DETERMINANTS OF BUSINESS PERFORMANCE OF SMALL AND MEDIUM ENTERPRISE: A STUDY ON MARUTHAMUNAI AREA

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ABSTRACT

Small and Medium Enterprises are the real backbone of all economies globally and a key source of economic growth, innovation, employment generation and poverty reduction. The country like Singapore has achieved its success as they focused more on SMEs. More than 90% of ventures in Singapore accounts for SMEs. In Sri Lanka, it is just 75% and provides just 45% of job opportunities. Hence, SMEs' contribution towards the economy is significantly low and there is a doubt about the performance level of SMEs of Sri Lanka. Accordingly, this study aims to investigate the factors affecting SMEs' business performance in the Maruthamunai area, Sri Lanka. The study was conducted based on positivism philosophy and deductive approach was executed. Further, the current study is an exploratory cross-sectional study and data were gathered by deploying a survey method. In this study, SMEs' business performance was used as the dependent variable and factors influencing the business performance of SMEs were used as independent variables. The target population was 469 SMEs registered in Kalmunai Municipal Council in Ampara district, Sri Lanka and sample selection was based on judgmental sampling method. Out of the total population of 469 there was 80 sample was selected. Data was gathered using structured questionnaires. Data were analysed by using IBM SPSS. This study used correlation and multiple regression

models to analyse the collected data. There were five independent variables statistically significants with business performance. Namely; needs for achievement, entrepreneurial competencies, regulatory environment, technology, and information and two variables were insignificant with business performance. Namely; risk-taking propensity and managerial competencies. Hence, this study's findings can be used to make proper decisions to improve the performance level of SMEs in Sri Lanka.

Keywords: Business performance, External factors, Internal factors, Small and Medium Enterprises (SMEs)

INTRODUCTION

SMEs play an essential role in boosting any economy of the world by contributing to industrial production, export, and employment generation. Developing countries of the world are being benefited immensely with SMEs, which is the engine of growth for many countries. One of the most essential roles of SMEs in this context includes poverty reduction through job creation. Small scale industry sector plays an essential role in economic development through the creation of employment opportunities, the mobilization of domestic savings, poverty alleviation, income distribution, regional development, training of workers, and entrepreneurs, creating an economic environment in which large firm flourish and contribute export earnings (Central Bank of Sri Lanka, 1998). The Government of Sri Lanka recognizes SMEs as the backbone of the economy, as it accounts for more than 75% of the total number of enterprises, provides 45% of the employment and participates to 52% of the Gross Domestic Production (GDP). SMEs promote broad-based equitable development and provide more opportunity for Women and Youth participation in the country's economic development (Ministry of Industry and Commerce, 2016).

Though SME sector is introduced as the backbone of the economy, SMEs' performance level is questionable since the number of new establishments is decreasing while failure rate is also increasing. Figure 1 describes the established SMEs in Maruthamuania area from 2012 to 2017. Further, it is evident that established SMEs in Maruthamunai area is decreasing in every year.
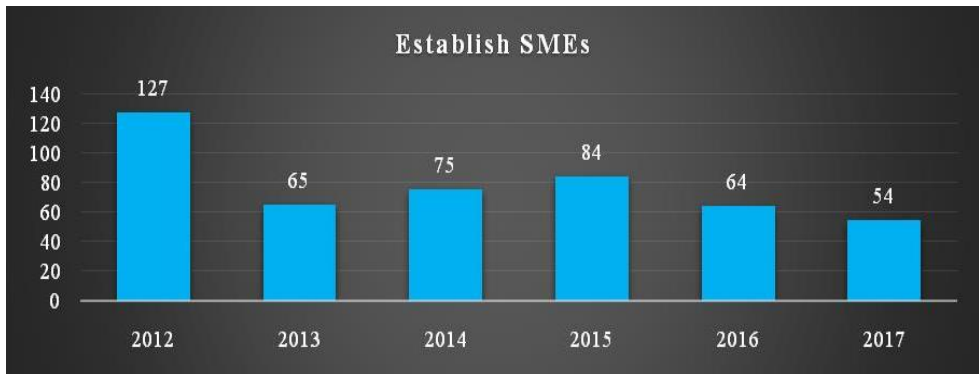
Source: Kalmunai Municipality (2018)

