

# Barriers to Micro and Small Enterprises in Sri Lanka

ADVOCATA





2020

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in Sri Lanka

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MARCH 2020

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# Acknowledgements

This project would not have been possible without the gracious support of many people who contributed their time, offered advice and helped in innumerable ways.

In particular we wish to thank Dr. Sarath Rajapatirana, our Academic Chair for his guidance and encouragement. We wish to thank our advisors, both the official and the unofficial, for their time, guidance and encouragement. We are truly indebted to their kind voluntary contributions.

# Foreword

This study fills an important gap in our knowledge with respect to micro and small enterprises in Sri Lanka. Its value lies in three areas. These are; to establish the nature and structure of micro and small enterprises in Sri Lanka, identify the barriers these enterprises face, particularly with respect to the legal and regulatory environment of the country, and to provide a practical guide to creating an enabling environment for them.

The context of the analysis is equally important because of the potential contribution of these enterprises to increasing national output, creating opportunities for employment and increasing economic mobility which in turn will help reduce regional disparities in income and remedy disparities within regions.

The study has zeroed in on the main barriers to the establishment and operation of these enterprises. These are; access to finance, finding places and space within them and skilled labour. Among the main barriers, regulatory processes are prominent. A country-wide survey done for the study documents

the barriers for registration for sole proprietorships and partnerships. Following the 13th Amendment to the Constitution, there are at least nine different regulatory requirements within a province and different processes among different zones in the same province.

The comparison of Sri Lanka's practices with those of Hong Kong and New Zealand, two countries that have higher rankings for economic freedom in the world and also have best practices for registration of enterprises is used to guide the reform recommendations. Sri Lanka can also follow similar practices. They include; providing better access (with trilingual forms), avoiding excessive documentation, adopting a single approval process and providing an online portal for registration. These are achievable goals to create room for success that these enterprises deserve.

**Sarath Rajapatirana Ph.D,**  
Chair Academic Programme,  
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# Executive Summary

Definitions of what constitutes a Micro and Small Enterprise (MSE), vary from country to country. In Sri Lanka the Department of Census and Statistics categorises micro and small businesses by employment numbers, with slight variations between economic sectors. With regard to the registration status in Sri Lanka, Sole Proprietorships are the most common form of registration, accounting for a little over 60% of all firms. In terms of employment and economic contribution, micro and small firms remain significant, although medium and large companies are the biggest contributors. This composition of industry is typical of countries in the low to lower-middle income category. Although Sri Lanka has graduated to upper-middle income status, our composition of firms does not reflect this shift.

A bird's eye view of Sri Lanka's micro and small enterprise landscape as provided through the survey conducted, indicates that access to finance remains a critical problem for these entrepreneurs; limiting their potential to reach the next level. A driving factor behind business registration is to have better access to finance. In addition, finding appropriate space, skilled labour, raw materials and low sales remain common challenges faced by these enterprises. Further, there is a high preference to register businesses as sole proprietors due to cost and tax related issues. Despite the overall lack of interest shown by these enterprises for registration of their business, they seem to be somewhat satisfied with the levels of service provided by Government institutions.

Those who refrained from registering their businesses in order to become a formal business entity seem to have done so mainly due to the entrepreneurs' lack of awareness of procedures, complexity of procedures as well as to avoid taxation. This is an indication of the necessity to have better access to information at the Divisional Secretariat offices; or assistance provided to help these individuals register their businesses. In this respect, improving the registration process remains crucial.

Although the registration process for companies in Sri Lanka has been reformed and streamlined to a one-day online process, the complexities within the process discourage many from obtaining registration. The registration process for companies in Sri Lanka, which is governed by the Companies Act No 07 of 2007 has been reformed and streamlined to a one day online process. However, as the registration of sole proprietors and partnerships are governed by the Business Names Ordinance No. 06 of 1918, this reform could not be extended to include these businesses.

This report expands on this issue in some detail, and recommends that the registration process for sole proprietorships and partnerships is reformed to align with the ease and convenience of company registration in Sri Lanka.





# Introduction

Successive governments have placed a significant amount of emphasis on small and medium enterprises (SMEs), contemplating their critical role in the economic development of a country. As a result, there have been numerous initiatives, schemes and projects aimed at the betterment of this sector which is a driving force of economic growth, employment generation, social cohesion and development. However, in this milieu, the focus on micro enterprises has been limited. While the Department of Census and Statistics has a clear definition for what constitutes a micro enterprise, in policy conversations the category of micro is often either completely excluded or incorporated within the definition of 'small' enterprises.

In this backdrop, Advocata Institute has attempted to understand the landscape of micro and small enterprises in Sri Lanka through two perspectives; carrying out an international comparison of MSEs through desk research and conducting a survey research study to fill the existing information gap relating to micro-small enterprises. The overall objective of this investigation is to gain significant knowledge of the current situation of the SME sector thereby providing practical recommendations in creating an enabling environment for the MSEs in Sri Lanka to thrive.



# Overview of Micro and Small Enterprises

The Organization for Economic Co-operation and Development (OECD) recognises the variance in defining micro, small and medium enterprises, and for statistical purposes have referred to SMEs as firms employing up to 249 persons, with a breakdown of micro enterprises as entities that engage 1-9 persons, small enterprises as entities that engage 10-49 persons, and medium enterprises as entities that engage 50-249 persons. In this OECD definitional framework, the acronym 'SME' is a catchall phrase that includes micro, small and medium enterprises.<sup>1</sup>

In OECD countries, SMEs play a large role in the economy. These forms of business account for an estimated 99% of all enterprises, and are a source of an average of 70% of employment. The OECD estimated that SMEs contribute up to 50-60% of total value addition in these economies. In emerging economies, SME contributions have reduced to an estimated 45% of total employment and 33% of GDP. While these are not paltry figures, it is a drop when compared to the numbers for OECD countries.<sup>2</sup>

While these numbers are impressive, an important caveat is that the OECD definition of SMEs includes medium sized enterprises and that the scale, productivity and value addition of a firm that is able to employ between 50-149 individuals is considerably more significant than firms that are only able to employ a maximum of 9 individuals.

These findings are corroborated by the International Organisation for Labour (ILO), which finds that globally self-employed and micro and small enterprises, which they refer to as 'small economic units' account for the largest share of employment, with over an estimated two-thirds of total employment created by these small economic units.

