

## 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, especially among developing 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 the growth affecting factors between low-growth and high-growth SMEs would be useful to develop a customized mechanism for treating separately for the needful SMEs. This paper aims to reveal the demarcations of the growth affecting factors between the low-growth and high-growth SMEs by selecting a sample of SMEs in the Southern Province of Sri Lanka. Two hypotheses were formulated based on the existing research gaps. Independent Sample T-Test and Mean Importance Index method was applied to test the hypotheses. Comparison between the high-growth and low-growth SMEs revealed that significant difference is there in the impact of internal factors on the business growth between the low-growth and high-growth SMEs and

no such a significant difference exists in the impact of external factors on the business growth. 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 both types of SMEs. As per the mean important indexes, owner-manager capabilities including growth orientation, risk-taking ability, innovation and networking ability affect highly on their business growth of high-growth SMEs 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. The 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*

**1. Introduction**

Small and Medium Scale Enterprises (SMEs) in any country has been considered as the backbone of economic development. SMEs are defined differently by various countries by using a variety of parameters including the number of persons employed, the amount of capital invested, amount of turnover etc. By using the number of employees in the entity, the European Union (EU) and a large number of OECD (Organization for Economic Co-operation and Development) countries define the SMEs as the number of

employees between 200-250, in japan up to 300 employees, and the USA up to 500 employees (Berger and Udell, 1998 – cited by Cressy, 2006). In Sri Lanka, as per the “National Policy Framework for Small and Medium Enterprise (SME) Development – 2016”, the number of employees between 11-50 and annual turnover between 16mn-250mn are considered as small scale enterprises and the number of employees between 51-300 and annual turnover between 251mn-750mn is considered as medium scale enterprises.

The development of this SME sector has been identified as of paramount importance for any country 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, 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 transforming lagging regions into emerging regions of prosperity*” (p1). Even though it is believed that the SMEs contribute significantly for the economic development of the country, the failure rate of SMEs remains very high as 45% (Bandara, 2016) with 75% of closing down rate within seven years of the origin (Jayathilaka, 2016).

Moreover, the Sri Lankan Enterprise Survey (as cited by Hettiarachchi, 2013) revealed that compared to the 5.2 per cent of the growth rate of SMEs in the world context, Sri Lankan SMEs reported a very low rate of growth (2.9%). Therefore, a concentration needs to be given on why such a low growth rate as well as the high failure rate in the SME sector of Sri Lanka.

Several past studies (for example, Gunarathne, 2008; Kuluppuarachchi & et al, 2017; Kumarasinghe, 2017) have studied the factors affecting the growth of this thriving sector of SMEs. As per the existing research literature, these growth affecting 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 the demarcation of such growth affecting factors between low growth and high growth SMEs is rare. Therefore, it remains the question of why some SMEs prosper while others are unable to survive under similar economic conditions (Kuluppuarachchi & et al,

2017). Therefore, identification separately the factors affecting to growth between the low - growth and high-growth SMEs seems as essential in the current scenario of Sri Lanka. 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 help achieve 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. Methodology**

### *2.1. Hypotheses Development*

Growth affecting factors of SMEs have been categorized by many researchers as internal factors and external factors. Internal factors

which were identified as hampering the growth of SMEs 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 management competencies and capabilities, productivity aspect, strategic orientation, etc. (Perenyi, 2008; and Isaksen, 2006). Gunarathne (2008) subdivided the internal factors affected on the growth of SSEs into four categories including 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 Meulenberg, 2004). Lack of talented and skilful 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; Sardana and Dasanayaka, 2008; SME-White Paper, 2002). Further, lack of management skills and competencies (Grimsholm and Poblete, 2010; Thassanabanjong et al., 2009) lack of financial management capabilities (Gunarathne, 2008) and business planning and strategic orientation (Bhatti and Dileep, 2012; Barringer et al., 2005) were identified as main internal factors which affect on the growth in SMEs. Kulupparachchi and et al, (2017) highlighted that the most perceived obstacle for SMEs 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, 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 skilful human resources, management skills and competencies, marketing capabilities and technical know-how were identified as highly affecting factors on the growth or performance of SMEs.

Among the external factors which affect 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), inadequate infrastructure (Abeyratne, 2005), regulatory and policy barriers (Wickramasingha, 2011; Nicther & Goldmark, 2005; World Bank Report,

2018; Bartlett & Bukvic,2001), labour market issues such as shortage of skilled workers (Grimsholm and Poblete, 2010; Dasanayake, 2009; SME White Paper-2002) lack of access to credit (Perera, and Wijesinghe, 2011; Grimsholm and Poblete, 2010; Nichter and Goldmark, 2005; Dasanayake, 2009; SME White Paper-2002), market infrastructure (Kulupparachchi & 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 Kulupparachchi and et al, 2017). Amaradiwakara and Gunathilake, (2016) also revealed that growth of SMEs is constrained by some regulations imposed by the government.

As per the above literature review, a number of past studies were addressed on the factors affecting the business growth of SMEs. However, the

research studies which have been addressed on the demarcation between the growth affecting factors for the low-growth and high-growth SMEs are very limited. Based on this research gap, the 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.

H<sub>1</sub>: There is a significant difference in the impact of internal factors on the business growth between high-growth and low-growth SMEs.

