



DEMARCATIONS OF THE GROWTH AFFECTING FACTORS BETWEEN THE LOW GROWTH AND HIGH GROWTH SMES: A Sri Lankan Perspective

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Abstract: Small and medium scale entrepreneurs are vital for the economic development of any country. High failure rate and low survival rate of SMEs obstruct to this expectation specially among developing and least developed countries. Past studies have identified the growth affecting factors for SMEs as internal and external factors without demarcation between high-growth and low-growth SMEs. Studying the distinctiveness of those factors between low-growth and high-growth SMEs would be useful to treat separately and provide customized solutions for these two categories of SMEs. This paper was designed to reveal the demarcations of the growth affecting factors between the low-growth and high-growth SMEs by selecting a sample of SMEs in Southern Province of Sri Lanka. Two hypotheses were formulated and Independent Sample T-Test and Mean Importance Index method were applied to test the hypotheses. Comparison between the high-growth and low-growth SMEs revealed that there is a significant difference in the impact of internal factors on the business growth between the two groups of SMEs while external factors were considered as equally affect on the business growth by both groups. This implies that growth affecting factors internal to the firm differently effect on the business growth of high-growth and low-growth SMEs while factors external to the firm affect equally to the both types of SMEs. As per mean important indexes, for high-growth SMEs, owner-manager capabilities including growth orientation, risk taking ability, innovation and networking ability affect highly on their business growth meanwhile factors beyond the firm's control including labour rules and regulations, poor market support systems and ineffectiveness of the BDS services affect highly on the low growth of their firms. High cost of financing affects highly for the growth in both categories.

Key Words: Business growth, Demarcation, External factors, High-growth and low-growth SMEs, Internal factors

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1. INTRODUCTION

Small and Medium Scale Enterprises (SMEs) in any country have been considered as the backbone of economic development. As a source of employment generation, contribution to the growth of Gross Domestic Production (GDP), embarking on innovations and value additions and stimulating other economic activities, the development of this sector is of paramount importance for any country. In Sri Lanka, this sector is vital to the national and local economic development as it accounts for more than 75% of the total number of enterprises, 45% of the employment, 52% of the GDP contribution, and provides more opportunity for women and youth participation in the economic development of the country (National Policy Framework for SME Development, 2016). Further this report mentioned that *“SME sector is envisaged to contribute to transform lagging regions into emerging regions of prosperity”* (p1). Eventhough it is believed that the significance of SMEs for economic development of the country, failure rate of SMEs remain very high as 45% (Bandara, 2016) with 75% closing down within seven years (Jayathilaka, 2016). Moreover, the Sri Lankan Enterprise Survey (as cited by Hettiarachchi, 2013) revealed that comparatively to the 5.2 percent of growth rate of SMEs in the world context, Sri Lankan SMEs reported a very low rate of growth (2.9%). However, the Government of Sri Lanka still recognizes the SME sector as a very important strategic sector for enhancing the national and international competitiveness and for this to achieve it requires studying the emerging challenges and developing SMEs as a thriving sector. Due to the immense contribution to economic growth while reporting high failure rate of this sector, many researches (for example, Gunarathne, 2008; Kuluppuarachchi & et al, 2017; Kumarasinghe, 2017) were addressed on the factors affecting on the growth of SMEs. These factors have been categorized as owner-manager factors, internal and external factors (Kuluppuarachchi & et al, 2017; Gunarathne, 2008; Isaksen, 2006). However, SME research literature on demarcation of such growth affecting factors between low growth and high growth SMEs is rare. Therefore, it still remains the question of why some SMEs prosper while others fail under similar economic conditions (Kuluppuarachchi & et al, 2017). Therefore, demarcation between the factors affecting to growth between the low growth and high-growth is essential. Hence this study focuses on fulfilling this research gap by emphasizing the differences in growth affecting factors between low-growth and high-growth SMEs and if such difference exists, emphasizing on which factors affect highly. Identification of such differences in growth affecting factors and treat separately for low-growth and high-growth SMEs will be helpful for achieving the aim of the SME Policy Framework in Sri Lanka (2016) that is

to promote high potential, promising SMEs and address to the main barriers to allow them to realize their full potentials in today's globalized business arena.