A trend they identify is that as country income levels rise, the share of employment created by micro and small enterprises decreases. Breaking this down further, self-employment accounts for 54% of total employment share in low-income countries, while in high-income countries this share drops to 11%. This trend is replicated for micro enterprises, with the share for low and lower-middle income countries being much larger than the share of employment created in upper-middle and high-income countries.<sup>3</sup>

Regionally, self-employment and micro enterprises are the largest source of employment in South Asia, the Middle East and North Africa. In South Asia, they contribute over 80% of total employment, and for the Middle East and North Africa numbers come close to 70%. Micro enterprise contribution to employment is less significant in East Asia and the Pacific where medium and large enterprises account for 46% of total employment, and in Europe and Central Asia, where they account for 43% of total employment.<sup>4</sup>

## Engines of innovation and economic mobility?

In recent decades SMEs have moved beyond being the shop on the roadside. The OECD notes that new, small firms are often times the change-makers, it is these firms that are able to think far outside the box, and introduce 'radical innovations' that often stimulate the economy and spur growth. A key factor for this ability is in their size. These firms are not encumbered by the hierarchical and organizational structures and processes that larger firms may succumb to. This ability is also supplemented by changes in the nature and pace of work. The OECD finds that innovation in SMEs is driven by knowledge spillovers, access to networks and opportunity to

<sup>1</sup> The Organisation for Economic Co-operation and Development, "Enhancing the Contributions of SMEs in a Global and Digitalised Economy," <https://www.oecd.org/industry/C-MIN-2017-8-EN.pdf>, (accessed February 5, 2020).

<sup>2</sup> Ibid

<sup>3</sup> International Labour Organisation, "Small Matters: Global evidence on the contribution to employment by the self-employed, micro-enterprises and SMEs," 2019. Geneva: International Labour Office, [https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms\\_723282.pdf](https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_723282.pdf), (accessed February 14, 2020).

<sup>4</sup> International Labour Organisation, "Small Matters: Global evidence on the contribution to employment by the self-employed, micro-enterprises and SMEs," 2019. Geneva: International Labour Office, [https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms\\_723282.pdf](https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_723282.pdf), (accessed February 14, 2020).



partner with other larger players in the economy.

As highlighted above, SMEs are an important part of the economy when looking at their contribution to job creation and employment. The impact of this spreads far beyond the boosting of national statistics; they are a vital part of poverty alleviation and economic empowerment, as they provide gainful employment opportunities to segments of the population that may be left out, or those that struggle to find work in more established, formal entities. The OECD finds that SME contribution to job creation and value addition plays a role in economic inclusion and poverty alleviation across the board, with the greatest impact being felt in low-income and emerging economies.<sup>5</sup>

### Overview of the Sri Lankan landscape

As is the case internationally, defining and capturing micro and small enterprises proved to be a challenge in Sri Lanka. The listing operation of Economic Census conducted in 2013/2014 has provided a substantial criterion for defining MSMEs that can be acceptable to all agencies. This listing defined turnover, value of assets and number of employees as key variables to distinguish SMEs.<sup>6</sup>

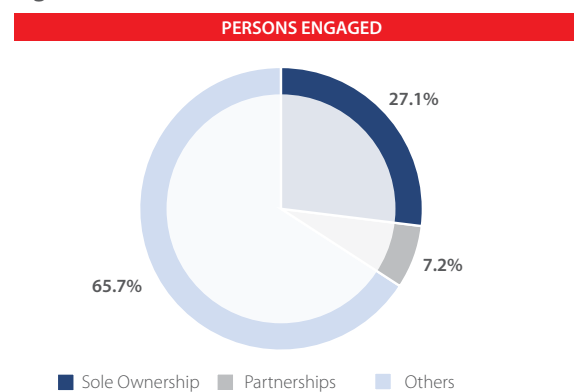
According to the listing operation, the number of SMEs in Sri Lanka, most of which are categorised as sole ownerships, accounts for 1,019,681 of which 71,126 are small enterprises and 10,405 are medium scale enterprises. These enterprises comprised of employees, self-employed persons, employers, active partners and unpaid family workers who engage in economic activity. At the time of the listing operation, there were 3 million people who engaged in SMEs related to industry, trade and services sectors of the

country.<sup>7</sup>

Although business registration is in existence at the Divisional Secretariat in the country, 45% of the micro enterprises and 10% of the small enterprises remain unregistered enterprises. Overall in Sri Lanka, 42% of the business establishments remain unregistered entities. Moreover, 25% of the establishments are run by women entrepreneurs or decision makers and this percentage is significantly higher amongst the rural sector (35%) than the urban sector (28%).<sup>8</sup>

When comparing the landscape of Sri Lankan micro and small enterprises with that of South Asia, and our comparator upper middle income countries, some overlap can be seen. While in South Asia self-employed and micro enterprises account for over 80% of total employment, this is not the case in Sri Lanka. While sole ownership is a sizable component of employment, accounting for 27.1%, larger companies are clearly the most significant source of employment numbers, as illustrated below.

Figure 1



Source: Department of Census and Statistics, Annual Survey of Industries (2018)

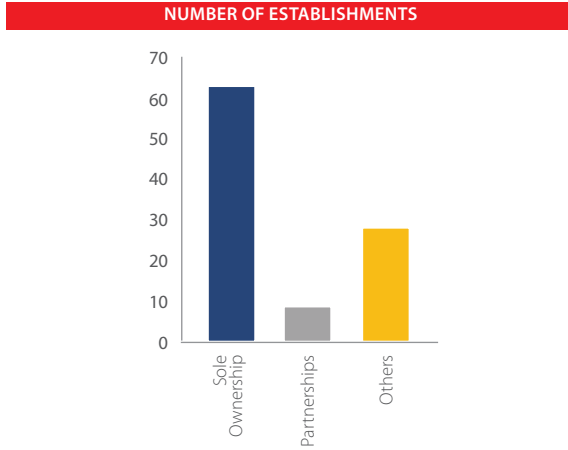
<sup>5</sup> The Organisation for Economic Co-operation and Development, "Enhancing the Contributions of SMEs in a Global and Digitalised Economy," <https://www.oecd.org/industry/C-MIN-2017-8-EN.pdf>, (accessed February 5, 2020).

<sup>6</sup> Government of Sri Lanka, Department of Census and Statistics, "Non-Agricultural Economic Activities in Sri Lanka Economic Census 2013/2014," <http://www.statistics.gov.lk/Economic/Non%20agri.pdf>, (accessed March 2, 2020).