H<sub>2</sub>: There is a significant difference in the impact of external factors on the business growth between high-growth and low-growth SMEs.

## 2.2. *Sample and Data Collection*

The sample of this study included the SMEs 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 the

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 the National Policy Framework for SME Development in Sri Lanka (2016). Further, the enterprise which has at least 3 years of existence has been considered to include in the sample of this study. A structured questionnaire was used to collect data from the respondents. The first section of this questionnaire was emphasized the demographic profile of the respondents and followed by the profile of the business and next to the questions related to business growth and growth affecting factors which were based 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 subcategories of factors based on entrepreneurship and strategic management literature, discussions with experts and

facilitators and institutions for SME development. The 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 used. Sample included 91 (70%) male entrepreneurs and 39 (30%) female entrepreneurs.

### 2.3. *Measures*

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 business growth. Business growth is the dependent variable of this study. Even though the business growth of any firm is usually considered as a critical precondition for its longevity (Storey, 1994), in measuring the ‘business growth’, diverse measurements such as the number of employees, sales turnover, capital investment, value additions, productivity, etc. were used in the research literature (Nicher and Goldmark, 2005; Daunfeldt & et al, 2010; Piazza & et al, 2016). Sales growth has been utilized as a single measure of business growth by several researchers (Moreno and Casillas, 2007). As per Storey (1987), high-

growth firms have been defined as firms that have achieved a sales growth of at least 25 per cent in each of the 4 years for businesses with current sales of £5–10 million, or of at least 15 per cent for businesses with current sales amounting to £10–100 million. Arrighetti and Lasagni (2013) also measured growth in terms of sales. According to the National Commission on Entrepreneurship (2001), rapid-growth firms are firms with an increase in headcount by at least 15 per cent per year. As per the definition of Eurostat/ OECD Manuals on Business demography (2007), all enterprises with average annualized growth greater than 20 per cent per annum, over a three-year period have been considered as “high-growth enterprises” and otherwise as “low-growth enterprises”. Also, Piazza & et al (2016) suggested that the composite growth measure which considers both absolute and relative growth may be more appropriate and many studies used a combination to measure growth. Moreover, the number of employees has been widely used as a measure of business growth (Gunaratne, 2008; Freel and Robson,



2004; Chaganti et al., 2002; Davidsson & et al., 2000). 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. By taking into account how the business growth was measured in the past research literature, this study used both the commencing year and the present year figures relating to the three criteria including investment, sales revenue, and the number of employees of the SMEs in the sample. Further, the Aggregated Index method was used in measuring the business growth. The formula which has been used in the OECD Manual on Business Demography Statistics (2007) for calculation of the business growth has been used for this study.

The formula is as follows:

$$(AIBG) \text{ Aggregated Index of Business growth} = \frac{(X_1 - X_0)}{X_0}$$

Where:  $X_0$  is either employees or sales turnover or investment in the commencing year  
 $X_1$  is either employees or sales turnover or investment in the present year

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 and low - 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 per cent per annum, over a three-year period have been considered as “high-growth enterprises” and otherwise was considered as “low-growth enterprises”.

### 3. Results and Discussions:

Independent Sample T-Test and Mean Important Index methods were applied 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., (2014, 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 - growth” and “Low – growth” SMEs. By using the OECD guide, 71 SMEs of the sample were rated as “High-growth SMEs” and 59 as “Low-growth SMEs”.

The first hypothesis of this study ( $H_1$ ) assumed that “There is a significant difference in the 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 significant difference in the impact of internal factors between high-growth and low-growth SMEs in the sample of this study. Hence, the first hypothesis ( $H_1$ ) of this study can be accepted.

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

		Internal Factors	
		Equal variances assumed	Equal variances not assumed
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	-24.64227	-24.46646
	Lower of the Difference	-15.29965	-15.47545
	Upper		

Source: Author Survey 2018/19

The second hypothesis of this study (H<sub>2</sub>) assumed that “there is a significant difference in the 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 (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 having an equal influence on both high growth and low-growth SMEs and hence H<sub>2</sub> of this study cannot be accepted.

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

		External Factors	
		Equal variances assumed	Equal variances not assumed
Levene's Test F		.839	
for Equality of Sig.		.361	
Variances			
	<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	-6.57874	-6.66532
	Interval Lower	-4.98807	-5.07476
	of the Difference		
	Upper		

Source: Author Survey 2018/19

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 was revealed relating to the impact of external factors. Due to the lack of prior research on this aspect relating to the 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 the business growth between high and low growth SMEs, which factors affect highly on 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 business growth and low-growth SMEs marked external factors as the most critical factors that impede business growth. 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.

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

	High growth firms		Low growth firms
Growth orientation(I)	5.14	Labour rules and regulations	4.41
Risk-taking ability(I)	4.99	The 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
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*I= Internal Factors*

Source: Author Survey 2018/19

These findings were aligned with the views of prior studies. OECD country report (2002) revealed that innovation and networking skills as the main characteristics of the high-growth SMEs. Grimsholm and Poblete (2010), David (2009), Macpherson and Holt (2007) and Barratt-Pugh (2005) 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 centres has been established in several countries in Asia, for example, China External Trade Development Council, Trade Development Council in Hong Kong, 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.

#### 4. 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 subfactors, 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 the 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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