2. LITERATURE REVIEW

2.1. SME Definition

SMEs are defined differently by various countries and different institutions within a country using variety of parameters including number of persons employed, amount of capital invested, amount of turnover etc. The most commonly used criteria included number of employees (OECD, 2004) sales turnover and investment (Berger and Udell, 1998 – cited by Cressy, 2006). The EU and a large number of OECD countries, transition and developing countries set the upper limit of number of employees in the SMEs between 200-250, with a few exceptions such as Japan (300 employees) and the USA (500 employees). Sri Lanka does not have a commonly acceptable definition for SMEs until recent past. Different institutions adopt varying definitions depending on convenience and objectivity of studding SMEs such as in terms of value of fixed assets, the size of employment, sales turnover or a combination of these criteria. For example, Department of Census and Statistics used the criteria of “number of employees” (employees more than 25 up to 100 as medium scale and less than 25 and up to 10 as Small Scale), Task Force for SME Sector Development in Sri Lanka (SME White Paper-2002) used two criteria such as “asset value excluding land and buildings” and “number of employees” (asset value not exceeding Rs. 50 Mn and employees between 30-149 as medium scale and asset value between Rs. 1-20 Mn and employees between 5 – 29 as small scale), etc. After many years without a clear definition for SMEs, Ministry of Industry and Commerce has finalized a definition for SMEs in 2016 under its ‘National Policy Framework for Small and Medium Enterprise (SME) Development’ by using the annual turnover and number of employees as the criteria. Accordingly, number of employees between 11-50 and annual turnover between 16mn-250mn are considered as small scale enterprises and number of employees between 51-300 and annual turnover between 251mn-750mn are considered as medium scale enterprises.

2.2. Theoretical perspectives on Small Business Growth

Critical precondition for a firm's longevity is considered as the business growth (Storey, 1994). Due to the diverse nature of the growth construct, variety of operational definitions and measurements including number of employees, sales turnover, capital investment, expansion of product line,

product diversification, market diversification, etc. were used in research literature related to SME performance (Nicher and Goldmark, 2005). Sales growth has been utilized as a single measure of business growth by several researchers (Moreno and Casillas, 2007). Storey (2001) defined high-growth firms as firms that have achieved a sales growth of at least 25 percent in each of the 4 years for businesses with current sales of £5–10 million, or of at least 15 percent for businesses with current sales amounting to £10–100 million. According to the National Commission on Entrepreneurship (2001), rapid-growth firms are firms with an increase in headcount by at least 15 percent per year. As per the definition of OECD Manual, all enterprises with average annualized growth greater than 20 percent per annum, over a three-year period have been considered as “high-growth enterprises” and otherwise as “low-growth enterprises”. Moreover, number of employees has been widely used as a measure of growth (Gunarathne, 2008; Freel and Robson, 2004; Chaganti *et al.*, 2002; Davidsson & *et al.*, 2000). Arrighetti and Lasagni (2013) also measured growth in terms of sales. However, researchers have found a strong correlation between sales and employment growth, which are frequently used in the SME context, (North and Smallbone, 1993; Storey *et al.*, 1987). Other than these two measures, numerous measures have been used to discern between high and low growth intentions of the entrepreneurs. Kickul *et al.*, (2002) used three measures to determine growth intentions: the amount of start-up funding they needed to grow their business; the amount of additional funding they will need in the next five years to grow; and their level of sales revenue. Moreno and Carsillas (2007) used an extraordinary growth in comparison with the average growth of other firms in the same industry, and not in absolute terms.

2.3. Growth affecting factors on SMEs

A variety of categories in the extant literature can be found relating to identification of factors affecting on small business growth. These categorizations are range from 2 to 5 types. However, it can be seen a quite similarity of the factors presented under the different labels by different studies. Many researchers used two distinct categories. Schmitz (1982) categorized as internal nature (Entrepreneurship, management) and external nature (access to resources, exploitation by larger enterprises, and discrimination from government) and Baum *et al* (2001) included organizational level and the individual level of the firm owner (personality, human capital, goals, strategies and background of the owner).

