
	Full time		Part time		Casual/temporary		Total	
Business sector	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	63%	37%	73%	27%	63%	37%	63%	37%
Textiles & garments	35%	65%	21%	79%	37%	63%	34%	66%
Woodworking	78%	22%	95%	5%	91%	9%	83%	17%
Hospitality	69%	31%	84%	16%	83%	17%	73%	27%
Total	56%	44%	58%	43%	65%	35%	58%	42%
Unpaid workers								
	Full time		Part time		Casual/temporary		Total	
Business sector	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	74%	26%	75%	25%	80%	20%	75%	25%
Textiles & garments	57%	43%	20%	80%	24%	76%	51%	49%
Woodworking	91%	9%	100%	0%	100%	0%	92%	8%
Hospitality	81%	19%	100%	0%	.	.	81%	19%
Total	74%	26%	44%	56%	50%	50%	72%	28%
Total workers (paid + unpaid)								
	Full time		Part time		Casual/temporary		Total	
Business sector	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	65%	35%	73%	27%	63%	37%	65%	35%
Textiles & garments	37%	63%	21%	79%	36%	64%	36%	64%
Woodworking	80%	20%	95%	5%	92%	8%	84%	16%
Hospitality	71%	29%	84%	16%	83%	17%	74%	26%
Total	58%	42%	57%	43%	64%	36%	60%	40%

Table B.4: Distribution of employees in MSEs in Sri Lanka across gender for different types of employment in each sector, 2009

Paid workers								
Business sector	Full time		Part time		Casual/temporary		Total	
	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	64%	36%	69%	31%	63%	37%	64%	36%
Textiles & garments	35%	65%	27%	73%	30%	70%	33%	67%
Woodworking	77%	23%	95%	5%	95%	5%	84%	16%
Hospitality	68%	32%	79%	21%	80%	20%	71%	29%
Total	56%	44%	59%	41%	61%	39%	58%	42%
Unpaid workers								
Business sector	Full time		Part time		Casual/temporary		Total	
	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	76%	25%	57%	43%	50%	50%	71%	29%
Textiles & garments	56%	44%	100%	0%	50%	50%	56%	44%
Woodworking	93%	7%	.	.	100%	0%	94%	6%
Hospitality	76%	24%	92%	8%	50%	50%	77%	23%
Total	75%	25%	81%	19%	53%	47%	73%	27%
Total workers (paid + unpaid)								
Business sector	Full time		Part time		Casual/temporary		Total	
	Male	Female	Male	Female	Male	Female	Male	Female
Agro processing	67%	33%	69%	31%	63%	37%	65%	35%
Textiles & garments	37%	63%	28%	72%	31%	69%	35%	65%
Woodworking	80%	20%	95%	5%	95%	5%	85%	15%
Hospitality	69%	31%	81%	19%	80%	20%	72%	28%
Total	59%	41%	60%	40%	61%	39%	59%	41%

Table B.5: Percentage distribution of employees in MSEs in Sri Lanka across payment modality, by different business sectors

Payment modality	Agro processing	Textile & garments	Woodworking	Hospitality	All
Hourly basis	0.1%	1.2%	1.0%	0.5%	0.8%
Daily basis	24.1%	8.5%	21.6%	15.7%	16.1%
Weekly basis	18.8%	5.0%	10.3%	3.8%	9.0%

Monthly basis	39.0%	62.7%	38.6%	78.0%	56.1%
Piece-rate	18.0%	21.9%	27.6%	1.5%	17.5%
Lump sum	0.0%	0.6%	0.1%	0.0%	0.2%
Other	0.0%	0.0%	0.9%	0.5%	0.2%
Total	100%	100%	100%	100%	100%
Base (total no. of employees)	1 486	2 243	1 051	1 317	6 097

Table B.6. Percentage of MSEs in Sri Lanka that do not maintain an official employment register, across reasons

Reason	% MSEs
It is not legally required	27%
It is legally required, but not enforced	11%
Takes too much time	3%
Unnecessarily complicated (do not see the benefit)	7%
Too costly	3%
Not necessary – daily wage payment	62%
Other (specify)	27%
Base (total no. of MSEs that do not maintain employment register)	149
Note: Percentages do not add to 100% because the same enterprise can give more than one reason	

