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## **SUSTAINABILITY OF SMALL AND MEDIUM ENTERPRISES IN SRI LANKA: IMPACT OF ECONOMIC CRISIS**

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### **ABSTRACT**

*The economic crisis had diverse impacts throughout the world. Countries that relied heavily on foreign markets for commerce and finance were affected by the global contagion more than the countries that relied less on them. However, there is minimal variation in the world economy with small enterprises, which are limited in product range and the ability to downsize. Small and medium-sized businesses are significant in the sourcing process of both exporting and non-exporting major sectors due to strong backward connections or widespread engagement in the supply chain. In contrast, even if generally considered less credible and more credit dependent than large companies, the credit shortage of small businesses intensified the financial crisis. Due to the small size, small businesses and enterprises were more susceptible to the financial crisis. A random sampling technique was used in the quantitative study to collect data from a sample of 180 small and medium enterprise businessmen. The study revealed a significant impact on the sustainability of Small and Medium Enterprises (dependent variable) by inflation and perceived political relations (the two independent variables).*

**Key Words:** Inflation, Perceived political relations, Small and Medium Enterprises, Sustainability, Economic crisis

## 1. Introduction

The term "economic crisis" refers to a wide range of scenarios in which some financial institutions or assets lose a significant amount of their value. At times in the early twentieth century, banking panics were coupled with the financial crisis, and many economic downturns occurred simultaneously. In addition to stock market crashes and other financial bubble bursts, currency crises, and sovereign defaults, financial crises are also commonly referred to as "financial crises" (Castells, 2014). When it comes to the causes of financial crises and how to avoid them, many economists have come up with different hypotheses. Financial crises are nevertheless a recurrent occurrence around the world, despite the lack of unanimity (Acharya & Richardson, 2009).

Researchers have long been interested in the survival and expansion of small businesses (SEs). Recent studies on the expansion of businesses have found that multiple levels of analysis are not combined enough. Furthermore, the vast majority of research has concentrated on the factors contributing to rapid economic development in industrialized nations. There is still a lack of evidence addressing the factors that drive the rise of SEs in emerging regions, particularly in South Asia (Ryazantsev, 2015).

To demarcate and identify the problem of the study, the experts' statements, observations and studying through the current events were evaluated. Accordingly, as per the statements made by an SME adviser/coach, Bamunusinghe (2022), regarding his recent observations on the inadequate growth of SMEs on its contribution to GDP and employability rate in the country, claimed that given the nation's current economic situation, there is an urgent need to increase SME GDP contribution. The fact that they account for 90% of all enterprises in Sri Lanka and provide chances for employment that account for 45% of all jobs there demonstrates the critical role that SMEs play in fostering inclusive growth. As per the records, SMEs currently contribute about 52% of Sri Lanka's GDP, with exports accounting for barely 5% of total GDP contributions from SMEs, compared to over 90% in successful economies. Bamunusinghe (2022) further claimed that according to scholars, the nation wouldn't be economically viable without at least 75% of GDP coming from the SME sector alone. Furthermore, Sri Lankan SMEs would be unable to expand a particular firm, as the endeavor could collapse within three to five years of its commencement. This condition would drastically affect the sustainability of existing and upcoming SMEs. Hence, Sri Lankan SMEs should ultimately provide a platform that engages businesses to be proactive participants in addressing their business-related questions and challenges.

SME performance in Sri Lanka has often been dismal. Researchers have looked at the factors that contribute to the underperformance of SMEs in Sri Lanka from many angles. Levy (1993), considering the body of literature, examined several restraints that can be divided into three categories: financial, regulatory, and cost-related. A study by Wickremasinghe (2011) identified some major constraints that affect the development of Sri Lankan SMEs at both the industry and policy levels. These constraints included unfavorable economic policies, insufficient market demand, difficulties accessing credit, issues with the supply of raw materials, strict and unfavorable regulations, a lack of

infrastructure and utilities, a lack of business development services, and a lack of information.

