ALL HOPE IS NOT LOST:

RESURGENCE OF A FORMIDABLE ECONOMY

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Mr. Heshana Kuruppu is a renowned professional in the Sri Lankan corporate landscape, whose expertise has been a key factor in the development of various organizations in the country. Mr. Kuruppu earned his primary degree, BSc in Accounting from the University of Sri Jayewardanepura. He holds a Master's in Financial Economics from the University of Colombo as well as a Master's in Business Administration from the Postgraduate Institute of Management. He is a Fellow Charted Accountant of ICASL. Mr. Kuruppu started his career as a Management Pillar Head-Curriculum Development Project and went on to hold numerous designations over the years. He was the Chairman of a few key organizations in the country including the National Conference Committee, School of Accounting Business, and Annual Report Committee. From 1999 to 2003 he was an Audit Supervisor- at KMPG before moving on to become the Group CFO at First Capital Group. Having worked as the General Manager at MAS Holdings, He is currently working as the Group CFO of David Pieris Group. Taking a break from his busy schedule, Mr. Kuruppu joined us to share his thoughts on how our country could recover from the economic hardships that we are experiencing at the moment.

As a pioneering business personality in the country, what is your personal view on the current economic status in the country?

I think we all know the current situation, where we are today as a country, and how it has unfolded since March 2022. In the context of the current situation, I will take you through a few economic indicators to determine where we are today in terms of inflation. It is about 42% annual average inflation. Basically, from last October to this October, it has been around 66%. We also know that the forecast for GDP is a negative growth as of now, and I think the quarterly figure shows an 8% negative GDP growth. In terms of the financial system and monetary side, the banking system and lending have been curtailed because of the rates. This happens because of the risk-free treasury bill rate and even the last auction was around 29% to 30%. So prime lending rate is around 27% and that is for prime customers. Private sector credit growth has declined. Adding to that we recently observed, some of the policies that the government implemented concerning the budget deficit have also created several issues. If you take a look at the budget for 2023, there are so much of taxes implemented. Last year's budget deficit was around 12% and to arrest the situation, corporate taxes' current level of 24% is raised up to 30%. This is irrespective of whether you are an exporter or a domestic supplier. So, across the board, the majority of businesses will have over 30% of the tax regime. Even personal taxes are going up from 18% to as high as

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> OVERALL, IF I CONCLUDE, I THINK WITH ALL THESE INDICATIONS WE ARE GOING TO HAVE A NEGATIVE AND CONTRACTED ECONOMY WITH A PROLONGED DECREASE IN PRIVATE INVESTMENTS, CONSUMER SPENDING, AND DISPOSABLE INCOMES

30% to 36% levels. These indicators provide a clear image of the economic situation of the country now. When credit is not available or credit is not reachable, the private sector will have less investment, restricting any form of business expansion. It can already be seen that businesses are shrinking, and the demand is decreasing with the tax increases. It will further come down, because the disposable income of customers will also come down, so they will reduce their consumption so overall that contraction will continue. That is precisely why the government is also expecting to have negative GDP growth.

Looking at the foreign reserves and foreign exchange side, one positive remark is that we have been able to maintain the same level of trade exports. Nevertheless, there are some groups in remittances and then we are still struggling to get our at least three months' equivalent and import as a reserve. I think the rule of thumb is for a country to be stable; you need three months equivalent import to be covered with your foreign resources and we have not been able to maintain it over the last 8 to 12 months. So that is the challenge we have at the moment, and it is also the reason why all the import restrictions have also been imposed. Overall, if I conclude, I think with all these indications we are going to have a negative and contracted economy with a prolonged decrease in private investments, consumer spending, and disposable incomes.

You mentioned that there will be a continued decline in private investment. What do you think would be good measurements and different mechanisms that we can implement to improve or rather attract foreign direct investments?

Yes. Some prerequisites are needed for foreign direct investments. For instance, if you look at countries like Vietnam or India, they have so many foreign direct investments. Recently, I came across very interesting information on foreign

direct investment. Let me share it with you. So, this is about actual trade goods exports by Sri Lanka versus Vietnam in 1995. Sri Lanka's exports were 4 billion dollars in 1995, while Vietnam's was 5 billion dollars. In 2020, Sri Lanka recorded 10 billion in exports. What do you think about Vietnam? Vietnam has gone up to 283 billion dollars.