Figure 1: Established SMEs in Maruthamunai Area

Further, figure 2 shows the SMEs' failure in the Maruthamunai area from 2012 to 2017 and the failure of SMEs in the Maruthamunai area is increasing every year.
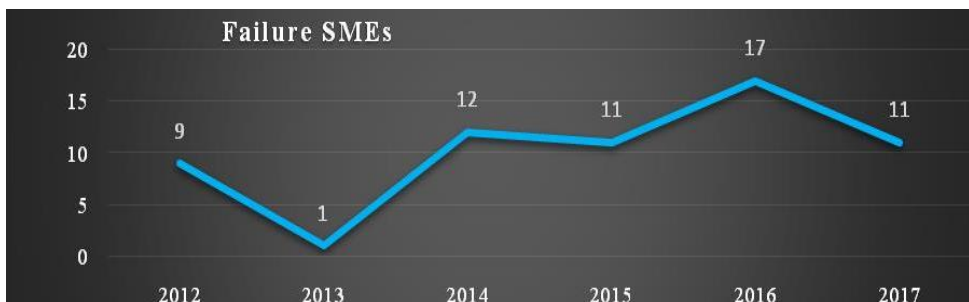
Source: Kalmunai Municipality (2018)

Figure 2: Failure of SMEs in Maruthamunai Area

Research Problem

SMEs are playing a significant role in the economic context in Sri Lankan arena. Sri Lanka has the potential to get the maximum outcomes from SMEs. Even though currently, Sri Lanka has faced a significant problem in the SMEs sector. Lack of access to bank facilities, the lack of knowledge of bank procedures, long delay and the inability for providing guarantees, lack of management skills, inappropriate technology skill, low productivity, low quality of the product, and market competitiveness are some reason to fail the SMEs (Gamage, 2003). Moreover, nowadays, SMEs are fragile and some of them have been dropped. There are many reasons behind these failures of SMEs and these factors are influencing on business performance. Accordingly, this study is dedicated to finding out the factors influencing business performance based on Maruthamunai area. Therefore, the study was conducted based on the research problem of "What are the factors affecting SMEs' business performance in the Maruthamunai area?".

Research Objectives

The study's main objective is to investigate the factors affecting the business performance of small and medium enterprises and other specific objectives are to explore internal factor and external factors that are affecting the business performance of small and medium enterprises.

Hypotheses of the Study

The researcher developed below mentioned hypotheses based on research objectives.

H$_{1A}$: There is a significant relationship between needs for achievement and business performance of SMEs.

H$_{1B}$: There is a significant relationship between locus of control and business performance of SMEs.

H$_{1C}$: There is a significant relationship between risk-taking propensity and business performance of SMEs.

H$_{1D}$: There is a significant relationship between managerial competencies and business performance of SMEs.

H$_{1E}$: There is a significant relationship between entrepreneurial competencies and business performance of SMEs.

H$_{1F}$: There is a significant relationship between functional competences and business performance of SMEs.

H$_{1G}$: There is a significant relationship between a financial resource and business performance of SMEs.

H$_{1H}$: There is a significant relationship between taxation and business performance of SMEs.

H$_{1I}$: There is a significant relationship between government support and business performance of SMEs.

H$_{1J}$: There is a significant relationship between the regulatory environment and business performance of SMEs.

H$_{1K}$: There is a significant relationship between technology and the business performance of SMEs.

H$_{1L}$: There is a significant relationship between information and business performance of SMEs.

H$_{1M}$: There is a significant relationship between networking and business performance of SMEs.

LITERATURE REVIEW

SME plays a vital role in almost all countries globally, especially in developing countries like Sri Lanka. Different authors and authorities have usually given different definitions of SMEs. The definitions of the SMEs vary from scholar to scholar. They use different basis to define SMEs such as capital assets, number of employees and turnover level. Kayanula and Quartey (2000) stated that there is no single, universal or uniformly acceptable definition for SMEs.