<sup>7</sup> Ibid

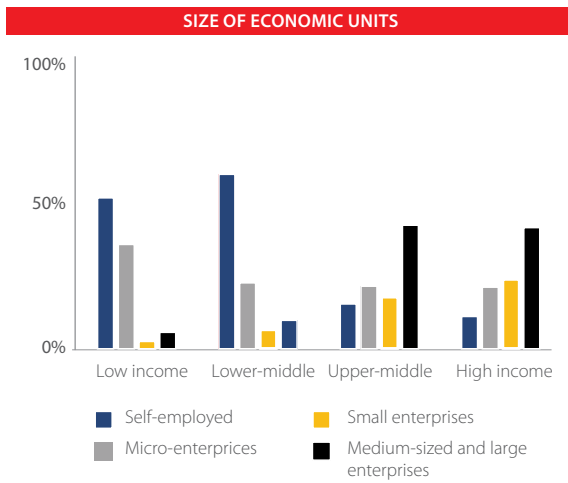
<sup>8</sup> Ibid

Figure 2



Source: Department of Census and Statistics, Annual Survey of Industries (2018)

Figure 3



Source: International Labour Organisation, Small Matters, (2019)

The disparity continues when looking at the spread of enterprises in Sri Lanka. Micro and small enterprises in the upper middle income bracket have transitioned from having a majority of enterprises in the self-employed category to a drop in self-employment and a rise in medium sized and large enterprises. Sri Lanka however, is yet to witness this shift.





# Findings of the Survey

## Background to the Survey

As a component of this project, an island wide survey was conducted between the period from 15th September to 20th October 2019 covering a total sample of 1511 respondents (micro and small entrepreneurs) in the nine provinces. Of the total sample, 1319 comprise of micro entrepreneurs while 186 comprise of small entrepreneurs.<sup>9</sup>

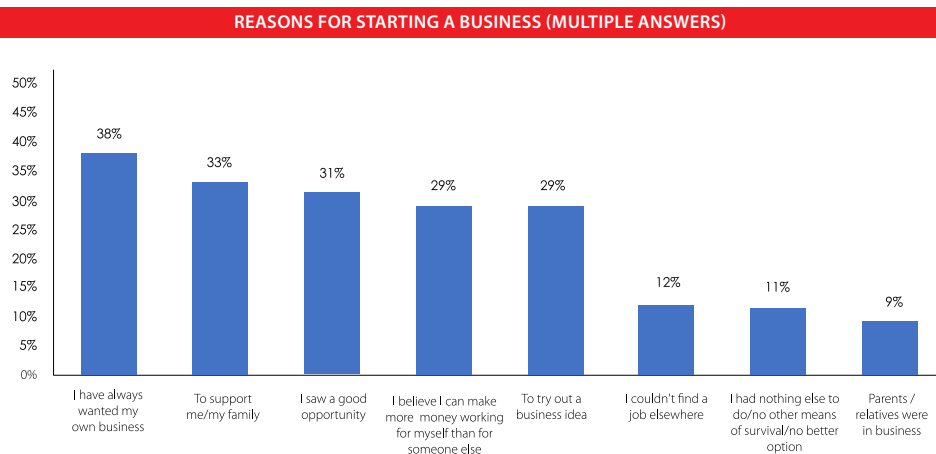
## Nature of Micro and Small Enterprises covered in the Study

A large percentage of the micro and small enterprises within the sample claim to have been in the business for less than 10 years, indicating their novelty to the market and almost all these MSEs tend to exist as sole proprietorships. While over 80% of the micro enterprises engage 1-2 employees, most of the small

enterprises engage 5-7 employees or more. However, despite the number of employees engaged in the business, most of these businesses operate from home (micro – 42%, small – 48%). A considerable 40% of the micro enterprises covered through the survey operate in public spaces including on the streets, and also carry out door-to-door-operations.

The necessity to be in charge of their own career and destiny, support their family, belief that this type of self-start up enterprise provides better opportunity for income generation compared to paid employment, and enthusiasm to try out a new business idea have motivated most of these micro and small entrepreneurs to venture out on their own. This eagerness is considerably high amongst the micro level, male, individual entrepreneurs who seem to perceive themselves as aspirational entrepreneurs.

Figure 4



## Study Objectives

In this context, the survey focuses on achieving the following key objectives;

- To establish the nature/ structure of the micro enterprises in Sri Lanka and understand the current legal and regulatory practices followed.
- To understand the level of awareness, consideration and intention to follow legal and regulatory practices.
- To understand the restrictive legal and regulatory environment in Sri Lanka, which hinders the earning of a livelihood through entrepreneurship for poorer sections of society.
- Profile segments of micro enterprises and design a practical approach for creating an enabling legal and regulatory environment for micro enterprises in Sri Lanka.

<sup>9</sup> For more details on sampling refer Annex – Research Methodology and Sampling

### Challenges to Micro-Small enterprises

According to the survey, micro- small enterprises are faced with several challenges when running their business. The top of mind perception of the respondents indicates that issues such as sourcing finance, finding space to run the business and low sales of their product or service are the main

