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## KEY SUCCESS FACTORS OF SMALL BUSINESSES IN SRI LANKA

T.D. Weerasinghe<sup>a</sup>, C.K. Batagoda<sup>b</sup> and W.H.G. Jayasundara<sup>c</sup>

<sup>a</sup> Tutor, Department of HRM, University of Sri Jayewardenepura, Colombo, Sri Lanka  
*tdmdananjaya@gmail.com*

<sup>b</sup> Senior Lecturer, Department of HRM, University of Sri Jayewardenepura, Colombo, Sri Lanka  
*kusummalieb@gmail.com*

<sup>c</sup> Department of Finance, University of Sri Jayewardenepura, Colombo, Sri Lanka  
*ganeshanjayasundara@gmail.com*

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### **Abstract**

Small Businesses are considered the stamina of any economy as they play a critical role by generating jobs, accelerating regional development, empowering innovations and stimulating many economic functions. Small Businesses are more important to a developing country like Sri Lanka where inflation, poverty and unemployment are now serious problems in the economy. It is estimated that only one in three Small Businesses survive to their fifth anniversary. Thus, the study was initiated to identify the key success factors of Small Businesses in Sri Lanka. This was carried out as a cross sectional field study among a sample of 246 Small Businesses in the country except the Eastern province. Convenience sampling was applied to select the sample. Data were collected via a self – administered, pre - tested questionnaire that met accepted standards of validity and reliability. Descriptive statistics, simple ranking and factor analysis were performed to analyze data. It is found that, availability of financial resources, available human resource, management skills of the owner, proper planning, cash & credit management, suppliers' support, marketing strategy, customer loyalty, business location and the government support are the top ten key success factors of Small Businesses. Findings revealed that nine out of top ten success factors are management related. The findings of this study serve as a guideline for Small Businesses, Management Practitioners & Policy Makers in the country. It is recommended to review the support given by the government and the Small and Medium Enterprise Development Policy in Sri Lanka.

*Keywords:* Key Success Factors; Small Businesses; Sri Lanka

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### **1. Introduction**

Today we are living in an entrepreneurial economy. In the global market there is a shift from a managerial to an entrepreneurial economy as thousands of new businesses are being created each year across the world hoping to grow into large enterprises. Small Businesses play a very important role in any economy by generating job opportunities, contributing to the growth of Gross Domestic Production, stimulating innovations and many other economic activities. Small businesses are considered the backbone of any country irrespective of their development level. This sector is even more important to a developing country like Sri Lanka where inflation, poverty and unemployment are pressing issues in the economy. Small Businesses have acquired increasing importance in Sri Lanka in recent years where they are regarded as a significant component of the economy and creator of jobs. The Small Industries in rural areas in Sri Lanka

are the major source of employment and production of foods, and hence, the Sri Lankan villages' livelihood (Gamage, 2003).

According to Rose, Kumar & Yen (2006) Small and Medium Enterprises should be the main focus of developing nations. Thus, Small Businesses are very important to the development of Sri Lankan economy and to address the existing unemployment problem. In the development of a country the importance of Small Businesses cannot be underemphasized. Small Businesses constitute majority of all the enterprises in Sri Lanka and they generate more than US\$ 30 billion to Sri Lankan economy annually (Athukorala, 2012).

Small Businesses perform a strategic role in Sri Lankan economy (Gamage, 2003). Hewaliyanage (2001) mentioned that Small Businesses promote economic growth by import substitution as well as through direct exports, and contribute to alleviate the balance of payment difficulties by supplying goods and services to large exporting ventures. Significance of Small Businesses in a developing country like Sri Lanka is largely because of following multi – faceted merits of them.

Small businesses generate maximum socio economic benefits with low level of investment. They require less capital and relatively less infrastructure. The relatively labour intensive nature of small businesses enables the creation of substantial employment opportunities which is a crucial solution for unemployment in the economy. They have a shorter gestation period. They discourage the migration from rural to urban areas, so that it is an aid to promote balanced regional development. Small businesses contribute to the capital formation of the country by mobilizing and diverting financial resources in the country. Small businesses play the complementary role to large scale businesses through sub contracting and outsourcing. Hence, Gamage (2003) concluded that well – organized small businesses can make the foundation for the growth of the industrial sector in Sri Lanka. Thus, all the above facts evident that studying the small business sector in the economy is significant for any nation.

