

# FACTORS DETERMINING THE GROWTH OF SMES: EVIDENCE FROM REGISTERED SMES IN NORTHERN PROVINCE, SRI LANKA

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## Abstract

*The objectives of this study were to explore the factors determining the growth of SMEs in the Northern Province of Sri Lanka and to examine the influence of those factors on the growth of SMEs. A field survey was conducted to collect the necessary data from the owners/ managers of 189 SMEs which are functioning in the Northern Province of Sri Lanka. Self reported questionnaire was designed to recognize the factors that influence the growth of SMEs. Data were analysed with SPSS 22 and SmartPLS. Exploratory Factor Analysis was performed to identify the factors influencing growth of SMEs. As a result, need for achievement, motivation, location, business environment, accounting and control and network were recognized as factors influencing on the growth of SMEs. PLS - SEM was performed to assess the impact of these factors on the growth of SMEs. The results of the study revealed that need for achievement and business environment had a medium size influence on growth. The rest of the factors had the small effect on growth. Overall, this study has made parametric contributions as identified the factors influencing the growth of SMEs and geographical contribution as investigated the effect of unidentified factors on the growth of SMEs of Northern Province in Sri Lanka .*

**Keywords:** Business Environment, Growth, Need for Achievement, SMEs, Northern Province

## 1. Introduction

The pursuit of the growth of small and medium-sized enterprises has become necessary in the current context of the works towards a higher economic growth. The fact that SMEs represent more than 90% of the businesses in the country with an involvement of around three million people demonstrates the importance of this sector in Sri Lanka. Therefore, SMEs has been recognized as a vital sector in the Sri Lankan economy. It is estimated that this sector provides 45% of employment in the country. SMEs play an important role in the economy and employment in every country. Towards accelerated economic growth, SMEs need to be strengthened to be globally competitive. A policy framework for SME development has been developed by Ministry of Industry,

with the participation of other stakeholders to create an SME-friendly business environment, to facilitate the acquisition of modern and appropriate technology and to foster an entrepreneurial culture in the country. The SME sector comprises micro, small and medium-sized industries.

The Northern Province is located in the north of Sri Lanka which is comprised of five administrative districts: Jaffna, Kilinochchi, Mulaitivu, Vavuniya and Mannar. After 30 years of civil war, post-war social and economic challenges were enormous in terms of the devastated and immature infrastructure, worsen social institutions and human resources that lagged behind the rest of the country. Shortly after the war, local production was subjected to a market shock because the road connection was resumed to the wider

market with much more advanced production. Industrialization is vital to achieving higher levels of economic growth in any developing country. Industries can create employments with regular monthly income, which is in high demand in the war-torn northern province. National policy framework of Sri Lanka promoting to micro, small and medium enterprises should be applied by targeting their investments and activities to specific industries and sectors where the North has a comparative advantage over existing resources or skills. Post war development strategies of the government in the Northern Province focused policies and investment towards infrastructure driven development, credit expansion of rural development and tax incentives for private sector led development. As indicated in the Economic and Social Statistics of Sri Lanka in 2018, Government of Sri Lanka recognized SMEs as most important sector to consider in developing the national policy framework as it has been noticed as driving forces of economic growth, regional development, employment generation and poverty reduction. Most considerably, over 75% of the total number of enterprises provides 45% of the employment and 52% of contribution from the SMEs has given to national GDP. Northern Province GDP contribution to National GDP was 4.2 in 2016 (Economic and Social Statistics of Sri Lanka,2018). Between 2011 and 2015, the percentage increase in the Contribution of the industrial sector to provincial GDP was 42% in the North (Economic and Social Statistics of Sri Lanka, 2017) . As cited in the study of Ranjith (2014) Sri Lanka has the highest income inequality in South Africa. Due to theses reasons government is highly

encouraging the SMEs sector in the Sri Lanka. Therefore, understanding the factors determining the growth of SMEs will help policy makers – governments (state and local), NGOs, and other stakeholders – to design targeted policies and programs that will actively stimulate innovation, as well as helping those policy makers to support, encourage, and promote SMEs for poverty alleviation in Sri Lanka. Having understood the importance of SMEs to the country, present study tries to find out the answers for the following questions:

1. What are the factors determining the growth of SMEs in Northern Province of Sri Lanka?
2. To what extent do these factors impact on the growth of SMEs?