Economic Census of Sri Lanka conducted in 2015 provided a strong base to define SMEs logically, which may be acceptable to all the agencies. Turnover, the value of assets, and the number of persons engaged were identified as key variables in defining SMEs, and listing forms were designed to encompass those variables. The final data of the listing operation was plotted and analyzed against each variable identified to define SMEs. However, the distribution of establishments against the number of persons engaged was proved to be the most reliable and consistent variable in defining SMEs of the country. Further, the industrial and construction sector, trade sector and the services sector gave rise to substantially different distributions. Different thresholds were identified for each of those sectors to define micro, small, medium and large establishments (Department of Census and Statistics, 2015).

Business Performance of SMEs

Performance has two strategic outputs: firm success and firm failure (Ostgaard & Birley, 1995). This performance is traditionally measured in

financial terms (Laitinen, 2002). The most commonly used performance measures are efficiency (ROI), sales growth and profit (Murphy, Trailer & Hill, 1996).

Factors affecting Business Performance of SMEs

Needs for Achievement is the first factor**.** Mc Clelland (1987) mentioned that the need for achievement is the basic driving trait in a successful entrepreneur's character. Also, entrepreneurial characteristics such as creativity and achievement are considered critical success factors in succeeding as an entrepreneur (Rotter, 1996; Barkham, 1994). The second factor is the **Locus of control.** Miller and Toulouse (1986) observed that a positive relationship between internal locus of control and the firm's performance when empirically investigated 97 firms, however, varies in function of environmental variables. Next, **Risk-Taking Propensity** is the third factor**.** Delmar (1994) told that risk-taking is important for the success and growth of a business that entrepreneurs realize and manage risk appropriately in their environment. On the other hand, Siegel, Siegel and Macmillan (1993) observed no relationship between business growth and the willingness of risk-taking. The fourth factor is identified as **Managerial Competencies.** Managerial Competencies have a positive effect on the performance of the small-scale enterprise. Managerial experience, education, knowledge and start-up experience are used to measure managerial competencies (Hisrich & Drnovsek, 2002). Many studies found that most business failure was due to lack of management skills (O' Neill & Duker, 1986; Terpstra & Olson, 1993). **Entrepreneurial Competencies** is also another important factor**.** Lyons (2002) point out entrepreneurial skills as the skills that needed to develop innovative goods and services and to generate solutions to

emerging needs in the market place. He mentioned three skills under entrepreneurial competences Namely, Business concept, environmental scanning, and advisory board and networking. Kiggundu (2002) points out that entrepreneurial capabilities are entrepreneur characteristics such as attitudes, beliefs, knowledge, skills, capacities, personality and behavioral tendencies are needed to sustain and business achievement. Further, **functional competencies are the next factor, and functional competencies indicate the skills that the entrepreneurs wanted** to perform their functional area. Particular skills in the job-related task is an essential requirement for the entrepreneur. These competencies must need because the entrepreneur must take decisions relevant to the business and its systems and training staff (Chandler & Janson, 1992; Baum, 1994; Winterton, 2002). **Financial Resources** can be introduced as the next factor and **s**everal empirical studies have indicated that entrepreneurs consider the shortage of capital access, credit schemes and restriction of financial systems as the main obstacle to business creation and success in improving economies (Marsden, 1990; Meier & Pilgrim, 1994). **Taxation** is also another factor**.** Taxation can have essential effects on numerous pieces of the economy, including impacts on firm creation and SMEs' growth. If tax rates are high, it strongly decreases the profit incentive (Ahwireng-Obeng & Piaray, 1999).

Moreover, **Government Support** is also important as a factor which impacts on business performance of SMEs**.** Most of the world's government focuses on SMEs development by conducting programs to achieve a stable national economy (Butler, 2008). **Regulatory Environment** is the next factor identified**.** Unexpectedly changes in

government regulation and other restrictions have negatively impact on SMEs performance. Government regulation is an external factor that impacts on SMEs performance (Yusuf, 1995; Simbi, 2004). **Technology** can be introduced as another critical factor. Technology improvement support to improve SMEs' growth and technological constraints are significant barriers to developing countries that reduce the outcome of SMEs performance (Robertson, 2003; Chandrasiri, 1999). As the final factor, **Information and networking** is identified. Business information availability is vital for starting a new business and Willingness of information seeking is one of the significant entrepreneurial characteristics (Singh & Krishna, 1994). Access to new information is necessary to initiate, survive, and grow firms (Duh, 2003; Kritiansen, 2002; Mead & Liedholm, 1998; Swierczek & Ha, 2003). Networking indicates the social-culture aspect of the environment. Several researchers point out that these social-cultural factors have a significant influence on business performance (Boddy, 2002; Gurol & Atsan, 2006).