Table B.7. Percentage of MSEs in Sri Lanka that are inspected by different officers/departments in one year in each business sector

Inspecting officers/departments	Agro processing	Textile & garments	Woodworking	Hospitality	All sectors
Labour inspector	63.6	66.7	65.0	65.5	65.3
Factory inspector	9.9	12.5	18.3	7.1	12.0
Local authority - Public health inspector (PHI)	77.5	47.9	50.0	93.8	65.1
Central Environmental Authority (CEA)	9.3	9.9	30.0	14.2	14.8
Environmental officer	12.6	14.1	40.0	24.8	21.2
Department of Inland	37.1	18.8	26.7	50.4	31.4

Revenue (tax inspector)					
Board of Investment (compliance officer)	0.7	0.5	1.7	1.8	1.0
Department of Quality Control (DQC)	2.6	0.5	0.8	0.9	1.2
Forest department	0.0	0.5	14.2	0.0	3.1
Price Control of the Ministry of Consumer Affairs	0.0	0.5	0.0	1.8	0.5
Tourist board	0.0	1.6	0.0	4.4	1.4
Officers of Pradeshiya Sabha	0.0	0.0	0.0	0.9	0.2
Police officer	0.0	1.0	3.3	2.7	1.6
Tax officer (Rates Tax) - Pradeshiya Sabha	0.7	0.0	0.0	0.0	0.2
Officers of Urban Council	0.0	0.0	0.0	0.9	0.2
Loan Officers of People's Bank	0.0	0.5	0.0	0.0	0.2
Ministry of Traditional Industries and Small Enterprise Development	0.0	0.5	0.0	0.0	0.2
Coconut Development Board	0.7	0.0	0.0	0.0	0.2

Table B.8. Percentage distribution of MSEs in Sri Lanka across status of awareness and payment of government-specified minimum wage, by business sector

Status of awareness and payment	Agro processing	Textile & garments	Hospitality	All (except woodworking sector)
Aware and pay	74%	64%	72%	69%
Aware but do not pay	1%	10%	2%	5%
Not aware	25%	26%	27%	26%
Total	100%	100%	100%	100%
Base (no. of MSEs)	151	192	113	456

Table B.9. Percentage of MSEs in Sri Lanka across status of awareness and payment of government-specified minimum wage, by worker group

Status of awareness and payment	Enterprises with 5–14 workers	Enterprises with 15–70 workers	All
Aware and pay	68%	74%	69%
Aware but do not pay	6%	4%	5%

Not aware	26%	22%	26%
Total	100%	100%	100%
Base (no. of MSEs)	371	85	456

Note: This table does not include the woodworking sector.

Table B.10. Percentage of MSEs in Sri Lanka who are aware of minimum wage regulations but do not comply with the regulations across reasons

Reason	MSEs (%)
It is not legally required	8%
Too costly	4%
Other: Specify	100%
Base (total no. of MSEs that are aware but do not comply with regulations on minimum wage)	24

Note: Percentages do not add to 100% because the same enterprise can give more than one reason.

Table B.11. Percentage of MSEs in Sri Lanka who have heard of or made informal payments to avoid compliance with regulations on minimum wage

Business sector/worker group	Heard of informal payments	Of those who heard, percentage who made informal payments	Base (total no. of MSEs)
Agro processing	15%	4%	151
Textiles & garments	14%	11%	192
Woodworking	11%	8%	120
Hospitality	17%	0%	113
Enterprise with 5–14 workers	14%	4%	480
Enterprise with 15–70 workers	14%	15%	96
All	14%	6%	576

Table B.12. Distribution of MSEs in Sri Lanka by who makes EPF/ETF contributions, across time required to file a monthly EPF return

Time	Agro processing	Textiles & garments	Woodworking	Hospitality	Enterprise with 5–14 workers	Enterprise with 15–70 workers	All
Less than 30 minutes a month	11%	6%	18%	11%	12%	6%	11%

30–60 minutes a month	43%	49%	42%	38%	47%	31%	44%
1–2 hours a month	32%	30%	28%	33%	31%	30%	31%
More than 2 hours a month	13%	15%	13%	18%	11%	33%	15%
Base (all MSEs who make EPF/ETF payments)	97	120	72	79	301	67	368