The reason for doing this study is to contribute to the body of existing knowledge concerning the growth of the SME sector in Sri Lanka with specific reference to Northern Province. This study will not only have academic and educational potential, but can also impact on the actual economic life of the SMEs owners/managers in the rural areas in many countries. Owners of such SMEs can search for answers to their questions in this study and understand many issues that will help them to maintain and develop their business successfully, supporting their countries in an economic and social manner. Therefore the objectives of the study are to investigate the determinants of growth of SMEs in Northern Province; and to examine the impact of these factors on growth of SMEs.

## 2. Literature Review

### Small and Medium Enterprises (SMEs):

The term SME is used to denote micro, small and medium enterprises. Different countries use different definitions for SMEs based on their level of development. The most commonly used measures are total number of employees, annual turnover and total investment. In the Sri Lankan context, the SME policy framework of Sri Lanka of the Ministry of Industry and Commerce defines SMEs based on the number of employees and annual turnover. In similar way, number of persons engaged in the business, turnover, and

assets are initially identified to define SMEs, listing data, collected at the Economic Census, Sri Lanka exhibited that the number of persons engaged to be the most reliable and consistent variable in defining SMEs. There are some major differences shown by major economic sectors such as; Industry and Construction, Trade, and Services; different criterion was laid out for each of those economic sectors. Consequently, the thresholds identified to define micro, small, medium and large scale establishments for each of the major economic sectors by the Economic Census Department Sri Lanka are as follows:

Table 1: Classification of SMEs

Major Economic Sector	SME Groups	Criteria (Number of Persons Engaged)
Industry and Construction	Micro	1 to 4
	Small	5 to 24
	Medium	25 to 199
	Large	200 and above
Trade	Micro	1 to 3
	Small	4 to 14
	Medium	15 to 34
	Large	34 and above
Services	Micro	1 to 4
	Small	5 to 15
	Medium	16 to 74
	Large	75 and above

Source: Adopted from ECONOMIC CENSUS Report of Sri Lanka 2013/2014

### Empirical studies relating to factors determining the growth/ success of SMEs

Time to time, there are number of studies have been conducted to examine the entrepreneurs success factors in Sri Lanka (e.g: Gunatillake ,1992; Kodithuwakku &

Rosa, 2002; Ranasinghe, 1996; Fernando, 2006; Ratnayake, Menika & Perera, 2013; Yogendrarajah, 2019). Several factors have been identified as determinants of growth and success of SMEs from the previous studies,. According to the previous studies, identified factors are discussing below:

Knowledge, skills, experience are recognized as factors to determining the success in the study of Naser, Mohammed and Nuseibeh (2009). Level of education (White & Cooper, 1997), family support (Winn, 2004; Kodithuwakku & Perera, 2003), social networking (Kodithuwakku & Perera, 2003), internal motivation (Marlin & Wright, 2005), Consumer satisfaction, diversification, personal freedom (Akhawaya & Havenga, 2012), technology, business feature, training and motivation, interpersonal skills, family support (Sarker & Palit 2014) have listed in the previous are that those are success and growth factors of SMEs. Following paragraphs are highlighting studies relating the factors determining the success and growth factors specially in Sri Lankan context.

There is a factor analytic study has been performed by Wijewardena and Zoysa in 2005 to identify the determinants of success in manufacturing SMEs in Colombo area. Data were collected for this study based on the perceptions of 168 owners/ managers using questionnaire survey. Factor analytic study identified six factors which were customer orientation, product quality, efficient management, supportive environment, capital accessibility and marketing strategy. All these factors had positive significant influence on success of selected SMEs.

Ratnayake et al.(2013) conducted a study to identify managerial factors of sustainable growth of SMEs within the tourism industry of Sri Lanka. Empirical study was carried out using questionnaire survey with 306 respondents from tourism SMEs in the Southern region of Sri Lanka. Outcome of their study revealed

that entrepreneurial characteristics had positive relationship with sustainable growth of the firm. This relationship was moderated by strategy making, employee commitment, employee competency and organizational culture. Further, they have found that employee commitment and organizational culture have not shown any influence on sustainable growth of the firm. Ratnayake et al. (2013) pointed out that factors of government policies, usage of market information and usage of technology need to be considered to examine in the future studies.

