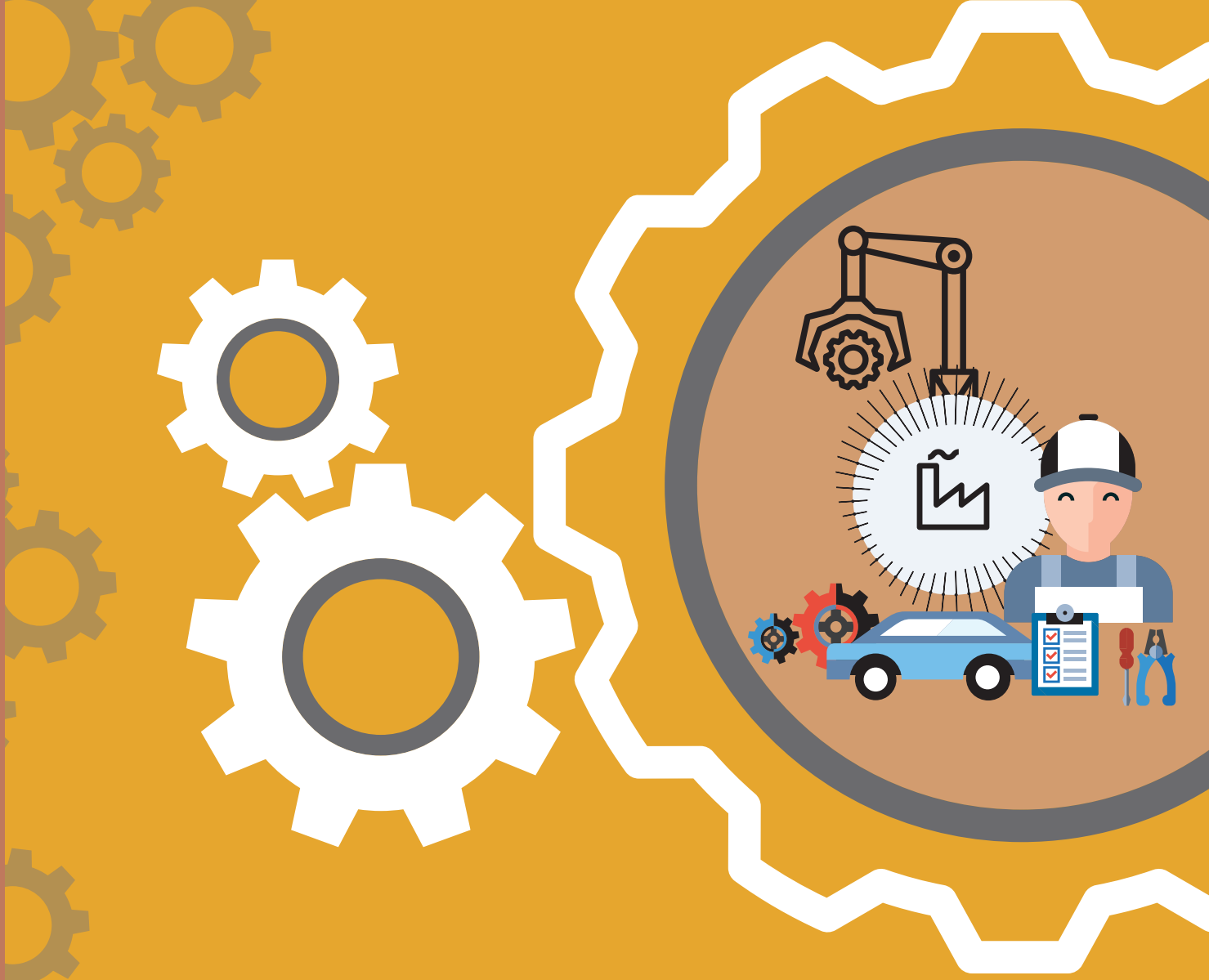


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Firm - Level Analysis of Manufacturing Sector Investment in Sri Lanka

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INSTITUTE OF POLICY STUDIES OF SRI LANKA

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Acronyms and Abbreviations

BOI	-	Board of Investment of Sri Lanka
BOP	-	Balance of Payments
CBSL	-	Central Bank of Sri Lanka
EMNEs	-	Emerging Multinational Enterprises
EPZ	-	Export Processing Zone
FDI	-	Foreign Direct Investment
FIAC	-	Foreign Investment Advisory Committee
GCEC	-	Greater Colombo Economic Commission
GCI	-	Global Competitiveness Index
GDP	-	Gross Domestic Product
GVC	-	Global Value Chain
IMF	-	International Monetary Fund
IPS	-	Institute of Policy Studies of Sri Lanka
ISLFTA	-	Indo-Sri Lanka Free Trade Agreement
LLC	-	Limited Liability Company
MNEs	-	Multinational Enterprises
OECD	-	Organisation for Economic Co-operation and Development
OLI	-	Ownership, Location, Internalisation
SAFTA	-	South Asian Free Trade Agreement
SOEs	-	State Owned Enterprises
SWIFT	-	Single Window Investment Facilitation Task Force
UNCTAD	-	United Nations Conference on Trade and Development
UPFA	-	United People's Freedom Alliance
WEF	-	World Economic Forum

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Executive Summary

Foreign direct investment (FDI) has long been viewed as a major factor in economic growth and development. Whilst FDI predominantly originates and flows between advanced industrial nations, recent history has witnessed it soar in importance as a source of capital, management, and technology for both developing and transitional economies. Recognising its importance, successive Sri Lankan governments since independence have made the attraction of FDI a cornerstone of their development policy. However, despite efforts to attract FDI, protectionist economic approaches have been a disincentive. The liberalisation reform package of 1977 in particular and successive reforms since were aimed at creating a conducive environment for FDI entry and operation. Despite this focus, existing literature suggests that Sri Lanka's success in attracting FDI has been limited, especially when gauged against comparator countries . While the three-decade long civil war hampered the realisation of the country's investment potential, the country appears to have fallen short of expectations even in a post-conflict environment – largely owing to inconsistencies in the policy regime.

Against this backdrop, the objective of this study is to analyse trends and patterns of FDI into the country over the last one and half decades, in the manufacturing sector. Trends and patterns are analysed using firm-level data from the Board of Investment (BOI) of Sri Lanka for the years 2002, 2009, and 2016. The databases comprise of firms that are locally owned, foreign owned and those that are joint ventures. The composition of firms, their entry and exit patterns, and ease of doing business are some of the firm-level factors analysed, in an effort to understand the overall FDI policy environment and investment climate in Sri Lanka, in the period under analysis.

Specifically, the following analyses are conducted in the study. First, the study provides an aggregate analysis of firm level data based on the Central Bank classification of sub-sectors within the manufacturing sector. Second, the study focusses on a firm entry/exit analysis, by considering two time periods: 2002-2016 and 2009-2016. The former enables us to look at firm turnover in the long term over a 15 year period, while the latter tells us about firm turnover in the post-conflict period in Sri Lanka. Third, a duration analysis is conducted on how long it took for entrant firms in the 2009-2016 period to set-up their businesses and begin commercial operations. Finally, we discuss the implications of the firm-level findings on Sri Lanka's overall investment climate, and delve into why FDI inflows to the country have not reached the expected levels, particularly in the post-war period.

The main findings from the firm-level analysis can be summarised as follows: (1) BOI enterprises are largely locally owned, with the equity stake in firms moving away from foreign/joint ownership towards more local ownership. (2) Turnover of firms is high, with more firms exiting than entering both in the short and long term period analysed. (3) Ease of starting a business for investors is poor, with a majority of firms taking over a year to begin commercial operations.

These findings are reflective of Sri Lanka's poor performance on the FDI front in recent years. The firm-level data corroborate with the numbers on FDI inflows of BOI enterprises, both at the aggregate level and for the manufacturing sector alone, which have been on the decline in recent years. Hence, this study finds that the firm-level data reflects Sri Lanka's lackluster performance on the FDI front and adds to existing empirical evidence that Sri Lanka's investment climate and ease of doing business are not satisfactory. The study recommends that Sri Lanka should shift gear towards attracting more efficiency seeking FDI, streamline the investment approval process, and reduce restrictions on foreign land ownership and improve land security.

විධායක සාරාංශය*

ප්‍රධාන සාරාංශගත කරුණු

ආර්ථික වර්ධනය මෙන්ම සංවර්ධනය කෙරේ බලපාන ප්‍රධාන සාධකයක් වන්නේ විදේශීය සෘජු ආයෝජනයි (FDI). සෘජු ආයෝජන සම්භවය ප්‍රධාන වශයෙන් පළවන ලෝකයේ කාර්මික රටවල් අතරින් ආරම්භ වී එකී රටවල් අතර ම සංසරණය වීම සිදුවූ නමුත් මෑත කාලය වන විට එහි යම් වෙනස්කම් සිදුව තිබේ. මෑත ඉතිහාසයේ දක්නට ලැබෙන ආකාරයට පරිවර්තන ආර්ථික සහ සංවර්ධනය වෙමින් පවතින ආර්ථිකවල ප්‍රාග්ධනය, කළමණාකරණය සහ තාක්ෂණය යන අංශ සඳහා විදේශීය සෘජු ආයෝජන වැදගත් කාර්යභාරයක් ඉටු කරනු ලැබේ. එහි වැදගත්කම වටහා ගැනීමත් සමග, ශ්‍රී ලංකාවේ නිදහසින් පසු බිහිවූ අනුප්‍රාප්තික ආණ්ඩු ඔවුන්ගේ සංවර්ධන ප්‍රතිපත්තිවල මූලිකාංගයක් බවට සෘජු විදේශීය ආයෝජන ආකර්ෂණය කර ගැනීමට කටයුතු කර තිබේ. කෙසේ වෙතත්, ශ්‍රී ලංකාවේ සෘජු විදේශීය ආයෝජන ආකර්ෂණය කර ගැනීමේ උත්සාහයන් දුර්වල කිරීමට ආරක්ෂණවාදී ආර්ථික ප්‍රවේශයන් හේතු වී තිබේ. 1977 දී ලිබරල් ප්‍රතිසංස්කරණ රාමුවේ අඩංගු විශේෂ හා අනුක්‍රම ප්‍රතිසංස්කරණ වලින් සෘජු විදේශීය ආයෝජන ප්‍රවේශය හා මෙහෙයුම් සඳහා හිතකර පරිසරයක් නිර්මාණය කිරීම සිදු විය. කෙසේ වෙතත්, සාහිත්‍යය විමර්ශන මගින් අනාවරණය කර ඇති අන්දමට අනෙකුත් රටවලට සාපේක්ෂව, සෘජු ආයෝජන ආකර්ෂණය කර ගැනීම අතින් ශ්‍රී ලංකාවේ සාර්ථකත්වය සීමා වී ඇති බවක් පෙනේ. දශක තුනක දිගුකාලීන සිවිල් යුද්ධය හේතුවෙන් රටේ ආයෝජන විභව්‍යතාවයට දැඩි බලපෑමක් සිදුවූ අතර පශ්චාත් ගැටුම් වාතාවරණයක් තුළ වුවද, ප්‍රතිපත්තිමය නොගැලපීම් හේතුවෙන් අපේක්ෂිත ප්‍රතිලාභ නොලැබීම නිසා රටට ගැටලු රාශියකට මුහුණදීමට සිදුව ඇත.

