

# **SMEs as the Backbone of an Economy**

## **AAT Level I** **BEN - Business Environment**

**Susantha Weerakoon**  
B.Sc. (MIS), MBA (ISM), PHD (Business Psychology)



# SMEs as a Backbone of an Economy



## Definition of SME

SME is **varied from country to country, and from institution to institution** within single country, depending on the business sector concerned, size of the domestic country, and character of the relevant host country. As such, a standard **international definition of small and medium-sized enterprise (SME) does not exist.**

### Organization for Economic Co-operation and Development defined SMEs as

- ❖ Small and medium-sized enterprises (SMEs) are non-subsidary, independent firms which employ **fewer than & given number of employees**, This number varies across countries.
- ❖ The most frequent **upper limit designation as SME is 250 employee, as in the European Union**
- ❖ However, some **countries set the limit at 200 employees,**
- ❖ while the **united states consider SMEs** to include firms with **fewer than 500 employees.**

# Definition of SME

## According to the World Bank

If any enterprise has **below 99 people**, it can be defined as an SME

## Government of India defines SMEs as:

**India defines MSMEs** (Micro Small and Medium Enterprises) based on investment in plant and machinery and equipment. **The value of the investment depends on the sector as per MSMED Act 2006.**

## Government of Singapore defines SMEs as

Singapore defines SMEs as **enterprises having annual turnover less than \$100 M or less than 200 no of employee**, implemented since 2011.

Singapore **does not define Micro or Small and Medium industries separately but all three types as a whole**



## Definition of SMEs in Sri Lankan Context

- In Sri Lanka, there were **several definitions** established by **several institutions** over the time period and these definitions are **not considered as clear and consistent in terms of parameters that used to define SMEs**
- However, **Ministry of Industry and Commerce** has finalized a definition for SME in 2015 under its 'National Policy Framework for Small and Medium Enterprise (SME) Development' and this has been considered as accepted definition in Sri Lanka.

Table 1: Defining SMEs in Sri Lanka

Size \ Sector	Criteria	Medium	Small	Micro
Manufacturing Sector	Annual Turnover	Rs. Mn. 251 - 750	Rs. Mn. 16 - 250	Less than Rs. Mn. 15
	No. of Employees	51 - 300	11 - 50	Less than 10
Service Sector	Annual Turnover	Rs. Mn. 251 - 750	Rs. Mn. 16 - 250	Less than Rs. Mn. 15
	No. of Employees	51 - 200	11 - 50	Less than 10

## Importance of SMEs

- Small and Medium Enterprises (SMEs) play a vital role in many countries including Sri Lanka, because of its role for the country's economic growth and social development.
- An eminent management scholar, *Peter Drucker* emphasized that small enterprises represent the main catalyst of economic development.
- Those small businesses contribute intensely to achieving the fundamental goals to any national economy, becoming the backbone of social-economic progress.



### The Following Significant Have Been Identified By The Policy Makers and Scholars

SMEs contribute to the Gross domestic product of Country

Creating employment opportunities

Mobilizing Domestic Savings

Poverty Alleviation

Income Distribution

Regional development

Flexibility and ability to adapt to new economic milieu

## The Following Significant Have Been Identified By The Policy Makers and Scholars

### ➤ SMEs contribute to the Gross domestic product of Country

In Sri Lanka, **nearly 52%** of the GDP **encompassed by Small Medium Business** which is **comparatively greater than the other South Asian and South East Asian Countries**



### ➤ Creating employment opportunities

**Generating employment opportunity** is **one of the benefits of Small medium enterprise** and **large share of jobs created by SME** in developed and developing countries. According to the industrial survey conducted by the Department of Census and Statistics (2017) there are **45% of employments** created by the Small Medium Enterprise in Sri Lanka.



## The Following Significant Have Been Identified By The Policy Makers and Scholars

### ➤ Mobilizing Domestic Savings

Mobilizing **domestic savings** is a **process of capital formation**. As such **savings** converted as an investment through which people are able to enhance their domestic income



### ➤ Poverty Alleviation

As the **SMEs** started with a **limited investment**, it gives an **opportunity to start up entrepreneurship at any level of people**. It **contributes to earn profit by entrepreneur** as well as **people are able to get employment opportunity** through which the **poverty level of people** can be eradicated or reduced.