Ranjith (2014) performed a study to examine the determinants of the success of 150 small business in Kuliyaipitiya region of Sri Lanka. A detail questionnaire was used to collect the data. He has found that family background of the entrepreneur, ability to make decision, level of training and the amount of money invested on the business are the determinants of success of small business.

Sareena Umma and Varothayan (2015) investigated to identify the strategic factors affecting the performance of manufacturing based SMEs in Batticaloa district in Sri Lanka. Randomly selected 150 owner / manager of SMEs included for this survey. Results of their study revealed that financial based factors, management based factors, marketing based factors, technology based factors and infrastructure based factors have significant relationship with performance.

Amaradiwakara and Gunatilake (2016) studied to recognize the factors influence the growth of SMEs in Sri Lanka. They have used stratified sampling technique to select the sample and based on that 15 SMEs were selected as sample

from the Western Province of Sri Lanka. Data have been collected using questionnaire. Findings of their study expressed that financial inadequacy, the lack of access for new technology and government regulations are the constraints to SMEs growth. Most importantly, level of education of the owner of the business has been identified as the determinant of SMEs growth.

Madumali and Nirushan (2017) undertaken a study on factors affecting success of SMEs in Elpitiya Division in Southern Province of Sri Lanka. 100 successful entrepreneurs and 100 un successful entrepreneurs have been considered for this survey. Results of the study revealed that education, management and resources, financial base, and socio economy were most significant factors affecting success of businesses.

Yogendrarajah (2019) explored the factors on micro and small women entrepreneurs' success in Northern Province of Sri Lanka. 284 women entrepreneurs included in this survey and who were selected using stratified sampling method. Questionnaire was used to collect the data. Motivation, self sufficiency, network, risk taking, financial strength, locus of control, problem solving, leadership and encouragement have been identified as factors determining the success of women entrepreneurs. She has suggested that to conduct the qualitative study to examine the factors determining the success of women entrepreneurs.

From the 2005 to 2019, there are several studies have been conducted to identify the factors determine the growth or success of SMEs in Sri Lanka. To the best of my knowledge, very few number of studies have been conducted

in the Northern Province area of Sri Lanka specially in the Post War context. Thus current study focusing on the Northern SMEs sector in Sri Lanka.

### 3. Methodology

Present study employed a quantitative technique, using survey to collect data. The survey questions measuring the factors determining the growth of SME sector were collected from previous Sri Lankan studies (e.g:Kodithuwakku 1992; Ratnayake et al.,2013; Essmui et al., 2014; Amaradiwakara & Gunatilake, 2016; Yogendrarajah, 2019). Nonetheless, some fundamental changes were made to the questionnaire in order to adapt it to the Northern Province of Sri Lankan context. Respondents were asked to indicate factors determining the growth of SMEs on a five-point Likert scale (ranging from 1 = strongly disagree to 5 = strongly agree) the extent to which they agreed with the statements provided. Further, respondents have also been asked to indicate the perceived growth of SMEs on a five point likert scale as indicated above. The questionnaire was pre-tested by an academic and industry expert. Feedback from the pre-test was used to refine the questions for pilot testing and the field survey. In this study the pilot survey was conducted using a paper-based self-administered questionnaire with five owners/ managers of SMEs. The respondents understood all of the questions in the way that the questionnaire was intended and they each spent 15 minutes completing the questionnaire. The owners/ managers did not express any concerns about the questionnaire, hence, the refined questionnaire was distributed among

the selected potential respondents by the field survey from September to November 2019. Selected sample of this study was 354 SME's owners/managers operating in Northern Province as at 31st December 2018. The choice of this number is based on the Department of Industries report (2018) of Northern Provincial Secretariat. Altogether, there were 705 registered SMEs in the Northern Province in 2018 as per the records of department of industries. Classification of the industries was not clear as per their registration. SMEs owner/

manager who have at least 3 years experience in their business activities in 2019 were considered for this study. Considering into the regional distribution of SMEs according to the Department of Industries of Northern Province, the sample was selected from the five districts of the Northern Province. Respondents were selected on the basis of convenience and ease of access to get the necessary information. Details are given below in Table 2.