Even though such previous literature gives insights as to the problem areas and constraints on SMEs, the effects of recent events have been considered for this study. Hence, one of the major limitations was lack of resources and literature to determine the scope and variables of the study. Through the observations of recent events in 2022 since its inception, one of the major issues was the political instability caused in the country due to people's movement against the corrupt system. The country had to undergo a police curfew from time to time. The impact of such political-related issues was concentrated as an independent variable, 'perceived political relations'. The country's political turmoil and mismanagement led to an economic crisis. One concern that was strongly affected by this crisis was inflation. SME s daily operations and sustainability were threatened due to these issues. Hence, the study aimed how SME owners perceived and confronted the consequences of inflation caused by the economic crisis.

Thus, the objective statements were identified as follows:

To identify the impact of perceived political relations on the sustainability of SMEs;

To identify the impact of perceived inflation on the sustainability of economic crisis.

## **2. Literature Review**

### **Economic Crisis**

In the middle of 2007 and the beginning of 2008, the repercussions of the global financial crisis began to emerge. Many major financial firms have gone bankrupt or been acquired worldwide, and governments in even the richest countries have been forced to come up with rescue packages to save their financial systems (M Castells, 2012). People worry that individuals responsible for the financial difficulties are being bailed out, but at the same time, a global financial crisis will damage the livelihoods of everyone in a more interconnected globe (Kirman, 2010) . Economic models would not have been in danger had the ideologues backing them not been so loud and disrespectful of other views. The causes and prevention of financial crises have been the subject of numerous economic theories. However, there is little agreement, and financial crises continue to occur regularly on the globe (Stiglitz, 2009).

### **Sri Lanka faces an economic crisis**

According to studies, the current economic crisis is the first of its kind in human history, and it has shocked the world in the first decade of the 21st century. Since countries' economies are dependent on the banking system, its failure has resulted in numerous issues, including mass unemployment, a halt in development and the closure of businesses and industries, as well as a drop in the living standards of populations and a downward spiral in global trade (Uslaner, 2010).

In 2008, the U.S. housing market sector was the first industry to show signs of a global economic crisis. As a result, it has now reached nearly every country, both developed

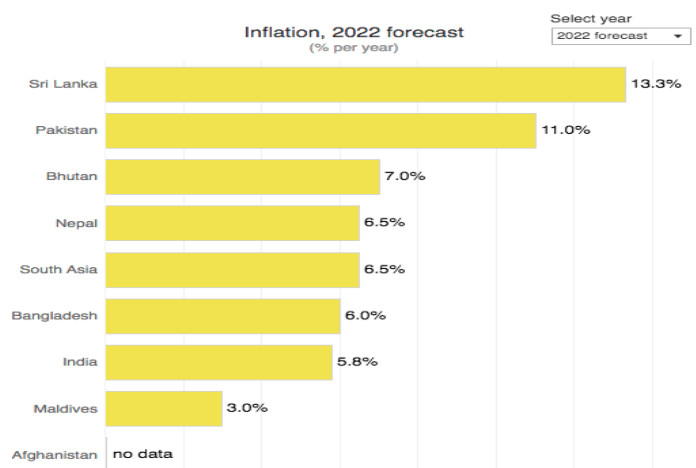
and underdeveloped. To meet the country's import requirements, we export items including tea, rubber, coconut, spices, ready-made clothing, and jewelry. There is less and less demand from the country to purchase these items from us. As the crisis takes hold, there are signs that the plantation industry is starting to feel its effects.(Kotz, 2009).

With no its effects on their products, several businesses have already laid-off employees. Another major source of foreign cash for the country's economic development is the influx of people who have left the country to work abroad. Economic crises in their various countries have put them at risk of losing their jobs and many others. Even Sri Lanka's economy has grown vulnerable as a result of this predicament (Ruwanpura & Wrigley, 2011).