Table B.13. Percentage distribution of MSEs in Sri Lanka who are aware of the existence of penalties for non-compliance with EPF/ETF regulations, across knowledge of different penalties

Business sector	Know the category and quantum	Know category but not the quantum	Do not know	Answer mismatched	Base (no. of MSEs who have heard about existence of penalties)
Enterprise with 5–14 workers	1%	72%	26%	2%	477
Enterprise with 15–70 workers	0%	81%	16%	5%	95
Agro processing	1%	81%	17%	3%	149
Textiles & garments	0%	69%	28%	4%	191
Woodworking	0%	70%	29%	1%	119
Hospitality	4%	75%	19%	3%	113
All	1%	73%	24%	3%	572

Table B.14. Percentage of MSEs in Sri Lanka who have heard of or made informal payments to avoid compliance with regulations on EPF/ETF

Business sector/worker group	Heard of informal payments	Of those who heard, % who made informal payments	Base (total No. of MSEs)
Agro processing	38%	9%	151
Textile & garments	34%	17%	192
Woodworking	34%	15%	120
Hospitality	42%	11%	113
Enterprise with 5–14 workers	36%	12%	480
Enterprise with 15–70 workers	42%	18%	96
All	37%	13%	576

Table B.15. Awareness of gratuity payments among all MSEs with 5–14 regular employees and its impact on growth

Gratuity payment awareness	% distribution of MSEs with 5–14 workers
Aware and tried to stay below the threshold	0.4%
Aware but did not try to stay below the threshold	32%
Not aware	68%
Total	100%
Base (no. of MSEs with 5–14 regular employees)	480

Table B.16. Percentage of MSEs in Sri Lanka with 15 or more workers who have ever made gratuity payments, by business sector

Business sector	% MSEs who make gratuity payments	Base (No. of MSEs with 15 or more workers)
Agro processing	13%	24
Textiles & garments	14%	37
Woodworking	9%	11
Hospitality	25%	24
Total	16%	96

Table B.17. Percentage of MSEs in Sri Lanka with 15–70 workers who never paid gratuity, across reasons

Reason	% MSEs
It is not legally required	14
It is legal, but not enforced	32
There was no resignation/retirement	27
Takes too much time	5
Too costly	0
Workers have not demanded it	64
Others	18
All MSEs with 15–70 workers who never paid gratuity	22

Note: Percentages do not add to 100% because the same enterprise can give more than one reason.

Table B.18. Percentage of MSEs who are aware of gratuity payments businesses with 15 or more regular employees are required to make

Sector/worker group	% MSEs that are aware of rate of EPF contribution
Agro processing	29%
Textiles & garments	29%
Woodworking	28%
Hospitality	42%
Worker group 5–14	28%
Worker group 15–70	47%
Total	31%

Table B.19. Percentage of MSEs in Sri Lanka who have heard that there are penalties if businesses do not comply with gratuity regulations

Business sector	% MSEs who are aware	Base (Total MSEs)
Enterprise with 5–14 workers	99%	480
Enterprise with 15–70 workers	99%	96
Agro processing	98%	151
Textiles & garments	99%	192
Woodworking	99%	120
Hospitality	100%	113
Total	99%	576

Table B.20. Percentage distribution of MSEs in Sri Lanka who are aware of the existence of penalties for non-compliance with gratuity regulations, across knowledge of different penalties

Business sector	Know the category and quantum	Know category but not the quantum	Unable to specify the penalties	Answer mismatched	Base (no. of MSEs who have heard about existence of penalties)
Enterprise with 5–14 workers	0%	29%	71%	0%	476
Enterprise with 15–70 workers	0%	33%	67%	0%	95
Agro processing	0%	31%	69%	0%	148
Textiles & garments	0%	29%	70%	1%	191
Woodworking	0%	28%	72%	0%	119

Hospitality	0%	32%	68%	0%	114
Total	0%	30%	70%	0%	572

Table B.21. Percentage of MSEs in Sri Lanka who have heard of or made informal payments to avoid compliance with regulations on gratuity