## **2. Problem of the Study**

Even though small businesses are considered the backbone of any economy it is estimated that only one in three businesses survive to celebrate their fifth anniversary and a mere one in five will celebrate their tenth anniversary. Rose & Yen (2006) stated that only 10% of start up small businesses survives beyond the ten years mark. Davis and Keys (1996) discovered that smaller firms have a higher failure rate in any country. The fact that small businesses have a success rate of less than 65% makes it more important to understand what makes the success of small businesses. Watson & Everett (1999) mentioned that the success or failure of a small business depends on many factors such as nature of the industry, owner's experience, business location and age of the business. Therefore it is obvious that researching the key success factors of small businesses in Sri Lanka as a developing country is significant. The study addresses the interest of academics, practitioners and industry professionals as it is of interest to determine what factors contribute to the success of small businesses. Hence, the research problem of the study was:

What are the key success factors of small businesses in Sri Lanka?

The objective of this study was to examine what key factors contribute to the success of small enterprises in Sri Lanka.

### **3. Literature Review**

There is no universally accepted formal definition for small businesses. Different bodies use different criteria to define small businesses. The number of regular employees, amount of invested capital and nature of the business and the sector are well known criteria among them. Gamage (2003) cited Ponnampereuma (2000) and defined small businesses according to the Industrial Development Board as an establishment whose capital investment in plant and machinery does not exceed Rs. 4 million and the total number of regular employees does not exceed 50 employees. The World Bank defines enterprises those with fewer than 49 employees are small. Hewaliyanage (2001) cited Sri Lanka Export Development Board and defined export oriented small businesses as those enterprises with a capital investment excluding lands and buildings of less than Rs. 8 million or with annual export turnover of less than Rs. 50 million.

Small businesses do not mean that they are the scaled down version of big businesses (Gamage, 2003). The success of a small business could be measured in various ways. Watson & Everett (1999) measured the success of a business by the continuance in operations or longevity of the business. Moreover there are many objective and subjective measures of business success. Most often, objective measures such as longevity, sales, and profit are the forms in practice, while subjective measures are taken as owner's goals, owner's personal perception and owner's evaluation of own performance.

Many researchers identified different key success factors of small businesses in different ways. Orser & Foster (1992) concluded that small businesses that are operating on a full time basis generally earn a greater return than those operating on lesser hours. Hence, small businesses that put more hours in developing and maintaining their business will reap rewards. The failure rate of small businesses is about 75% in first five years of existence and one of the major causes of failure is lack of experience (Spilling and Berg, 2000). Thus, if lack of prior experiences is cited as a cause of failure then increased business experience would be a reason for business success.

Gamage (2003) mentioned the major problem in the small business sector in Sri Lanka is the shortage of capital. It is due to many underline reasons such as lack of access to bank facilities, lack of knowledge of bank procedures, long delays and inability to provide guarantees. If so, then it could be concluded that the availability of financial resources is a major determinant of small business success in Sri Lanka. Management skills are the critical success factors in all of businesses thus small businesses have no exception (Gamage, 2003).

Knowles & White (1995) emphasized that no one should start a business in today's economy without a proper plan. They mentioned that success of small businesses is achieved via planning, commitment, nurturing, financing and positioning to grasp business opportunities. Knowles & White (1995) stated that many of these activities must be done on regular basis as the modern business environment is dynamic. Wasilczuk (2000) found that the number of employees, business dependency, educational level of the owner, use of technology and the age of the owner as key success factors of Poland small businesses.

Technology available is another critical factor of small business success. Ariss, Raghunathan & Kunnathar (2000) concluded that increased adoption of technologies can increase productivity and performance in several ways. It can reduce the amount of skilled labour needed, improve safety, reduce lead time and cycle time, reduce inventories and easy to handle capacity requirements. Gamage (2003) revealed that the use of obsolete technology in small businesses in Sri Lanka result in low productivity and the reduction in market

competitiveness. Moreover employee training and development has a significant impact on business success.

Small businesses are vulnerable to the changes of external business environment. Due to the inherent nature of smallness they cannot compete with big businesses soundly (Gamage, 2003). Thus, government and institutional support to protect and encourage small businesses also considered a critical factor of small business success in any country.

