OBSTACLES FOR THE SUSTAINABILITY OF BUSINESS START-UPS: THE CASE OF NORTH WESTERN PROVINCE IN SRI LANKA

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Introduction

Entrepreneurs are the change agents in economies. Small and Medium Enterprises (SMEs) play a vital role in almost all economies in the world. Especially in developing countries like Sri Lanka, they serve as stepping stones for large enterprises and most of the large enterprises have begun as SMEs at their inception. SMEs have gained recognition as a major player of employment, income generation, poverty alleviation and regional development [1]. Furthermore, they play important roles in developing entrepreneurial skills and innovation and promoting economic growth and wealth creation. The Government of Sri Lanka recognizes SMEs as the backbone of the economy since they accounts for more than 75% of the total number of enterprises, provides 45% of the employment and contributes to 52% to the GDP [2].

At present, Sri Lanka doesn't have a generally accepted set of criteria for SMEs. Instead, different agencies use different criteria based on their objectives [3] and hence there is no consistency. Turnover, wealth and number of employees employed have been identified as major criteria in defining SMEs. The industrial, trade and the service sectors have given rise to substantially different distributions, and as such, different thresholds have been identified for each of those sectors to define micro, small, medium and large establishments. It is has been estimated that at present there are 1,019,681 business firms of all sizes in Sri Lanka [4]. Statistics show that at least 99.8% of the firms are micro, small and medium enterprises having only 0.2% are large ones. It is vital for Sri Lankan SMEs to look beyond Sri Lankan boundaries in order to gain sustainability and growth. The study is based on the start-up culture of SMEs [4].

Start-ups are new businesses that are innovative. They generate new products and ways of doing things. Technology ideas are now driving innovation as much as business and product ideas [5]. There are specific reasons which cause business failure among the SMEs. It explores the fundamental question of why some businesses succeed while others fail under similar economic conditions. Most of the SMEs fail at their start-up stage itself. At present, the government provides various services through many public institutions which are directly involved in the development of SMEs in Sri Lanka. Though they provide various assistance with loans, training, technology, marketing, and management, the principal issue in the SME sector is its poor performance against the large scale enterprises in the national economy [6]. Role of the SME sector is paramount for the Government's efforts in the promotion of a balanced regional growth and development of the rural

economy. The SME sector is an ideal platform for the government to build human capital to a level where the potential benefits of a state-led SME drive could be fully realized [7]. For example, in 1983, 98% of small enterprises accounted for 48.6% of the total employment and 31.1% of value added products. In 2008, 91.6% of small enterprises accounted for 29.6% of total employment and 20.3% of value added products [6].

It is observed that statistics show a downward trend in SMEs in Sri Lanka. The Sri Lankan entrepreneur is culturally different from her western counterpart. Social power is a key stimulus for the Sri Lankan entrepreneur. Studies have suggested that entrepreneurial drive in Sri Lanka is rooted not in the need for individual achievement, but in a conscious or unconscious need to satisfy a sense of social intimacy. Studies have also recognized business failure upon the exit, bankruptcy, or liquidation of the enterprise. The rate of business failure among SMEs in Sri Lanka is 45% [8]. According to statistics published by the Small Business Administration (SBA), at least 30% new establishments fail within the two years from its inception while 49% fails within five years [9]. Business start-ups often fail because founders and investors surge forward without taking time to realize that base assumption of their business plan is wrong. They believe that they predict the future accurately, rather than trying to create a future of their own. Entrepreneurs tend to be single-minded with their strategies wanting the venture to be all about the technology or all about the sales, without taking time to form a balanced plan [9]. It is crucial to overcome these shortcomings. New SMEs are seen as a significant component of the solution to Sri Lanka's development issues, but most of the new SMEs fail during the first few years of operation. The objective of this study is to identify major causes for such failures and to evaluate both internal and external business environmental factors that stand as obstacles for the growth of new SMEs in NWP, Sri Lanka.

Materials and Methods

Theoretical framework

Consequent to a comprehensive survey of literature and several focus group discussions with Bank managers, SME Development Officers and SME owners, 34 obstacles were identified as major obstacles for the growth of new SMEs, which were broadly identified and categorized into five major components.