RESEARCH METHODOLOGY

This paper aim is to analyse the business performance of SMEs by using 13 factors. Namely; needs for achievement, locus of control, risk-taking propensity, managerial competencies, entrepreneurial competencies, functional competencies, financial resources, taxation, government support, regulatory environment, technology, information and networking.

This study is based on the deductive approach, which usually begins with a hypothesis and the researcher uses descriptive research design. The

researcher conducts this study by using whole SMEs in Maruthamunai area as a population. According to the Kalmunai Municipality data, 469 small and medium enterprises are registered in the Maruthamunai area. The researcher selects 80 SMEs are selected as sampling by using a judgmental sampling method. The survey methodology is used for this study. Therefore, the researcher collects data from primary data sources through questionnaires. The researcher uses IBM SPSS as a data analysing tool & multiple linear regression analysis techniques. Therefore, to examine the effect of the factors on SMEs' business performance, the following model has been constructed.

$$BP = \beta_0 + \beta_1\,NFA + \beta_2\,LOC + \beta_3\,RTP + \beta_4\,MC + \beta_5\,EC + \beta_6\,FC + \beta_7\,FR + \beta_8\,TAX + \beta_9\,GS + \beta_{10}\,RE + \beta_{11}\,TECH + \beta_{12}\,INF + \beta_{13}\,NTWK + \mathcal{E}_t$$

Where,

BP   -Business Performance

β_0 -Intercept Term

NFA   -Needs for Achievement

LOC   - Locus of Control

RTP   -Risk Taking Propensity

MC   -Managerial Competence

EC   -Entrepreneurial Competence

FC   -Functional Competence

FR   -Financial Resources

TAX   -Taxation

GS   -Government Support

RE   -Regulatory Environment

TECH -Technology

INF   -Information

NTWK -Networking

ε_t -Error Term

DATA ANALYSIS

Reliability Analysis and Validity Analysis

The alpha value was above the rule of thumb of 0.7 for a reliable scale. The Cronbach's Alpha value is 0.837 and it is above the 0.7. So, the research questionnaire contains reliable questions. KMO measure is used to decide the external validity and it should be greater than 0.5. KMO value is 0.618. So, the validity of this questionnaire was ensured.

Correlation Coefficient Analysis

According to the correlation analysis, there are 06 independent variables which do not show any correlation to business performance and significance values are greater than the critical p value of 0.05. Locus of control, functional competencies, financial resources, taxation, government support and networking are those insignificant independent variables. Locus of control, risk taking propensity, managerial competencies, entrepreneurial competencies, regulatory environment, technology and information are the variables which show a significant and positive correlation with the values of the correlation of 0.626, 0.587, 0.288, 0.697, 0.582, 0.683 and 0.434 respectively. Accordingly, the insignificant variables were removed and did the other analysis.

Multiple Linear Regression Analysis

Table 1: Model summary

Model	R	R Square	Adjusted R Square	Std. error of the Estimate
1	0.862	0.743	0.718	0.24528

Source: (Survey data, 2019)

The above model summary explains the impact of factors affecting SMEs' business performance in the Maruthamunai area. Here, the correlation value (R) in this model is 0.862. It is explained that there is a strong positive correlation between business performance & independent variable. The R Square value in this model is 0.743 (74.3%). It is explained that those independent variables explain 74.3% variance of business performance and the rest of 29.7% variance of business performance is explained by other variables.

