Effects of Economic Conditions on Small and Medium Enterprises: Evidence from Sri Lanka

Thasika Thanushan
Lecturer, Department of Human Resource Management
Faculty of Management Studies and Commerce, University of Jaffna
ythasika@univ.jfn.ac.lk

Abstract: In Sri Lanka SMEs are considered the backbone of the economy as it gives massive support to socio-economic development. They have considered the dependent factors for many families when it comes to household income and support in the battle against poverty. However, the country's Socioeconomic conditions badly affect it roots of the business. The purpose of this research is to explore the effects of economic conditions on Small and Medium Enterprises in Sri Lanka. The data were collected through In-depth interviews and the purposive sampling technique was used as it is a widely used technique in qualitative studies to provide evidence from the participants (Patton, 2002). A total number of 10 SMEs from different cities in Sri Lanka participated in the survey and provided their perspectives. This study disclosed the factors that are affecting the SME's operations, such as Shortage of raw materials, Lack of fuel, banned chemical fertilizers, Supply, and demand disruption, imbalanced financial system, longest power cut, disruptions in the supply chain, and daily price varies of commodities. In line with the findings, this study also derived the solutions for overcoming challenges in terms of facilitating the support and assistance to develop value-added exportable products, innovative schemes of integration business models with large-scale organizations, continuous research and development system for further future advancements, proper progress maintenance at the regional and national level to strike them when the struggle comes.

Keywords: *Development Forum, Economic Crisis, Integrated Business Model, Progress Maintenance System, Value Added Export System*

Economic Crisis and Sri Lanka

Sri Lanka is facing its worst devastating economic and political crisis which continues with high inflation, no fuel, no medicines, cancellation of critical surgeries, daily power outages, difficulties in getting emergency health services, and inability to obtain milk powders for children and shortage of food. Several factors contribute to and lead Lanka crisis from 2019 onwards. The rise in domestic and foreign debt, economic mismanagement, deep tax cuts as a fulfillment of election promise, national policy shift towards organic farming, diminishing foreign reserve, excess demand in domestic economy relied on imports, less competitive domestic commodities in the international market, declined of the tourism sector due stoppage of all arrival flights to the country, Easter bomb attacks as well as the effect of COVID-19 pandemic were the final blow (George, George, & Baskar, 2022). The external debt of Sri Lanka doubled from 2010 to 2020. It rises from 21.7 billion USD in 2010 to 56.3 billion USD in 2020 which has gone up nearly 119 percent of its GDP in 2021. Many commentaries concur that Sri Lanka has fallen into china's debt trap diplomacy however china accounted for only 10 percent of loans as of April 2021 (MacDonald, 2022). Meanwhile, in the last couple of years, before the pandemic, the government enacted tax-cut police as one of the election promises. That led to the elimination of PAYE tax, withholding tax, credit service tax, and Economic service charge. This unplanned tax scheme enhances the budget deficits significantly from 9.6 percent of GDP to 12.2 percent of GDP in 2021 (Ranasinghe, Sammani, & Perera, 2021).



Figure 1: Sri Lanka's Real GDP Growth Rate (2010-2022)
Source: World Bank, 2022 Projection by Central Bank of Sri Lanka

As a result of election campaign promises, the elected government announced that Sri Lanka will only permit organic fertilizer and phase out all agrochemical fertilizers in April 2021. As 90 Percentage of Sri Lankan farmers used chemical fertilizers, this move of the government made them experience 85 percent of crop failure (Kataria, Manur, & Pradhan, 2022). Although the economist warned the move towards the green economy needs careful preparation. The tourism industry in Sri Lanka had an initial dire impact by the Easter Sunday bombings in April 2019 and the COVID-19 pandemic that followed in 2020 resulted in a 50 percent loss of income. It is further compounded by the impact of Sri Lanka's economic crisis and sporadic demonstrations throughout the country (Ranasinghe, Sammani, & Perera, 2021).