Business sector/worker group	Heard of informal payments	Of those who heard, % who made informal payments	Base (total no. of MSEs)
Agro processing	13%	5%	151
Textiles & garments	8%	0%	192
Woodworking	8%	10%	120
Hospitality	12%	0%	113
Enterprise with 5–14 workers	10%	4%	480
Enterprise with 15–70 workers	9%	0%	96
All	10%	4%	576

Table B.22. Percentage of MSEs in Sri Lanka who did not have a trade union, across reasons

Reason	No. of MSEs	%
It is not legally required	23	7.5
It is legally required, but not enforced	8	2.6
Too costly for the firm	6	2.0
There are regular meetings/communication with workers	119	38.9
Workers have not demanded a union	200	65.4
Total Not Responded	306	116.3
Base (total no. of MSEs who do not have a trade union)	523	

Note: Percentages do not add to 100% because the same enterprise can give more than one reason.

Table B.23. Percentage distribution of MSEs in Sri Lanka, across status of overall wage increase for their employees during the year prior to the survey in each business sector

Status of wage	Agro processing	Textiles & garments	Woodworking	Hospitality	All
There is overall wage increase	65%	54%	54%	54%	57%
No wage increase	35%	46%	46%	46%	43%
Base (Total no. of MSEs)	151	192	120	113	576

Table B.24. Percentage distribution of MSEs in Sri Lanka that had an overall wage increase for their employees during the year prior to the survey, across rate of wage increase

Rate of wage increase	Agro processing	Textiles & garments	Woodworking	Hospitality	All
Less than equal to 5%	28%	39%	12%	26%	28%
5–9%	28%	17%	3%	11%	17%
10%	25%	26%	56%	45%	35%
11–15%	12%	12%	20%	13%	14%
Greater than 15%	6%	6%	9%	5%	6%
Total	100%	100%	100%	100%	100%
Base (no. of MSEs whose employees had overall wage increase)	113	105	66	62	346

Table B.25. Percentage of MSEs in Sri Lanka who have heard that there are penalties if businesses do not comply with regulations on trade unions

Business sector	% MSEs who are aware	Base (Total MSEs)
Enterprise with 5–14 workers	99%	480
Enterprise with 15–70 workers	99%	96
Agro processing	97%	151
Textiles & garments	99%	192
Woodworking	99%	120
Hospitality	99%	113
Total	99%	576

Table B.26. Percentage of MSEs in Sri Lanka who are aware of labour laws related to operations of trade unions, across knowledge of category and quantum of penalties

Worker group/business sector	Know the category and quantum	Know category but not the quantum	Do not know	Answer mismatched	<i>Base (total MSEs) who are aware of regulations related to trade union</i>
Enterprise with 5–14 workers	0%	18%	81%	1%	474
Enterprise with 15–70	0%	11%	88%	1%	95

workers

Agro processing	0%	22%	76%	1%	147
Textiles & garments	1%	13%	86%	1%	191
Woodworking	1%	13%	85%	1%	119
Hospitality	0%	17%	83%	0%	112
Total	0%	16%	83%	1%	569

Table B27. Percentage of MSEs in Sri Lanka who have heard of or made informal payments to avoid compliance with regulations on trade unions

Business sector/worker group	Heard of informal payments	Of those who heard, % who made informal payments	Base (total no. of MSEs)
Agro processing	13%	5%	151
Textiles & garments	9%	0%	192
Woodworking	7%	13%	120
Hospitality	10%	9%	113
Enterprise with 5–14 workers	10%	6%	480
Enterprise with 15–70 workers	7%	0%	96
All	10%	5%	576

Table B.28. Percentage of MSEs in Sri Lanka who did not pay income tax, across reasons

Reason	% MSEs
It is not legally required/exempted	66%
It is legally required, but not enforced	8%
Takes too much time	1%
Unnecessarily complicated (do not see the benefit)	11%
Too costly	8%
Others	9%
No reason specified	17%
Base (total MSEs who did not pay income tax)	327

Note: Percentages do not add to 100% because the same enterprise can give more than one reason