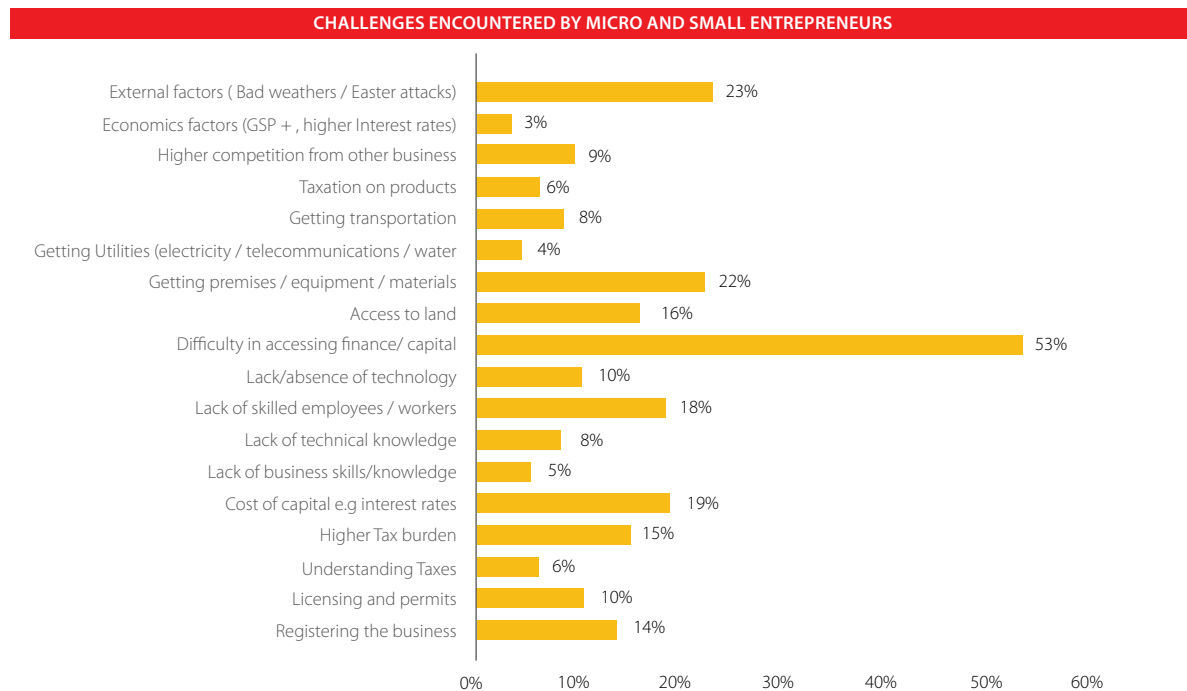
difficulties faced by this sector. A considerable 42% of the respondents state that obtaining finance for such business is a significant challenge while 10% respectively state that low sales of product/service and finding adequate space to run a business are critical challenges curtailing the progression of micro-small enterprises. In addition, the respondents also raise marginal factors such as higher competition, sourcing appropriate raw material and issues relating to registering a business as matters affecting the operations of micro-small enterprises sector.

Table 1

Problem faced	Percentage (%)
Sourcing Finance	42%
Low/dull Sales	10%
Finding place/space issues	10%
Higher competition	6%
Sourcing raw material	6%
Registering/licencing procedure	5%
Bad weather condition	3%
Do not have a problem	10%

Nevertheless, when asked about the respondent’s opinion in relation to their own business, slightly over 50% stated that accessing finance or capital is the key hindrance to their further expansion. A considerable number of entrepreneurs are also faced with difficulties relating to finding a proper premise, equipment, material, as well as skilled employees. Provided the time period in which the survey was conducted, people also felt that external factors such as bad weather conditions during the time and the Easter attacks also affected their enterprises.

Figure 5



### Lack of Finance

Absence of adequate capital remains a serious challenge for these enterprises despite the need for additional funding to sustain their growth and expansion. A significant 53% of the entrepreneurs state that they have faced difficulty in accessing finance needed for their businesses. This percentage is somewhat high amongst the micro entrepreneurs (54%) compared to the small entrepreneurs (46%).

One of the key factors that prevent them from accessing finance is their underlying fear of taking collateral based loans. The high interest rates and other hidden charges when obtaining a loan, as well as time consuming documentation processes have discouraged them from applying for credit.

**“It’s better to manage with the money that I have instead of taking a loan. I don’t want to take a risk by investing everything that I have by taking bank loans.”**

However, interestingly, most of the respondent’s fear is based on hearing stories of other businesses going bankrupt or auctioning properties due to non-payment of loans rather than their actual experience of such situations. This fear factor has persuaded them to maintain their business as it is (at micro level) without taking the risk of expansion to the next level (small business) through borrowed money and running the danger of losing everything if they are unable to repay.

### Absence of skilled labour and difficulty in finding premises

Finding premises for the enterprise (22%) and lack of skilled workers (18%) also remain two of the leading resource related barriers to the expansion of micro-small enterprises.

**“They work here for two to three months and then move to another place. I can only expand if I get a trustworthy person who is good in business and will not cheat me.”**

While finding skilled workforce have been difficult, those who are willing to work also demand high salaries leaving entrepreneurs to depend only on their own strength and skill in sustaining their enterprise. This situation poses a greater challenge to small entrepreneurs (37%) compared to micro entrepreneurs (16%). Further, despite the nature of the enterprise, it has also become a challenge to find a trustworthy workforce who is capable of handling responsibilities. These hindrances have led the micro-small enterprises to be run by the proprietors themselves, leaving limited time and space for additional expansion of their businesses. In fact, ‘better to do everything by myself’ has become the common norm among micro-small entrepreneurs.

Similarly, finding appropriate space to run the business for a reasonable rental cost is another critical problem faced by these entrepreneurs. There seems to be a persistent struggle amongst these

**“If I want to expand my business then I need to relocate to a suitable place. The rents are at Rs 30,000, 35,000, 40,000.”**

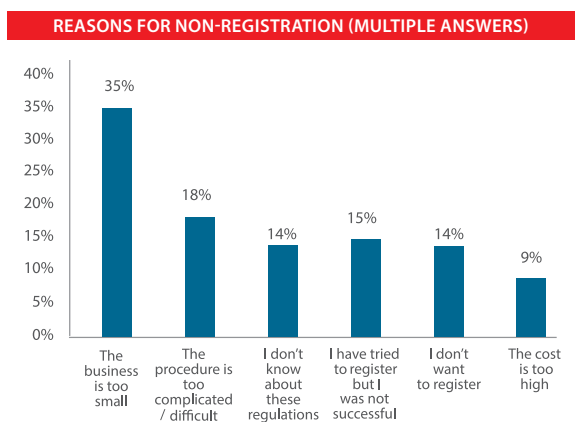
entrepreneurs to earn sufficiently to meet high rental costs. Hence, they seem reluctant to take the next step of expansion considering that they require increased space which eventually leads to even higher rental costs. In this backdrop, entrepreneurs show a preference to managing their business from their own residence or from a known person’s place due to the flexibility of operations and financial viability.

### Barriers to registration/licensing of MSEs

#### Reasons for non-registration

Of the total sample, nearly 2/3rd of the enterprises are registered (67%) while others have avoided registrations (33%) due to complex procedures, their lack of awareness of such procedures and due to the smaller size of their business.

Figure 6



Of the unregistered micro enterprises, 34% have attempted to register their business while the majority (65%) either did not attempt to register or were not interested in registering. Of the unregistered small enterprises, 31% have tried registering the business while the majority (69%) either did not attempt to register or were not interested in registering. Registration is higher amongst the males (73%) compared to females (54%). Further, a large majority (over 90%) of the micro and small enterprises are willing to register as a sole proprietorship business.

The common reason for non-registration is the requirement of a rent agreement. Some respondents have obtained information and documentation from their local government authorities such as the Divisional Secretariat, Municipal Council or the Grama Niladhari and have stopped the process at that point onwards, even after having prepared the necessary documentation. However, they do not provide a substantial reason as to why they have not proceeded from that point onwards.