Literature Review: SME Sector in Sri Lanka

Micro Small and Medium scale enterprises greatly contribute to socio-economic development, rural and regional development, employment creation, and eliminating poverty in every country. Sri Lankan SMEs are mostly rural-based and considered the backbone of the economy. In Sri Lanka, enterprises with fewer than 300 employees and not exceeding a turnover of Rs. 750 million are defined as SMEs (Small medium enterprise policy framework, n.d). According to the National Human Resources and Employment policy of Sri Lanka reported, the SME sector plays important role in increasing youth and women participation with more than 80 percent of businesses in the country for economic development. As per the report of the Ministry of Industry and Commerce, SMEs made up 75 percent of enterprises facilitating 45 percent of employment and contributing to 52 percent of GDP. Tambunan (2016) stated that subcategories of SMEs may differ in their characteristics other than the criteria defined such as formality or way of doing business, market orientation, the socioeconomic profile of the owner/producer, nature of employment, organization, and man- agreement system, nature of the production process, sources of main raw materials and capital, location, external relationships, motivation, the level of entrepreneurship, and the level of women involved as entrepreneurs.

In Sri Lanka SMEs are fallen into 12 major categories thus, hotel and tourism, Gem and Jewelry, Trading, business and services, Textile apparel and leather products, Fish products, Wood and wood products, Food, beverage and tobacco products, Paper and paper products, Fabricated metal products, Coir-based products, Lime and fruit manufacturing, Other manufacturing products not elsewhere specified (IDB, 2005). However, the National policy framework for SMEs in Sri Lanka categorizes the SMEs into two in the event of the nature of business such as Manufacturing and Service. Followed by the pandemic, and the ongoing Crisis, SMEs are severely affected. During the time of covid-19 pandemic government stay-at-home orders, resource immobility, social distancing policy, and shutting down the doors of the businesses that hit the SMSs were vulnerable (Robinson & Kengatharan, 2020).

The Association of Small and Medium Enterprises in Tourism reported to The Sunday Morning All SMEs run out its business due to the current Social and economic unrest and no financial support for the SMEs. Officials of the apparel industry also emphasized that, as the current manufacturing process is jeopardized. A few studies have been undertaken to explore the key problem of the crisis which affects SMEs in Sri Lanka (Sriyani, 2022;

Dahanayake, 2022). In previous studies, very few exposed the conditions of SMEs in Sri Lanka during the crisis. From the review of those studies, the effect of the Socioeconomic crisis on SMEs in Sri Lanka has not been addressed and explored clearly. Even though the recent study focused on the consequences of SMEs based on ranking the key problems (Sriyani, 2022) the present study aimed at exploring the consequences of the Economic crisis affecting SMEs in a similar vein in Sri Lanka.

Research Objectives

By considering the existing research gap his study aims to reveal the key problems encountered by SMEs in times of prevailing economic crisis, as well as to reveal the relief and survival strategies for SMEs' survival during the economic crisis. Based on these perspectives the study was undertaken with the following specific objectives:

- ✓ To explore the key problems encountered by SMEs in times of prevailing economic crisis
- ✓ To identify whether the economic crisis similarly affects all the SMEs.
- ✓ To reveal the coping and sustaining strategies for SMEs during the economic crisis

Method of Inquiry

The data for the present study is derived from semi-structured, in-depth interviews carried out with 10 SME holders in Sri Lanka. The semi-structured interview is a tool to explore the in-depth experiences of the research participants, and the real meaning they attribute (Adams & Eike, 2010). The interviews were conducted in both Tamil and English languages and the interviews conducted in Tamil were translated into English. With prior permission from the participants, interviews were tape-recorded and then transcribed for analysis.

The participants were selected using a purposive sampling technique through personal contacts and snowballing as it is a method of data collection that denotes the selection of units and groups together to yield the same average of characteristics in qualitative research (Paul Oliver, 2015). Before the interview, we prepared an interview protocol that consists of open and closed-ended questions. Sample questions we asked from SME holders include: "Does your business still open?", "What are the challenges you facing currently in this economic crisis?", "Do you have enough materials and resources to run your SME smoothly?", "what are alternative ways and strategies you follow to sustain in the market during this economic crisis?", "What support you are expecting from the government?" and "what support do you need to rebuild your business?". Finally, we analyzed transcripts and applied coding techniques with the help of NVivo-10 (inductive coding). The roles of open, axial, and selective coding are enabling researchers to identify, organize, and build theory (Williams, Michael, & Tami Moser, 2019).