Table B.29. Percentage distribution of MSEs in Sri Lanka that pay income tax across rate of income tax in each business

sector					
Income tax rate	Agro processing	Textiles & garments	Woodworking	Hospitality	All
Less than equal to 5%	21%	21%	14%	17%	18%
6–9%	0%	0%	2%	0%	0%
10%	13%	19%	22%	20%	18%
11–14%	1%	3%	10%	2%	4%
15%	46%	27%	20%	37%	33%
Greater than 15%	1%	1%	2%	6%	2%
Information missing	18%	29%	30%	19%	24%
Base (no. of MSEs who pay income tax)	72	73	50	54	249

Table B.30. Percentage distribution of MSEs in Sri Lanka that pay income tax across time spent on filing and paying for income tax, by business sector

Time spent for filing and paying income tax	Agro processing	Textiles & garments	Woodworking	Hospitality	All
1 day	11%	16%	18%	22%	16%
2 days	18%	15%	20%	17%	17%
3–8 days	36%	38%	32%	39%	37%
Greater than 8 days	14%	14%	6%	9%	11%
Information missing	21%	16%	24%	13%	18%
Total	100%	100%	100%	100%	100%
Base (no. of MSEs who pay income tax)	72	73	50	54	249

Table B.31. Percentage of MSEs in Sri Lanka who have heard that there are penalties if businesses do not comply with regulations on income tax

Business sector	% MSEs who are aware	Base (total MSEs)
Enterprise with 5–14 workers	73%	480
Enterprise with 15–70 workers	79%	96
Agro processing	79%	151

Textiles & garments	65%	192
Woodworking	79%	120
Hospitality	75%	113
Total	73%	576

Table B. 32. Percentage of MSEs in Sri Lanka who are aware of the existence of penalties for non-compliance with income tax regulations, across knowledge of different penalties

Business sector	Know the category and quantum	Know category but not the quantum	Unable to specify the penalties	Answer mismatched	Base (total MSEs) who are aware of regulations related to gratuity payment
Enterprise with 5–14 workers	4%	69%	27%	1%	477
Enterprise with 15–70 workers	6%	73%	21%	1%	95
Agro processing	6%	73%	21%	1%	149
Textiles & garments	4%	61%	34%	2%	191
Woodworking	3%	76%	22%	0%	119
Hospitality	3%	72%	23%	3%	113
Total	4%	69%	26%	1%	572

Table 4.33. Percentage distribution of MSEs in Sri Lanka (sole proprietorships & unregistered businesses) across their knowledge of income tax payment and its impact on growth

Status of awareness and impact on growth	Enterprise with 5–14 workers	Enterprise with 15–70 workers	Agro processing	Textiles & garments	Woodworking	Hospitality	All
Aware and tried to stay below threshold	2%	4%	2%	2%	2%	3%	2%
Aware but not having effect on growth	34%	31%	35%	33%	35%	33%	34%
Not aware	64%	64%	63%	66%	63%	64%	64%
Total	100%	100%	100%	100%	100%	100%	100%
Base (no. of MSEs that are sole proprietorships & unregistered businesses)	444	70	134	174	109	97	514

Table B.34. Percentage distribution of MSEs in Sri Lanka who are partnership businesses and private limited companies, across their knowledge of income tax payment and its impact on growth

Status of awareness and impact on growth	Enterprise with 5–14 workers	Enterprise with 15–70 workers	Agro processing	Textiles & garments	Woodworking	Hospitality	All
Aware and tried to stay below threshold	0%	4%	0%	0%	0%	7%	2%
Aware but not having effect on growth	30%	52%	50%	29%	45%	33%	39%
Not aware	70%	43%	50%	71%	55%	60%	59%
Total	100%	100%	100%	100%	100%	100%	100%
Base (no. of MSEs that are sole partnership businesses & private limited companies)	33	23	16	14	11	15	56

Table B.35. Percentage of MSEs in Sri Lanka who have heard of or made informal payments to avoid compliance with regulations on income tax

Business sector/worker group	Heard of informal payments	Of those who heard, % who made informal payments	Base (total no. of MSEs)
Agro processing	60%	14%	151
Textiles & garments	52%	19%	192
Woodworking	58%	19%	120
Hospitality	65%	14%	113
Enterprise with 5–14 workers	58%	15%	480
Enterprise with 15–70 workers	59%	23%	96
All	58%	17%	576

Table B.36. Percentage distribution of MSEs in Sri Lanka across status of awareness about VAT payments and its impact on growth