මෙම පසුබිම තුල, මෙම අධ්‍යයනයේ අරමුණ වනුයේ නිෂ්පාදන අංශයේ දශක එකහමාරක කාලය තුලදී රට තුළට ආ සෘජු ආයෝජනවල ප්‍රවණතා හා රටාවන් විශ්ලේෂණය කිරීමයි. 2002, 2009 සහ 2016 වසර සඳහා ශ්‍රී ලංකා ආයෝජන මණ්ඩලයේ ආයෝජන මට්ටමේ දත්ත භාවිතා කරමින් මෙහි ප්‍රවණතා සහ රටාවන් විශ්ලේෂණය කර තිබේ. දත්ත සමූහය තුල දේශීය වශයෙන්, විදේශීය වශයෙන් සහ ඒකාබද්ධ ව්‍යාපාර ඇති සමාගම් ඇතුළත් වේ. විශ්ලේෂණයට ලක් වූ කාල පරිච්ඡේදය තුළ, ශ්‍රී ලංකාවේ සමාගම්වල සංයුතිය සහ කර්මාන්තය තුලට ආයතන ප්‍රවේශ වීම සහ පිටවීම, ව්‍යාපාර කටයුතු පහසු කිරීම, ශ්‍රී ලංකාවේ සමස්ත සෘජු ආයතනික ආයෝජන ප්‍රතිපත්තිය සහ ආයෝජන වාතාවරණය වටහා ගැනීමට යොදා ගන්නා ස්ථාවර මට්ටමේ විශ්ලේෂණ සාධක කිහිපයක් වේ.

විශේෂයෙන්, අධ්‍යයනය තුල පහත සඳහන් විශ්ලේෂණයන් සිදු කරනු ලැබේ. පළමුව, අධ්‍යයනය කරනු ලබන්නේ, නිෂ්පාදන අංශය තුළ ඇති උප අංශයන්හි මහ බැංකු වර්ගීකරණයේ පදනම් මත ආයතනික මට්ටමේ දත්ත විශ්ලේෂණය කිරීමයි. දෙවනුව, 2002*2016 සහ 2009*2016 කාලයන් දෙකට අදාලව ආයතනවල ප්‍රවේශවීම සහ පිටවීම පිළිබඳ විශ්ලේෂණයක් අධ්‍යයනය කරනු ලැබේ. මුල් කොටසින් වසර 15ක පිරිවැටුම් පිළිබඳ අදහසක් අපට ලබා දෙන අතර දෙවන කොටසින් පශ්චාත් යුධ සමය තුල පිරිවැටුම් හැසිරීම පිලිබඳ ඉගියක් ලබා දෙයි. තෙවනුව, 2009*2016 කාල සීමාව තුළ ව්‍යාපාර කටයුතු ආරම්භ කිරීම සහ වාණිජ මෙහෙයුම් ඇරඹීමට ගත වූ කාලය පිළිබඳව විශ්ලේෂණයක් සිදු කරනු ලබයි. අවසාන වශයෙන්, ශ්‍රී ලංකාවේ සමස්ත ආයෝජන වාතාවරණය පිළිබඳව ආයතනික මට්ටමේ සොයාගැනීම් පිලිබඳ ඉගි සාකච්ඡා කෙරෙන අතර විශේෂයෙන්ම, පශ්චාත් යුධ සමය තුළ අපේක්ෂිත මට්ටමට රට තුලට සෘජු විදේශ ආයෝජන ගලා ඒම පිලිබඳ සාකච්ඡා කෙරෙයි.

ආයතනික මට්ටමේ විශ්ලේෂණයන්වල ප්‍රධාන සොයා ගැනීම් පහත දැක්වෙන පරිදි සාරාංශ ගත කළ හැකි වේ: (1) අයෝජන මණ්ඩලයේ ආයතන විශාල වශයෙන් දේශීය හිමිකාරීත්වයක් ඇති අතර ව්‍යාපාර හිමිකාරීත්ව වපසරිය විදේශීය සහ හවුල් හිමිකාරීත්වයෙන් මිදී දේශීය හිමිකාරීත්වයට පත් වී ඇත. (2) සමාගම්වල ප්‍රවේශවීම සහ පිටවීම ඉහළ මට්ටමක පවතින අතර, කෙටි හා දීර්ඝ කාලීන වශයෙන් විශ්ලේෂණය කර ඇති පරිදි ප්‍රවේශ වන ආයතන ප්‍රමාණයට වඩා වැඩි ආයතන ප්‍රමාණයක් පිටවී ඇත. (3) ආයෝජකයින් සඳහා ව්‍යාපාරයක් ආරම්භ කිරීමේ පහසුව ඉතා පහල මට්ටමක පවතින අතර බොහෝ සමාගම්වලට වාණිජ මෙහෙයුම් ආරම්භ කිරීම සඳහා වසරක පමණ කාලයක් ගතවේ.

මෙම සොයා ගැනීම් වි,න් මෑත වසරවලදී ශ්‍රී ලංකාවේ විදේශීය සෘජු ආයෝජන පරිමාණයේ දුර්වල කාර්ය සාධනය පිළිබිඹු කෙරේ. වසර ගණනාවක් තිස්සේ පහල යමින් පවතින නිශ්පාදන අංශය සඳහාත් සමාහාර මට්ටම සඳහාත් අපනයන මණ්ඩලයේ කර්මාන්තවල විදේශීය සෘජු ආයෝජන දත්ත ආයතනික මට්ටමේ දත්ත සමග ගැලපේ. එබැවින්, මෙම අධ්‍යනය මගින් සවිස්තරාත්මක දත්ත අනාවරණය කරනු ලබන්නේ, විදේශීය සෘජු ආයෝජන ලබාගැනීම සඳහා ශ්‍රී ලංකාව දක්වන්නේ දුර්වල ක්‍රියාකාරිත්වයක් බවය. තවද ශ්‍රී ලංකාවේ ආයෝජන වාතාවරණය සහ ව්‍යාපාර කිරීමේ පහසුව තෘප්ත නොවන බවට පවතින දත්ත සහ පර්ේෂණ සනාථ කරයි. ඒ අනුව විදේශීය සෘජු ආයෝජන වැඩියෙන් ආකර්ෂණය කරගැනීම උදෙසා ශ්‍රී ලංකාව සෘජු ආයෝජන සෙවීමේ කාර්යක්ෂමතාව වැඩි කිරීම සඳහා පියවර ගත යුතු බවත්, ආයෝජන අනුමත කිරීමේ ක්‍රියාවලිය වඩා පහසු කල යුතු බවත්, විදේශ ඉඩම් හිමිකම සීමා කිරීම් අවම කොට ඒ සම්බන්ධ සීමාවන් ලිහිල් කල යුතු බවත් සහ ඉඩම් සුරක්ෂිතභාවය වැඩිදියුණු කල යුතු බවත් මෙම අධ්‍යයනය හරහා නිර්දේශ කරනු ලබයි.

* Disclaimer: The Sinhala Executive Summary is a translation of the original in English. In case of a discrepancy, the English original will prevail.

நிறைவேற்றுச் சுருக்கம் *

பொருளாதார வளர்ச்சி மற்றும் அபிவிருத்திக்கான பாரிய காரணியாக வெளிநாட்டு நேரடி முதலீடு மீளாய்வு செய்யப்பட்டுள்ளது. வெளிநாட்டு நேரடி முதலீடுகள் பிரதானமாக மூலவுருவாக்கம் அடைந்து உயர் கைத்தொழில் நாடுகளுக்கிடையே பாயும் அதே வேளை, மூலதனம், முகாமை மற்றும் பொருளாதார அபிவிருத்தி மற்றும் பொருளாதார நிலைமாற்றம் ஆகிய இரண்டும் விடயங்கள் தொடர்பாக மூலம் ஒன்றாக அண்மை வரலாற்றில் அதன் முக்கியத்துவம் அதிகரித்து வருகின்றது. அதன் முக்கியத்துவைத்தை அங்கிகரிக்கும் அதே வேளை, இலங்கை அரசாங்கங்களானது அதன் சுதந்திரத்தின் பின்னர் மிக முக்கியமான விடயமாக வெளிநாட்டு நேரடி முதலீடுகளை கவர்ந்து வந்திருக்கின்றன. எவ்வாறாயினும், வெளிநாட்டு நேரடி முதலீடுகளை கவர்ந்து கொள்வதற்கான முயற்சிகள் தவிரந்து, காப்பாளர்களின் பொருளாதார அணுகுமுறைகள் ஒரு ஊக்கக் குறைவாகும். குறிப்பாக 1977 ஆம் ஆண்டின் சுதந்திரமய மறுசீரமைப்பு பொதியில் மற்றும் தொடர்ச்சியான மறுசீரமைப்புக்களினாலும் வெளிநாட்டு நேரடி முதலீடுகள் பிரவேசிப்பதற்கும் செயற்படுவதற்கும் பாதுகாப்பான சூழலொன்றை உருவாக்குவதற்கு இலக்கு வைக்கப்பட்டது. இந்த நோக்கத்திற்கு புறம்பாக, போட்டி நாடுகளுக்கு எதிராக மதிப்பீடு செய்யும் போது விசேடமாக, இலங்கை வெளிநாட்டு நேரடி முதலீடுகளை கவர்ந்து கொள்வதில் வரையறுக்கப்பட்ட வெற்றியையே அடைந்துள்ளது என தற்பொழுதுள்ள ஆய்வுக் கட்டுறைகள் பிரேரிக்கின்றன. நாட்டின் முதலீட்டு வாய்ப்புக்களின் முக்கியத்துவத்தை மூன்று தசாப்த னபவ நீண்ட கால சிவில் யுத்தம் சீர்குலைத்த போதும், அரசியல் கொள்கைகளின் நிலையற்ற தன்மையின் பாரிய பாதிப்பால், யுத்தத்தின் பின்னரான சூழ்நிலையிலும் கூட நாட்டின் முதலீட்டு எதிர்பார்ப்பில் தோய்வினை கொண்டிருந்தமையை நாடு வெளிப்படுத்துகின்றது.