## The Following Significant Have Been Identified By The Policy Makers and Scholars

### ➤Income Distribution

SMEs **contribute for job creation**. In particular, their role as **major employers in the secondary labor market** of **absorbing semi-skilled and unskilled labor** help those in the lowest income quartile to boost up earnings out of SMEs wages

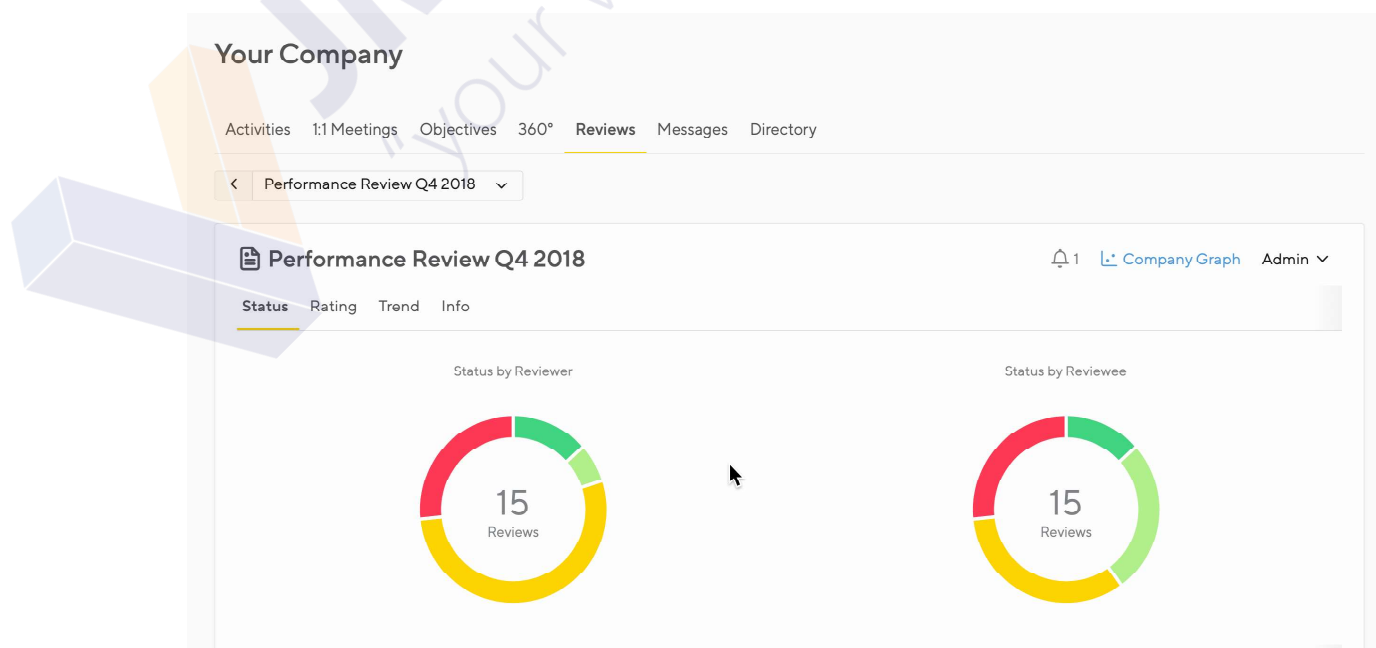
### ➤Regional development

The role of SMEs in **creating jobs also extends to poverty reduction** this is the reason why SMEs continue to survive even where there is a noticeable economic

### ➤Flexibility and ability to adapt to new economic milieu

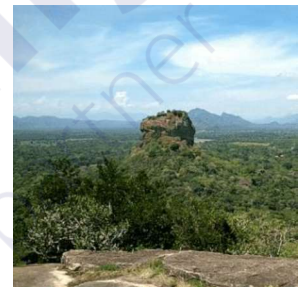
One unique characteristic of SMEs is **their flexibility**. It emanates from the fact that they are **less capital intensive** and **more labor intensive**, use mostly **unskilled and semi-skilled labor**, and have **simple managerial structure amenable change**.