Awareness of VAT	Enterprise with 5–14 workers	Enterprise with 15–70 workers	Agro processing	Textiles & garments	Woodworking	Hospitality	All
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Aware and tried to stay below threshold	1%	2%	1%	1%	2%	2%	1%
Aware but not stayed below threshold	33%	44%	34%	33%	36%	39%	35%
Not aware	65%	54%	64%	66%	63%	59%	64%
Base (total no. of MSEs)	480	96	151	192	120	113	576

Table B.37. Percentage of MSEs in Sri Lanka who did not pay VAT, across reasons for not paying

Reason	% MSEs
It is not legally required/exempted	79%
It is legally required, but not enforced	7%
Takes too much time	0%
Unnecessarily complicated (do not see the benefit)	16%
Too costly	9%
Other	6%
Information missing	8%
Base (no. of MSEs that do not pay VAT)	524

Note: Percentage may not add to 100% since one MSE can give more than one reason.

Table B.38. Average number of days spent by MSEs in Sri Lanka on collecting and paying VAT on a three-month basis

Business sector	Average no. of days spent in collecting and paying VAT	Officially defined duration (no. of days)	Difference (no. of days)
Agro processing	6	None defined	n.a.
Textiles & garments	4	None defined	n.a.
Woodworking	3	None defined	n.a.
Hospitality	3	None defined	n.a.
All	4	None defined	n.a.

Table B.39. Percentage of MSEs in Sri Lanka who have heard that there are penalties if businesses do not comply with regulations on VAT

Business sector	% MSEs who are aware	Base (total MSEs)
Enterprise with 5–14 workers	45%	480
Enterprise with 15–70 workers	56%	96
Agro processing	48%	151
Textiles & garments	37%	192
Woodworking	53%	120
Hospitality	58%	113
Total	47%	576

Table B.40. Percentage distribution of MSEs in Sri Lanka who are aware of the existence of penalties for non-compliance with VAT regulations, across knowledge about different penalties

Business sector	Know the category and quantum	Know category but not the quantum	Unable to specify the penalties	Answer mismatched	Base (total MSEs who have heard of regulations related to VAT)
Enterprises with 5–14 workers	1%	44%	54%	1%	476
Enterprises with 15–70 workers	1%	55%	41%	3%	95
Agro processing	1%	47%	51%	1%	148
Textiles & garments	2%	35%	61%	3%	191
Woodworking	1%	52%	47%	0%	119
Hospitality	2%	56%	42%	1%	113
Total	1%	46%	52%	1%	571

Table B.41. Percentage of MSEs in Sri Lanka who have heard of or made informal payments to avoid compliance with regulations on VAT

Business sector/worker group	Heard of informal payments	Of those who heard, % who made informal payments	Base (total no. of MSEs)
Agro processing	31%	6%	151
Textiles & garments	19%	3%	192

Woodworking	26%	6%	120
Hospitality	36%	5%	113
Enterprise with 5–14 workers	28%	5%	480
Enterprise with 15–70 workers	25%	4%	96
All	27%	5%	576

Table B.42 Awareness and effects of incentive schemes

Status of awareness by sector/worker group	Agro processing	Textiles & garments	Woodworking	Hospitality	Worker Group 5–14	Worker Group 15–70	All
Informed of incentive schemes							
	%	%	%	%	%	%	%
None	95.4	95.8	98.3	98.2	97.1	94.8	96.7
One only	4.0	4.2	1.7	1.8	2.7	5.2	3.1
2–3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
>3	0.7	0.0	0.0	0.0	0.2	0.0	0.2
Availed of incentive schemes							
None	95.4	95.8	98.3	98.2	97.1	94.8	96.7
One only	4.0	4.2	1.7	1.8	2.7	5.2	3.1
2–3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
>3	0.7	0.0	0.0	0.0	0.2	0.0	0.2
Aware of threshold for incentive schemes							
None	95.4	95.8	98.3	98.2	97.1	94.8	96.7
One only	4.0	4.2	1.7	1.8	2.7	5.2	3.1
2–3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
>3	0.7	0.0	0.0	0.0	0.2	0.0	0.2
Incentive scheme threshold affecting growth							
None	99.3	99.0	100.0	100.0	99.6	99.0	99.5
One only	0.7	1.0	0.0	0.0	0.4	1.0	0.5
2–3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
>3	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Table B.43. Enterprises which were started with incentive schemes