Data collection

North Western Province was identified as the study area which is consisted of two districts, Kurunegala and Puttlam. Primary data were collected using a pre-tested structured questionnaire from a randomly selected sample of 152 newly registered coir based, milk based and broiler firms which are the most prominent and established SMEs in the area. Collection of data was carried out during the period from 1st March to 9th April 2016 with the help of development officers of the National Enterprise Development Authority.

Data Analysis

A pilot study had been carried out to pre-test the viability of the questionnaire while its reliability was ensured by using Cronbach's Alpha. The large number of internal and external variables related to the obstacles for the start-up of new SMEs made the analysis of data more difficult and complicated. The Principal Component Analysis was used to avoid grouping of highly correlated variables together, instead of dividing them into principal components and, as a result it brought a simplification to the analysis. Bartlett's test of sphericity (BTS) and the Kaiser-Meyer-Olkin (KMO) were accommodated to measure the sampling adequacy and used to determine the factorability of the matrix as a whole. High values (between 0.5 and 1.0) indicate factor analysis is appropriate.

Results and Discussion

Geostatistical Analysis

To ensure the appropriateness to use PCA, the KMO and BTS tests were carried out. BTS 2.700E3 and the level of significance P=0.000 indicated that data were appropriate for the purpose of PCA. The results showed that KMO measure of sampling adequacy was 0.797 which indicated that there were sufficient items for each component (Table1).

Table 1. Kaiser-Meyer-Olkin (KMO) and Bartlett's test

KMO Measure of Sampling Adequacy		0.797
Bartlett's Test of Sphericity	Approx. Chi-Square	2.700E3
	Df	561
	Probability	0.000

The Most Crucial Obstacle for New SMEs

The first component had an Eigen value of 8.17 and a percentage variance of 24.04% (Table 2). The component consisted of seven statements. The statement of the highest factor loading was collateral/guarantee requirements to obtain bank loans which is said to be too stringent (0.838) (table 3). Component one was labeled as Finance which is largely external to the business environment.

Table 2. Variance explained

Comp onent	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulat ive %	Total	% of Variance	Cumulati ve %	Total	% of Variance	Cumulati ve %
1	8.17	24.04	24.04	8.17	24.04	24.04	4.79	14.09	14.09
2	3.42	10.06	34.10	3.42	10.06	34.10	4.51	13.27	27.36

3	2.93	8.63	42.73	2.93	8.63	42.73	3.30	9.70	37.06
4	2.26	6.63	49.36	2.26	6.63	49.36	3.29	9.69	46.75
5	1.81	5.31	54.67	1.81	5.31	54.67	2.69	7.92	54.67

Management

The component had an Eigen value of 3.42 and percentage variance of 10.06% (Table 2). The component consisted of 12 items. The item with the highest factor loading was poor knowledge about government rules and regulations (0.770). This may be because SME owners do not have much knowledge about government rules and regulations when registering and continuing their business (Table 3). The obstacle was labeled as management which is also internal to the business environment.

Table 3. Rotated component matrix

Component	1	2	3	4	5
1. Collateral/guarantee requirements to obtain bank loans are too stringent	0.838				
2. The process of loan applications is time consuming	0.833				
3. Not interested in obtaining loans from banks	0.792				
4. Too much restrictions from the money lenders	0.719				
5. The repayment of the loan is not enough.	0.711				
6. Interest rates are high	0.664				
7. Access to Finance is difficult	0.503				
8. Poor knowledge on government rules and regulations		0.770			
9. Application of ICT is low		0.724			
10. Lack of awareness about quality certificates		0.661			
11. Lack of planning for the next stage of the business		0.642			
12. Lack of information about new technology		0.620			
13. Lack of knowledge in business planning/management		0.618			
14. Lack of higher education		0.603			