Other group of researchers concluded that growth determinants fall into three groups. Those include: business strategy, management characteristics and firm characteristics (Storey, 1994 cited by Foreman-Peck

et al., (2006); external environmental issues, factors relating to internal structural dynamics of the business, and owner-manager characteristics (Walsh, 1994); owner-specific factors, firm-specific factors, and external factors (Gunarathne, 2008; Bruederl *et al.*, 1992). Several researchers have emphasized four and five different factors. Nicher and Goldmark (2005) grouped as four sets: business environment (macro-economic context, regulatory and institutional context, location and sector, infrastructure, value chain), social (inter-firm cooperation, social networks), firm (firm age, formality, technology, finance), and individual factors (education, work experience, gender and the household). Islam (2011) classified the factors as: characteristic of entrepreneur, management and know-how, products and services, customer and market, the way of doing business and cooperation, resources and finance, strategy, and external environment.

In the entrepreneurship literature, internal factors which were identified as growth affecting factors were mostly relating to the functional areas of the business including: human resources, marketing, finance, and production and technological. Other than these factors, several researchers have emphasized on the management competencies and capabilities, productivity aspect, strategic orientation, and etc. (Perenyi, 2008; and Isakson, 2006). Gunarathne (2008) subdivided the internal factors affected on the growth of SSEs into four categories: the characteristics of the business, factors that correspond to its ownership and organizational form, internal management competencies, and strategy employed by the business. Marketing management perspective such as lack of marketing effort and market research, poor customer relationships, lack of market orientation and problems relating to marketing strategies were widely cited by many researchers (Grimsholm and Poblete, 2010; Brush and *et al.* 2009; Verhees and Meulenber, 2004). Lack of talented and skillful human resources has been considered as one of the key constraints which differentiate rapid-growth firms from slow-growth firms (Barringer *et al.*, 2005, Bartlett and Bukvic, 2001). Performance between high growth and low growth SMEs were identified based on lack of know-how on up-to-date technology, operational efficiency, product quality, and non-availability of new and advanced technology (Amaradiwakara and Gunathilaka, 2016; Grimsholm and Poblete, 2010; Ibrahim 2008; Sardana and Dasanayaka, 2008; SME-White Paper, 2002). Further, lack of management skills and competencies (Grimsholm and Poblete, 2010; Thassanabanjong *et al.*, 2009) as well as lack of financial management capabilities (APO, 2001; Gunarathne, 2008) and business planning and strategic orientation (Bhatti and Dileep, 2012; Barringer *et al.*, 2005) were identified as main internal factors affecting on SME growth. Kuluppuarachchi & *et al.*, (2017) highlighted that the most

perceived obstacle was finance which is largely internal to the firm and poor management is the other obstacle. Amaradiwakara and Gunathilake (2016) revealed that the growth of SMEs is constrained by financial inadequacy and lack of access to new technology, and level of education of the owner of the enterprise. Arrighetti and Lasagni (2013) found that the quality of human capital as a strong point for affecting firms' rapid growth. As per the review of literature on internal factors affecting on the business growth of SMEs, lack of finance, talented and skillful human resources, management skills and competencies, marketing capabilities and technology know-how were highly the highly affected factors.