	Agro processing	Textiles & garments	Woodworking	Hospitality	Total
	%	%	%	%	%
Worker group 5–14	6.6	9.4	2.5	5.3	6.4
Worker group 15–70	1.3	2.6	0.8	0.9	1.6
Total with incentive	7.9	12.0	3.3	6.2	8.0
Total without incentive	92.1	88.0	96.7	93.8	92.0
Total No of MSEs	100.0	100.0	100.0	100.0	100.0

Table B.44. Percentage of MSEs in Sri Lanka with 5–14 workers who are aware of regulations related to retrenchment of workers and retrenchment payments

Status of awareness and impact on growth	Agro processing	Textiles & garments	Woodworking	Hospitality	All
Aware and tried to stay below threshold	2%	1%	2%	0%	1%
Aware but not having effect on growth	18%	24%	17%	20%	20%
Not aware	80%	75%	82%	80%	79%
Total	100%	100%	100%	100%	100%
Base (no. of MSEs with 5– 14 workers)	127	155	109	89	480

Table B.45. Percentage of MSEs in Sri Lanka with 15–70 workers who had ever taken government permission to retrench workers and provided retrenchment payments, by business sector

Business sector	% MSEs who followed regulations on retrenchment	Base (no. of MSEs with 15 or more workers)
Agro processing	8%	24
Textiles & garments	3%	37
Woodworking	0%	11
Hospitality	21%	24
All	8%	96

Table B.46. Percentage of MSEs in Sri Lanka with 15–70 workers who did not make retrenchment payments across reasons

Reason	% MSEs
It is not legally required / exempted	18%
It is legally required, but not enforced	3%
Takes too much time	0%
Too costly	1%
It has not been demanded	24%
It has not been necessary	6%
The separation was voluntary	42%
Others	6%
No reason specified	32%
Base (no. of MSEs with 15 or more workers who did not make retrenchment payments)	88
Note: Percentage may not add to 100% since one MSE can give more than one reason.	

Table B.47. Percentage of MSEs in Sri Lanka that are aware of the kind of costs involvement in retrenchment of employees

Business sector	Awareness of kind of costs involvement in retrenchment of employees		Base (total MSEs)
	Monetary cost	Transaction cost	
Agro processing	11%	10%	151
Textiles & garments	4%	4%	192
Woodworking	6%	5%	120
Hospitality	9%	6%	113
Enterprise with 5–14 workers	6%	5%	480
Enterprise with 15–70 workers	10%	9%	96
All	7%	6%	576

Table B.48. Percentage of MSEs in Sri Lanka who have heard of or made informal payments to avoid compliance with regulations on retrenchment payments

Business sector/worker group	Heard of informal payments	Of those who heard, % who made informal payments	Base (total no. of MSEs)
Agro processing	15%	0%	151
Textiles & garments	7%	0%	192

Woodworking	8%	10%	120
Hospitality	11%	0%	113
Enterprise with 5–14 workers	10%	2%	480
Enterprise with 15–70 workers	8%	0%	96
All	10%	2%	576

Table B.49. Percentage MSEs in Sri Lanka with different licenses who have heard of or made informal payments for Having Each Licence

Licences	Heard of informal payments	Of those who heard, % who made informal payments	Base (MSEs with the particular licence)
Company registration	20%	11%	543
Trade license	27%	24%	391
Factory license	25%	32%	161
Registration with labour department	28%	21%	354
Tax registration	42%	28%	263
Import license	33%	50%	13
Export license	30%	33%	10

Table B.50: Percentage of MSEs in Sri Lanka that do not comply with different environmental regulations across reason(s) for not registering/ acquiring license

What are the reason(s) for not registering/ acquiring license	Initial Environmental Examinations (IEE)	Environmental Impact Assessment (EIA)	Environmental Protection License (EPL)
It is not legally required	93%	93%	80%
It is legal, but not enforced	3%	3%	6%
Takes too much time	0%	0%	0%
Complicated/do not see the benefit	1%	1%	2%
Don't want to pay the required fees	2%	2%	2%
Not aware of requirement	5%	5%	15%
Base (MSEs that did not comply with regulations and gave reasons)	546	554	384