Findings and Discussion

The unpredicted challenges to the socio-economic well-being of the nations throughout the island are posed by the crisis. One of the SME holders sadly said, "*I have been in this field for the last 20 years as an employee and owner of this restaurant. Even though we come to across certain challenges due to war and other natural disasters in the northern province. However, this socio-economic crisis gave us a very worst situation that we ever had in previous. We run our business daily basis. When we are facing challenges of getting gas and other fuel. Being in long queues and getting gas cylinders forced us to increase the prices of food items. We sell one cup of tea for 100 rupees. It is nearly 5 times multiplied compared with the previous price. Therefore, we lose customers. Customers cancel the orders due to the variable price scale we do due to these vulnerabilities".*

A similar problem was articulated by another SME holder "*In my business experience, I never had such an unsafe situation before the pandemic. I receive limited supply to my vegetable shops due to the dropped down in harvesting. The government has completely banned all chemical fertilizer imports immediately without strengthening natural organic farming. It severely affected food production mainly rice and vegetables. It causes rising food prices and reduces the income badly poorest and most vulnerable people like us".*

The majority of the informants agreed that the demand for their products and services significantly dropped due to the crisis. Similarly, one informant added here "*Due to the limited fuel supply we often get power cuts nearly 3 hours per day. We depend on a power supply to run my mini garment. This is the longest power cut regulated by the government. Therefore, most of the time we are returning the order and accepting orders with high sewing costs. I have ten swing girls and I need to pay the salary on time as the families relied only upon this income.*

Increasing the unit price of the electricity also increases our variable cost. Though we are unable to fix the prices firmly. Customers are getting annoyed whenever we increase prices for stitching garments along with the variable cost because we did not have this practice in increasing different prices day by day".

As respondents said fuel is the main problem for all businesses. One informant stated clearly "*We are running a seafood factory for the last 40 years. We have come across many hardships such as war, natural disasters, tsunamis, Pandemics, and now this crisis. Every fisherman has been facing challenges and serious difficulties in getting fuel for their vessel. Most of them decided to stop fishing due to the shortage of Diesel and kerosene. We had been in long queues more nearly 3 days and nights and slept on the road, staying at the fuel station for getting at least one Littre diesel. Currently, the government introduced a QR system to issue fuel we get 30 liters of diesel for 10 days without being in a queue according to our weekly quota. However, it isn't sufficient. we might lose fuel to return. Last time in march, we received kerosene. Meanwhile, we should manage the transportation cost of fish".*

Notably, another SME operator mentioned "*With the rising cost of paper, ink, and other stationery items, printing charge cost double the amount it cost the first time. It leaves us no other way to do it. Schoolchildren are currently paying the highest-ever prices for exercise books and other stationery items. For example, a ballpoint pen now cost Rs.30. how a poor parent affords this? Currently, printing papers are unavailable in Sri Lanka. We are facing problems in printing the new year calendars as the country's stationery supply chain being hampered for the last five months. consumers stopped their orders almost due to the weekly price hikes when purchasing these products. I think this is the first time we moved through the shortage of the paper"*.

The same problems were documented by another SME operator "*Still There are long queues for getting milk powder and daily fresh milk. We are unable to meet the demand for dairy products. Because quality feed is essential as animals play a major role in our supply chain. Our production has been reduced because the government banned the imports of maize and silage due to the forex crisis. Improper nutritional food affects the health of animals. Therefore, we don't have a proper supply for production. In addition to this, there are shortages of machinery and spare parts to process dairy products. Mainly we face struggles in storing the diary items due to long-hour power outages*".

It is very hard to hear from them as they are struggling to manage their day-to-day life. It is stated by the owner of the handloom business "*As our country face prolonged economic crisis, we left from the business due to unavailable material, unavailability of fuel and other commodities, disruptions in supply chain and low remuneration. We are struggling to continue our handloom manufacturing at this level. Even though the waving and colorful hand looming has a huge impact on Sri Lanka's tradition, it is difficult to run this process since Banks have renounced their interest rate for loans and limited their financial support".*

Similarly, another respondent detailed here *"We are producing leather items which are demanded one. During the pandemic times, we were able to go even beyond the margin by producing safety kits and hand gloves. We had enough storage of material and went through huge production. But this crisis was affected badly due to the shortages of raw materials. Even though we get raw materials, those aren't in accepted quality standards. We are at risk of closing down in near future".*