Having understood the importance of small businesses in stimulating economic development of Sri Lanka, this investigation was launched across the country except the Eastern province with the intention to identify key success factors of small businesses in today's entrepreneurial economy.

#### 4. Study Design and Methods

The research can be regarded as a causal study. In this study researcher interference was minimal and this can be taken as a cross sectional study. The unit of analysis was at the organizational level; a small business. The population of the study comprised all the Small Businesses in Sri Lanka. Convenience sampling was applied to select the sample. Researchers surveyed 246 Small Businesses in the country except the Eastern Province. Table 1 shows the sample of the study.

Table 1: Sample of the study

Province	No. of Small Businesses
Central	28
North Central	25
Northern	16
North Western	27
Sabaragamuwa	29
Southern	37
Uva	24
Western	60
Total	246

This study was mainly based on primary data, collected through a survey. A self administered questionnaire was used to collect data. Based on extensive review of the literature, the survey questionnaire was developed. It was mainly based on key success factors identified by Gamage (2003), Rose (2006), and Sadi & Qamar (2011). But many of those factors were tested in elsewhere and may not outfit with the intentions of this research. Thus, researchers made slight alterations to those to make them suit with the study context.

Table 2 exhibits the key success factors of Small Businesses identified in research literature by different authors in different countries.

The used questionnaire comprised three sections; (i) eight questions relating to socio - economic factors of the Small Business, (ii) 20 success factors to rank the level of agreement for each one, and (iii) same success factors (20 factors) to rank according to the priority order. The second section contained total of 20 likert scale statements relating to the key success factors of Small Businesses, and the level of agreement for each factor was given the value of 05, 04, 03, 02, and 01 for strongly agree, agree, average, disagree and strongly

disagree respectively. One open ended question was given at the end of the questionnaire to disclose the additional opinion/s of the respondent on key success factors of his / her business.

**Table 2: Key Success Factors of Small Businesses**

No.	Key Success Factors
1	Availability of financial resources
2	Marketing strategy
3	Technology available
4	Government support
5	Quickness of getting business information
6	Infrastructure
7	Management skills of the owner
8	Proper planning
9	Proper accounting practices
10	Cash and credit management
11	Time management ability of the owner
12	Pricing strategy of the product
13	Business location
14	Available human resource
15	Number of hours work in the business
16	Nature of the business environment and culture
17	Suppliers' support
18	Business experiences of the owner
19	Work life balancing ability of the owner
20	Customer loyalty

In order to ensure the reliability and validity of measurements, questionnaire was pre - tested through a pilot survey. Questionnaire was piloted to 08 small businesses in Western Province. To measure the reliability (internal consistency) of the questionnaire Cronbach's Alpha technique was functioned. The content validity of the questionnaire was assured by preparing it based on the validated literature. The construct validity of measurements of this research was guaranteed by doing a factor analysis which reached more than 0.50 level of factor loading for all the measurements, and the total variance explained in extraction sums of squared loadings was 68.001%. The coefficient of Cronbach's Alpha test of the questionnaire covered all the measurements more than 0.7 levels; where Cronbach's Alpha was 0.793. The pilot test showed that the questionnaire was valid and could reliably identify the key success factors of small businesses in Sri Lanka.

Collected data were analyzed using the software package; Statistical Package for Social Sciences (SPSS, 16.0). Descriptive statistics were used to present the sample profile. Simple ranking and factor analysis were performed to identify the key success factors of Small Businesses.

## 5. Results and Discussion

Most of the successful small businesses were brought up from lower income or poor families, but yet the greater determination to achieve the success could be found in them. It is found that the average number of regular employees working in small businesses in Sri Lanka is 28 and the average amount of capital invested in the business is Rs. 350,000 approximately. The average age of the owner / owner manager when he / she started the business is 39 years and the age range spreads from 23 to 44 years. Total of 194 out of 246 small businesses responded were started before the year 2000. Thus, it could be concluded that the tested small businesses have the longevity or operational continuity which is typically used as the measurement of success. Many of them have been operated for more than 10 years period. The annual average net profit of a small business is found to be Rs. 400,000 approximately. Majority of the business owners have less than G.C.E. A/L qualification and more than 63% of small businesses said that they utilized their own savings / funds to start the business. Table 3 below summarizes the socio economic information found in the study.