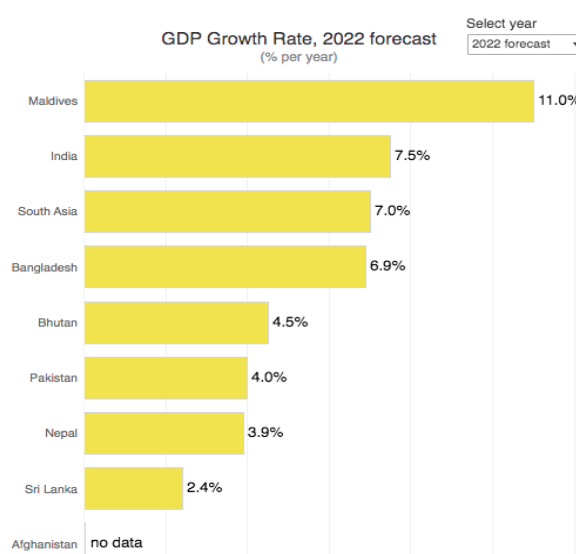
Amid the current global economic crisis, coping mechanisms should be devised such as to mitigate the impact of the crisis by the government implementing appropriate fiscal measures. When demand for a company's products drops in the international market, it isn't a good idea to immediately shut down the business. Employees will have to be cut in the scenario that's playing out (KADIRGAMAR, 2012). However, a complete shutdown is not an option. Instead, companies should look for ways to minimize overhead costs and day-to-day operational costs by developing new strategies so that when conditions improve, they will be able to resume their businesses. Alternatively, they could switch to making things that could be sold in their own community (Gunatilaka, 2015).

In this context, the internet's potential is of enormous aid in stabilizing shaky companies. Outsourcing has become the new normal in the workplace. This way of doing tasks has several advantages. Maintaining large workplaces and squandering resources is not necessary. There are many advantages to employing people who work from home. There is no interruption in the work flow due to strikes, and the management is not obligated to provide fringe benefits in the event of outsourcing (Sultana, 2022). All offices must maintain a skeleton workforce in this arrangement. It's time to reevaluate what's most important to the nation and to prioritize them.

The foreign exchange must be saved at this time if we are to avoid financial ruin. Because of the rapid development of information technology, some argue that there is no place for nationalism in contemporary times (Shibly, 2013). This assertion is not being challenged. Internationalism should not subordinate our national identity and make us unnecessarily dependent on the international community, which is what this statement is about. That is to say, we should make every effort to be self-sufficient. From such actions, this tragedy can be overcome, and the entire country will be better if they can believe that leaders are truly committed to ensuring that everyone is safe and secure. Figure 1 illustrates the impact of the South Asian economic crisis.



**Figure 1. Inflation, 2022 forecast**



**Figure 2. GDP Growth rate**

Government debt-to-GDP rose from 86.9% to 100.6 percent in 2020 and 105.6 percent in 2021, according to the latest data. In 2020 and 2021, Sri Lanka's economy experienced net repayments to foreign creditors, therefore the Central Bank of Sri Lanka covered the entire budget deficit (Central Bank of Sri Lanka, 2022).

### **The Economic Crisis's Root Causes**

This financial crisis is being compared to a 1930s-style economic collapse, in which market activity was almost paralyzed for several years, output and employment fell sharply, and it took a decade for the world's economies to return to pre-crisis levels. The current crisis, on the other hand, is distinct from previous crises in that financial institutions are now more intertwined than ever before. Due to their dependence on other institutions again for money they used to lend, the institutions that made low-quality mortgage loans in the United States quickly spun out of control (Crotty, 2009).

Furthermore, those institutions were reliant on other institutions. As a result, the crisis has taken on a global scope. Financial institutions are solely subject to national regulation. Another possibility is that these institutions now operate globally but lack an international framework for regulation; the crises' spread around the world is mostly not due to weak regulation but rather because there is no global framework for regulation at all. Deficiencies in this area might lead to a financial panic, forcing the decision-makers to develop worldwide regulations and reshape national ones if necessary (Ajith Nivard, 2008).