Among the external factors which effect on SME growth, huge competition (Bhatti and Dileep, 2012; Grimsholm and Poblete, 2010; Dasanayake, 2009), lack of BDS support and networking (Bhatti and Dileep, 2012; Gunarathne, 2008), lack of access to new information (Dasanayake, 2009; Duh, 2003), inadequate infrastructure (Ibrahim, 2008; Abeyratne, 2005), regulatory and policy barriers (Wickramasingha, 2011; Nicther & Goldmark, 2005; World Bank Report, 2005; Bartlett & Bukvic, 2001), labour market issues such as shortage of skilled workers (Grimsholm and Poblete, 2010; Dasanayake, 2009; SME White Paper-2002; Wijewardena et al, 2000;), lack of access to credit (Perera, and Wijesinghe, 2011; Grimsholm and Poblete, 2010; Nichter and Goldmark, 2009; Dasanayake, 2009; Ibrahim, 2008; SME White Paper-2002), market infrastructure (Kuluppuarachchi & *et al*, 2017) can be identified via the review of past entrepreneurship literature. According to the World Economic Forum's Global Competitiveness Report (2006/7), Sri Lanka's three most problematic factors for doing business are policy instability, access to finance and inadequate supply of infrastructure (cited by Kuluppuarachchi and *et al*, 2017). Amaradiwakara and Gunathilake, (2016) revealed that growth of SMEs is constrained by some regulations imposed by the government.

As per above literature review, number of past studies were addressed on the factors affecting to the business growth of SMEs. However, very limited research is available which have been addressed on the demarcation between the growth affecting factors for the low-growth and high-growth SMEs. Based on this research gap, following research hypotheses were developed in this study to reveal is there any demarcation exist in growth constraints between the low-growth and high-growth SMEs.

- H₁: Significant difference exists in impact of internal factors on the business growth between high-growth and low-growth SMEs.
- H₂: Significant difference exists in impact of external factors on the business growth between high-growth and low-growth SMEs.

3. METHODS

3.1. Sample and Data Collection

SMEs were selected from the members of Small Enterprise Development Division (SEDD), Chamber of commerce and Industries in Galle, Matara and Hambantota districts, and Trade and Mercantile associations of southern province of Sri Lanka. Cross sectional survey method was applied to collect primary data from the SMEs. SMEs were defined based on the number of employees of the entity (11-300) as per the criteria of National Policy Framework for SME Development in Sri Lanka (2016). Further, the enterprise which has at least 3 years of age has been considered to include into the sample. Structured questionnaire was used to collect data from the respondents and first section included the demographic profile of the respondents, second part included the profile of the business, questions related to business growth and growth affecting factors on the five point Likert-scale from strongly disagree (1) to strongly agree (5). Growth affecting factors were presented as statements that describe its importance relating to the firm's growth. A set of 159 structured factor statements was drawn up under the 31 sub categories of factors, based on entrepreneurship and strategic management literature, discussions with experts and facilitators and institutions for SME development. Researcher individually attended to collect data from the SMEs by participating for several discussion forums, training workshops and Annual General Meetings conducted for SMEs by the above mentioned BDS organizations. Out of 152 questionnaires were received, 22 questionnaires were discarded due to incomplete responses and missing data and 130 questionnaires were preceded. Sample includes 91 (70%) male entrepreneurs and 39 (30%) female entrepreneurs.

3.2. Measures

$$(\text{AIBG}) \text{ Aggregated Index of Business growth} = \frac{(X_{11} - X_{10})}{X_{10}}$$

Where; X_{10} is either employees or sales turnover or investment in the commencing year

X_{11} is either employees or sales turnover or investment in the present year

As per the research hypotheses, internal factors and external factors are the two independent variables of this study. Based on the critically concerned growth affecting factors in the SME research literature, 4 internal factors have been included into the model including: (i) management

incapability; (ii) lack of entrepreneurial know how; (iii) poor product and process technology; and (iv) lack of marketing capabilities. 13 sub factors were included to determine the position of each entrepreneur relating to these 4 major growth constraints internal to the firm. Seven external factors on business growth namely: (i) information barriers; (ii) credit barriers; (iii) infrastructure barriers; (iv) market difficulties; (v) labour market issues; (vi) business rules and regulations; and (vii) BDS services and networking have been included into the model. 18 sub factors under these seven major external growth constraints were used to determine the extent of the impact of external factors on the business growth. Business growth is the dependent variable of this study. Investment, sales revenue, and number of employees at the commencing year and the present year were obtained to reveal the extent of business growth. Aggregated Index method was used in measuring the business growth. The formula that has been used in OECD Manual on Business Demography Statistics (2007) for calculation of the business growth has been used for this study. The formula is as follows:

For testing the hypotheses, the SMEs in the sample had been divided into two categories as “low-growth” and “high-growth” SMEs. The definition of OECD Manual for high Growth Enterprises was applied in differentiating the firms as “Low-growth firms” and “High-growth firms”, Accordingly, all enterprises with average annualized growth greater than 20 percent per annum, over a three year period have been considered as high-growth enterprises and otherwise as “low-growth firms”.