வீழ்ச்சிக்கு எதிராக, உற்பத்தித் துறையில் ஒன்றரை சதாப்த காலத்திற்கு மேலாக நாட்டிற்குள் வெளிநாட்டு நேரடி முதலீட்டின் போக்கு மற்றும் அமைப்புக்களை பகுப்பாய்வு செய்தல் இந்த கற்கை ஆய்வின் குறிக்கோளாகும். 2002, 2009 மற்றும் 2016 ஆம் ஆண்டுகளுக்கான இலங்கை முதலீட்டு சபையின் உறுதியான மட்ட தரவுகளை பயன்படுத்தி இந்தப் போக்குகள் மற்றும் அமைப்புக்கள் பகுப்பாய்வு செய்யப்படுகின்றன. உள்நாட்டு சொந்த நிறுவனங்கள், வெளிநாட்டு நிறுவனங்கள் மற்றும் கூட்டு முயற்சி நிறுவனங்களாக செயற்படும் நிறுவனங்கள் தொடர்பில் தரவுத்தளம் உள்ளடக்கியுள்ளது. பகுப்பாய்வுக்கு உட்பட்ட கால எல்லையில், இலங்கையின் முழு மொத்த வெளிநாட்டு நேரடி முதலீட்டுக் கொள்கை சுற்றாடல் மற்றும் முதலீட்டு நிலைமையை புரிந்து கொள்வதற்கான ஒரு முயற்சியாக நிறுவனங்களின் உள்ளடக்கம், அவற்றின் பிரவேசம் மற்றும் வெளிப்படை போக்குகள் மற்றும் வியாபாரம் செய்வதற்கான இலகுத்தன்மை போன்றன பகுப்பாய்வு செய்யப்பட்ட நிறுவனங்கள் தொடர்பான காரணிகள் ஆகும்.

விசேடமாக, பின்வரும் பகுப்பாய்வுகள் இந்த கற்கை ஆய்வில் மேற்கொள்ளப்பட்டுள்ளன. முதலாவதாக, உற்பத்தித் துறையில் உப துறைகள் பற்றிய மத்திய வங்கியின் பகுப்பாய்வு தொடர்பான நிறுவன மட்ட தரவுகளின் கூட்டுப் பகுப்பாய்வொன்றை இந்த ஆய்வு வழங்குகின்றது. இரண்டாவதாக, 2002 – 2016 மற்றும் 2009 – 2016 ஆகிய இரண்டு கால எல்லைகள் பற்றி கவனம் செலுத்தி நிறுவன பிரவேசம் ∴ வெளியேறல் பகுப்பாய்வு தொடர்பில் இந்த ஆய்வு கவனம் செலுத்துகின்றது. 15 வருடங்களுக்கு மேற்பட்ட நீண்ட காலத்தில் நிறுவன புரழ்வு பற்றி ஆராய்ந்து பார்ப்பதற்கு இயலுமை கிடைத்துள்ளது, அதே வேளை, இலங்கையின் யுத்தத்தின் பின்னரான காலப்பகுதியில் நிறுவன புரழ்வினை பற்றி இந்த கடிதம் கூறுகின்றது. மூன்றாவதாக, 2009 - 2016 ஆண்டுகாலத்தில் பிரவேச நிறுவனங்கள் தமது தொழில்முயற்சிகளை உருவாக்கிக் கொள்வதற்கும் அதன் வர்த்தக செயற்பாடுகளை ஆரம்பிப்பதற்கும் எவ்வளவு காலம் எடுத்தது என்பது பற்றிய காலம் தொடர்பான பகுப்பாய்வொன்று நடாத்தப்பட்டது. இறுதியாக, இலங்கையின் முழுமையான முதலீட்டு நிலைமைகள், மற்றும் யுத்தத்தின் பின்னரான காலத்தில் குறிப்பாக, வெளிநாட்டு நேரடி முதலீடுகளின் உட்பாய்ச்சல் நாட்டினுள் எதிர்பார்த்த மட்டத்தை ஏன் நாடு அடைந்து கொள்ளவில்லை என்பது பற்றிய நிறுவன பிரயோகங்களின் நிறுவன மட்ட முடிவுகளைப் பற்றி நாங்கள் கலந்துரையாடினோம்.

நிறுவன மட்ட பகுப்பாய்விலிருந்தான பிரதான முடிவுகளை பின்வருமாறு சுருக்கமாக வழங்க முடியும் " (1) அதிகமான உள்நாட்டு உரித்தைக் கொண்ட நிறுவனங்கள் நோக்கி வெளிநாட்டு ∴ கூட்டுமுயற்சி உரிமையிலிருந்து நிறுவனங்கள் விலகிச் செல்கின்ற ஒப்புரவு உரிமையுடன் பாரந்த அளவில் உள்ளக ரீதியாக உரித்துடைய முதலீட்டுச் சபை தொழில் முயற்சிகளாக இருக்கின்றமை. (2) பகுப்பாய்வு செய்யப்பட்ட குறுங்கால மற்றும் நீண்ட காலம் ஆகிய இரண்டின் மீதும் அதிகமான தற்பொழுதைய பிரவேச நிறுவனத்தின் புரழ்வு உயர்வாகும். (3) வர்த்தக செயற்பாடுகளை ஆரம்பிப்பதற்கு ஒரு வருடத்திற்கு மேற்பட்ட காலம் அதிக நிறுவனங்களுக்கு எடுக்கின்றமையினால், முதலீட்டாளர்கள் வியாபாரங்களை ஆரம்பிப்பது தொடர்பான இலகுத் தன்மை குறைவாக இருக்கின்றமை.

இந்த முடிவுகள் அண்மைய காலத்தில் இலங்கையின் நிலையான வெளிநாட்டு முதலீடுகள் தொடர்பான குறைவான செயலாற்றுகையினை வெளிப்படுத்துகின்றன. உற்பத்தித் துறைக்கு கூட்டு மட்டம் மற்றும் முதலீட்டுச் சபை தொழில்முயற்சிகளின் நேரடி வெளிநாட்டு முதலீட்டு தொழில்முற்சிகள் தொடர்பான எண்ணிக்கையை இந்த நிறுவன மட்ட தரவு உறுதிப்படுத்துவதுடன் இது, அண்மைய ஆண்டுகளில் குறைந்து செல்லும் போக்கினைக் கொண்டுள்ளது. இருந்த போதும், இலங்கையின் முதலீட்டு நிலமை மற்றும் தொழில் முயற்சிகளை இலகுவாக ஆரம்பிக்கும் தன்மை போன்றன திருப்திகரமாக இல்லை என்பதை பரீட்சார்த்த சான்று குறிப்பிடுவதுடன் நேரடி வெளிநாட்டு முதலீட்டு முன்னிலை தொடர்பான செயலாற்றுகையில் மந்தத் தன்மையை இந்த நிறுவன மட்ட தரவுகள் வெளிப்படுத்துவதாக இந்த கண்டறிந்துள்ளது. வெளிநாட்டு நேரடி முதலீடுகளைத் தேடிக் கொள்வதில் மிகவும் வினைத்திறனான கவரச்சியை நோக்கி இலங்கை கட்டாயம் நகர்தல் வேண்டும் என்றும், முதலீடு தொடர்பான அங்கிகார செயன்முறையை அங்கிகரித்துக் கொள்வதை நெறிப்படுத்துவதற்கும் மற்றும் வெளிநாட்டுக் காணி உரிமை தொடர்பான கட்டுப்பாடுகளை குறைப்பதற்கும் நிலப்பாதுகாப்பை மேம்படுத்துவதற்கும் இந்த ஆய்வு சிபாரிசு செய்கின்றது.

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1. Introduction

Foreign direct investment (FDI) has long been viewed as a major factor in economic growth and development. Whilst FDI predominantly originates and flows between advanced industrial nations, recent history has witnessed it soar in importance as a source of capital, management, and technology for both developing and transitional economies. Recognising its importance, successive Sri Lankan governments since independence have made the attraction of FDI a cornerstone of their development policy. However, despite efforts to attract FDI, protectionist economic approaches have been a disincentive.

The liberalisation reform package of 1977 in particular and successive reforms since were aimed at creating a conducive environment for FDI entry and operation. Despite this focus, Sri Lanka's success in attracting FDI has been limited, especially when gauged against comparator countries (Rahman, 2009). While the three-decade long civil war hampered the realisation of the country's investment potential, the country appears to have fallen short of expectations even in a post-conflict environment – largely owing to inconsistencies in the policy regime (World Economic Forum [WEF], 2017).

Against this backdrop, the objective of this study is to analyse trends and patterns of FDI into the country over the last one and half decades, in the manufacturing sector. Trends and patterns are analysed using firm level data from the Board of Investment (BOI) of Sri Lanka for the years 2002, 2009, and 2016. The composition of firms, their entry and exit patterns, and ease of doing business are some of the firm-level factors analysed, in an effort to understand the overall FDI policy environment and investment climate in Sri Lanka, in the period under analysis.

2. Background: Evolution of FDI Policy in Sri Lanka

Through the years, the Sri Lankan economy has varied between different political-economic ideologies, which have consequently hindered policy consistency. This section attempts to contextualise prevailing policies that influence FDI in Sri Lanka. Following an initial overview of the evolution of FDI policy since economic liberalisation, the subsequent sub-section will move on to discuss more recent FDI policies, this intent, and current state of implementation.

a) 1977 – 2005

The first wave of economic liberalisation in Sri Lanka following the change of government in 1977 was a watershed moment for the Sri Lankan economy, as well as for other developing economies in the region. Sweeping economic reforms introduced in response to dismal economic performance during the preceding two decades, meant that Sri Lanka was the first South Asian nation to embrace export-oriented industrialisation as a core tenet of the national development strategy (Atukorala and Jayasuriya, 1994). Trade policy reforms formed a significant component of the overall strategy with tariffs replacing quantitative restrictions (QRs) and the tariff structure gaining greater uniformity. Moreover, reforms also included the lowering of restrictions on foreign investment, with special emphasis on incentivising export-oriented investment under a scheme of Export Processing Zone (EPZs). A number of bilateral investment treaties (BITs) and double taxation treaties (DTTs) were also signed between Sri Lanka and several major investing countries. Moreover, a constitutional provision was introduced to guard against the nationalisation of foreign assets without compensation (Atukorala and Rajapatirana, 2000).

The initial years since implementing economic reforms accrued impressive results with GDP growth doubling from 2.9 per cent between 1970-77 to 6 per cent between 1978-83. However, the momentum for economic reforms was lost due to a confluence of political economic factors. The Sri Lankan government also undertook large public investment projects at the time to run parallel to the liberalisation process. The Mahaweli program, urban development projects, and public housing projects became politically popular as they were largely sponsored through foreign aid and were expected to create demand for government and private resources. However, in practice public investment projects impeded the economic reform agenda and led to ad hoc changes to tariffs in order support local producers and meet the revenue demands of the public investment program (Cuthbertson and Atukorala, 1991). Consequently, the reform agenda gained secondary status as prioritisation was given to the more politically expedient public investment projects. The reform agenda was further undermined by the escalation of ethnic violence in July 1983.