As another informant expressed *"I am selling pharmaceutical items for the last 20 years. In hospitals, patients are at risk from a lack of medicines and medical equipment. We faced a similar situation during the pandemic and continued in the crisis. It severely affects pregnant mothers, elders, and children. Recently we had a 40% price increase for commonly used medicines. Such prices have risen every six weeks. Adding to this these medicines are imported for replacing quality medicines. Those aren't effective".*

One more respondent who is running the tuition center stated sadly **"***Our tuition center was famous for grade 6 to O/Level education. Mostly we collect 2000 rupees from O/L students for their tuition education. This cannot be affordable for financially vulnerable students. So that we give free of charge. Due to the fuel shortages, students pay bus fees to double the previous rate. Therefore, we give online classes as alternative ways to manage their cost. However, power outages, disturb the online classes too".*

Key Problems faced by SMEs in Sri Lanka during the Economic Crisis

Almost every type of SME is covered in this interview, they expressed their traumatic situation and sufferings disproportionally. The opinions revealed by most of the SME holders are that their businesses are most vulnerable because it is difficult to manage shrinking financing, shortage of raw materials, shortage of fuel, and disturbed supply chain flow. They further said that they are unable to proceed further if this country's situation continues without improvement. One of the respondents mention that the high inflation and price hike up will certainly

reduce the SMEs will lead to jobless and social unrest in near future. Throughout the interviews, as SME holders explained stopping the lending facilities, fluctuation of prices, and high prices of raw materials weaken the working capital position of every enterprise causing reduced production and reduce staff immediately. More and more pieces of evidence revealed from the interviews, especially from agricultural businesses that the government's immediate action of banning chemical fertilizers without taking prior action to survive in the agricultural sector diminishes the production volume of major agricultural production.

As this study aimed to find the whether consequences of the crisis are similar to all the SMEs, Facts have been collected from the SME holders from different types of enterprises in the interviews. Even though the general opinions of the SME holders are the same regarding the difficulties they faced, the consequences of those problems are entirely different. As one of the respondents representing Agricultural products said, "I am struggling to get the volume of output as it was before the crisis, the reason is the fertilizer banned". Another form that is selling pharmaceutical products and one another from Stationery products said that, unlike the previous response, they described that they are struggling due to the high prices of those products varying day by day. Some other enterprises like fishing and dairy products are affected severely due to fuel issues as those products easily get spoiled if they failed to deliver on time. Similarly, another SME holder who is running his tuition center expressed his views that educational activities are unmanageable due to the fuel crisis. Students and even teachers cannot accommodate the cost they pay for travel.

Conclusion: Implications (coping and sustaining strategies)

As pointed out by several studies in the past in global economic crises (for example Smeru, 2009; Akturk, 2014) this study also suggests that Entrepreneurial education and research and development should thrive to make a competitive cluster business model to integrate SMEs with large-scale organizations. Even though several positive opinions were found in past Literature about women entrepreneurship (Gikongo et al. 2006), the rare study focused on the context of economic social crisis, so this study recommends that women should empower to be a source of innovation in the SME sector. The country shouldn't miscue the opportunity to use female participation in the labor force. Above all, in this terrible economic condition of the country, SMEs cover more than 75% of businesses in Sri Lanka it provides essential livelihoods to many (Ministry of Industry and Commerce, n.d), and SMEs can provide more and more employment opportunities if proper plans and assistance are provided. As found in this study proper diversification with innovation is important to survive with alternative success, Kottika et al., (2020) explained the capabilities of SMEs in introducing new products with better quality. These new initiatives can be commenced as collaborative work with large organizations. According to a central bank report, in 2020 Sri Lanka's direct export is 73.8% even though the global value chain of the country was limited. Sri Lanka's strategic location contributes more and attracts many global value chains. The interim plans should be articulated by the government policymakers such as trade finance arrangements to continue SME businesses especially for making value-added exports (Sriyani, 2022). This research also suggests that Integrate initiations are essential as all the sectors of SMEs are collaborating and struggling due to the worst economic crisis. It will help the SMEs to expand new manufacturing and services to fierce international competition. This study also suggests a strategy to survive in the ever-changing environment to create an entrepreneurial development forum at the regional level to cope with crisis consequences and create an innovative integrated model which can ensure the demand and supply sources for a business. Experience with covid-19 pandemic crisis as it was suggested by Elshenawi and Wang, 2020, SMEs can go by through online to manage their unbearable cost during the crisis and this will lead to capturing the market at the local and global levels. Mainly this study strongly recommends that the SMEs that are in line with the value addition of their products will be pursued corporate sustainability which can be enabled through market need analysis via research and development (OECD, 2009).