Table 3: Socio economic information of the sample

Criteria	Finding/s
Average number of regular employees	28
Average amount of invested capital	Rs. 350,000
Average age of the owner when business was started	39 Years
Average annual net profit	Rs. 400,000
Typical educational qualification or owners	Less than G.C.E. A/L

Second section of the used questionnaire comprised 20 key success factors to be ranked by small businesses according to the perceived order of priority on the business success. Simple ranking method was applied to prioritize key success factors of small businesses ranked by respondents. The given rank for each success factor by respondents was entered against each key success factor separately and calculated the factor total. Factor which has the minimum factor total is taken as the first key success factor and so on. Table 4 below exhibits the top ten Key Success Factors of small businesses according to the Simple Ranking method, with the factor total of each.

Table 4: Top Ten Key Success Factors of Small Businesses (Simple Ranking)

Key Success Factors	Factor Total	Rank
Availability of financial resources	305	1
Available human resource	389	2
Management skills of the owner	418	3
Proper planning	465	4
Cash and credit management	501	5
Suppliers' support	513	6
Marketing strategy	539	7
Customer loyalty	616	8
Business location	665	9
Government support	708	10

According to the simple ranking analysis, availability of financial resources is the major determinant of success of small business in the tested domain. The second place goes to human resources available and the third is the management skills of the owner manager. Similar results were found by Rose, Kumar & Yen (2006) as the available financial resources play the major crucial role in small businesses as they have to make a trade – off among two conflicting extremes; viability and bootstrapping. Managing a high – growth venture typically emphasize on raising capital continuously. It is usually supported by external sources of funds (Rose, Kumar & Yen, 2006). Gamage (2003) found the major problem in the small business sector in Sri Lanka is the shortage of capital and if so, then it could be concluded that the availability of financial resources is a key success factor of small business success as it is found by the current study.

One employee's contribution to the business success in a small firm is greater than in a large scale firm. Thus the available human power in a small business is very significant. It is the second significant key factor of success according to the analyzed data. This is supported by Rose, Kumar & Yen (2006) as they stated that the available human power is essentially important and the optimal utilization of skills and knowledge of the workforce helps to achieve the success in many ways. Hence, small businesses can improve the productivity by developing and utilizing human resource properly. The current study confirms the Lavarack's (1995) argument that the ability to generate and retain appropriate employees with the application of proper HR practices such as compensation plan, training and development, fair performance appraisal and so on could be a key to success.

The third place goes to the management skills of the owner, in the list of key success factors. Indeed, successful management is a critical success factor for any business in the modern entrepreneurial economy in this knowledge era. Hence, small businesses have no any exception (Gamage, 2003). But there is no significant relationship was found by Rose, Kumar & Yen (2006) between success of a small business and owner's working and managerial skills & experience.

Moreover, factor analysis was done to recognize key success factors of small businesses in a different angle. The below table 5 and table 6 explain the factor loadings and extraction sums of squared loadings of key success factors respectively. Factors loaded on a particular component with the factor loading value which is greater than 0.7 are taken as significant key success factors. Under the extraction method of principal component analysis there are five components extracted. All the management related success factors are extracted and loaded on the component one. Government support is loaded on the component three as a significant factor. There are no significant factors loaded on component two, four and five. Findings revealed that nine out of top ten key success factors are management related in the tested domain. Hence, ultimately it could be concluded that success of a small business seriously depends on the successful management.

Table 5: Component Matrix-Factor Analysis

	Component				
	1	2	3	4	5
Government Support	.071	-.213	.712	.242	-.108
Proper Planning	.888	-.042	-.050	-.072	.126
Cash and Credit Management	.869	.079	-.075	-.121	-.051
Marketing Strategy	.765	.166	-.120	.047	.029
Availability of Financial Resources	.911	.053	-.044	-.120	-.017
Available Human Resource	.907	-.135	-.144	.095	-.047
Suppliers' Support	.818	.076	-.058	-.117	-.051
Business Location	.722	-.182	.102	-.114	.219
Management skills of the owner	.905	-.198	-.114	.012	.060
Customer Loyalty	.745	.090	-.273	.173	.071

Extraction Method: Principal Component Analysis.  
a. 5 components extracted.