Of those who are registered, a little less than half of the respondents (47%) are satisfied with business registration.

### Level of awareness of documentation

The level of awareness amongst the respondents in relation to the specific documentation required for business registrations is at a moderate level. Over 60% of the respondents were aware of the requirement of a name registration certificate (65%) and the Grama Niladhari approval (61%) for registration of their businesses. However, only less than half (48%) of the respondents were aware of the requirement of a rent agreement of the premises for their business registration.

When inquired about the specific licenses needed for specific enterprises (example such as "Trade License" for trading businesses), awareness is comparatively high amongst the small entrepreneurs (48%) compared to micro entrepreneurs (39%).

Figure 7

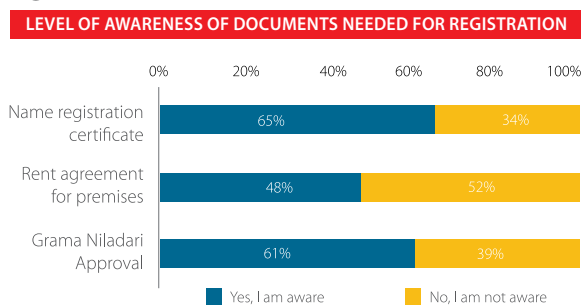


Figure 8

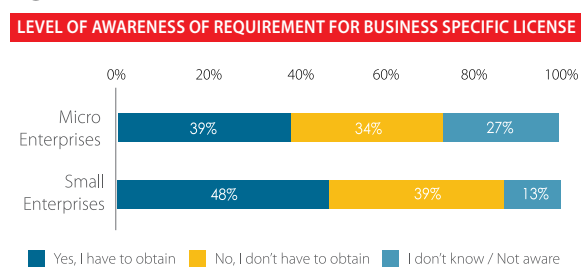
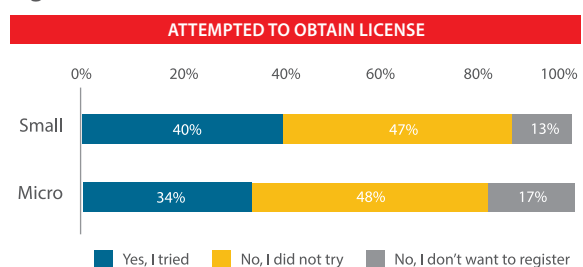


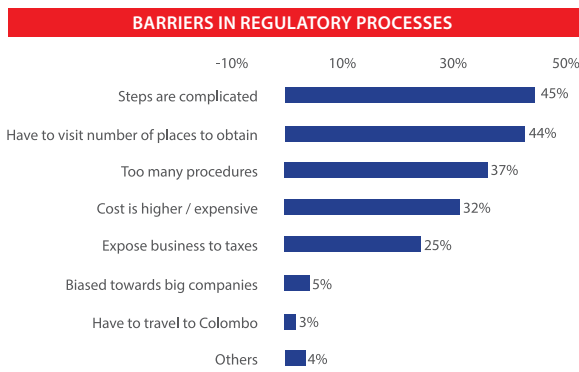
Figure 9



### Regulatory barriers to MSEs

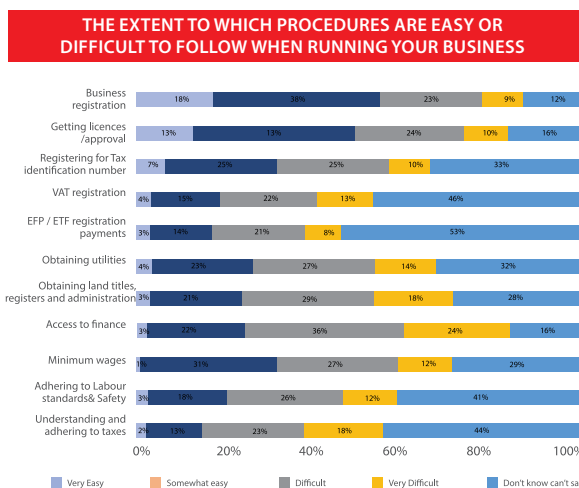
The respondents were asked to name three barriers/challenges they face on the regulatory front when running their business. Most of the respondents highlighted issues such as complicated procedures, presence of too many steps, having to pay multiple visits to a government officer or in some instances having to visit a number of Government offices to obtain business registration as a key hindrance to running their business.

Figure 10



Furthermore, the respondents were provided with a list of procedures that needed to be followed when running a business and were asked whether these processes were easy or difficult to follow. Apart from obtaining licenses/approval & business registration, most of the procedures were considered complicated by the respondents.

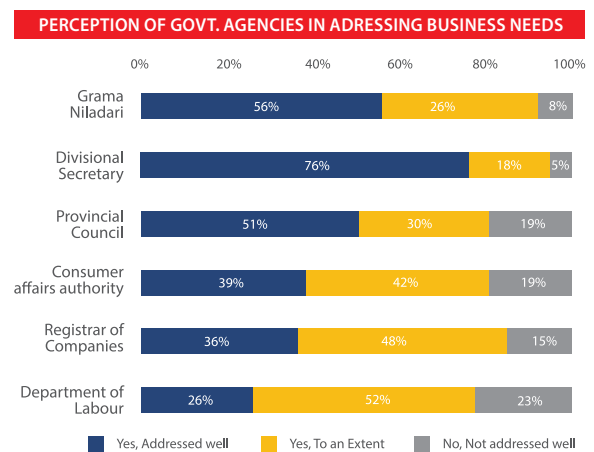
Figure 11



A majority of the respondents consider the Grama Niladari (86%) and the Divisional Secretariat (81%) as the most relevant government institutions for micro-small enterprises and perceive these two institutions to be effective touch points to better serve this sector.

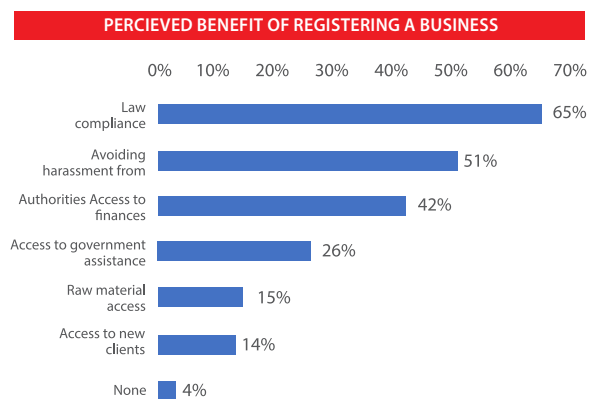
Of those who approached government institutions to address their business concern, a majority were satisfied with the level of service received by various government institutions.