Vietnam achieved this by creating a climate for industrialization and foreign indirect investments to come in. As I mentioned, there are some prerequisites that a country requires to welcome foreign direct investments. Proper infrastructure needs to be there to facilitate the businesses. Countries like India, and Bangladesh are preferred by foreign indirect investments because such countries have a market in the country itself. The country itself has a sizable market, which is another factor that may affect in favor of some of the countries.

In addition, what the investors would look for the most is the cost factor, which includes land cost and labor cost. Sri Lanka as a nation, I think that our labor cost is

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not going to be competitive anymore. Because when lifestyle changes happen such as when countries start moving towards a low income your labor cost also goes up. So, factor cost, if you look at it in terms of labor, may not be working in favor of Sri Lanka. Some countries look for fiscal incentives like tax transition, tax cuts, or extensions. So, as you know, Sri Lanka did it the other way. Though we had the regime of fiscal incentives, it has not led to increasing foreign direct investments. Another factor is that people will look for this business investment climate, in terms of consistency in policies, political stability, general public, and social unrests, and all these will be evaluated.

Further, trade barriers and openness, availability of open trade policy and barriers, tariffs, and non-competitive regulations prevailing in the country are also taken into consideration. In addition to some of these main measures I mentioned, the ease of doing business and according to the World Bank index Sri Lanka is currently ranked in the 99th place, whereas our neighboring country, India with such a large population, has placed itself in the 63rd place. Singapore is in the 2nd, and New Zealand is in the 1st. However, 99th place is around the mid-level out of 180 countries, which is a considerably good placement. So, what makes us difficult is that apart from the factors I mentioned, the business climate is not conducive. Therefore, in terms of ease of doing business, our ranking is not that great. So, we need to see how far

we can do some of these initiatives to increase the convenience of doing business.

In some criteria, we have low marks such as high tax rates, especially in the current context. Further, the banking system also needs to concentrate on different areas. One is getting credit, access to credit and collaterals that they are looking at are sometimes not supportive, but detrimental to the business. All property-related matters such as owning property, transfer of property, and credentials of a property will also have to improve.

Those are some of the areas we need to concentrate on in addition to enforcing the contract, because you know that there are so many delays in the legal system. Sometimes commercial quotes are not sufficient, disputes take months to get resolved. Foreign investors look for these things before they invest in any business. In my view, first we should have some level of political stability and the policy framework in place, and in addition to that operational level ease of doing business is vital. As mentioned, we have been ranked low, and thus need an increase for us to get to the next level of investment, because giving tax holidays alone will not be sufficient. It is only one incentive, because a few others might create higher costs. For instance, if one delays approval or starts a business, and if it takes 2 months for the approval process, then the whole project might not be viable, because you are spending half a year to get the business set up. These things need to be improved if we are to move forward. We have discussed things and we have heard them too, but reforms need to happen very soon. Therefore, for us to increase our foreign direct investments these initiatives need to be done, ideally should have happened yesterday, but at least it needs to happen now.

What do you think we can do to improve our foreign earnings? Because as we know, we do not earn foreign revenues as much as we would like to have. We also have very limited sources of foreign income. What do you think can be done to improve foreign revenue earnings?

Yes, as I mentioned earlier, our trade exports in 1995 were 4 billion and we have been able to double it only after 17 years. So, one area we have to see is how we increase our 10 billion goods trade account related exports increase because currently it is limited to mainly garment sector 5 billion dollars revenue annually, then tea another 1 billion.

Altogether, it is a handful of three to four major agriculture and industries in relation to garment are the key areas in terms of goods that we have contributed to this 10 billion. So, I think, for us to increase it from this level, I do not think the apparel industry alone will be able to support that kind of growth. So, we will have to see how we get the high-end technology-related investments coming into this country, and they set up because we have a well-skilled labor force, so strategize that in a way where those people understand Sri Lanka as a country with the ease of doing business and having high skilled labor so that that's one way to look at it. Similarly, our next growth story is just 2 hours away, that is India. As you know, India is currently the fifth-largest economy in the world. I think as per the growth forecast, they expect to reach third place by 2030. The 3 large economies in the world are going to be the USA, China, and India in another 7 years. At this point, it is a 3.5 trillion USD economy, whereas ours' is around 78-to-80-billion-USD economy, so there is a proximity advantage. There may be businesses that are willing to set up here in Sri Lanka, and serve the Indian market, then set themselves up in India. So, those are the opportunities I think we need to look for to increase our trade account and even get some of the high technology-related products and get them set up here. So, we may be able to offer some concessions, and from here to India. The service sector foreign earnings are also a major contribution. Currently, our IT BPO sector is doing relatively well. Slashcom, the IT BPO sector's policy body, expects the IT BPO sector to contribute around 5 billion USD in 2025. I am certain that the sector will start generating this benefit, as they are already working towards it. However, the government also can provide more facilities in terms of infrastructure, with no disruption in the electric power supply, because those are critical things for industry.

