



## **The Nature of SMEs and Their Access to Financial Services: A Study of Selected SMEs in Sri Lanka**

Kodippili KND<sup>1</sup>

Pallegedara A<sup>2</sup>

### **ABSTRACT**

**Small and Medium-size Enterprises (SME) contribute to the economic development of any country. However, SMEs especially in the developing world have encountered problems and constraints in accessing to bank finance. Thus, main purpose of this study is to understand the nature of SMEs with access to bank finance in Sri Lanka. This study utilizes descriptive research design which includes data collection using structured questionnaire with selected SME owners. Data were collected from randomly selected 200 SME customers in Colombo and Matara districts of Sri Lanka. The analysis of data was conducted using quantitative techniques. The findings reveal that the average monthly income is the critical factor to access the financial services from the banks and other financial institutions. Further, in order to improve the SMEs access to financial services, this study proposes financial service providers to offer more research and development targeted on SME sector, innovative products targeted on SMEs, IT facilities, technology expansion for SME financing, new investment possibilities, SME knowledge and training activities.**

**KEYWORDS: Small and Medium Enterprises, Banking and Financial Services, Information Technology, Sri Lanka**

### **INTRODUCTION**

Growing a diverse and competitive Small and Medium Enterprises (SME) sector is considered as one of the critical factors towards achieving sustainable economic growth:

In Sri Lanka, SMEs contribute 80-90% of the total number of business establishments. Therefore, Small and Medium Scale Enterprises (SMEs) make up a large part of Sri Lanka's economy.

In the manufacturing sector SMEs engage in numerous industrial activities accounting for about 20% of industrial establishments and in the service sector it is about more than 90% of business establishments. Therefore, SMEs play an

important role in promoting economic growth. However, inadequate access to financial services provided by banks and other financial institutions is a major problem in establishment, survival and growth of SMEs in Sri Lanka. Thus, it is important to examine the nature and perception of SMEs towards the role of banks and other financial institutions in Sri Lanka.

### **Research Objectives**

The main objectives of this study are to identify;

1. What are the critical factors affecting the access to financial services by the SMEs?
2. What are the issues SMEs have on current financial services targeted on SMEs?
3. What are the new suggestions for the improvement of the financial services of the banks and other finance companies targeted on SMEs?

<sup>1</sup>Graduate, Department of Industrial Management, Faculty of Applied Sciences, Wayamba University of Sri Lanka.

<sup>2</sup>Lecturer, Department of Industrial Management, Faculty of Applied Sciences, Wayamba University of Sri Lanka.

**LITERATURE REVIEW**

Literature suggests that several factors determine the SMEs access to financial services. According to the Yan et al, (2009) bank size, discretion over credit, incentive schemes, competition, and the institutional environment affect lending to small- and medium-sized enterprises. Also, there are many bottlenecks against the growth of SME sector.

Characteristics of SMEs such as firm size and age, ownership type and legal form, geographical location, industry sector and asset structure affect their financial decisions and influence the firm’s performance and growth (Abdulsaleh and Worthington, 2013).

Inadequate access to bank finance and other insufficient capital motivate SMEs to receive financial services (Kihimbo et al., 2012). Accordingly, success and survival of SMEs depend heavily on availability of finance (Cook, 2001).

**RESEARCH PROBLEM**

There are many issues faced by the SMEs such as insufficient profitability and other business-financial performance criteria on the part of funding applicants, lack of information in the borrowing process, lack of experience in the field, outdated knowledge of technology transfer and upgrading, lack of skill improvement programs and lack of skilled workers when they demand financial services from banks and other financial institutes. In addition, supply side banks and other financial institutions have to face the risk of non-payment of loans and other financial services by the SMEs.

**METHODOLOGY**

Characteristics, requirements, issues and needs of SME customers and types of SME financial services were identified by conducting the literature review. Based on the collected facts, questionnaire was designed to identify the nature, awareness

and perception of SME customers regarding the financial services targeted on SMEs. The collected data were analyzed empirically to achieve the research objectives.

Random sampling technique was applied to collect the data from 200 SME owners from both rural (Matara district) and urban (Colombo district) areas of Sri Lanka. The descriptive analysis was used to explore the data using statistical software STATA. Based on the findings of this research, solutions for the identified problems and recommendations for future improvements were suggested.

**DATA COLLECTION AND ANALYSIS**

Primary data collections were carried out, using structured questionnaire from randomly selected 200 SME owners in Colombo and Matara area representing urban and rural areas of Sri Lanka. To reduce the amount of error, the diversified sampling was considered from the banks and other financial institutions in Sri Lanka.

From the 200 SME owners, 149 owners responded and it was about 74% of the total sample. 26% have not replied to the questionnaire. Descriptive analysis was conducted according to the demographic factors of SME owners such as age, gender, religion, educational level and average monthly income. As shown in Figure 1, males were dominated in the SME business and the most are in the age category of 55-64 years. The highest proportion of females who are doing SME business was 18% and those are in the age category of 35-44 years.