Figure 12



Compliance with law (65%) and avoiding harassment from authorities (51%) are perceived benefits of registering/ obtaining a business license. In addition, access to finance (42%) is also a driving factor for businesses to register. There is also a high preference (over 90%) amongst the respondents towards being a sole proprietor due to costs and tax related procedures.

Figure 13



### Summarising the survey findings

- ▶ Micro-small entrepreneurs largely operate from their homes.
- ▶ Lack of access to finance limits this sector's potential to reach the next level.
- ▶ Sourcing finance, raw materials and low sales were the top-most common problems faced by these enterprises. Lack of access to finance is a serious concern particularly when businesses require additional capital to support expansion and growth. However, an underlying fear persists in terms of taking collateral based loans due to past experiences/observations.
- ▶ Labour shortages and finding space also remain common issues. Entrepreneurs in this sector are faced with the challenge of finding skilled a workforce who is capable of handling responsibilities. Even those who are willing to work demand high salaries.
- ▶ This sector seems to deliberately avoid registration required to become a formal business entity due to its lack of awareness of procedures, complexity of procedures and to avoid tax payment. There is a low level of registration amongst the females.
- ▶ Access to finance is the driving force to register businesses. In addition, compliance with law and avoiding harassment from authorities are the perceived benefits of registering/licensing business.
- ▶ There is a high preference to operate the businesses as a sole proprietorship due to costs and tax related issues.
- ▶ Most of the businesses are satisfied with the levels of service provided by Government institutions.
- ▶ The survey sample reported moderate performance in the last two years. However, issues such as higher competition, lack of government support and Easter attacks were considered as reasons contributing to the low performance of these enterprises.











# The Issue of Business Registration

The survey findings highlight that registration does not present itself as a major barrier to micro-small enterprises. As per the survey finding 67% of respondents stated that they had registered their business. The rate of registration did not fluctuate drastically between micro and small enterprises, remaining at 66% and 76% respectively.

When considering the 33% who had not registered their business, the most common answer provided by them as the reason for non-registration was that the business was too small and is still at the primary stage. Besides, complicated procedures, lack of knowledge of registration, an unsuccessful attempt to register the business and the costs associated with it have discouraged them from registering their business.

Among the unregistered businesses, only around 1/3 had tried to register their business at any given point. The survey results indicate that this group of individuals may not necessarily have prohibitive barriers that prevent them from registering their business, as they have rarely gone beyond getting information from a Municipal council or Divisional Secretariat, preparing documents halfway, simply asking friends about the process or checking the website. This is an indication of the necessity to have better access to information at the Divisional Secretariat offices; or assistance provided to help these individuals register their businesses. However, their lack of interest can also be a reason for not obtaining business registration at any point.

## What is the registration process at present?

The registration of sole proprietorships and partnerships is governed by the Business Names Ordinance No 06 of 1918, while the incorporation of companies is governed by the Companies Act No 07 of 2007. According to the survey, 97% of micro businesses and 85% of small businesses have registered their business as sole proprietorships, with only 3% of the businesses surveyed having registered themselves as a partnership, and 2% registering themselves as a Private Limited Company. Hence, it is evident that micro and small entrepreneurs have a clear preference towards registering their businesses as sole proprietorships.

List 1, Schedule 9 of the 13th Amendment to the Constitution,<sup>10</sup> devolved power to register business names to the Provincial Councils. Accordingly, each Provincial Council can enact their own statutes on the subject enabling each Province to decide the registration process for sole proprietorships and partnerships. The process of registration is implemented by the Divisional Secretariats. At best, the country currently has nine different regulatory processes for the registration of sole proprietors and partnerships. Looking at the case of the Western Province alone, the registration process for businesses in the area of Colombo 1-15 is different to the registration process for businesses in the rest of the province. Hence, it is evident that the reality of obtaining registration for an enterprise appears to be far more convoluted.

The process of registration is as follows:<sup>11</sup>

1. Visit the Divisional Secretariat and collect form and instructions
2. Fill out the application
3. Provide documentation
  - i. Proof of ownership of business premises
    - a. Original Deed and notarised copy or
    - b. Original Rent agreement and notarised copy, or
    - c. No Objection letter from the owner of the premises
  - ii. NIC copy
  - iii. Tax assessment notification for the premises
  - iv. Copy of the partnership business agreement
4. Visit the Grama Niladari and get the application and attached documents approved
5. Receive additional approvals depending on the business type eg: PHI approval
6. Hand over completed application to the Divisional Secretariat.

As illustrated on the preceding page, and detailed above, the process of registering a sole proprietorship or a partnership in Sri Lanka is a time consuming, complicated task. A majority of provinces do not have the application for business registration or the instructions sheet available for download from the Divisional Secretariat or Provincial Council website, and the instruction from is not always available in all three languages. The complexity of registration is heightened by the fact that the country does not have a uniform registration process, and instead there is variation across provinces and districts.

<sup>10</sup> The Government of Sri Lanka, 13th Amendment to the Constitution of Sri Lanka, 1987.

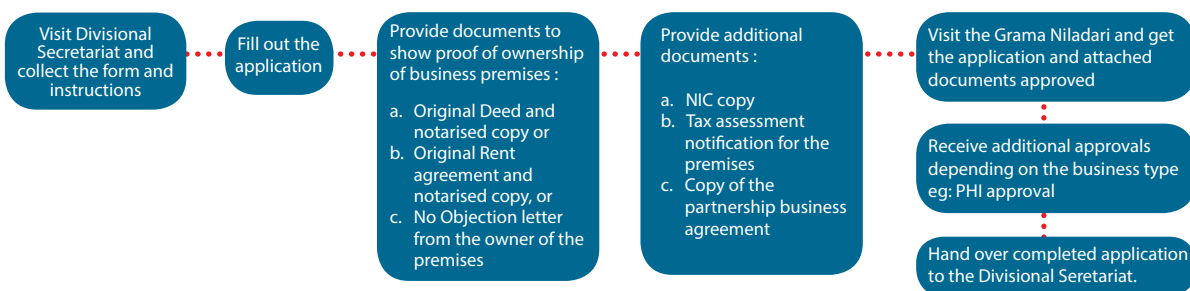
<sup>11</sup>

### Can this process be simplified?

At present, an entrepreneur looking to register their business as a sole proprietorship or a partnership in Sri Lanka must follow a complicated series of procedures in addition to producing several documents. They are further hampered by the fact that the process of registration varies across the island and there is also absence of a uniform process even within a province.