References

Adams, E. (2010). The joys and challenges of semi-structured interviewing. *Community Practitioner*, *83*(7),18+. https://link.gale.com/apps/doc/A229720174/HRCA?u=anon~4a954c77&sid=googleScholar&xid=6245c2fd.

Akturk, O. (2014). Impact of the economic crisis on SMEs (small and medium-sized enterprises): a general evaluation on SMEs in Turkey. *European Journal of Social Sciences Education and Research, 1*(1), 169-173.

Central Bank. (2020). Central bank Report 2022: Annual Report

Economic crisis: Increasing vulnerabilities impact SMEs (2022, April 30). The Sunday Morning

Elshenawi DM and Wang Y. (2020) How to protect factory workers from COVID-19? *Bio Resources* 15

George, A. H., George, A. S., & Baskar, T. (2022). Sri Lanka's Economic Crisis: A Brief Overview. *Partners Universal International Research Journal, 1*(2), 9-19.

Gikongo G, Zainalaludin Z, Masud J 2006. Empowering Young Women Through Micro-Enterprise ScalingUp: A Case of Malaysian rural women. From.

Kataria, A., Manur, A., & Pradhan, S. (2022). Sri Lanka's Economic Crisis.Bangalore : takshashila institution.

Kottika, E., Ozsomer, A., Ryden, P., Theodorakis, I.G., Kaminakis, K., Kottikas, K.G., & Stathakopoulos, V. (2020). We survived this! What managers could learn from SMEs who successfully navigated the Greek economic crisis. *Industrial Marketing Management, 88* (July), 352-365.

MacDonald, S. B. (2022). The New Cold War, China, and the Caribbean: Economic Statecraft, China and Strategic Realignments. Charm: Springer Nature

Ministry of Industry and Commerce. National Policy Framework for SME Development.

NHREPa(The National Human Resoures and Employment Policy). Small and Medium Enterprises (SME). [available at http://www.nhrep.gov.lk/index.php?option=com _content& view=article&id=81&Itemid=59&lang=en accessed on April 23 2022].

OECD [Organisation for Economic Co-operation and Development] (2009), The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses, OECD Publications, [available at http://www.oecd.org/dataoecd/40/34/43183090.pdf].

Oliver, P. (2015). *Sociology: A Complete Introduction: Teach Yourself*. Hachette UK.

Patton, M. Q. (2002). Two decades of developments in qualitative inquiry: A personal, experiential perspective. *Qualitative Social Work*, *1*(3), 261-283.

Ranasinghe, J. P. R. C., Sammani, U. G. O., & Perera, K. J. T. (2021). Impact of the COVID-19 pandemic on tourism operations and resilience: stakeholders' perspective in Sri Lanka. *Worldwide Hospitality and Tourism Themes, 13*(3), 369-382.

Ranasinghe, J. P. R. C., Sammani, U. G. O., & Perera, K. J. T. (2021). Impact of the COVID-19 pandemic on tourism operations and resilience: stakeholders' perspective in Sri Lanka. *Worldwide Hospitality and Tourism Themes, 13*(3), 369-382.

Robinson, J., & Kengatharan, N. (2020). Exploring the effect of Covid-19 on small and medium enterprises: Early evidence from Sri Lanka. *Journal of Applied Economics & Business Research, 10*(2), 115-125.

SMERU. (2009, November). Monitoring the socioeconomic impact of the 2008/2009 global financial crisis in Indonesia. *Media Monitoring No.04*/FS/2009.

Sriyani, G. T. W. (2022). Impact of Economic Crisis and Way Forward for the Survival of SMEs: A Sri Lankan Perspective. *Wayamba Journal of Management*, *13*(2).

Williams, M., & Moser, T. (2019). The art of coding and thematic exploration in qualitative research. *International Management Review*, *15*(1), 45-55.

World Bank. (2022). World Development Report 2022: Finance for an Equitable Recovery.