4. DATA ANALYSIS

Independent Sample T-Test and Mean Important Index were used for data analysis. The T-Test was used to compare the statistical significance of a possible difference between the means of two groups of high-growth and low-growth SMEs. As pointed out by Hair *et al.*, (2010, p. 11) with a moderate effect size power reaches acceptable levels at sample sizes of 100 or more for alpha levels of both .05 and .01. Because the sample size of this study is more than 100 and less than 200, alpha levels of both .05 and .01 have been selected. As per the results of this study, respondents rated 31 factors in terms of their importance in influencing their business growth. Importance indexes were calculated separately for “High” and “Low” growth SMEs. Of the sample, 71 SMEs were rated as “High-growth SMEs” and 59 as “Low-growth SMEs” by using the OECD guide.

The first hypothesis of this study (H_1) assumed that “Significant difference exists in impact of internal factors on the business growth between the high-growth and low-growth SMEs”. As per Table 1, Levene’s Test is

significant because the P -value (0.002) of less than .05 and the two variances are significantly different. By looking down the *Equal variances not assumed* column, it can be seen that the group means are significantly different as the value in the “**Sig. (2-tailed)**” row is less than 0.05. This implies that there is a difference in impact of internal factors between high-growth and low-growth SMEs and the difference is significant. Hence, the first hypothesis (H_1) of this study can be accepted.

Table 1: T-Test Results for Internal Factors and Business Growth

		<i>Internal Factors</i>	
		<i>Equal variances assumed</i>	<i>Equal variances not assumed</i>
Levene's Test for Equality of Variances	F	10.083	
	Sig.	.002	
	<i>t</i>	-8.459	-8.795
	<i>df</i>	128	120.65
	Sig. (2-tailed)	.000	.000
	Mean Difference	-19.971	-19.971
	Std. Error Difference	2.36083	2.7066
95% Confidence Interval of the Difference	Lower	-24.64227	-24.46646
	Upper	-15.29965	-15.47545

Source: Author Survey 2018/19

The second hypothesis of this study (H_2) assumed that “Significant difference exists in impact of external factors on the business growth between the high-growth and low-growth SMEs”. Table 2 shows the Levene's Test results of the impact of external factors on business growth between the high-growth and low-growth SMEs in the sample. The P -value

Table 2: T- Test Results for External Factors and Business Growth

		<i>External Factors</i>	
		<i>Equal variances assumed</i>	<i>Equal variances not assumed</i>
Levene's Test for Equality of Variances	F	.839	
	Sig.	.361	
	<i>t</i>	-.272	-.268
	<i>df</i>	128	115.237
	Sig. (2-tailed)	.786	.789
	Mean Difference	-.79528	-.79528
	Std. Error Difference	2.92285	2.96352
95% Confidence Interval of the Difference	Lower	-6.57874	-6.66532
	Upper	-4.98807	-5.07476

Source: Author Survey 2018/19

(0.361) of greater than .05 for Levene's test shows that there is an equal variance and the significance value of .786 (2-tailed) in the equal variance assumed column implies that there is no significant difference between the two groups of SMEs regarding the impact of external factors. This tells us external factors can be considered as equally effect on both high-growth and low-growth SMEs and hence H_2 of this study cannot be accepted.

The findings relating to the difference between the impact of internal factors and external factors on the business growth between the high-growth and low-growth SMEs show that impact of internal factors on the business growth of these two groups is significantly different and no difference revealed relating to the impact of external factors. Due to lack of prior research on this aspect in Sri Lankan context, it is impossible to critique the findings of this study with prior findings. However, as per the prior research findings of other countries, lack of talented and skillful human resources has been considered as one of the key constraints which differentiate rapid-growth firms from slow-growth firms (Barringer *et al.*, 2005; Bartlett and Bukvic, 2001).