Table 2: Population and sample

Districts of Northern Province	Registered Entrepreneurs	Selected No. of Sample
Jaffna	408	204
Kilinochchi	45	23
Vavuniya	55	28
Mannar	159	80
Mullaitivu	38	19
Total	705	354

#### 4. Results

Table 3: Demographic Profile of Survey Respondents

District	Frequency	Percentage	Experience	Frequency	Percentage
Jaffna	85	45.0	1-5 Years	35	18.5
Kilinochchi	21	11.1	6-15 Years	79	41.8
Vavuniya	35	18.5	Above 15 years	75	39.7
Mannar	29	15.3	Total	189	100
Mullaitivu	19	10.1	<b>Age</b>	<b>Frequency</b>	<b>Percentage</b>
Total	189	100	18- 25 years	12	6.3
<b>Education</b>	<b>Frequency</b>	<b>Percentage</b>	25-34 years	25	13.2
Primary education	10	5.3	35-44 years	82	43.4
G.C.E.(O/L)	46	24.3	45-54 years	44	23.3
G.C.E.(A/L)	75	39.7	Above 55 years	26	13.8
Technical Education	19	10.1	Total	189	100
Vocational Education	4	2.1	<b>Sex</b>	<b>Frequency</b>	<b>Percentage</b>
Degree	21	11.1	Male	136	72
Other	14	7.4	Female	53	28
Total	189	100	Total	189	100



The demographic summary of the results reflected in table 3. Out of the 354 selected sample, only 53.4 % of the responses have been received from the field survey. The sample was consisted of 85 owners/ managers from Jaffna district, 21 from Kilinochchi district, 35 from Vavuniya district , 29 from Mannar district and 19 from Mullaitivu district. In sum 189 responses have been received from the owners/ managers of SMEs which is representing the sample of Northern Province. Among the 189 respondents, 72% of the responses represent male respondents and rest of them are (28 %) represented by females.

Age distribution in the sample was categorized as 3 groups as indicated in the table 3. Age range between 35-44 was highly represented in the sample which was 43.4% of the sample. Age range between 18- 25 years was less represented in the sample which was 6.3%.

Education level of the business operators were categorized into seven groups as classified in the table 3. 39.7 % of the respondents hold G.C.E.(A/L) qualification. Very small

percentage of respondents was 2.1 % consisted of Vocational education.

Years of experience in their respected field of the sample was categorized as 1-5 years, 6-15, and Above 15 years. 18.5 % of sample was within 1-5 years of experience, 41.8 % of sample was within 6-15years of experience, and 39.7 % of sample was above 15 years of experience in their respected field.

### Exploratory Factor Analysis

Dess and Davis (1984) connoted that factor analysis aids in detecting the presence of meaningful patterns among a set of variables. Therefore, Exploratory Factor Analysis (EFA) has been performed to identify the factors determining the growth of SMEs. As per the results, a measure of sampling adequacy, the KMO was .714 exceeding the minimum recommended value of .60 (Tabachnick & Fidell, 2007) and Bartlett’s test of sphericity was significant ( $\chi^2 (153) = 1329.801, p <.001$ ) indicating factorability of the correlation matrix and thus, the data set is said to be appropriate for factor analysis.

Table 4: Summary of Exploratory Factor Analysis

Q No	Items	1	2	3	4	5	6	Communality
NA1	I am willing to work hard to become the best in my business field	.923						.806
NA3	I work with dedication to transform my life into a success story	.912						.780
NA2	I am willing to create contacts with the entrepreneurs who are interested to joint as a partner with my business	.878						.714
M1	Make my family rich and to enjoy best luxuries of life		.887					.704
M5	Family members and employees providing encouragement, praise, emotional support and recognition for my business		.822					.729

M4	Always be as an owner, never be as an employee	.811						.532
L1	Availability of regular supply for raw materials at the business place	.898						.831
L2	Availability of trained labourers in the business location	.873						.786
L3	Availability of market opportunities and facilities in the business location	.837						.853
BE3	Well organized and structured rules and regulations to conduct the business		.912					.698
BE1	Accessibility of finance		.900					.807
BE5	Infrastructural facilities		.641					.696
AC2	Preparing accounting and Financial Reports in proper method			.836				.522
AC3	Following accounting regulations			.829				.853
AC1	Having independent auditing practices			.692				.832
N5	My business contacts and employees refer me new customers to my business				.796			.423
N3	My business contacts and employees provide me with practical support for my business such as ideas, information or advice on how to run business and compete with business competitors				.702			.670
N2	My employees and close friends provide me with business resources such as financing or equipments				.625			.547
								Total
Eigen Values		2.799	2.343	2.320	2.095	1.787	1.440	
Kaiser's Criterion - Percentage of variance		15.55	13.01	12.88	11.64	9.93	8.00	71.01
Reliability : Cronbach's Alpha		0.842	0.701	0.904	0.802	0.763	0.743	