Table2: Analysis of Variance (ANOVA)

Model	Sum of squares	df	Mean Square	F	P(Sig.)
Regression	12.528	7	1.790	29.748	0.000
Residual	4.332	72	0.060		
Total	16.860	79			

Source: (Survey data, 2019)

The analysis of variance (ANOVA) was presented to ensure the overall significance of the regression model. According to the above ANOVA table, P-value is 0.000. According to the P-value condition, it should be less than 0.05 to be significant the overall model. Therefore, the entire model is significant because P-value is less than 0.05 (0.000<0.05).

Table 3: Coefficient Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	P(Sig.)
	B	Std. Error	Beta		
Constant	-0.811	0.601		-1.348	0.182
NFA	0.200	0.053	0.269	3.777	0.000
RTP	0.030	0.064	0.044	0.466	0.643
MC	-0.041	0.055	-0.054	-0.757	0.452
EC	0.311	0.073	0.329	4.276	0.000
RE	0.286	0.135	0.158	2.125	0.037
TECH	0.184	0.075	0.262	2.452	0.017
INF	0.276	0.126	0.147	2.187	0.032

Source: (Survey data, 2019)

According to the above coefficient analysis table, the needs for achievement, entrepreneurial competencies, regulatory environment, technology, and information have a positive significant relationship with business performance under a 95% confidence level. Risk-taking propensity has a positive insignificant relationship with business performance, and managerial competencies have a negative insignificant relationship with business performance under a 95% confidence level.

Table 4: Summary of Hypotheses test

No	Hypotheses	Results
1	H_0: There is a significant relationship needs for achievement and business performance of SMEs.	Accepted

2	H_0: There is a significant relationship locus of control and business performance of SMEs.	Rejected
3	H_0: There is a significant relationship risk-taking propensity and business performance of SMEs.	Rejected
4	H_0: There is a significant relationship managerial competences and business performance of SMEs.	Rejected
5	H_0: There is a significant relationship entrepreneurial competences and business performance of SMEs.	Accepted
6	H_0: There is a significant relationship between functional competences and business performance of SMEs.	Rejected
7	H_0: There is a significant relationship between financial resource and business performance of SMEs.	Rejected
8	H_0: There is a significant relationship between taxation and business performance of SMEs.	Rejected
9	H_0: There is a significant relationship between government support and business performance of SMEs.	Rejected
10	H_0: There is a significant relationship between the regulatory environment and business performance of SMEs.	Accepted
11	H_0: There is a significant relationship between technology and business performance of SMEs.	Accepted
12	H_0: There is a significant relationship between information and business performance of SMEs.	Accepted

13	H_0: There is a significant relationship between networking and business performance of SMEs.	Rejected

The first hypothesis is related to the needs for achievement and business performance of SMEs in Maruthamunai area. According to the regression analysis, there is a significant relationship between the needs for SMEs' achievement and business performance. Therefore, the researcher concluded a positive significant relationship need for achievement and business performance of SMEs based on regression analysis. This finding is consistent with Mc Cllelland (1987) and he found that the needs for achievement as the primary driving traits in the character of successful. , the second hypothesis resulted in no association between locus of control and business performance (R= -0.031 and P= 0.788). Therefore, these variables have not been selected to the regression analysis and these variables have been rejected. The third hypothesis is related to the risk-taking propensity and business performance of SMEs in Maruthamunai area. According to the regression analysis, there is no significant relationship between SMEs' risk-taking propensity and business performance. This finding is consistent with Siegel, Siegel and Macmillan (1993). This finding contradicts Hisrich and Peters (2002) and they have found that risk-taking propensity includes all elements regarding risk and all those are an essential element that has a positive impact on business. Different authors said that risk-taking propensity has positively and negatively impact on business performance. Forth hypothesis is related to the managerial competences and business performance of SMEs in Maruthamunai area. According to the regression analysis, there is no significant relationship between SMEs' managerial

competences and business performance. This finding contradictory with O'Neill and Duker (1986) found that most of the enterprise was a failure due to lack of management capabilities or competencies and these capabilities had a positive relationship with business success. The fifth hypothesis is related to the entrepreneurial competencies and business performance of SMEs in Maruthamunai area. According to the Regression Analysis, there is a positive significant relationship between SMEs' entrepreneurial competences and business performance. This finding is consistent with Kristiansen et al. (2003) found that entrepreneurial readiness was a significant relationship with business success. The sixth hypothesis had no association between functional competences and business performance (R=0.124 and P= 0.274). Therefore, these variables have not been selected to the regression analysis and these variables have been rejected.