### 3. Methodology

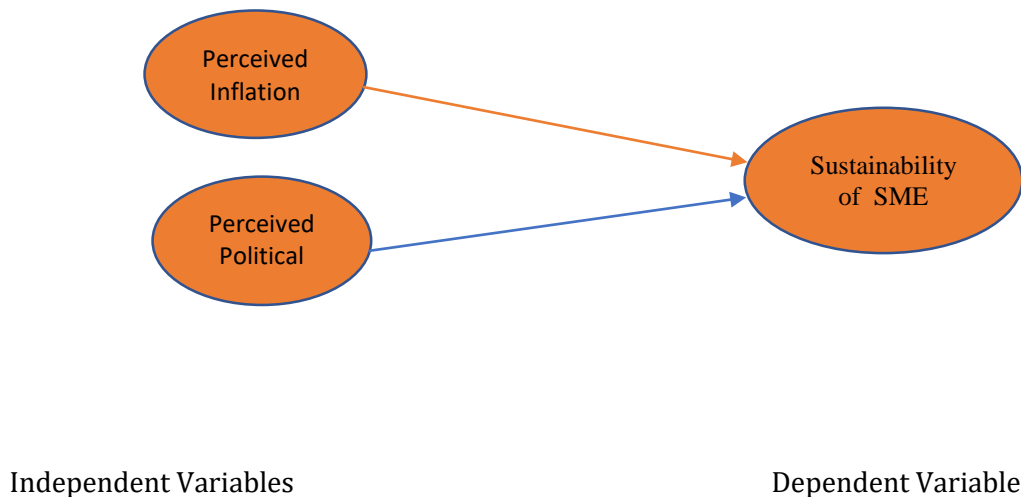
The research's main goal being to pinpoint SMEs' problems related to sustainability during the economic crisis, the study's methodology was set up to find the necessary study scope and to define the research areas were the key concerns. A background investigation was carried out. A questionnaire was created using the background research. Descriptive research design was utilized. This design was adopted since the literature suggests that this type of research design is ideal for testing objective theories by examining the relationship among variables (Creswell & Poth, 2017; Dahanayake & Priyashantha, 2020; Goonetilleke & Priyashantha, 2019). The sampling method was the simple random sampling. Data was collected through Google forms and analyzed using spss software. When considering the selection and determination of SMEs concerning the Sri Lankan context, a criterion used by Hareshankar et.al (2018) was used. Thus, enterprises, to be small or medium scaled, were determined according to their turnover and number of employees. Those with employees less than 50 and an annual turnover of fewer than 250 million rupees were considered small enterprises while those with 51-300 number of employees and an annual turnover rate between 251-500 M LKR were considered as medium scaled enterprises.

Since it was difficult to define and select the intended sample, the author decided to follow the 10-time rules, where the sample size was determined by the number of questions multiplied by 10 (Taherdoost, 2018)(Dilhani & Priyashantha, 2021; Koralege & Priyashantha, 2019; Priyashantha & Vidyaratne, 2021). That has been used by researchers in several other studies which used a similar methodology.

To figure out the variables for the conceptual framework, the previous literature findings revealed by Levy (1993), Aberathne (2005), Hareshankar (2018) were considered, which explained how financial constraints, political and regulatory constraints, and adverse economic conditions could severely hinder the sustainability of Sri Lankan SMEs. Considering them and the recent turmoil in Sri Lanka, Perceived inflation and perceived political relations were taken as the independent variables. The hypothesis was formulated as follows.

H1: There's a significant impact of perceived inflation on the sustainability of SMEs during the economic crisis.

H2: There's a significant impact of perceived political relations on sustainability of SMEs during the economic crisis.



**Figure 3. Conceptual framework of the study**

Source: Created based on the literature review

#### 4. Results/Analysis and Discussion

##### ➤ Reliability

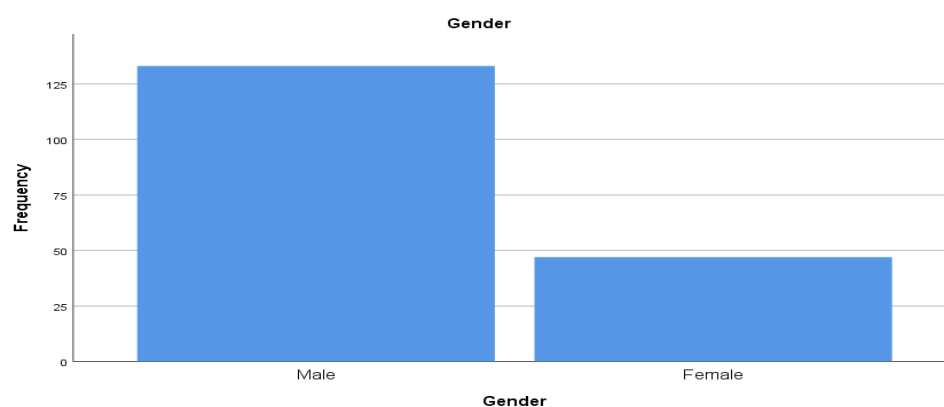
**Table 1: Study Reliability score**

Cronbach's Alpha	N of Items
.872	3

Source: SPSS Data analysis

As per Asuero, Sayago, & González, 2007 a reliability score between 0.7-0.94 is signified as an acceptable value therefore the study score of 0.921 is a reliable score.