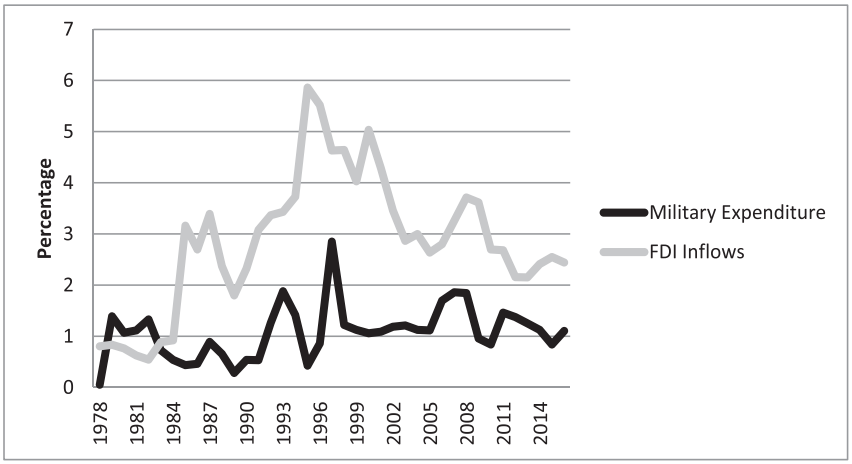
The political violence that ensued during the 1980s and continued into the following decade led to sharp increases in defence expenditure. As a result, the economy experienced widening fiscal deficits, growing macroeconomic issues, and an erosion of global competitiveness. For instance, FDI inflows decreased sharply since 1984 to a mere 10 per cent of the 1980-83 average by 1989 (Atukorala and Rajapatirana, 2000). In response the government undertook a second wave of liberalisation that included an ambitious privatisation drive, simplification and removal of tariffs, a commitment to move towards a flexible exchange rate, and a commitment to reduce the fiscal deficit in early 1990 (Kelegama, 2006). Moreover, new policies abolishing restrictions on ownership of joint ventures outside EPZs were introduced (Atukorala and Rajapatirana, 2000).

Even though economic policies remained reasonably liberal even after a change in government in 1994, the escalation of the conflict placed a heavy burden on the economy. As evidenced in Figure 1 below, military expenditure peaked close to 6 per cent of gross domestic product (GDP) in 1995 and remained between 4 and 6 per cent of GDP until 2001, placing a heavy fiscal burden on government finances. Moreover, the conflict had a significant economic cost, both

directly and indirectly due to inter-alia the loss of life, property, infrastructure, and opportunities. In fact, Arunatilake et al. (2001) estimated that based on a conservative estimate, the total accumulated cost of the conflict up to 1996 was 1.7 times the entire national output of the country in 1996. Furthermore, escalation of the conflict required the government to finance a rapidly increasing defence budget through tariff increases (Atukorala, 2017).

Amidst the conflict, FDI inflows rose during 1994-1998 as Sri Lanka's most significant focus on privatisation paid dividends (Figure 1). Moreover, it led to a change in the composition of FDI into Sri Lanka – from manufacturing to majority services. These changes were aided by deregulation and FDI into utilities such as telecom and energy. However, since late-1998, several elections at the provincial and national level derailed the momentum for structural reforms (World Bank, 2000). In addition, the country faced a severe economic crisis due to weak macroeconomic fundamentals in the form of "an expanded budget deficit, sharply increased interest rates, acceleration of the interest rate, a widened current account deficit, and a precipitous depletion of foreign exchange reserves" (Institute of Policy Studies of Sri Lanka [IPS], 2001). Consequently, just a year after island-wide victories in the provincial and presidential elections of 1999, the incumbent People's Alliance government only narrowly retained its place during parliamentary elections in 2000. The breakdown of the governing coalition created following the narrow victory led to another round of parliamentary elections in 2001, in which the United National Party usurped the People's Alliance.

Figure 1: FDI Inflows and Military Expenditure, 1978-2016 (Percentage of GDP)



Source: World Bank. (2018). *World development indicators,* Washington D.C.: World Bank.

The newly elected government led by the United National Party implemented a strict fiscal consolidation agenda in 2001 to arrest the growing debt burden and engaged in spending cuts through measures that included a hiring freeze in the public sector, easing foreign ownership of land, privatisation of industries (such as the insurance sector). However, these economic policies combined with the signing of the controversial ceasefire agreement in 2002 were deeply unpopular; leading to another change in government in 2004.

Notably, during this period in time, Sri Lanka embarked on negotiating and signing a trifecta of free trade agreements with India, Pakistan, and SAARC. While the FTAs covered goods trade only, one of the primary aims of pursuing these FTAs was to attract FDI. For instance, the Indo-Sri Lanka Free Trade Agreement (ISLFTA), which came into effect in 2000, granted preferential access to the Indian market for over 4000 tariff lines (Department of Commerce, 2017). The ISLFTA, in particular, succeeded in attracting FDI due to improved business confidence. The agreement was not only beneficial to the export sector but also encouraged Indian FDI in Sri Lanka for re-exports to India, while also positively influencing ancillary industries such as aviation connectivity between the two countries (Mukherji and Iyengar, 2013). The consequent flow of Indian FDI into Sri Lanka into both manufacturing as well as services led India emerging among the top five FDI sources (Kelegama and Mukherji, 2007). The Pakistan-Sri Lanka Free Trade Agreement and the South Asian Free Trade Agreement (SAFTA) were also negotiated and came into operation respectively in 2005 and 2006.

b) 2005 – 2015

The United People's Freedom Alliance (UPFA) coalition victory in 2004 and the subsequent Presidential election in 2005, led to a departure from the open market economy envisioned by previous reform agendas. Even though there was no stated move away from an open economy, several measures backtracked on previous reforms. However, in other areas the distinction between previous administrations and the UPFA administration was more marked. As military costs escalated during the final stages of the war, Sri Lanka's import tariff regime became even more protectionist with the imposition of a plethora of para-tariffs and other taxes. These taxes provided revenue while also providing protection to local industries, in line with the government's thinking at the time.

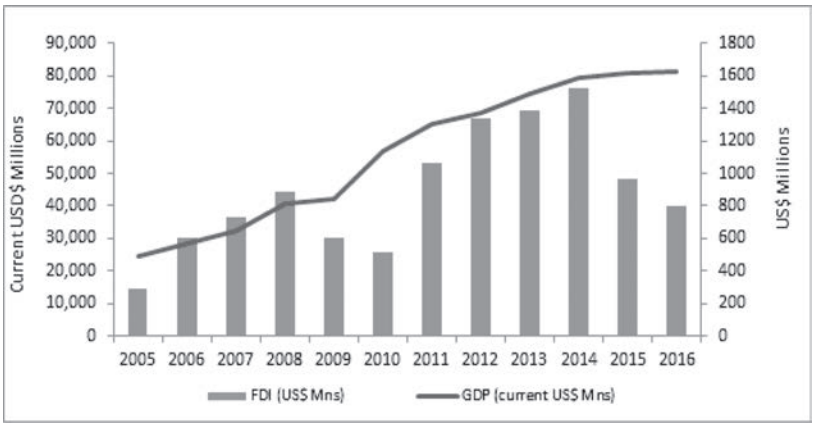
Moreover, the government moved away from privatisation to an approach that hoped to restructure and improve the performance of state owned enterprises (SOEs). In fact, the role of SOEs in the Sri Lankan economy grew during this period as some previously privatised ventures were re-nationalised. This policy gained particular significance with the passage of the Expropriation Bill titled the "Revival of Underperforming Enterprises and Underutilised Assets Act", in 2011. This act allowed the government to take ownership of 37 private enterprises, including several foreign investments. In addition, the government also passed the Land (Restrictions on Alienation) Act in 2014, restricting foreigners from buying land in Sri Lanka. Under the Act, foreigners were only allowed to lease land up to 99 years, while paying a lease tax of 15 per cent on the total rent payable.

However, amidst reversing certain economic reforms the economy experienced significant growth averaging over 7 per cent per annum. Growth was dependent on a development policy heavily reliant on public investment financed through external debt (IPS, 2015). These investments were mainly focussed on the infrastructure development and construction sectors. The strategy paid short-term dividends as the economy successfully took-off following the conclusion of the conflict in 2009. It is important to note that during this period, Sri Lanka also graduated from "Low Income" status to "Lower-Middle Income" status. Consequently, the country was no longer eligible for concessionary loans and had to borrow from more costly international capital markets instead. Moreover, Sri Lanka faced international political pressure regarding its human rights record, which also had negative developments on the economy. For instance, Sri Lanka lost GSP+ access to the EU market leaving Sri Lankan exports, especially in the apparel export sector at a considerable disadvantage (Abayasekara, 2013).

Moreover, in 2011 Sri Lanka faced a large current account and balance of payments (BOP) deficit due to increased imports, including rising petroleum imports. In response, the government took several policy measures to stem import growth. For example, it depreciated the rupee and moved to a flexible exchange rate policy in early 2012 while also increasing tariffs on imported vehicles (IPS, 2014). Moreover, the government also continued to rely heavily on the imposition of para-tariffs such as the Nation Building Tax and the Ports and Airports Development Levy (Saggu and Parisotto, 2015). Overall, the post-conflict growth dividend was short-lived as debt continued to rise at unsustainable rates while economic productivity continued to lag in the absence of meaningful reforms, causing macroeconomic instability (Weerakoon and Hewage, 2017). The impact of macroeconomic instability was worsened by protectionist economic policies touting import-substitution, which reduced Sri Lanka's competitiveness even further, resulting in a further decrease of export revenue (WEF, 2015). Sri Lanka's loss of global export market share is further evidence of a loss of international competitiveness.

In terms of FDI as represented in Figure 2, Sri Lanka experienced a post-war recovery concurrent to the economic expansion it experienced immediately following the conclusion of the conflict in 2009. However, as discussed further in Section IV below, FDI flowed mainly to non-productive sectors such as real estate and mixed development projects. This trend culminated with the Port City bringing the largest FDI commitment of US$ 1.4 billion in 2014. Therefore, the Sri Lankan economy faced a twin challenge of achieving macroeconomic stabilisation while also reforming towards an outward orientation that incentivised productive FDI and improved the export sector.

Figure 2: GDP and FDI Inflows, 2005-16



Source: Board of Investment of Sri Lanka. (2017). Foreign direct inflows. Colombo, Sri Lanka : Board of Investment of Sri Lanka.
World Bank. (2018). World development indicators. Washington D.C. : World Bank.

3. Literature Review

FDI takes place when a corporation in one country establishes a business operation in another country, through setting up a new wholly owned affiliate, acquiring a local company, or forming a joint venture in the host economy (Moran, 2012).

