

Sri Lanka Monthly Business Review: April 2009

Businesses Face Painful Adjustments to Global Recession

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The business climate in Sri Lanka remained volatile and turbulent during the month of April 2009. The global financial crisis has caused a substantial reduction in the demand for Sri Lankan goods and services in many overseas markets thus adversely affecting revenue and foreign exchange earnings. Tourism, garments, manufactured goods, tea and services such as business process outsourcing (BPO) and software development were some of the worst affected. Loss of jobs and repatriation of Sri Lankan workers in the Middle East, especially the highly paid professionals engaged in the construction and related industries have created numerous problems for both the employment agencies and the job seekers.

The tourism industry which has been in the doldrums because of the escalated war has further declined. For the first quarter of 2009, total arrivals fell by 21.3 percent to 106,702 visitors compared with the same period in 2008. According to Sri Lanka Tourist Board, arrivals have fallen sharply from key Western European, Eastern European, South Asian and South East Asian markets. The country's biggest exporter, the apparel industry has seen some tough times since the onset of the global economic crisis. According to the Chairman of the Joint Apparel Association Forum (JAAF) about 50 garment factories have closed down over the past six to eight months mostly in the SME sector resulting in the loss of about 40,000 jobs, though exact data is not available for the period under review. A large number of export-oriented manufacturing organizations complain that their exports have significantly dropped due to either cancellation or delaying of orders by the foreign buyers. Tea started to pile up at the Colombo tea auction due to sharp drop in buyers during the early part of 2009 but this situation did not last long due to positive responses shown by Middle East and CIS countries. However, dry climatic conditions have caused a significant drop in the yields thereby reducing the quantities available for export. According to Sri Lankan Tea Board, tea exports in February 2009 have fallen by about 26% in volume terms compared to 2008 to 38.67 million kg and by 29.2% compared to 2008 to US\$ 131`.3 million in value terms.

With a view to incentivizing exporters, the government has introduced an Export Development Reward Scheme (EDRS), which is seen as a pro-labor support package by the business community as no reductions in employment levels are allowed for reaping benefits under this scheme. In addition, only those who have continuously exporting since 2006 will be eligible to apply and that they should maintain a minimum of 90% of exports for each quarter compared with the

corresponding quarters of 2008 to earn a reward of 3% of the export value. A reward of 5 percent will be paid to those who equal quarterly export proceeds. However, the exporters claim that this package is not workable as these targets are difficult to achieve given the slump in international trade and weakening demand for Sri Lanka's exports and have offered their inputs and suggestions to the government.

In the domestic environment, high interest rates, high taxation, artificially strengthened rupee until April and then allowing it to float and drop in sales due to low disposable income levels of the consumers despite the drop in inflation to 5.3 in March 2009, had a cumulative adverse effect on businesses in several ways. Bank interest rates which are as high as 25-35% caused a serious problem for businesses in meeting their financial needs. Moreover, banks also adopted a policy to be extra cautious in lending due to widespread default problem experienced by many financial institutes. The SME sector was the worst hit as a result of this situation. During the month of April, Central Bank of Sri Lanka requested commercial banks to reduce their lending rates. Accordingly, most commercial banks reduced overall penal rates of interest applicable to unauthorized excesses to a figure not exceeding 29% per annum from 39%. In a statement the Sri Lanka Banks' Association said its member banks will also consider a further reduction for priority sector facilities within their respective bank portfolios on a case by case basis. In addition the two state banks- Bank of Ceylon and Peoples Bank reduced their interest rates by 2% points for development oriented loans and by 0.5% points for other loans. However, most of the other banks are yet to fall in line.

High taxation by the government further aggravated problems faced by the business community. The excise duty imposed by the government in January 2009 on the importers of liquid petroleum (LPG) gas at Rs.8.00 per kg was a heavy burden on the ceramics industry in Sri Lanka which is the largest consumer of gas in the country consuming over 1170 metric tons per month. Amidst this problem the government increased this duty to Rs. 27.50 per kg by March 2009 leaving this industry in dire straits. The raised duty increased their energy cost to about 50% of the total cost of production thus making Sri Lankan ceramics highly uncompetitive in foreign markets. However subsequent to constant lobbying, the government recently decided to waive this excise duty for bulk users of LPG gas thus benefiting the ceramics industry. Having granted some relief to the ceramics industry, the government has recently increased Nations Building Levy (NBL) from

1% to 3% with effect from May 2009. This is payable by businesses on a quarterly basis if the turnover for that quarter exceeds Rs. 100,000.00 which means that even small businesses will be liable for this burden under difficult conditions. Leading business chambers are planning on lobbying with the government to reconsider this tax increase by offering alternative options for the government to raise revenue.