At a global level, registration of a sole proprietorship is a simple procedure. For instance, Hong Kong and New Zealand are two of the world's most economically free countries and the task of registering a business as a sole proprietorship is easily completed within a day.

#### Registration process for Sole Proprietors and Partnerships in Sri Lanka<sup>12</sup>



#### Process of registering a Sole Proprietorship in Hong Kong<sup>13</sup>



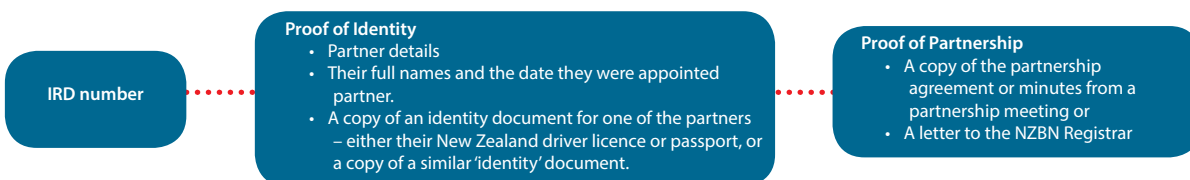
#### Process of registering a Partnership in Hong Kong<sup>14</sup>



#### Process for an optional Business Registration Number for Sole Proprietors in New Zealand<sup>15</sup>



#### Process for an optional Business Registration Number for Partnerships in New Zealand<sup>16</sup>



<sup>12</sup> Government of Sri Lanka, "Instructions related to individual and partnership business names", Provincial Department of Business Names Registration Sri Lanka, [http://bnr.wp.gov.lk/sin/?page\\_id=714](http://bnr.wp.gov.lk/sin/?page_id=714), (accessed February 12, 2020).

<sup>13</sup> The Government of Hong Kong Special Administrative Region, Inland Revenue Department, "Business Required to be Registered and Application for Business Registration", Inland Revenue Department, [https://www.ird.gov.hk/eng/tax/bre\\_abr.htm#a3](https://www.ird.gov.hk/eng/tax/bre_abr.htm#a3), (Accessed March 2, 2020).

<sup>14</sup> Government of Hong Kong Special Administrative Region, Inland Revenue Department, "Business Required to be Registered and Application for Business Registration", Inland Revenue Department, [https://www.ird.gov.hk/eng/tax/bre\\_abr.htm#a3](https://www.ird.gov.hk/eng/tax/bre_abr.htm#a3), (Accessed March 2, 2020).

<sup>15</sup> Government of New Zealand, "Get your NZBN", More business, less work: New Zealand Business Number, [https://www.nzbn.govt.nz/get-an-nzbn/get-your-nzbn?utm\\_source=business.govt&utm\\_medium=website&utm\\_campaign=get%20an%20nzbn&utm\\_content=become%20sole%20trader](https://www.nzbn.govt.nz/get-an-nzbn/get-your-nzbn?utm_source=business.govt&utm_medium=website&utm_campaign=get%20an%20nzbn&utm_content=become%20sole%20trader), (Accessed February 15, 2020).

<sup>16</sup> Ibid

At present, an entrepreneur looking to register their business as a sole proprietorship or a partnership in Sri Lanka must follow a complicated series of procedures in addition to producing several documents. They are further hampered by the fact that the process of registration varies across the island and there is also absence of a uniform process even within a province.

When registering a business as a sole proprietorship in New Zealand, there is no legal process or registration process that an individual must follow and the process is only limited to ensuring that they have met the following requirements<sup>17</sup>

- A personal IRD number for paying income tax and GST
- Government Licenses and Permits your business needs
- Qualifications or registrations for your trade or profession

If they so wish, a business can register for a New Zealand Business Number which is a unique identifier that helps speed up engagements with the government, suppliers and customers. In order to register for a New Zealand Business Number, applicants must complete an online application. The steps for which are detailed in the process chart above.

Individuals starting a partnership in New Zealand must inform the Inland Revenue Department and create an IRD number for the partnership. However, signing a partnership agreement and registering for a New Zealand Business Number is optional. If the partnership wishes to register for a business number, they must complete an online application. The steps for which are detailed in the process chart above.

In the case of Hong Kong there is only a requirement to fill out a form, provide an identification copy and pay the fees and levies. Registration can either be completed online, submitted in person at the Business Registration Office, or posted to the office.<sup>18</sup>

This clearly shows that International best practice for registering a sole proprietorship or a partnership is simple and uncomplicated.

<sup>17</sup> Government of New Zealand, Ministry of Business, Innovation & Employment, "Becoming a sole trader", <https://www.business.govt.nz/getting-started/choosing-the-right-business-structure/becoming-a-sole-trader/>, (Accessed February 19, 2020).

<sup>18</sup> The Government of Hong Kong Special Administrative Region, Inland Revenue Department, "Business Required to be Registered and Application for Business Registration", Inland Revenue Department, [https://www.ird.gov.hk/eng/tax/bre\\_abr.htm#a3](https://www.ird.gov.hk/eng/tax/bre_abr.htm#a3), (Accessed March 2, 2020).

# Reform Recommendations

Considering the above, it is evident that the registration process for registering a sole proprietorship or a partnership in Sri Lanka is unreasonably complicated even though the country has the capacity and the expertise to implement reforms in the registration process. In 2018 Sri Lanka successfully transitioned from a manual paper-based system of company registration to an electronic registration process. The e-RoC system, launched by the Registrar of Companies has streamlined the process of registering a company, bringing the total time required for registration down from 4 days to 1 day. The entire registration process is completed online, and the applicant has to,

1. Complete the requisite forms
2. Submit in Articles Of Association
3. Give public notice of incorporation

However, the documentation required to register a sole proprietorship or a partnership in Sri Lanka is far greater than the documentation required to register a company; if a company registration process does not call for the original deed and a notarised copy of the deed - why is it a requirement for a sole proprietorship or partnership?

The reform process for the registration of sole proprietorships and partnerships will be more challenging than the process of streamlining registration of companies. As the registration of these entities has been devolved to the Provincial Councils, and there is an absence of a single registration system, the first step should be to unify and simplify registration across the island. The final objective of reform would be to bring the registration process of sole proprietorships and partnerships in line with the registration process for companies in Sri Lanka.