#	Item					
15.	Cost for obtaining quality certificates are high		0.546			
16.	Poor account management		0.496			
17.	Difficulty in obtaining information on markets		0.402			
18.	Difficulty in obtaining business registration		0.358			
19.	Bad credit history		0.308			
20.	High competition			0.704		
21.	High production costs			0.680		
22.	Infiltrations are high			0.657		
23.	Decline of demand for the products			0.568		
24.	Nonpayment risk on credit sales			0.566		
25.	Lack of novel business opportunities based upon new technologies			0.523		
26.	Interruption of water supply				0.813	
27.	Poor roads				0.790	
28.	Breakdown of electricity supply				0.782	
29.	Poor communication facilities				0.770	
30.	Location of the business is less pivotal now				0.482	
31.	Inflation is high					0.684
32.	High tax rates					0.652
33.	Deterrent rules & regulations of the government					0.613
34.	Political instability					0.499
Cronbach's Alpha		**0.889**	**0.845**	**0.774**	**0.812**	**0.728**

Market

This component had an Eigen value of 2.93 and a percentage variance of 8.63 % (Table 2).This component was consisted of six statements. The item with the highest factor loading was high competition (0.704) (Table 3). This component is external to the business environment and labeled as market.

Infrastructure

The component had an Eigen value of 2.26 and a percentage variance of 6.63% (Table 2). This component consisted of five statements. The item with the highest factor loading was interruption of water supply (0.813) (Table 3). This component is external to the business environment. Expanding and constantly upgrading infrastructure facilities, and thereby bridging the disparity in facilities between the rural and urban areas may prevent failures at start-up stage [5].

 Economic

The final component with least importance consisted of 1.81 Eigen value and a 5.31% of variance with four items (Table 2). The component was labeled as economic. The final component is also largely external to the business environment.

Conclusions and Recommendations

The importance of SMEs in economy is underpinned by the role it plays in the creation of employment, addressing the issues of income distribution, regional development and social cohesion. Today SME sector is a key component of our economic strategy. The thrust areas that has a huge potential in this economy are furniture, IT, dairy industry, horticulture, floriculture, food industry, fruit and vegetable, inland fishing, beauty culture, ornamental fish and etc.

Study revealed that the most crucial obstacle for business start-up of new SMEs in NWP is largely internal to the business environment. Most SMEs find expansion difficult, mainly due to the obstacles they face in accessing funding, both equity and debt. The established financial institutions including Banks have shown a marked reluctance to lend to innovative SME due to high administration costs and high risks involved in these sectors. Financial Institutions have become over reliant on collateral based financing which new entrepreneurs as well as existing entrepreneurs are not in a position to provide. The lack of collateral by SMEs and unwillingness of banks to lend without it, is due to both to shortcomings within SMEs as well as shortcomings in the financial system as SMEs are driven by poor knowledge on financial management, poor financial literacy, and lack of transparency in SME management.

Therefore, the study suggests that it is needed to revisit the micro finance accessibility of SMEs by providing them credit guarantee facilities to formulate effective financial management plans. This should be followed by business education to uplift their managerial skills within their early years from the inception to avoid failures. Adoption of SME-friendly banking practices and re-orienting bank branches to serve SME clients better is also important. Possible financial assistance should be given in order to support the start-ups in a way that they gain access to professional support in order to identify pathways to growth and discover untapped areas of opportunity.

Choice of the business location needs to be considered carefully in order to minimize distribution costs, meet demand and beat competition. It is essential to provide up-

to-date training programmes that focus on the needs of entrepreneurs rather than out dated programmes that cater predominantly for general managers. Tax incentives need to be put in place to favor new venture creation and development. Business incubators in NWP should be further developed to support SMEs which have an issue in marketing their products. Given the lack of funds at SMEs for engaging in marketing and advertising activities, their products do not get displayed prominently at Supermarkets and shops. Therefore, the large supermarkets and retail sellers should be encouraged to lend hand to the SMEs by providing them with some prominent shelf space at a reasonable price.

The study suggest to carefully monitor newly registered SMEs in NWP by; providing intensive care through Business Development Centers, genuinely orienting them towards the unique banking needs of them, establishment of special banks dealing only with SMEs, establishment of Business Education Centers as well as commencing of Enterprise Research Centers where continuous researches will be taken place on SMEs and identify the major causes for the underdevelopment of this sector when compared with large scale establishments.

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