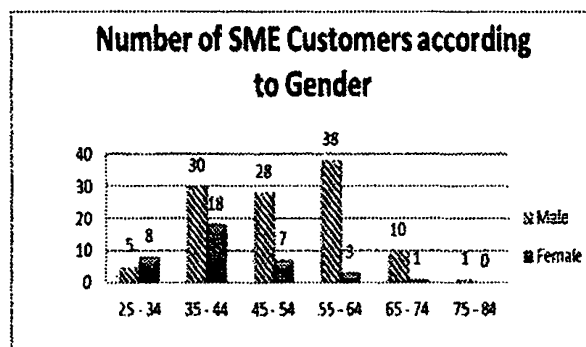


Figure 1: Number of SME Owners by Gender and Age

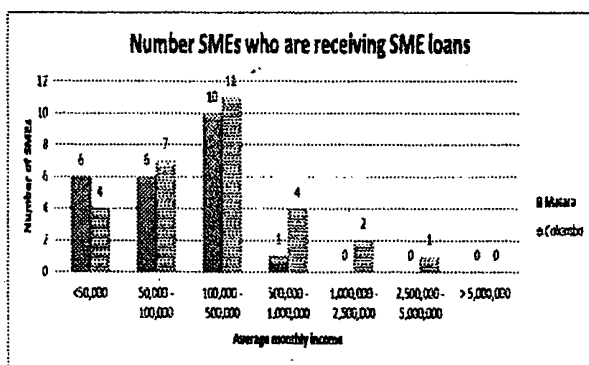
**Table 1: Number of SME Owners by Religion**

Religion	Number of SME owners	Number of SME owners (%)
Buddhism	59	39.60
Hinduism	22	14.77
Islam	54	36.24
Catholic	14	9.40
Other	0	0.00
Total	149	100.00

As shown in Table 1, majority of SME owners were Buddhists (39.60%) and Islam (36.24%). In addition, most SME owners have completed their secondary education. Among them majority have completed their GCE advance level examination.

**Table 2: Number of SME Owners by Education Level**

Education level	Number of SME owners	Number of SME owners (%)
O/L	32	21.48
A/L	50	33.56
Diploma	41	27.52
Undergraduate	18	12.08
Post Graduate	8	5.37
	149	100.00



**Figure 2: Average Monthly Income of SME Loan Receivers**

It can be seen from Figure 2, that most SMEs who have access to bank finance earn less than 500000 rupees per month. 52 SME owners out of total number of respondents, have received some form of financial loans from banks or financial institutions. From these 52 SME owners, 44 earn less than 500000 rupees per month. There is no any significant difference between rural area (Matara) and urban area (Colombo) regarding the access to bank

finance and income level. Therefore, average monthly income of the SME owners seems to be a critical factor that affects receiving financial services from the banks and other financial institutions.

As shown in Table 3, 26.17% of SME owners said that they would like to have friendly environment in the financial institution. Around 28.19% of SME owners mentioned that they wish to have new investment opportunities from banks and other financial institutions. Further, 26.85% of SME owners suggested that bank and financial institutions should improve research and development activities targeted on SME sector. In addition, SME owners also suggested improving technology expansion for SME financing, more information technology facilities in SME banking to improve banking services targeted on SMEs.

**Table 3: Suggestions of the SME Owners to Improve Banking Services Targeted on SMEs**

Suggestions	%
More R & D on SME Sectors with Banking services	26.85
SME Innovation	21.48
More IT Facilities	28.86
Technology expansion for SME financing	22.15
New investment possibilities	28.19
Diversify the training and awareness methods	10.07
Searching International SME financing movements & new market trends	14.77
More certification & authority facilities	10.07
Improving access to finance	15.44
Access to skill development training & advisory services	14.77
Jointly organizing, capacity building with the SME sector	15.44
Partnerships with international finance corporations	11.41
Motivating & Movement for state of art technology	18.12
Promoting E- Commerce & Credit card facilities	10.74
More contact facilities with the servers who provide the SME service	13.42
More friendly environment in the bank and/or financial institutions	26.17
Increase the SME skilled servers in the banks and/or financial institutions	11.41
Other	1.34

## RESULTS AND DISCUSSION

Research findings reveal that Buddhists and Islam SMEs are dominated in the SME sector in Sri Lanka. Most of SME owners are males and 78.52% SME owners have completed their secondary education. Thus, it seems that most of the SMEs are well educated. According to the analysis, when the average monthly income is high SME owners tend to cover the business expenses from their income without moving to obtain loans and when their average monthly income is low they tend to access to bank finance to cover up their business expenses. Therefore, SME owners expect to receive more customized SME services on loans and other financial services from banks and other financial institutions since access to bank finance is major factor for survival in the SME business.

SME owners expect more, friendlier environment in the current status, new investment possibilities, research and development on SME sector with banking services and more IT facilities for their business developments. A friendly environment in the service receiving place, motivate SME owners for more financing. More financing will increase the SME development in Sri Lanka and the economy.

Introducing new investment possibilities for the SME owners will make easy to behave in the small and medium sector competitively. While providing financial services, introducing new investment opportunities will increase the satisfaction of the SME owners towards the financial institutions. From that SME owners can reduce their risk while developing their businesses. Not only the SME owners but also the financial institutions can start doing researches on SME sector and customized financial services and introduce more financing options and more profitable business options which can motivate SME owners for more financing. Providing effective, efficient and timely updated online system for financing,

24 hour service, effective contact lines with the staff of the financial institutions, well functioned SME financing options in the automated teller machine system of the financial institution will increase the satisfaction of the SME owners towards financing. Above mentioned suggestions will motivate the SME owners to involve with more developments in their current businesses and to start new businesses.

## CONCLUSION

The results from this paper reveal that the reason to obtain more financial services is the lower average monthly income of the SME owners and it is not depended on area whether rural or urban. But males are involved with more small and medium businesses than women. Majority of the SME owners are well educated. Therefore providing knowledge and more customized financial services with effective information and communication can improve the awareness and satisfaction of the SME owners towards the financial services from the banks and other financial institutions. Further, providing more research and development and introducing new investment possibilities will help to increase the satisfaction towards the financial services and will enhance the businesses by overcoming their financial problems.

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