## Recommendations for reform

### 1. Simplify the registration process and bring it in line with the process for company registration.

1. Allow individuals to download the application from the Divisional Secretariat website, along with the instructions for registration.
2. Remove the requirement for proof of ownership, Grama Niladari approval, and additional documentation.
3. Remove the requirement of signatures from the Divisional Secretariat.

### 2. Ensure trilingual access

1. Application forms and instructions should be provided in all three languages, both at the Divisional Secretariat and online.

### 3. Introduce an online registration process

1. Allow for online registration, where applicants can submit the forms online through the Divisional Secretariat websites, while keeping the option of submitting an application in person at the Divisional Secretariat.

# Annex

## Research Methodology & Sampling

A combination of quantitative and qualitative methods was adopted in gathering information for the survey. Hence, an island wide survey was conducted amongst a nationally representative sample of 1511 respondents, following which, 7 in-depth interviews were conducted to supplement the quantitative information. The data gathering for the survey was carried out between the period of 15th September to 20th October in 2019.

### Research Approach

In establishing a nationally representative sample, the Grama Niladari (GN) division/s were randomly selected through a software as sample points in each District. Afterwards, 10 interviews were carried out in each sample point by searching for micro and small enterprises located in that area. In the event the selected GN sample point does not have an adequate number of micro and small enterprises, interviewers were advised to expand their search to the adjoining GN sample point. Similar to the selection process of the first sample point, expanding the survey to the next GN division was also considered randomly.

### Profile of the Survey Sample

Of the total sample, 69% include male respondents while 31% include female respondents. The respondents between the ages of 18 years and above were considered for the study, and hence, 76% of the respondents were between the ages of 18-60 years.

### Selection of Respondent

The owner or the key decision maker of micro and small enterprises (formal or informal), who has the authority or knowledge to talk on behalf of the business was approached for the survey. When selecting the respondents, the research team focused specifically on those engaged in industry, trade and services sectors.

### Administering the Survey

A structured questionnaire was administered through face-to-face interviews with the selected respondents of micro and small enterprises. An interview spanned over an average duration of 10-12 minutes and was conducted in both Sinhala and Tamil languages.

## Questionnaire Development

The questionnaire for the survey was developed by Advocata Institute in collaboration with Sparkwinn research team. Upon finalisation of the research instruments, the questionnaires were translated into Sinhala and Tamil languages. After which the interviewers were given comprehensive training on the content of the questionnaire and techniques in questionnaire administration including adhering to ethical standards.

## Data Analysis

The survey data was analysed using the Statistical Package for Social Science (SPSS); a specialised statistical tool widely used by the social researchers.

## Study Limitations

This is a perception survey that covers a limited set of questions related to the MSE sector in Sri Lanka and hence, does not probe issues at an in-depth level. Therefore, the study presents only a snapshot view of the MSE landscape in Sri Lanka. The scope of the analysis of legal and regulatory barriers was also limited as a result of time constraints.

### Data Weighting

To arrive at overall statistics for each question, data was weighted for each Province, Small and Micro Enterprises

### Margin of Error

Margin of error at overall level is approx. 2.5%, Margin of error for other cross analysis such as Gender, Micro/small enterprise stays in the range of 5-7.5%, Margin of error for province level data is 10%

### Quality Control Measures

Phone number of the respondents were obtained for the entire sample. Of which, 30% of the sample on average were called and back checked based on certain parameters such as respondent's identity, duration of interviews, responses for selected questions.

# Tables

## Sample Distribution

Table 2

By Province			
Province	% GDP Contribution	Sample Proposed	Sample Achieved.
Western	37.2	558	558
Southern	9.9	149	150
Central	10.7	161	159
North Central	5.6	84	86
North Western	10.6	159	154
Uva	7.9	119	119
Sabaragamuwa	8.0	120	115
Northern Province	4.5	68	83
Eastern	5.7	86	69
<b>Total Sample</b>		<b>1,500</b>	<b>1,500</b>

Table 3

By Type of Industry		
Industry	Sample Proposed	Sample Achieved.
Industry Sector	362(25%)	432 (29%)
Trade	613 (41%)	556 (37%)
Services	505 (34%)	523 (35%)
<b>Total Sample</b>	<b>1,500 (100%)</b>	<b>1,511(100%)</b>

Table 4

By Micro and Small Enterprises		
Type	Sample Proposed	Sample Achieved.
Micro Enterprises	1,350 (90%)	1,324(88%)
Small Enterprises	150 (10%)	186(12%)

Table 5

By Registered Vs Non-registered businesses		
Type	Sample Proposed	Sample Achieved.
Registered Business	1,018(67%)	1,324(88%)
Non - Registered Business	492(33%)	186(12%)

Table 6

Number of Employees		
	Micro Enterprises	Small Enterprises
One Employee	53%	-
2 Employees	31%	-
3 Employees	9%	-
4 Employees	3%	5%
5 - 7 Employees	3%	76%
8 - 15 Employees	-	15%
15 - 24 Employees	-	3%
Base: All Respondents	1319	186

**Table 7**

Age of the Business		
	Micro Enterprises	Small Enterprises
Before 2000	16%	25%
2001 -2010	22%	31%
2011 - 2015	24%	22%
After 2015	38%	22%

**Sample Profile**

**Table 8**

Gender	
Type	Sample Achieved.
Male	69%
Female	31%

**Table 9**

Marital Status	
Type	Sample Achieved.
Married	88%
Unmarried	12%

**Table 10**

Marital Status	
Age	Sample Achieved.
18-30	14%
31-45	43%
46-60	33%
Over 60	10%

**Table 11**

Monthly Household Income	
Income	Sample Achieved.
Less than 20K	21%
21-40K	28%
41-70K	17%
71-100k	7%
Over 100K	8%
Refused to answer	18%

**Table 12**

Engagement/Capacity	
Type	Sample Achieved.
Manages only this venture	62%
Housewife	26%
Full time job	6%
Other part time job	4%
Student	2%

**Table 13**

SEC Spread	
Type	Sample Achieved.
SEC A	17%
SEC B	38%
SEC C	38%
SEC D	6%
SEC E	1%

**Table 14**

Educational Qualifications of Entrepreneurs	
Type	Sample Achieved.
Post graduate/ professional	4%
Passed GCE Advanced Level	34%
Passed GCE Ordinary Level	41%
Grade 6 - 9	17%
Upto Grade 5	3%
Illiterate	1%





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