Central Bank of Sri Lanka maintained the rupee around 108 rupees to one US dollar for several months until April 2009 due to various economic considerations thereby making our export products overpriced and uncompetitive in foreign markets causing increasing demands from the business community to allow adjustment of the exchange rate to an acceptable level. The government positively responded to this situation by mid April 2009 mainly because connected action will also meet the conditions laid down by the IMF for granting a loan of US\$ 1.9 billion requested by Sri Lanka. Since then the rupee started to adjust to new levels with a rapid rise in the exchange rate and surpassing Rs. 120.00 towards the end of the month. This is expected to help exports. However, the increase in cost of imports coupled with anticipated increase in cost of living which can cause higher wage expectations among the employees and further erosion of disposable income of the consumers are likely create continuous problems for the business sector.

The extremely difficult operational conditions have compelled several businesses to take drastic action such as re-organization of their operations, re-scheduling working patterns, laying off employees on a temporary or permanent basis and closing of a part of the business or even in full. The Colombo office of the ILO is in the process of compiling a rapid assessment of the global economic crisis and its effect on employment in Sri Lanka. The Employers' Federation of Ceylon (EFC) is also working on a survey of the voluntary retirement schemes that have been offered since the global financial crisis broke. The Secretary to the Ministry of Labor Relations and Manpower recently announced that the Commissioner of Labor has received 32 applications, mainly from the SME sector, for laying off their workers. The industries that are worst affected are the apparel and textiles, ceramics, leather and tourism. According to the data released by the JVP-led Inter Company Workers Union (ICWU), 19 businesses have been already closed while another 29 businesses have laid off part of their employees. In addition serious problems have arisen in another 29 businesses. The above mentioned businesses fall into garments, mining, manufacturing, construction, food, shoe, agricultural, gems, ceramics and financial sectors.

The Employers' Federation of Sri Lanka has made a submission to the government drawing attention to the current difficult situation for the business sector seeking relief in several ways. Their suggestions include, a 5 day week with extended working hours in place of the present 5.5 day week, approval for laying off the workers depending on unavoidable business circumstances, revision in gratuity payment scheme and a number of other revisions in labour rules and regulations.

The government took some time to negotiate these matters with the relevant parties and has positively responded recently by permitting 5 day working arrangement wherever mutual agreements could be reached between the employers and employees thus avoiding possible reactions of labour unions. Steps have also been taken to approve laying off the workers depending on the merits of each case without giving the employers a blanket approval. In such cases, if companies retrench employees on a temporary basis they should pay them an agreed partial pay with all statutory payments up to 3 months and then re-employ them, failing which procedures pertaining to the termination of employment should be followed, which includes the payment of termination benefits in full.

The Colombo stock exchange which operated on a low key for a long time suddenly rejuvenated towards end of April with continued success in military operations and the anticipated ending of the war within a short time. Elevation of the investor confidence level was very evident from increased transactions and rise in share prices across the board. Speculations relating to possible privatization of some state entities which is expected to be a condition laid down by International Monetary Fund (IMF) to grant US\$ 1.9 billion loan also contributed to reactivation of the stock exchange. Consequently Sri Lanka Telecom share price rose by 11.4% to Rs. 39.00 during the third week in April.

Amidst all these problems and uncertainties, some Sri Lankan companies have excelled at international level during this month. Opening of a modern luxury hotel in the Maldives by Aitken Spence, opening of a fashion accessories store for women in Singapore by Odel and Global Finance (USA)'s selection of Commercial Bank as the "Best Bank in Sri Lanka" for the 11th successive year could be cited as some examples.

All the key factors and issues, especially the uncertainties in the business environment, discussed in this review are likely to remain relevant for the next several months or even longer.