Table B.51. Average number of days taken by MSEs to prepare the report for the environmental compliance process, by worker group

Environmental license/regulation	Enterprise with 5–14 workers	Enterprise with 15–70 workers	All	
			Average days actually taken	Officially defined duration (no. of days) average period
Initial Environmental Examinations (IEE)	11	49	24	15-45
Environmental Impact Assessment (EIA)	13	18	15	15-45
Environmental Protection License (EPL)	16	24	18	15-45

Table B.52: Average number of days taken by government agencies to approve the environmental registration/licence by worker group

Environmental license/regulation	Enterprise with 5–14 workers	Enterprise with 15–70 workers	All	
			Average days actually taken	Officially defined duration (no. of days) no officially set dates but on average
Initial Environmental Examinations (IEE)	26	37	30	15–180 days (depending on the requirements stipulated by the Central Environmental Authority)
Environmental Impact Assessment (EIA)	6	20	12	15–180 days (depending on the requirements stipulated by the Central Environmental Authority)
Environmental Protection License (EPL)	160	310	193	1–12 months

Table B.53. Average official government fees (inspection fees) for initial environmental licensing (LKR)

Environmental license/regulation	Actual amount paid	Officially set fees	Difference
Initial Environmental Examination (IEE)	20 208	EIA, IEE – cost depends on the nature of the project	NA
Environmental Impact Assessment (EIA)	9 800	EIA, IEE – cost depends on the nature of the project	NA
Environmental Protection License (EPL)	5 455	List A Industries (list of 80 significantly high polluting activities) LKR7,500 + 12%VAT + stamp fees LKR750 (valid for one year)	Actual fees less than official fees
		List B (medium pollution potential) LKR6,000 + 12%VAT+ stamp fees LKR750 (valid for three years)	
		List C (low pollution potential) LKR4,000 12%VAT+ stamp fees (valid for three yrs)	

Table B.54. Percentage MSEs in Sri Lanka who have heard of penalties if businesses do not comply with environmental regulations

Worker group/business sector	Environmental Impact Assessment (EIA/IEE)	Environmental Protection License (EPL)	Base (total no. of MSEs)
Enterprise with 5–14 workers	5%	97%	480
Enterprise with 15–70 workers	9%	96%	96
Agro processing	3%	97%	151
Textiles & garments	4%	98%	192
Woodworking	9%	95%	120
Hospitality	8%	95%	113
All	6%	97%	576

Table B.55. Percentage of MSEs in Sri Lanka who have heard of or made informal payments to avoid compliance with environmental regulations

Business sector/worker group	Heard of informal payments	Of those who heard, % who made informal payments	Base (total no. of MSEs)
Agro processing	32%	15%	151
Textiles & garments	25%	10%	192
Woodworking	41%	35%	120
Hospitality	43%	24%	113
Enterprise with 5–14 workers	34%	21%	480
Enterprise with 15–70 workers	33%	22%	96
All	34%	21%	576

Table B.56. Percentage of MSEs in Sri Lanka who are aware of environmental regulations across knowledge of category and quantum of penalty

Business sector	Unable to specify the penalties	Answer mismatched	Know the category and quantum	Know category but not the quantum	Base (total MSEs) who have heard of regulations
EIA/IEE					
Enterprise with 5–14 workers	25%	46%	29%	0%	24
Enterprise with 15–70 workers	11%	78%	11%	0%	9
Agro processing	0%	100%	0%	0%	5
Textiles & garments	13%	50%	38%	0%	8
Woodworking	36%	36%	27%	0%	11
Hospitality	22%	56%	22%	0%	9

All	21%	55%	24%	0%	33
EPL					
Enterprise with 5–14 workers	25%	9%	6%	62%	465
Enterprise with 15–70	24%	7%	5%	70%	92
Agro processing	29%	5%	1%	67%	147
Textiles & garments	26%	13%	3%	59%	189
Woodworking	21%	12%	11%	62%	114
Hospitality	23%	5%	12%	68%	107
All	25%	9%	6%	64%	557