The OLI (Ownership, Location, Internalisation) paradigm developed by Dunning (1988) is a useful approach of thinking about FDI in the context of multinational enterprises (MNEs) as it addresses the reasons for firms choosing to invest abroad, where they will invest, and how they will operate in a chosen country. This study observes firm level data to which the OLI paradigm may be applied, as the approach focuses on incentive seeking individual firms. According to Dunning, firms may choose to invest abroad due to three main factors; ownership advantages such as trademarks, production techniques and returns to scale that enable competitiveness, location advantages (including raw materials, tariff concessions, low wages) and internalisation advantages which arise from own production (as opposed to producing through a partnership arrangement) (Dunning, 1988).

FDI can occur in several forms; import-substituting FDI (or market seeking FDI), resource or asset seeking FDI and export-oriented FDI (efficiency seeking FDI). In general, the degree of importance of factors that affect FDI are believed to vary according to whether it is market seeking or efficiency seeking (Caves, 1996). Many countries have attempted to obtain access to efficiency seeking FDI, as this is the preferred form of foreign investment. This form of investment presents access to factor endowments, cultures, institutional arrangements, economic systems and policies and market structures by concentrating production in a limited number of locations to supply multiple markets. In order for efficiency seeking foreign production to take place, cross-border markets must be both well developed and open, and therefore it often thrives in regionally integrated markets (Dunning, 1993). When transportation costs fall, companies relocate labour intensive production to low wage countries (Eckel, 2003). Countries with attractive productivity adjusted labour costs are likely to continue to secure efficiency seeking investments, especially in the textiles and clothing sector (International Monetary Fund [IMF], 2003).

What Attracts FDI Globally?

The literature primarily focuses on the impact of macroeconomic factors, incentives, and political and social systems on FDI inflows. Studies suggest that FDI is increasingly being used by industries to slice up the global value chain (GVC). Kowalski (2015) identifies structural characteristics as the main determinants of a country's GVC participation. The characteristics identified as important are; market size, level of development, industrial structure and location. Trade and other policies can also play a significant role, including factors such as inward FDI openness, low import tariffs, engagement in regional tariff agreements and logistics performance factors such as quality of infrastructure, trade facilitation, intellectual property protection and quality of institutions. Further, the structural and policy drivers of GVC participation can vary with sector and level of development (Kowalski, 2015).

The link between FDI and Ease of Doing Business indicators is quite strong in developing countries. A study (Bayraktar, 2013) covers the years 2004-10 and examines recent trends in FDI, possible links between FDI inflows and macroeconomic indicators and the link between FDI and Ease of Doing Business indicators. These indicators were found to be rapidly improving in developing countries, particularly in BRIC countries while they remained relatively stationary in developed countries. The improvements were strong in indicators such as starting and closing a business and protecting investors.

A paper by Sekkat et al. (2007) assesses the importance of openness, infrastructure availability and sound economic and political conditions in increasing the attractiveness of FDI in developing countries (see also: Govil, 2013).

The paper finds that these factors are particularly important for South Asia, Africa and the Middle East. The result also indicates a higher impact from an improved investment climate on manufacturing sector FDI than on total FDI. In particular, the impact of openness was higher for FDI in manufacturing sector than for total FDI. Certain regions such as Africa and South Asia benefit more than others from increased openness and an improved investment climate (Sekkat, Ange, and Varoudakis, 2007).

Political systems also play a significant role in how corruption and democracy are perceived when it comes to FDI to developing economies. Evidence suggests that FDI flows to less corrupt countries, as might be expected. When it comes to democracy, certain literature is inconclusive, noting that democracy produces both negative and positive effects on FDI (Li and Resnick, 2003). But certain results suggest that FDI goes to less democratic countries. This could explain why countries like China and Singapore with low levels of democracy do well in terms of FDI flows (Mathur and Kartikeya, 2013). This idea is contested by (Rodrik, 1996); in the study the author regressed an indicator for democracy (and other control variables) on the value of investment by majority owned US affiliates abroad. The result was that countries with weaker democratic rights attracted less US capital (See also: Busse, 2003; Harms and Ursprung, 2002). This contests the idea that weaker democracies attract MNEs attempting to weaken political power and gain unfair advantages.

FDI in Sri Lanka

There is some literature focussed on FDI inflows to Sri Lanka, but much of it is dated pre-war and thus does not examine the impact of the significantly different quality of institutions and business environment in the post-war period. Most literature focusses on the country's two distinct phases of investment policy from 1948-78 and 1978 to present (Athukorala and Rajapathirana, 2000; Kelegama, 2006). A 2004 study examining data from 1977-2003 to consider the relationship between GDP and FDI in Sri Lanka and found that FDI was a key determinant of Sri Lankan growth after 1977 (Balamurali and Bogahawatte, 2011).

A private sector assessment by the World Bank (1995) estimates that 70 per cent of the national economy was in the public domain from 1971-77. Post 1977 and by 1995 (when the report was published), Sri Lanka has made good progress in the areas of tariff reform, liberalising the foreign exchange market, privatising state enterprises engaged in productive activities and streamlining investment approval procedures.

The most important aspect of these new investment policies was the establishment of the Greater Colombo Economic Commission (GCEC) in 1978, which was granted with wide ranging powers to establish and operate EPZs. There was no major change in policy towards foreign ventures not meeting the criterion of 'full' export orientation with majority local ownership continuing to be a general requirement. However, with the emphasis on export-oriented industrialisation, the Foreign Investment Advisory Committee (FIAC) could adopt a more liberal ownership criteria depending on the project's export potential. The 1990 Investment Policy Statement brought several significant changes to the foreign investment framework; abolition of restrictions on ownership of joint-venture projects outside the EPZs, extension of free trade zone (FTZ) status to export oriented foreign ventures in all parts of the country and the amalgamation of the FIAC and GCEC to form the BOI for an approval process which is more efficient (Athukorala and Rajapathirana, 2000).

As discussed above, the literature identifies three main types of FDI across the world – incentive seeking, market seeking, and efficiency seeking. These supply-side determinants are further complimented by factors such as openness, infrastructure, and political systems. A recent study by Ravinthirakumaran (2015) identified six determinants of FDI flows to Sri Lanka by analysing data from 1978-2013. These are market size, trade openness, infrastructure, labour cost, macroeconomic stability and political instability. Empirical analysis of country level data has revealed that market size, trade openness and infrastructure have a positive effect on FDI inflows, while labour cost and political instability have negative effects. This also suggests that cheap labour led FDI hypothesis is supported by the Sri Lankan data (Ravinthirakumaran, 2015).

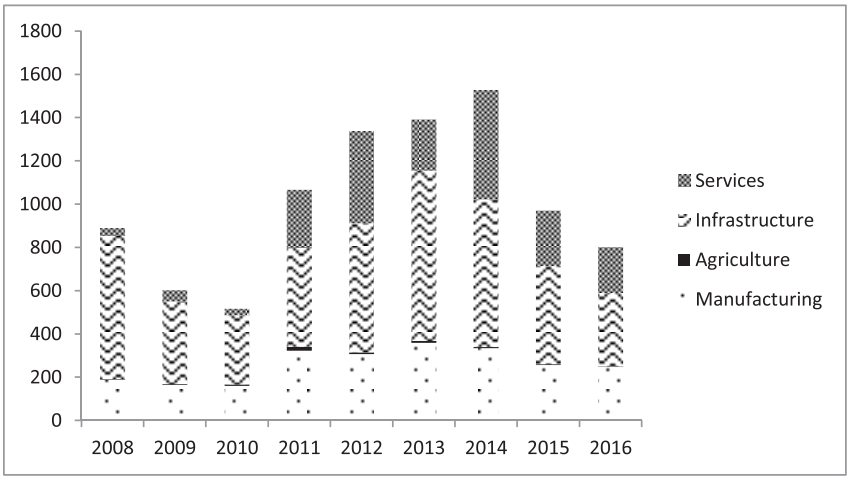
A study by Jayasekara (2014) of country level secondary data from 1975-2012 suggests that GDP growth rate, government expenditure, lending interest rate, trade balance, and corporate income tax were significant determinants of FDI in Sri Lanka during this period. Tax concessions and benefits played a significant role in attracting FDI during the same period. Foreign investors are interested in the local capital market and especially, the economy's currency stability (Jayasekara, 2014). In combination, these studies demonstrate that a greater proportion of FDI flows into Sri Lanka have been incentive seeking and market seeking (or import substituting FDI), rather than efficiency seeking FDI. The impact of attracting few efficiency seeking FDI, especially those that are export oriented, can be clearly observed in the following section that provides an overview of recent FDI trends. Existing literature has not analysed firm level data to assess the FDI climate in Sri Lanka. The contribution of this paper is to add to the literature by filling this gap.

4. Overview of Recent FDI Trends in Sri Lanka

Before proceeding to the analysis of the firm-level data from the BOI database (which has been restricted to manufacturing sector firms) it is useful to assess the overall picture of FDI inflows to BOI enterprises at the macro level.

The numbers on FDI inflows of BOI enterprises, both at the aggregate level and for the manufacturing sector alone, have been on the decline in recent years; the former experienced a dip in 2015, while the latter has been on the decline since 2014 (Figure 3). This is driven by both domestic and external factors. On the domestic front, the government cancelled the Port City project in 2015 (later resumed in 2016) which was a key contributor to the FDI drop witnessed. External factors also had a part to play, with global FDI flows witnessing a dip in 2015 (IPS, 2015) along with experiencing dull global investment sentiments. However, it is primarily domestic factors such as policy uncertainty and uncertain tax policies that may have contributed to below par inflows. Sri Lanka struggles in attracting inward investment in contrast with the fortunes of regional trade competitors such as Bangladesh, Malaysia, Vietnam, etc. These countries have received a steady flow of FDI into high value sectors, allowing them to enhance international competitiveness in vital export oriented sectors (IPS, 2015).

Figure 3 : FDI of BOI Enterprises by Sector, US$ Millions



Source: Data from the BOI.

It is also useful to consider the inflow of FDI to BOI enterprises by sub - sector. This is depicted in Table 1 below, for the 2012-2016 period.