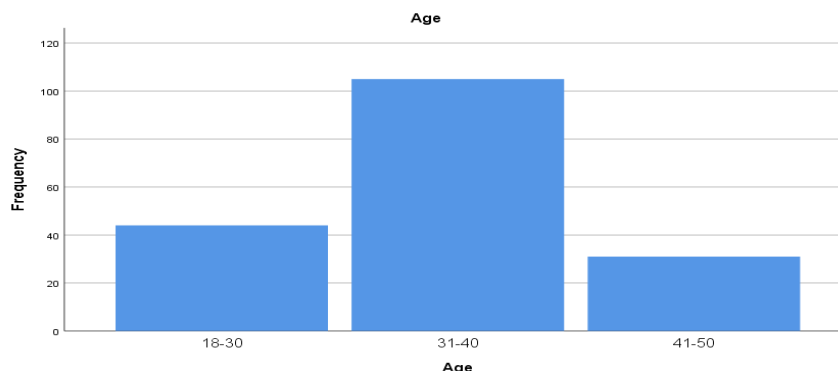
##### ➤ Demographic data analysis



**Figure 4. Gender of the Participants**

Source: SPSS Data analysis, 2022

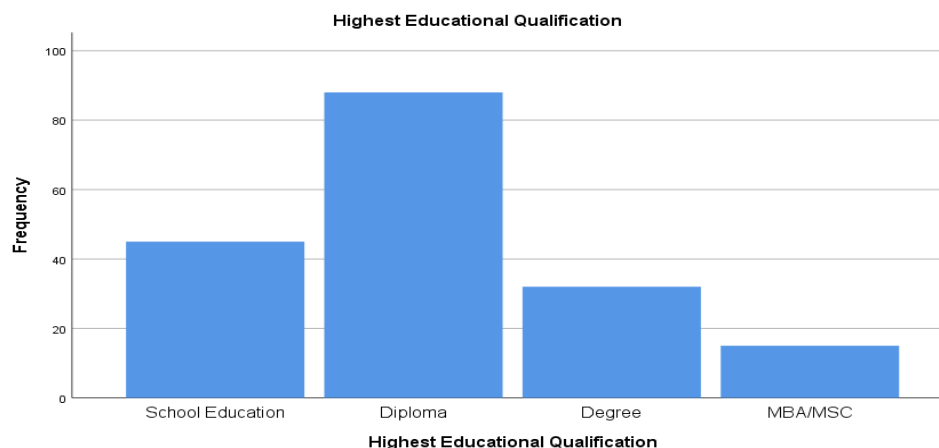
The figure above clearly indicates that male participation in the study is greater than that of female participants. As 73.9 % of the participants represent the males and only 26.1% represent the female participants in the study.



**Figure 5. Age of the participants**

*Source: SPSS data analysis, 2022*

According to the study results Majority of the participants are between the age group of 31-40 years and they represent 58.3 % of the entire sample population. Furthermore, participants in the age group of 18-30 represent 24.4% of the entire sample population. The least number of participants between the age groups of 41-50 and they represent 17.2 % of the entire population respectively.