Tourism is another important sector in this regard. As we all know, tourism in the country was badly affected after the 2019 Easter attack and has been continuously declining in later years. However, looking at the current trends, I am sure that we should be able to achieve successful growth. The highest number we have seen so far was in 2018, around 2.3 million tourists came to Sri Lanka, and we generated 4.4 billion USD in that year. As of this year, I think it has been around five hundred thousand tourists, and only 1 billion in revenue. So hopefully, next year we can have 2 to 3 million or more tourist arrivals and reach 4 billion. Then we would have a significant impact on our balance of payment in 2023.

Then we can turn to remittances. I think remittances in 2020 were around 7 billion USD and it was 25 billion USD in 2021 and in 2022, it is expected to be around 3.5 billion USD. So, compared to 2020, it is only 50% remittances this year. We have to look into ways to increase that figure back to 7 billion. That is another inflow, I think we have to get going. Sometimes it may go up even, because there is always talk in the market about brain drain and talent leaving the country. On the one hand, it is a disadvantage to the local economy, because you need that productive talent to continue the local business. On the other hand, if they move out and spend money, it will serve some different positive purposes. Therefore, what I like to highlight is that the majority of migrant workers, according to the foreign bureau around 51%, are unskilled. We need to change that composition, which I think is not a difficult task.

We have around 1.5 million migrant workers and even with the previously mentioned composition,

when you take the average per person, the contribution per month is roughly around $330. The challenge, I think is that we will have to take how to change this composition from unskilled to skilled, and the increase is $330 to $600, for example. When you do that, assuming the same level of people are working, 7 billion automatically goes up to 14 billion.

This is where our greater education, our internal university system needs to come in. How we cater to that world market where there is skill demand is the question that needs to be answered. So, as you know, accountants, nurses, masons, carpenters, and many other skilled professionals are demanded in a lot of European countries, even in New Zealand and Australia, and many other parts of the world. Similarly nurses other skill jobs masons, and carpenters. This is an important strategy we can implement, so we need to work quickly to change and advance our internal education system from A/L itself directing the students towards the demanded subject fields. If we can focus on that, I think within 3 to 5 years this much-needed trend can be established. So, these are some of the strategies and areas that can be developed and implemented to improve foreign revenue earnings.

Who do you think are the key stakeholders that should come forward and play a major role in this rebuilding stage?

Yeah, I think. I would like to name several parties. The first part is political leadership. Because right now Sri Lanka is so divided, and the political ideologies are so engrossed among the public. So, we tend to believe what the party politicians tell us, especially when it comes to more than the middle class, the rural sector from generation to generation they are attached to a party, so that leads to a different scenario, where you don't look at what is right or wrong but solely what the party politician says. Therefore, I think our political leadership needs to come to a consensus and an understanding. For instance, let's say that the current party fails, then the opposition must take over but still, the issues remain without being resolved. Still, they are facing the same issue. Taking a momentarily political advantage and hiding the issue and saying something different will only prolong the issue. So, I think that the first thing is all parties need to get together. For that, civil society also has a role to play as well as professional organizations and other similar responsible agencies.

Everyone needs to push the political parties to say that they do not take mileage out of the situation and criticize everything openly look at it because first, we need to stabilize the country before fulfilling political agendas. If you try to bring in your political ideology and take advantage of the situation it doesn't work in favor of the country. We have seen that happening over and over again, where an individual is in a position, they oppose but once they come into power they do the same thing, then become unpopular, get thrown out and the cycle goes on. People continue to suffer through this, as we already witnessed this in March, April, and May last year. Hence, political leadership needs to understand. They need to come together, and then, genuinely feel for the country keeping the political agenda aside. Having said that I don't know whether our politicians are mature enough, because I don't think the majority are having the intellectual capacity to even understand the real issue, so they may look at it on the surface and try to drive their agendas.