Table 1: FDI of BOI Enterprises by Sub-sector - US$ Millions

Sector	2012	2013	2014	2015	2016
Manufacturing	**307.7**	**359.8**	**333.9**	**257.0**	**247.7**
Food, Beverages and Tobacco Products	75.9	49.7	44.7	42.7	49.5
Textile, Wearing Apparel and Leather Products	86.7	102.6	83.1	45.4	21.3
Wood and Wood Products	2.4	1.7	2.5	2.8	3.1
Paper, Paper Products, Printing and Publishing	4.0	2.1	36.3	2.2	3.1
Chemicals, Petroleum, Coal, Rubber and Plastic Products	59.2	114.4	91.9	75.4	99.5
Non - metallic Mineral Products	17.7	45.2	29.7	13.7	31.2
Fabricated Metal, Machinery and Transport Equipment	38.8	17.0	7.0	46.1	11.9
Manufactured Products (n.e.s.)	22.9	27.1	38.7	28.7	28.2
Agriculture	7.2	8.5	5.7	3.9	1.9
Services	**367.7**	**236.3**	**506.3**	**255.4**	**211.9**
Hotels and Restaurants	117.3	67.9	68.4	181.9	141.3
IT and BPO	25.9	19.3	24.7	13.6	23.0
Other Services	224.6	149.1	413.3	59.9	47.6
Infrastructure	**596.6**	**786.8**	**682.5**	**453.4**	**339.5**
Housing, Property Development and Shop Office	55.7	217.6	339.2	212.1	79.5
Telephone and Telecommunication Network	242.1	359.8	152.5	138.8	243.6
Power Generation, Fuel, Gas, Petroleum &Other	96.5	44.9	12.5	51.3	14.8
Port Container Terminals	202.2	164.5	178.2	51.2	1.6
Total	**1,279.2**	**1,391.4**	**1,528.4**	**969.7**	**801.0**

Source: Annual Report 2016, Central Bank of Sri Lanka, based on BOI data

The infrastructure sector has been the key driver of FDI inflows in the 2012-2016 period. This is a reflection of the policy-environment in the post-war period which supported construction-led growth of the economy. The services sector is the second-most dominant sector drawing FDI, with the manufacturing sector following closely behind and overtaking in 2016. The dominant sub-sectors have consistently been the tourism (hotels and restaurants) and telecommunications sectors. Within the manufacturing sector, the apparel and chemical/ petroleum /coal/rubber/plastic products sub-sectors have been the top performers in this period, albeit the apparel sector displays a sharp declining trend in inflows potentially owing to the loss of GSP+ access in this period.

The policy environment, especially in the post-conflict period, left room for crowding out of private investment. As discussed in Section 2, SOEs were given a more prominent place in the economy and the emphasis was on import-substitution industries. The total number of SOEs rose drastically from 107 entities in 2009 to 245 entities by 2015 (Advocata Institute, 2016). As a result, private investment in these areas was crowded out by SOEs and protected industries, resulting in a fall in FDI and export-oriented investment. In addition, the lack of land security has posed a severe hindrance to the inflow of FDIs. Particularly for the manufacturing sector, the 'sunk costs' of starting a business are higher due to the need to acquire vast amounts of land to build factories to facilitate production, etc. When land security is lacking, it is possible that foreign manufacturing firms are reluctant to invest in Sri Lanka.

5. Methodology and Data

The study will conduct a firm-level analysis of BOI enterprises over the 2000-2016 period. The analysis will be undertaken using the firm level databases of the BOI for the years 2002, 2009 and 2016. The databases comprise of firms that are locally owned, foreign owned and those that are joint ventures. The study retains only the observations (firms) belonging to the 'manufacturing sector' and that are 'currently in operation' in the BOI database. Limiting the analysis to the manufacturing sector allows for focussing on a sector which is not attracting FDI to its full potential; albeit being a top FDI earner after telecommunications and tourism sub-sectors in 2016, at the sectoral level, infrastructure and services sectors outweigh the manufacturing sector when considering the FDI inflows of BOI enterprises in the 2012-2016 period (Central Bank of Sri Lanka [CBSL], 2016).

The following analyses are conducted using firm level data. First, the study provides an aggregate analysis of firm level data for the years 2002, 2009 and 2016 based on the Central Bank classification of sub-sectors within the manufacturing sector.

The reasoning for analysing these specific years is as follows: in 2002, Sri Lanka witnessed the 'third wave of liberalisation' under the UNP led government, which potentially lends itself as a useful period to analyse FDI. The year 2009 marks the end of a 30-year long conflict in Sri Lanka, following which a 'post-conflict dividend' was expected. The database for 2016 is the latest available, which serves as a point of comparison.

Second, the study focusses on a firm entry/exit analysis. We consider two time periods based on the available data: 2002-2016 and 2009-2016. The former enables us to look at firm turnover in the long term over a 15 year period, while the latter tells us about firm turnover in the post-conflict period in Sri Lanka. We define an 'entrant' firm as one which is present in the 2016 dataset, but absent in the 2009 or 2002 datasets. Similarly, an 'exit' is defined as a firm which is present in the 2002 or 2009 datasets, but absent in the 2016 dataset. A limitation to this approach is that we are unable to capture firms that both enter as well as exit within the given period; for instance, entrants between 2009-2016 don't include firms that may have entered after 2009 and exited before 2016, as these are not captured by either database. Hence, attention should be paid to the gap between the number of entering and exiting firms, rather than to the absolute magnitude of each, in this analysis.

Third, a duration analysis is conducted on how long it took for entrant firms in the 2009-2016 period to set-up their businesses and begin commercial operations. The 2016 database is the only one for which application, approval and commercial operation dates are provided. Hence, we use the sample of 202 entrant firms in the 2009-2016 period for the purpose of this analysis.

Finally, we discuss the implications of the firm-level findings on Sri Lanka's overall investment climate, and delve into why FDI inflows to the country have not reached the expected levels, particularly in the post-war period.

[2] Access to full time series data for the 2000-2016 period was not possible. As such, the analysis is conducted using staggered databases within this period.

6. Data Analysis and Discussion

(a) Aggregate Analysis

This section focusses on firm-level data restricted to the manufacturing sector as per the BOI databases for 2002, 2009 and 2016. Table 2 below provides an overview of the number of manufacturing firms registered with the BOI that are in operation in the given years. This includes local and foreign investment as well as joint ventures.

Table 2: Firm Count and Foreign Ownership Stake by the Manufacturing Sub-sector

	2002	2009		2016	
Central Bank Classification Breakdown	**Number of Firms**	**Number of Firms**	**Foreign Ownership**	**Number of Firms**	**Foreign Ownership**
Chemicals, Petroleum, Coal, Rubber & Plastic	129	126	52%	123	38%
Fabricated Metal, Machinery & Transport Equipment	68	92	69%	78	57%
Food, Beverages & Tobacco	144	142	32%	115	30%
Manufactured Products (n.e.s.)	155	157	59%	138	58%
Non-Metallic Mineral Products	64	71	57%	56	50%
Paper, Paper Prod., Printing & Publishing	23	28	49%	28	44%
Textile, Wearing Apparel & Leather Products	328	282	48%	318	30%
Wood & Wood Products	22	32	35%	21	28%
Total	**933**	**930**		877	

Source: Authors' calculations, based on BOI Data.
Note: Ownership data is not available for 2002.

The apparel sub-sector has the largest number of firms in all three years, followed by manufactured products (n.e.s) and food sub-sectors. In terms of the foreign ownership stake in each of these subsectors, the metal/machinery/transport equipment sector has the highest (yet declining) stake in 2009 and 2016. Manufactured products (n.e.s) closely follow with a foreign ownership stake of 58 per cent in both 2009 and 2016. The lowest foreign stake is seen in the food and wood products sub-sectors; this is due to the fact that these sectors have a statutory restriction of up to 40 per cent foreign ownership imposed on them (BOI, 2015).

Overall, the ownership composition of BOI investments in manufacturing – whether firms are foreign, locally, or jointly owned – has remained largely unchanged when comparing 2009 with 2016, as per Table 3 below. Local ventures remain as the highest, followed by foreign ventures and joint ventures. However, local investments have notably increased from 348 to 431 firms between these two periods, whilst the number of joint ventures has decreased significantly from 278 to 172 firms. Such a shift in the composition of firms away from joint ventures towards local ownership is discouraging. There are many benefits that joint ventures bring to the table, such as technology upgrading and transfers and providing links to global value chains that Sri Lankan firms will potentially lose out on.

Table 3: Ownership Stake – Number of Firms

Ownership Stake	**2009**	**2016**
Foreign	304	274
Join Venture	278	172
Local	348	431
Total	930	877

Source: Authors' calculations, based on BOI Data.
Note: Ownership data not available for 2002.

In addition, the databases provide data on the composition of FDI to BOI enterprises by country. This information is available only for the 2016 database. Of the manufacturing firms currently in operation in the 2016 database, we investigate country level investments (either a full or joint foreign ownership stake) by sub-sector. Overall, out of a total of 358 of such firms, India, Hong Kong and the United Kingdom have made the largest number of investments in the manufacturing sector with ownership stakes in 70, 52 and 51 firms respectively. India leads in all manufacturing sub-sectors, except apparel, which is dominated by Hong Kong (Table 4).

India is the leading source country for total FDI inflows to Sri Lanka for 2016, followed by China, Singapore and Hong Kong (CBSL, 2017). Although India and China also appear to be leading in manufacturing as in Table 4, the UK, USA and Japan are more dominant players in the manufacturing sector, compared to China and Singapore.

(b) Entry and Exit of Firms

The turnover of firms is an important aspect to consider in an analysis of FDI inflows and investment climate of a country. Using the three databases of the BOI, we are able to assess the number of firms which have continuously been in operation between a given period, and in addition, the number of firms that have entered and exited between a given period of time.

We consider two time periods in this analysis: 2002-2016 and 2009-2016. The former enables to us to look at turnover of firms in the long term over a 15 year period, while the latter tells us about turnover of firms in the post-conflict period in Sri Lanka.

Table 4 : Number of BOI Firms Invested in by Country – Full or Partial Ownership - 2016

Country	Chemicals, Petroleum, Coal, Rubber & Plastic	Fabricated Metal, Machinery & Transport Eq.	Food Beverage & Tobacco	Manufactured Products (n.e.s)	Non - Metallic Mineral Products	Paper, Paper Products Printing & Publishing	Textile Wearing Apparel & Leather Products	Wood & Wood Products	Total (a)
Sri Lanka	85	46	92	74	29	19	238	15	598
India	10	17	9	6	9	3	15	1	70
Hong Kong	3	3	1	5	5	1	34	0	52
United Kingdom	5	8	4	6	3	2	23	0	51
United States	7	3	5	6	2	2	8	0	33
Germany	2	3	3	9	3	1	5	0	26
Japan	3	5	1	8	6	0	1	1	25
Singapore	3	0	4	7	4	0	7	0	25
China	0	7	3	2	3	0	2	1	18
Australia	5	2	0	2	0	0	7	1	17
South Korea	8	0	0	2	0	1	5	0	16
Netherlands	3	0	3	3	2	1	0	2	14
North Korea	3	1	0	3	1	1	3	0	12
Other	16	5	7	26	11	3	25	2	95
Total	**153**	**100**	**132**	**159**	**78**	**34**	**373**	**23**	**1052**

Source: Authors' calculations, based on BOI Data.