## Performance of Sri Lankan SMEs and ways of enhancing the Performance of SMEs



## Performance of Sri Lankan SMEs

- As the SMEs is **considered as a strategic sector**, contribution of **SMEs in the economy and social well-being is remarkable**. Performance of SMEs can be measured through the **qualitative and quantitative measure**, on which, the **quantitative aspects like contribution to the GDP, employment creation, value addition, industrial output, and export earnings** are the main criteria to measure overall performance of SMEs in a country.
- The Government of Sri Lanka **recognizes SMEs as the backbone of the economy** as it **accounts for more than 75% of the total number of enterprises provide 45% of the employment and contributes to 52% of the Gross Domestic production (GDP) in 2017**



## Ways of Enhancing The Performance of SMEs



## Enabling Environment

In order to enhance the ease of doing business to **improve the competitiveness and support** in **establishing a conducive environment** for SME development, the government of Sri Lanka set the policies to **improve legislative, regulatory and institutional framework** including **proper coordination, simplification and rationalization of procedures.**



## Modern Appropriate Technology

The Government should **facilitate the acquisition and adoption of state of-the-art modern and appropriate clean technologies** for SMEs to **increase quality, innovative, productive and competitive products.**



## Entrepreneurial Culture and Skills Development

Government Should **promote, facilitate and support entrepreneurship development** and **build capacity at schools, universities, technical and vocational training institutions** and **focus on Youth and Women** and **strengthen capacity of institutions providing such training and skills development** on entrepreneurship and SME development



## Access to Finance

Government **should facilitate, support and strengthen the mechanisms for easy and affordable access to finance** to SMEs **through the banks, financial institutions**





## Market Facilitation

Government support SMEs to access local and export market

### *The following strategies can be adopted:*

- Promoting business linkages between large enterprises and SMEs and facilitate buyer seller meetings
- Support SMEs to participate in the local and international market through trade fairs and exhibitions.
- Overseas market information will be made available to SMEs to access international market.
- Road side marketing outlets will be expanded specially in tourist and heavy public visiting locations to help SMEs to market their products
- Policy will be implemented to assist SMEs to increase the market share
- Establish SME website and e-commerce arrangements to enable the SMEs to link with exporters and buyers and strengthen their marketing network

## Research and Development

Research and development is a powerful process to develop cost effective modern technologies, innovations and market oriented new designs with a view to improve product development, process development, productivity improvement and to increase the competitiveness

## Resource Efficiency

It helps to protect the natural environment thus maintain sustainable foundation for future development

## Regional Balance

Enhance existing and establish new industrial zones and clusters in the regions are the main strategies recommended by government of Sri Lanka.



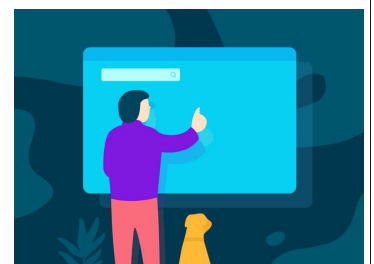
## Ways of Enhancing The Performance of SMEs



## Challenges faced by Sri Lankan SMEs

➤ Skills shortages, poor management practices and workforce training limit SME productivity and innovation.

There is evidence that SMEs have **higher skills deficiencies than large firms** and SME **training effort is on average significantly weaker** per employee than in larger firms.



## Challenges faced by Sri Lankan SMEs

- Lack of **economies of scale and scope**
- Higher **transaction costs** relative to large enterprises
- Lack of networks that can contribute to a **lack of information, know-how, and experience of domestic and international markets.**



## Challenges faced by Sri Lankan SMEs

Increased market competition and concentration from large multinational enterprises caused **by globalization and economic integration, inability to compete against larger firms in terms of R&D expenditure and innovation** (product, process, and organization).



## Reasons for Failures of SMEs

### Internal factors

- Internal factors mean that factors which arise within the organization and it can be influenced and controllable by the management.
- Managerial decisions such as of poor planning of entrepreneur and managers, lack of managerial skills and insights, inflexibility, inappropriate personal characters, lack of succession planning to carry out the business to second generation, and lack of financial discipline are the main causes for the failure in Sri Lanka.



## Reasons for Failures of SMEs

### Immediate Environmental Factors

- Failure factors occurs from the immediate environment such as Customer, Supplier, Financial institutions.
- Lack of coordination between supplier network, low service quality, and ability to meet the requirements of financial institutions to get financial support, Bankruptcy of main Customer or Supplier are considered as a main failure factor.



# Reasons for Failures of SMEs

## Macro Environment

It is an **uncontrollable environment** to Small Medium Businesses enterprises and factors arises from beyond the control of Entrepreneurs.

Changes in Monetary and fiscal policies may impact the business performance of SMEs.



*Thank You*