The second point is trade unions. I think there is a very important role

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that they have to play, especially when we are talking about reforms. Reform means changing to the current status, so sometimes it could be privatization. Sometimes it would be a reduction in the number of people, so there will be hard calls that the governments may have to take. The issue is all the time what we have seen is that the trade unions then collide or come together more than national interest, they to safeguard some political party interest, or their job interest so that doesn't work favorably. This again goes back to how the political leadership needs to come in and create that idea for the laborers and trade unions to say this has nothing to do with your jobs, this is about our country and the country's future.

Before even having that negotiation, people come onto the street, that's what we see now. So, I think great unions also will have to work more responsibly and the general public at large has a responsibility. I think there is a certain level of understanding because if you remember, 2 or 3 years ago I don't think you would have been able to adjust cost-based pricing even a five rupee price increase per petrol liter was a talking point at the time. Now you see that adjustment is happening. So, in a way, you can say that the general public has some level of understanding, but politicians should play their role to expand that understanding rather than ruining it and dividing people. So, all the political parties have an equal role to play so the general public and civil society need to be the pressure group that urges the politicians to take necessary actions.

My next question to you is this; in terms of readjusting what do you think of the challenges the private organizations would face? As you mentioned earlier, the Government might have to take hard calls, and I think because of that even the private sector organizations are being forced to take certain difficult decisions. What do the hardships that they would have to face in this process?

I think the private sector is more than willing to take hard calls because sometimes due to the circumstances, they have no choice. For instance, let's say, most SMEs cooperate, and companies have a lever balance sheet, and their main funding source is bank borrowings because they don't have much equity capital. So, at this moment if someone was having working capital funding, I don't think any business can give you a 30% return because when you have 30% cost of borrowing obviously when you have a levered balance sheet, let's say 60-40% debt-equity or 80-20% debt equity, you are having a clear loss. So, for how long you can continue that loss, and how resilient you are is a question. Sometimes these SMEs will be forced to close or downsize. That is the main challenge I think they are going to encounter with the situation and the interest rates are not going to come down quickly. I think we are already seeing that pressure. The banks and the government have to do something urgently to reduce this high interest rate. We will have to do something quickly to reduce that interest rate. I am hopeful that if and when the IMF facility an announcement in January, there'll be some reduction in the rates but until such a time, there is this

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struggle that businesses have to go through.

Then, another key challenge is the retention of talent. Even our group, or any other group at this moment, is facing the situation, as I mentioned before. Skilled and experienced professionals are leaving their jobs and leaving sometimes the country. It is a key issue during this period that most businesses are facing right now. In addition, due to this 42% average inflation, material, and other input costs are rapidly rising. Further, sometimes it is not possible to increase the prices considering the extent of input cost. This erodes the established margins.

Also, as a result of the rapidly growing cost of living, now there will be pressure to increase salaries as well, creating another major challenge for businesses. Moreover, due to some of these tax changes and inflation people are going to have a low, disposable income and they cut down their consumption. When you cut down consumption the demand for production services comes down. It directly affects the corporation. I think this also causes a major challenge to the business.

On top of all this, if the government is also coming up with ad hoc decisions I am sure the remaining business is also in collapse. Let's imagine if suddenly they decide to float the dollar and allow it to go up to 400. That will be the end of it because people get adjusted and now somehow try to be resilient and sail through this period, but another shock will be very difficult to absorb. Businesses will not want to face such situations given the difficulties they are already facing. According to my opinion, these are some of the major challenges the business has in front of them at this point.

As you mentioned, it is a difficult time for businesses and individuals alike. How has your organization attempted to safeguard your employees during this crisis?

The core products of our organization are import-related. If you look at it now, over the last 8, and 9 months, as well as during the pandemic, import businesses have been limited. But even without those businesses not being there we have not reduced any benefit given to the employees. We also offered, I think, one of the highest rewards, like a bonus to our employees based on their performance. We continue to engage our employees in terms of training, and different engagement activities conducted by HR. For example, last week we had training for our employees on managing personal finance. As you know, when you have a disposable income issue, your inflation is high, and you have to borrow. Sometimes you get into different issues. So, how do we avoid such issues? How do we not get into a debt trap? So those are some of the things that we do to protect the interest of our employees by offering a certain level of flexibility. So, we consider those things we are doing to protect and safeguard the employees' interest.

By Tharani Sooriyaarchchi & Jinandi Patabandi