Note: (a) Since the table includes joint ventures (firms with ownership stakes from multiple countries) the totals do not represent the total number of firms, but rather the total number of firms in which countries have ownership stakes, since one firm can be invested in by several countries.

Table 5: Entry/Exit Summary

Year	Number of Firms
2002	933
2009	930
2016	877
In 2002 and 2016 (Continuous)	408
Not in 2002, in 2016 (New Entrants)	469
In 2002, not in 2016 (Exits)	665
In 2009 and 2016 (Continuous)	675
Not in 2009, in 2016 (New entrants)	202
In 2009, not in 2016 (Exits)	410

Source: Authors' calculations, based on BOI Data.

Based on Table 5, it is glaringly clear that more firms have exited than entered within a given period– in both cases, over double the number of firms have exited compared to the number of entrants. Furthermore, out of 933 firms that were in operation in 2002, only 408 have continued operations through to 2016. In the post conflict period, out of 930 firms that were in operation in 2009 only 675 firms have continued operations till 2016.

The post-conflict turnover is particularly concerning, given that this period was dubbed as the era that would usher in FDI in the aftermath of the war.

For further insight, the breakdown of entrants and exit firms for these two periods by manufacturing industry sub-sector is depicted in Table 6. It appears that the pattern seen in the aggregate numbers – of exits being approximately double the number of entrants – is consistent across most sub-sectors, in the 2009-2016 period.

The gap between the number of entrants and exits is wider in the 2009-2016 period than in the 2002-2016 period, across all sub-sectors. Even in sub-sectors such as metal and paper which had marginally more entrants than exits in the 2002-2016 period, exits have become higher than entrants in the 2009-2016 period. In sub-sectors such as metal and paper which had marginally more entrants than exits in the 2002-2016 period, exits have become higher than entrants in the 2009-2016 period.

Table 6: Number of Entry and Exit Firms by the Manufacturing Sub-sector

	2002 - 2016		2009 -2016	
Manufacturing Sub-sector	**Entrants**	**Exits**	**Entrants**	**Exits**
Chemicals, Petroleum, Coal, Rubber & Plastic	68	86	29	40
Fabricated Metal, Machinery & Transport Eq.	57	54	28	47
Food Beverage & Tobacco	77	111	35	71
Manufactured Products (n.e.s)	64	97	31	56
Non -Metallic Mineral Products	29	40	12	28
Paper, Paper Products - Printing & Publishing	12	9	5	7
Textile Wearing Apparel & Leather Products	150	255	59	146
Wood & Wood Products	12	14	3	15
Total	**469**	**666**	**202**	**410**

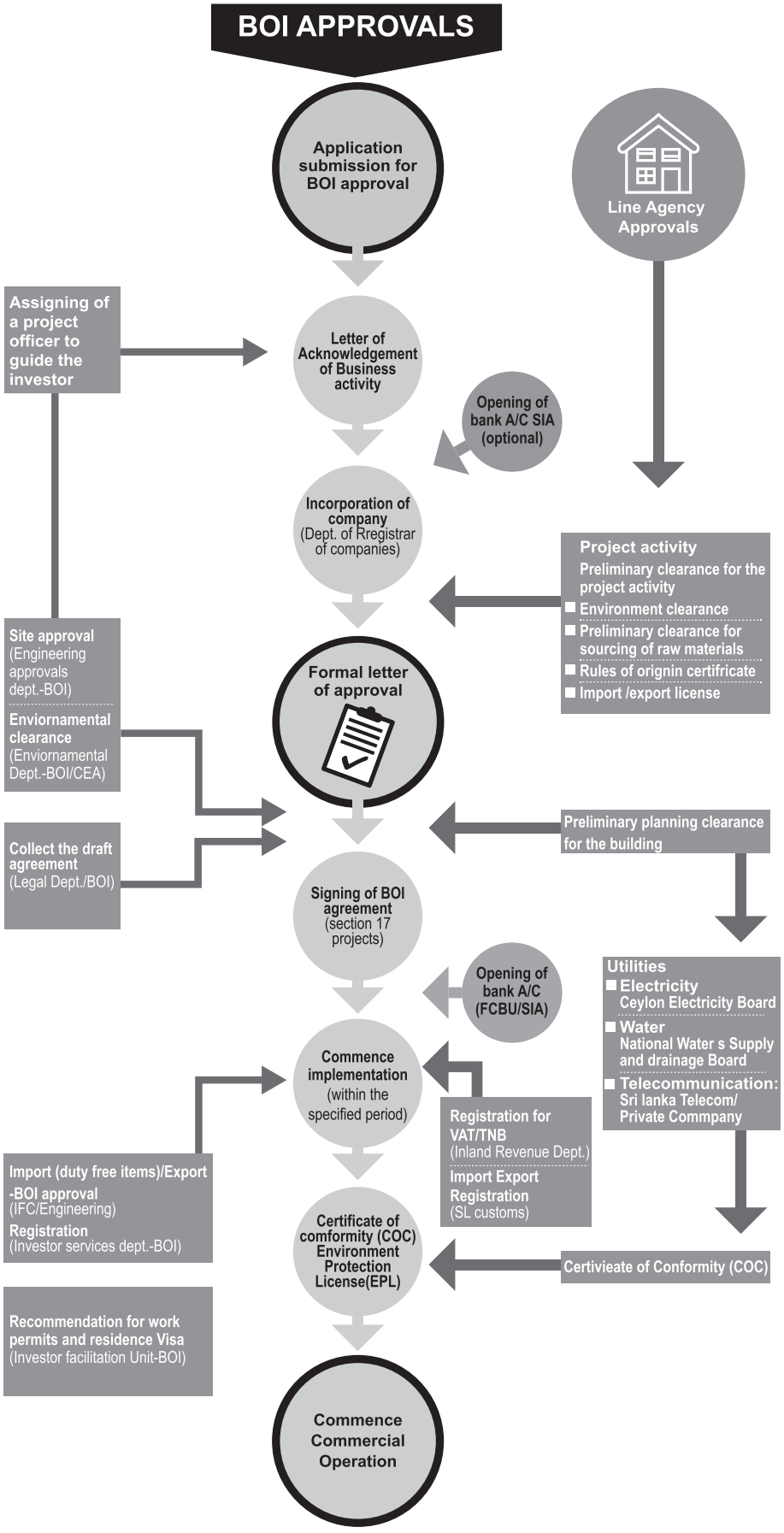
Source: Authors' calculations, based on BOI Data.

The turnover in the textiles and garments (T&G) sector is particularly high relative to the other sectors in both periods under analysis; almost double the number of entrant firms exited in the full 2002-2016 period (150 vs. 255) , while over double the number of firms exited within the 2009-2016 period (59 vs. 146). This is potentially a reflection of the footloose nature of the T&G industry relative to other sectors. T&G firms are highly mobile, and are constantly on the lookout for low cost locations for production. The industry is a relatively low-skill labour intensive operation which means that the labour intensive components of production have been shifted to low wage countries like Sri Lanka, Bangladesh, Philippines, Thailand, etc (Kelegama, 2004). Production is now shifting to even lower cost bases such as Vietnam, Cambodia and Laos. Hence, relatively high exits in the T&G sector could be a reflection of this shift, given that Sri Lanka's labour costs have steadily increased (IPS, 2015). This aside, the high turnover of firms which is characteristic of almost all sub-sectors of Sri Lanka's manufacturing sector, based on the above analysis is a cause for concern.

(c) Duration Analysis

In this section, we look at what firm-level data tells us about the ease with which investors can start-up a business. Application, approval and commercial operation dates are provided only in the 2016 database. Hence, we use the sample of 202 entrant firms in the 2009-2016 period for the purpose of this analysis.

Table 6: Number of Entry and Exit Firms by the Manufacturing Sub-sector



Source: Based on data of BOI

We analyse two stages of the business start-up process; i.e. from the stage of application to the stage of BOI approval, as well as from application to the beginning of commercial operations. Figure 4 illustrates the procedures investors must undergo and permits they must receive in each of these stages.

Table 7: Number of Firms by Duration – 2016 Entrants

Duration	Application to BOI Approval (No. of Firms)	Application to Commercial Operation (No. of Firms)
Less than 3 months	165	7
Greater than 3 months	37	195

Source: Authors' calculations, based on BOI Data.

Table 7 shows the number of firms that take less/more than three months to obtain BOI approval to start a business. From the point of submitting an application to the BOI up to the point of obtaining BOI approval, it takes less than three months for a majority of firms (165 of 202). This is in line with the World Bank's "Investing Across Borders" database, which finds that it takes six procedures and 65 days to establish a foreign-owned limited liability company (LLC) in Sri Lanka. In addition, Sri Lanka's Global Competitiveness Index (GCI) rankings on this front are below those of comparator economies, especially in South-East Asia: in the 2017-18 report, Sri Lanka has been placed 70th and 56th out of 137 countries for number of procedures required to start a business, and time taken (days) to start a business, respectively (WEF, 2017). However, the time taken for most firms to begin commercial operations, in the period after gaining BOI approval, is far longer. Only seven out of 202 firms began commercial operations in a period of less than three months. Table 8

Table 8: Duration to Begin Commercial Operations – 2009-2016 Entrants

Duration - Application to Commercial Operation	No. of Firms
Less than 6 months	24
Greater than 6 months	178
Less than 1 year	80
Greater than 1 year	122
Less than 2 years	140
Greater than 2 years	62

Source: Authors' calculations, based on BOI Data.

Table 9: Duration to Begin Commercial Operations by the Manufacturing Sub-sector

Manufacturing Sub -sector	No. of Firms > 1 Year	No. of Firms > 2 Years	Total Entrants 2009-2016	Percentage of Firms > 1 Year	Percentage of Firms > 2 Years
Chemicals, Petroleum, Coal, Rubber & Plastic	16	4	29	55.2	13.8
Fabricated Metal, Machinery & Transport Eq.	19	13	28	67.9	46.4
Food Beverage & Tobacco	27	17	35	77.1	48.6
Manufactured Products (n.e.s.)	19	8	31	61.3	25.8
Non Metallic Mineral Products	8	6	12	66.7	50.0
Paper, Paper Products-Printing & Publishing	4	2	5	80.0	40.0
Textile Wearing Apparel & Leather Products	29	12	59	49.2	20.3
Wood & Wood Products	0	0	3	0.0	0.0
Total	**122**	**62**	**202**		

Source: Authors' calculations, based on BOI Data.

Hence, the time taken beyond the approval stage leading up to the beginning of commercial operations is lengthy; this is owing to the fact that investors are referred to different ministries/agencies to obtain other required approvals, as depicted in Figure 4 (VAT registration from Inland Revenue, import export registration from Sri Lanka Customs, registration with utilities authorities). Hence, the BOI functions as more of an intermediary rather than a 'one-stop-shop' facilitator for investors (which was its originally intended purpose) (IPS, 2016). For this reason, Ease of Doing Business type indices don't capture the full procedural burden for firms in the start-up process in Sri Lanka, since the time taken to gain ancillary approvals to begin commercial operations, beyond gaining the main BOI approval, is time consuming.