The Kaiser's criterion (eigenvalue rule) is most commonly used technique for retaining number of factors and the components with an eigenvalue greater than 1 is retained (Hair et al., 2010; Pallant, 2010; Field, 2013). The Kaiser's criterion is presented in table 4. As can be seen in table 4, all factor loading were greater than .625 indicating a very significant loading (Stevens, 2002). There are six factors have been detected from the EFA. All the six factors were made up of three variables as results presented in the table 4. Having given meticulous attention to the composite of variables of factors, they were named as Need for Achievement, Motivation, Business Location, Business Environment, Accounting & Control and Business Network respectively. In sum, all these six factors accounted for 71.01% of variance and have good reliability. The factors are robust and theoretically meaningful and interpretable. Results of the reliability, validity and the VIF measures are presented in the table 5.



Minimum threshold for the AVE was 0.5 (Hair et al., 2016). According to the results in table 5, values of AVE were well above 0.5. Values of CR for all six variables are ranging from 0.739 to 0.940 indicating the strong composite reliability as CR had minimum value above 0.7 in this study (Hair et al., 2016). Existence of multicollinearity among the variables were measured and results presented in the table 5.

As per the results, highest value of VIF was 3.267 and lower value of tolerance was 0.306 and highest value of tolerance was 0.584. All tolerance and VIF values were clearly below the threshold value of .2 and 5 respectively (Hair et al., 2016). This provides evidence that this model was free from the multicollinearity issues.

Table 5: The Reliability, Validity and the VIF measures of the variables

Motivation	0.611	0.824	3.141	0.318
Business Location	0.838	0.940	2.530	0.395
Business Environment	0.715	0.882	3.267	0.306
Accounting & Control	0.684	0.865	1.712	0.584
Networking	0.504	0.739	2.190	0.456

AVE: Average Variance Extracted, CR: Composite Reliability, VIF: Variable Inflation Factor

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Heterotrait- Monotrait Ratio of correlations (HTMT) were used to evaluate the discriminant validity. HTMT ratios that falls between 0.066

and 0.407 are less than 0.85 (Hair et al., 2016). Therefore, it can be concluded that the present model confirms strong discriminat validity of the model.

Table 6: Heterotrait- Monotrait Ratio (HTMT)

	1	2	3	4	5	6
1: Need for Achievement	0.075					
2: Motivation	0.100	0.066				
3: Business Location	0.069	0.155	0.124			
4: Business Environment	0.084	0.104	0.185	0.103		
5: Accounting & Control	0.122	0.174	0.176	0.168	0.209	
6: Networking	0.382	0.251	0.282	0.363	0.343	0.407

### Influence of identified factors on the growth of SMEs

There are six factors have been identified by performing EFA. Therefore, how these factors are influencing on growth of SMEs.

PLS - SEM was performed to assess the Figure 1:Results of PLS- SEM Model

impact of all these variables simultaneously and results of the study presented in the Figure 1 below:

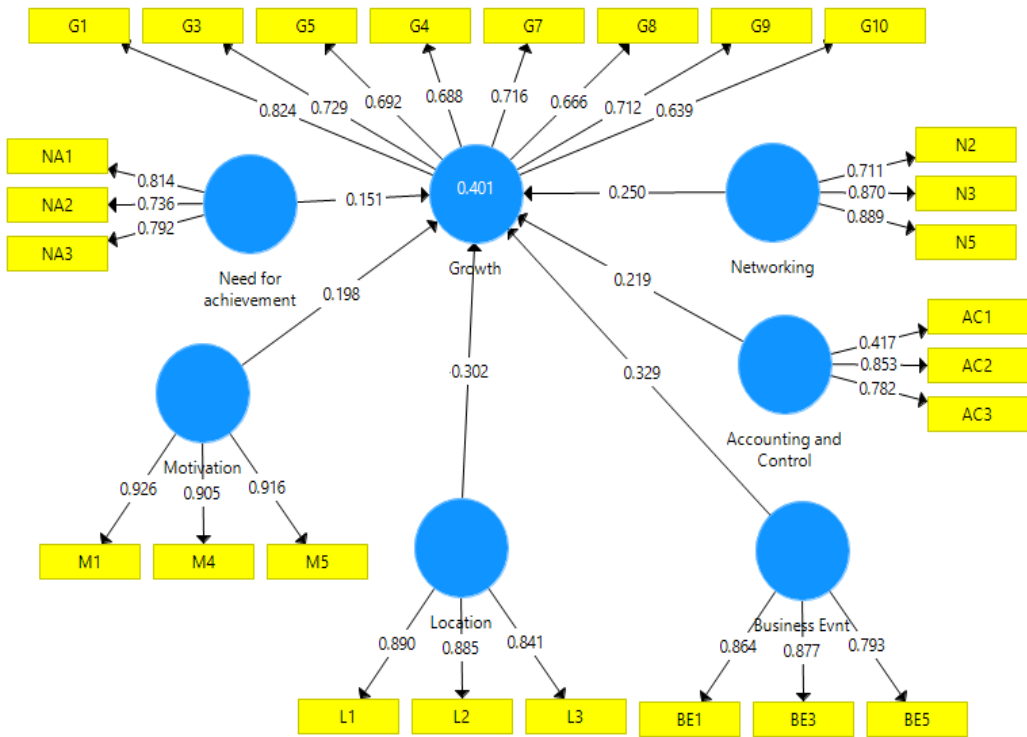


Table 7: PLS - SEM results for the relationship between identified factors and growth of SMEs

	Path Coefficients	T_Value	P_Value	F <sup>2</sup>
Need for Achievement	0.151	2.224	0.027	<b>0.150</b>
Motivation	0.198	2.098	0.036	0.037
Business Location	0.302	3.860	0.000	0.064
Business Environment	0.329	4.297	0.000	<b>0.178</b>
Accounting & Control	0.219	2.806	0.005	0.102
Networking	0.250	2.887	0.004	0.077
R <sup>2</sup> = 0.401		Adjusted R <sup>2</sup> = 0.380		

As per the results presented in the table 7, it can be said that all the factors identified in this study which are need for achievement, motivation, location, business

environment, accounting and control and networking together explained 38 % (Adjusted R<sup>2</sup> = 0.380) of the growth of the SMEs in the sample. The path coefficients of the each variables were positively and significantly influenced on the growth of SMEs. Significance level of the path coefficients can be measured as suggested by Hair et al. (2016) that t value

should be more than 1.96 and p value should be less than 0.05. Therefore, it can be explained the individual influence of the factors as individually: Need for achievement (path coef = 0.151, T > 1.96, P < 0.05), motivation (path coef = 0.198, T > 1.96, P < 0.05), business location (path coef = 0.302, T > 1.96, P < 0.05), business environment (path coef = 0.329, T >

1.96,  $P < 0.05$ ), accounting and control (path coef = 0.219,  $T > 1.96$ ,  $P < 0.05$ ), networking (path coef = 0.250,  $T > 1.96$ ,  $P < 0.05$ ) were significantly positively influenced the growth of the SMEs.

$F^2$  measures the impact of each independent variable on the dependent variable. As per the results,  $F^2$  values for need for achievement and business environment were 0.15 and 0.178 respectively. This values have indicated the medium size effect of need for achievement and business environment on the growth of SMEs as those were above 0.15 (Cohen, 1988). All the other variables had small effect on growth as those have fallen less than 0.15 and more than 0.02 (Cohen, 1988). According to the outcomes of the study, impact of business environment on growth in the current study are consistent with the study of Essmui et al. (2014). It was found that there was a significant influence of motivation on growth in the present study. This result is in line with the findings of Janssen (2006).

## 5. Conclusion

The present study conducted the purposes to explore the factors determining the growth of SMEs in Northern Province of Sri Lanka and also to evaluate the effect of explored factors on the growth of SMEs. The study revealed the need for achievement, motivation, location, business environment, accounting and control and network are factors as the determinants of growth. Further, a study concluded that all these factors have the positive influence on the growth. This study recommends that policy makers should strengthen the legislative and regulatory framework for the creation and development of SMEs by establishing rules to promote SMEs to be tailored to each sector.

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