The seventh hypothesis was also rejected because the correlation analysis results show no association between financial resource and business performance (R=-0.063 and P= 0.580). Therefore, these variables have not been selected to the regression analysis and these variables have been rejected. The eighth hypothesis also rejected due to the correlation analysis results, there is no association between taxation and business performance (R= -0.051and P= 0.653). Therefore, these variables have not been selected to the regression analysis and these variables have been rejected. Similarly, the ninth hypothesis rejected due to no association between government support and business performance (R= -0.163 and P=0.149). Therefore, these variables have not been selected to the regression analysis and these variables have been rejected. The tenth

hypothesis is related to the regulatory environment and business performance of SMEs in Maruthamunai area. According to the Regression Analysis, there is a significant relationship between SMEs' regulatory environment and business performance. Therefore, the researcher concluded that there is a positive significant relationship between the regulatory environment and business performance of SMEs based on regression analysis. This finding is consistent with the argument that government regulation and other restrictions have negatively impacted SMEs' performance, and government regulation is an external factor that impacts SMEs' performance (Yusuf, 1995; Simbi, 2004).

The eleventh hypothesis is related to the technology and business performance of SMEs in Maruthamunai area. According to the Regression Analysis, there is a significant relationship between SMEs' technology and business performance. The researcher concluded a positive significant relationship technology and business performance of SMEs based on regression analysis. This finding is consistent with some arguments. In their study in the US, Gundry et al. (2003) proposed that technological change innovations had a significant relationship with market growth. Arinaitwe (2006) said that small-scale enterprises have difficulty neither competing nor improving because of technological deficiency. The twelfth hypothesis is related to the information and business performance of SMEs in Maruthamunai area. According to the Regression Analysis, there is a significant relationship between SMEs' information and business performance. Therefore, the researcher concluded positive significant relationship information and business performance of SMEs based on regression analysis. This finding is

consistent with arguments. Availability of new information is necessary for the initiation, survival and business growth (Duh, 2003; Kristiansen et al. 2002). , the last hypothesis was rejected because of the correlation analysis results, there was no association between networking and business performance (R= 0.056 and P= 0.623). Therefore, these variables have not been selected to the regression analysis and these variables has been rejected.

CONCLUSION AND RECOMMENDATIONS

The overall objective of this study is finding the factors that are affecting on business performance of SMEs in Maruthamunai area and specific objectives are to explore internal factor that is affecting on business performance of small and medium enterprises and explore external factor that is affecting on business performance of small and medium enterprises. The regression analysis shows there are five variables positively significant impact on business performance. Namely; needs for achievement, entrepreneurial competences, regulatory environment, technology, and information. Rest of the other two variables are not a significant impact on business performance, namely; risk-taking propensity and managerial competences. According to the specific objective, firstly, in the internal factor, there are four variables associates with business performance, namely; needs for achievement, risk-taking propensity, managerial competences, and entrepreneurial competences, except locus of control and functional competences. After running regression analysis, there are two variables: needs for achievement and entrepreneurial competences, positively significant impact on SMEs' business performance and rest of other variables, namely; risk-taking

propensity and managerial competences, are not a significant impact on business performance of SMEs.

Secondly, in the external factor, there are three variables associated with business performance, namely; regulatory environment, technology, and information, except financial resource, taxation, government support, and networking. The regression analysis concludes that all these variables, namely; regulatory environment, technology, and information, positively impact theimpact SMEs' business performance.A business owner who should concentrate these factors to achieve the goals of the business. In Maruthamunai area, no studies have been conducted regarding this context. Hence, the study will be the most essential and initial step to exploring this discipline's research. Therefore, future research can include the whole district or province. Finally, the current study adopted only quantitative research methodology, for future researches it is better to use qualitative research methodology to establish the factors affecting the business performance of SMEs.

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