Further analysis by sub-sector shows that the food and beverage, mineral products and wood products sub-sectors perform worst in terms of the time taken to begin commercial operations. Of the new entrants to the food and beverages sector in 2009-2016, 77 per cent took longer than one year to begin commercial operations, while almost 50 per cent took over two years for same. This could be due to food manufacturers requiring additional time to obtain health and standards certification, and environment protection licenses on account of the fact that it is a high waste sector.

In addition, certain products belonging to the food based and mining based industries are only granted up to a 40 per cent foreign equity stake in a BOI approved firm. As such, the data suggests that firms falling under this statutory restriction might be taking longer to begin commercial operations. In the food sector, specifically the growing and primary processing of tea, rubber, coconut, rice, sugar and spices are subject to statutory requirements (BOI, 2015). A majority of the 27 entrants to the food sub-sector that take over one year to begin commercial operations (as per Table 9) belong to these categories. In addition, the 66 per cent of entrants in to the mineral products sector, that took over one year to begin commercial operations are firms involved in diamond processing, granite processing, etc., which fall under the statutory restrictions. Hence, it might be the case that foreign firms functioning under restricted sectors take longer to set up due to regulatory bottlenecks.

As proposed in the National Budget proposals for 2018, the government proposes to establish a 'National Single Window' to overcome these failings,. This will enable foreign investors to apply on an online registration platform, and undergo a fast-track approval process that doesn't require approvals from different line agencies, as per the current procedure illustrated in Figure 4 above. To this end, the BOI has established a Single Window Investment Facilitation Taskforce (SWIFT) with the Inland Revenue Department, Registrar of Companies, Sri Lanka Customs, Urban Development Authority, Colombo Municipal Council and Central Environment Authority, at the time of writing. Towards the end of 2018, the BOI plans to extend this to 18 more line agencies to collectively incorporate a total of 24 agencies, which will cover the majority of approvals necessary for foreign companies that are planning to establish themselves in Sri Lanka. Further research should be conducted once the SWIFT has been fully implemented, to test if the duration for firms to start up has reduced as intended.

Summary

The main findings from the firm-level analysis can be summarised as follows: (1) BOI enterprises are largely locally owned, with the equity stake in firms moving away from foreign/joint ownership towards more local ownership. (2) Turnover of firms is high, with more firms exiting than entering both in the short and long term period analysed. (3) Ease of starting a business for investors is poor, with a majority of firms taking over a year to begin commercial operations.

These findings are reflective of Sri Lanka's poor performance on the FDI front in recent years. The firm-level data corroborate with the numbers on FDI inflows of BOI enterprises, both at the aggregate level and for the manufacturing sector alone, which have been on the decline in recent years. Hence, this study finds that the firm-level data reflects Sri Lanka's lackluster performance on the FDI front and adds to existing empirical evidence that Sri Lanka's investment climate and ease of doing business are not satisfactory.

7. Recommendations and Concluding Remarks

As discussed above, analysis of the data identifies three major trends in manufacturing sector investment in Sri Lanka; high firm turnover, large time lags before commercial operation, and a reduction in foreign and joint ownership of investment. This section provides deeper insights to these trends, identifies some contributing factors, and attempts to provide some policy recommendations.

High Firm Turnover

As observed above, the number of firms that exited Sri Lanka between 2002 and 2016, and between 2009 and 2016, is nearly twice as many as those entering into the economy. Notably, there appear to be few entrants into the manufacturing sector since 2009, a time period during which Sri Lanka was expected to benefit from a peace dividend and attract higher rates of private investment. While protectionist economic policies could possibly result in low entries, the consistently high rates of firm exits across the time period under analysis appear to be linked with the type of investment prominent in Sri Lanka. As discussed previously, Jayasekara (2014) and Ravinthirakumaran (2015) find that there is more incentive seeking investment rather than efficiency seeking investment. Incentive seeking investments are more "footloose" and tend to move between locations and engage in "incentive shopping" (Shughart II and Thomas, 2015). Therefore, the tendency for incentive seeking investments that enter Sri Lanka to exit after their investments incentives expire could potentially be a factor affecting the high rate of exits. Furthermore, the greater presence of incentive seeking investment relates to the low level of Sri Lanka's integration into global and regional supply chains (Athukorala, 2014).

Cognisant of the above, Sri Lanka should attempt to incentivise the entry of more efficiency seeking investments instead. As such, the focus of investment facilitation in the country should not be based on incentives, but rather on improving the economic competitiveness of the country and improving the efficiency gains of investing in Sri Lanka. The strengthening of the trade-investment nexus, for instance, is a key component which could influence such gains. For instance, given Sri Lanka's relatively small market with a total population of 21 million, access to large markets complements efficiency seeking investment with potential market seeking investment as well. The Indo-Sri Lanka investment linkage substantiates the importance of the trade-investment nexus, as each factor tends to follow one another. For example, Indian investment in Sri Lanka increased significantly following the implementation of the Indo-Lanka Free Trade Agreement in 2000 and is currently one of the biggest sources of private investment in the country.

However, given that free trade agreements tend to be limited in focus and specific to certain countries, the onus should be on investment climate reforms to improve Sri Lanka's competitiveness in order to be able to cater to a wider group of countries. For instance, recent global trends in investment suggest that the onus is shifting away from the Organisation for Economic Co-operation and Development (OECD) nations to emerging economies in East Asia. This trend is also reflected in economic growth patterns since the global recession in 2009. Given the shift in global economic activity towards Asia, Sri Lanka should also adapt its investment regime accordingly towards attracting foreign investments from developing countries.

In fact, experiences elsewhere suggest that the benefits of technological innovation and absorption from "Third World MNEs" occur at a faster rate, especially through joint ventures (Yuo and Zhang, 2016). Furthermore, Emerging Multinational Enterprises (EMNEs), especially those that are knowledge-intensive, are found to respond positively to two main factors: strategic assets (in the form of local technological dynamism) and the agglomeration of foreign investments in the same business functions (Crescenzi, Pietrobelli, and Rabellotti, 2015). Thus, given its highly literate labour force, Sri Lanka has the potential to leverage EMNEs if the correct regulatory

environment that accommodates economic dynamism is created. Whilst the trade and investment agreements which are currently under negotiation with India, China, and Singapore are geared towards creating this shift in focus, an agreement alone will not guarantee investment. The Sri Lankan export sector should adequately restructure to cater to these emerging markets while regulatory and institutional barriers are also to be reformed accordingly. Thus, by focusing on regulatory, structural, and institutional reforms, Sri Lanka will be better placed to attract more efficiency seeking FDI.

Bottlenecks for Commercial Operation

As identified in the previous section, the fact that more than 50 per cent of firms analysed between 2009 and 2016 took more than a year to begin commercial operations indicates a significant weakness in the overall investment climate of the country. The fragmented processes involved in gaining approvals for commercial operation is a key factor causing such delays. The BOI was initially established as a one-stop-shop for investment regulatory approval. However, in reality, the BOI has failed to cater to this expectation and potential investors are required to gain authorisation from several institutions that increase "shoe-leather costs" and also increase inefficiencies associated with investment in Sri Lanka. The time lag between BOI approval and commercial operation, for instance, can be partly attributed to bureaucratic inefficiencies and weaknesses in institutional cooperation involved in facilitating investment, such as Ministries, local government authorities, and other departments. The wide ranging and often-contradictory mandate provided to the BOI in being a regulatory institution, while also promoting, developing, and managing economic zones, have further led to an inefficient allocation of institutional resources. Alarmingly, these institutional weaknesses were also identified in United Nations Conference on Trade and Development's (UNCTAD) Investment Policy Review of Sri Lanka in 2004.

Therefore, the government's proposal under its 2018 budget to establish a national single window to act as a "one-stop-shop" for investment approval, urgently requires implementation. The first stage of this policy has been implemented at the time of writing.

However, such a policy should be accompanied by institutional reform of the BOI that streamlines its role in order to circumvent duplication of mandates and further bureaucratic inefficiency.

Reduced Foreign Ownership

The gradual decline of foreign ownership stakes in the manufacturing sector of investments in Sri Lanka is the third significant trend identified through this study. One critical factor affecting this has been protectionist and nationalist economic policies restricting the participation of foreigners in the economy. For instance, the lack of land security has posed a severe hindrance to the inflow of foreign investment, in recent years. The passage of the Underutilised Assets Act (2011) and the Land Alienation Act (2014) were especially detrimental to improving investor security in the country. Particularly for the manufacturing sector, the 'sunk costs' of starting a business are higher due to the need to acquire vast amounts of land to build factories to facilitate production, etc (Holzl, 2003). As a result, when land security is lacking, foreign manufacturing firms are reluctant to invest or continue operations in Sri Lanka, leading to the decline in foreign and joint venture investments. Similar restrictions on foreign ownership of particular industries are other factors influencing the decline of foreign and joint venture investments (Panditharathna and Jayatilake, 2017).

The decline in foreign and joint ownership and the resulting decline in FDI are particularly worrisome for a small developing economy such as Sri Lanka, since it depends on foreign capital to compensate for inadequate domestic savings. Given that few local firms are integrated into global supply chains and engage in exports, the decline in foreign ownership is even more concerning. Foreign investment has the potential to improve Sri Lanka's competitiveness levels and improve its linkages with export markets. As such, restrictive land and ownership policies require immediate rectification from a policy front.

Concluding Remarks

In this study, the firm-level findings from BOI enterprise suggest that FDI inflows to Sri Lanka have been severely hampered by policies that allow for 'incentive shopping', investment facilitator inefficiency

and ad-hoc policy changes related to land and public enterprises that undermine investment security. While Sri Lanka has not maximised on its 'post-war dividend' to attract higher investment, the more recent necessity of shifting to a 'tradeable sector growth' led economy with the need to urgently overcome the country's current fiscal constraints, has made FDI attraction a priority reform agenda once more. The firm-level analysis in this study paints a gloomy picture of Sri Lanka's manufacturing sector investment front, with poor overall FDI performance in terms of inflows, turnover of firms, and ease of setting up business. While the broader requirement of 'policy consistency' is challenging to achieve, quick-wins such as speeding up the approval process for investors and re-orientation towards attracting more efficiency seeking FDI into the country, should be prioritised in the short-term. The current policy environment where the government is aiming to liberalise existing restrictions on foreign entry on certain sectors and make land ownership laws less restrictive for foreigners, along with the BOIs recently implemented SWIFT facility, are all positive steps in this direction.

Whether these efforts come to fruition and for how long a supportive policy environment is sustained, will undoubtedly affect whether we witness an improvement in firm-level outcomes for manufacturing sector investments in the country.

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