According to the factor analysis performed, the availability of financial resources (factor loading = 0.911), available human resource (factor loading = 0.907) and management skills of the owner manager (factor loading = 0.905) are recognized as major three key success factors of small businesses. Thus, the result of the factor analysis is consistent with the results of simple ranking method explained in table 4. Both analysis techniques give the similar result, but in different perspectives. Except the government support all other nine key success factors relate with the field of management. Hence, small business owners / managers must have proper application of many management areas; operations, finance, HRM, marketing, accounting, information technology and even research & development in their businesses.

Rose, Kumar & Yen (2006) identified small business owners generally pay more attention on marketing. Similar results are obtained in the current study as marketing strategy and the customer loyalty are recognized as key success factors of small businesses. Promoting the business image and its products & services, understanding market needs and obtaining customer feedback are critical determinants of success of small businesses. Majority of the small business owners consistently improve the product or service of the business (Rose, Kumar & Yen, 2006). This would again confirm that the products or the services are indeed the core of the business.

Even though the current study found cash & credit management as a key determinant of small business success, no significant relationship was found by Rose, Kumar & Yen (2006) between record keeping, financial control, budget planning & cash flow management and success of a small business. Sadi & Iftikhar (2011) found no evidence to justify cash management & credit management as a key success factor of small businesses.



Table 6: Total Variance Explained (Factor Analysis)

Comp:	Initial Eigen values			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	8.101	40.507	40.507	8.101	40.507	40.507
2	1.893	9.463	49.970	1.893	9.463	49.970
3	1.441	7.204	57.174	1.441	7.204	57.174
4	1.110	5.550	62.724	1.110	5.550	62.724
5	1.055	5.276	68.001	1.055	5.276	68.001

Extraction Method: Principal Component Analysis.

Findings revealed that 90% of top ten key success factors are management related. They have been loaded on component one. Management related factors could explain 40.507% of the variance of small business success as the value of extraction sums of squared loadings is 40.507%. Cumulative percentage of extraction sums of squared loadings of component one and three is 47.911%. Hence, the top ten success factors of small businesses recognized in the research could explain 47.911% of the variance of success of a small business in Sri Lanka. According to the table 6, all together twenty success factors (explained in table 2) identified in research literature could explain 68.001% of variance of small business success in Sri Lanka. But only ten factors are identified as significant key success factors, given in table 4 and table 5.

## 6. Conclusion and Recommendations

The study was initiated to identify the key success factors of Small Businesses in Sri Lanka. This was carried out as a cross sectional field study among a sample of 246 Small Businesses in the country except the Eastern province. Convenience sampling was applied to choose the sample. Self – administered, pre - tested questionnaire that met accepted standards of validity and reliability was used to collect data. Descriptive statistics, simple ranking and factor analysis were used to analyze data. It is found that, availability of financial resources, available human resource, management skills of the owner, proper planning, cash & credit management, suppliers' support, marketing strategy, customer loyalty, business location and the government support are the top ten key success factors of Small Businesses. Findings revealed that nine out of top ten key success factors are management related. Management related factors could explain 40.507% of the variance of small business success. The top ten success factors recognized in the current study could explain 47.911% of the cumulative variance of success of a small business.

The findings of this study serve as a guideline for owners of Small Businesses, Management Practitioners & Policy Makers in the country. It is strongly recommended to review the institutional support given by the government to small businesses, and the Small and Medium Enterprise Development Policy in Sri Lanka. It should be a national policy on small businesses which could recognize the importance of small business sector. Finally it is suggested that changes in the curricular as a must to give strength to entrepreneurs through technical & vocational training in Sri Lanka.

Despite the constructive recommendations given in the study, limitations are inevitable. This research focused only on Sri Lankan small businesses. Thus, there may be difficulties in generalizing findings. Therefore, similar studies across other Asia Pacific countries and developing countries are recommended.

Sample size (246 small businesses) which may not significant can also be considered as a limitation of the research.

However, within its limitations the study has achieved the pre set objectives and opened new avenues and directions for future studies. Hence, as a concluding remark it could be declared that, conducting more studies on small business management or/and considering more key success factors and relationships among them will help to insert additional information to this research work.

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