Moreover, this research aims to identify if a significant difference exists in factors affecting to the business growth between high and low growth SMEs, which factors affect highly for each category of SMEs. For this purpose, mean importance indexes were calculated based on the SMEs' responses on the severity of growth affecting factors. Table 3 shows the highest 10 sub factors (out of 31 sub factors under the main growth constraints) marked by the SMEs in the sample. Accordingly, high-growth SMEs marked the internal factors as the most critical for the business growth

Table 3: Mean Important Index of Factors Affecting on Business Growth

	<i>High growth firms</i>		<i>Low growth firms</i>
Growth orientation(I)	5.14	Labour rules and regulations	4.41
Risk taking ability(I)	4.99	High cost of financing	4.38
High cost of financing	4.38	Poor market support systems	4.31
Organized networks(I)	4.37	Ineffectiveness of the BDS services	4.27
Innovation ability(I)	4.36	Poor level of networking(I)	4.21
Lack of skilled labour	4.31	Poor marketing strategies(I)	4.06
Ineffectiveness of the BDS services	4.26	Lack of skilled labour	4.02
Labour rules and regulations	4.26	High competition	4.01
Poor market support systems	4.25	Low level access to information	3.92
Emotional support of family members and relatives(I)	3.88	Lack of technological developments(I)	3.91

I= Internal Factors Source: Author Survey 2018/19

and low-growth SMEs marked external factors as the most critical factors. As per the responses of high-growth SMEs, internal factors including growth orientation, risk taking ability, innovation ability, and networking ability work as the most influential factors on business growth.

These findings were aligned with the views of Grimsholm and Poblete (2010), David (2009), Macpherson and Holt (2007) and Barratt-Pugh (2005) which were highlighted that the firm growth is dependent on the skills and capabilities internal to the firm are very important for the growth and ensure the competitiveness of SMEs. A similar view was presented by O'Regan & *et al*, (2006) and they revealed that high growth firms place a greater emphasis on strategic orientation, their operating environment and the use of e-commerce compared with firms having static or declining sales. Also they viewed that external factors affect highly on the business growth of the slow growth firms. Chandrasiri (2006) and Abeyratne (2005) presented a similar view on inadequate support for accessing markets severely effect on the growth of the SMEs. Therefore, it needs a proper market support system for facilitating and encouraging SMEs operating in international markets and ensuring the availability of reliable and quick information etc. Buddhadasa (1999) and SME White paper (2002) also emphasized that, Sri Lankan SMEs have to face difficulties in receiving on-time information and find foreign market opportunities due to absence of market support centers as been established in several countries in Asia, for example, China External Trade Development Council, Trade Development Council in Hong Kong, and etc. By presenting a similar view to the findings relating to market difficulties, Dasanayaka (2009) expressed that marketing related problems always rank as the number 2 problem by Sri Lankan SMEs. So far in Sri Lanka, government organizations specifically to address the marketing issues of SSEs do not exist.

5. CONCLUSION

Main objectives of this study were to determine whether there are differences in growth affecting factors between high growth and low growth SMEs and to reveal which factors affect highly for each category of SMEs. The comparison of growth affecting factors between high-growth and low-growth SMEs revealed that no significant difference exists in the impact of external factors between high-growth and low-growth SMEs and there is a significant difference in the impact of internal factors between the two groups of SMEs. As revealed through the mean importance indexes of sub factors, majority of low-growth SMEs identified external factors affect on the business growth and this implies that the dependent mentality, poor attitudes and lack of growth orientation are the reasons for their low growth

in performance. Ensuring a conducive business environment in Sri Lanka is very critical because high cost of financing has been identified as a crucial barrier by both groups of SMEs. Therefore, to uplift the SME sector in Sri Lanka as a most vital strategic sector in the economic development of the country, it requires employing a customized approach separately for the low-growth and high-growth SMEs by taking into account the specific growth constraints faced by them rather than offering a uniform approach for all the SMEs in the country.

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