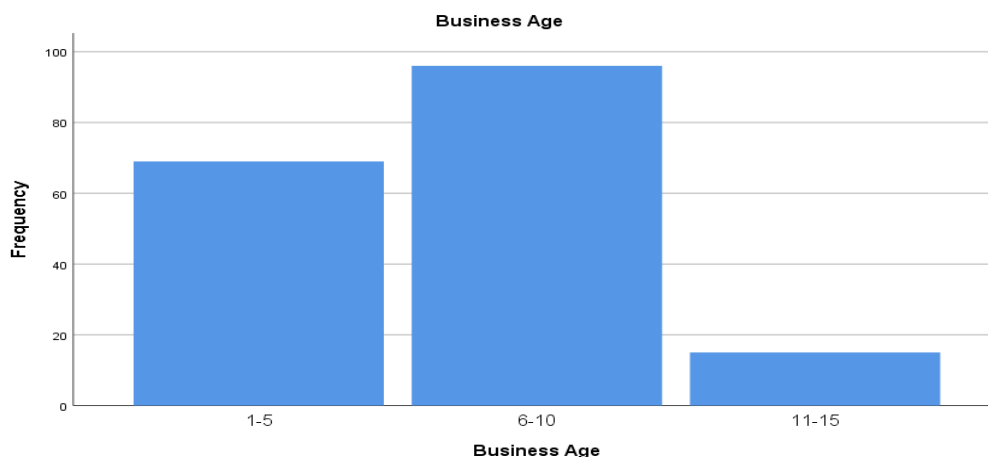


**Figure 6. The Highest educational qualification of the participants**

*Source: SPSS data analysis, 2022*

The study results indicate that the majority of the participants hold a Diploma and the least amount of them obtain a Ph.D. The Diploma holders in the study represent 48.9% and Ph.D. holders represent only 8.3% of the entire sample. Furthermore, there 25% of participants only have are school leavers and 17.8% hold a degree.





**Figure 7. The age of the business of the participants**

Source: SPSS data analysis

The Majority of the participants of the study have a business aged between 6-10 years and they represent 53.3% of the entire study sample population. Furthermore, 38.4% of the participants have 1-5 aged business. The least number of the participants have 11-15 aged business and they represent 8.3 % of the entire sample population.

### ➤ Correlation and Regression of Inflation and Sustainability

#### Correlation

**Table 2: Correlation between inflation and sustainability**

<b>Correlations</b>			
		Inflation	Sustainability
Inflation	Pearson Correlation	1	.727**
	Sig. (2-tailed)		.000
	N	180	180
Sustainability	Pearson Correlation	.727**	1
	Sig. (2-tailed)	.000	
	N	180	180

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Source: SPSS Data analysis (2022)

The interpretation of the table 2 data indicated that there is a significant correlation between the inflation and sustainability as the  $p=0.000 < 0.01$ . Furthermore, according to the “r” value (0.727), there is a strong positive linear relationship between the two variables.

## Regression

**Table 3: Model Summary of inflation and sustainability**

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.727 <sup>a</sup>	.529	.526	.42019

a. Predictors: (Constant), Inflation

Source: SPSS Data analysis (2022)

According to table 3, the inflation variable has a 52.9% impact on sustainability of small business based on the R<sup>2</sup> value.

**Table 4: Anova of inflation and sustainability**

ANOVA <sup>a</sup>						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	35.315	1	35.315	200.016	.000 <sup>b</sup>
	Residual	31.427	178	.177		
	Total	66.742	179			

a. Dependent Variable: Sustainability

b. Predictors: (Constant), Inflation

Source: SPSS Data analysis (2022)

The suitability of regression data is displayed in the table and according to table 4, the data is suited well as the significance of the data is displayed as 0.000 < 0.05. Hence Inflation is statistically significant for Sustainability.

**Table 5: Coefficient Table of inflation and sustainability**

Coefficients <sup>a</sup>						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.679	.281		-2.414	.000
	Inflation	1.173	.083	.727	14.143	.000

a. Dependent Variable: Sustainability

Source: SPSS Data analysis (2022)

There is a 5% threshold value as the significant level in table 5 is less than 0.05. This impact is considered as significant as p=0.000.

Y= a+b

Sustainability = -0.679 (Constant) + 1.173 (inflation)

## ➤ Correlation and Regression of Political relations and Sustainability

### Correlation

**Table 6: Correlation between Political Relations and sustainability**

		<b>Correlations</b>	
		Political Relations	Sustainability
Political Relations	Pearson Correlation	1	.659**
	Sig. (2-tailed)		.000
	N	180	180
Sustainability	Pearson Correlation	.659**	1
	Sig. (2-tailed)	.000	
	N	180	180

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Source: SPSS Data analysis (2022)

The interpretation of the table 6 data indicated that there is a significant correlation between the political relations and sustainability as the  $p=0.000<0.01$ . Furthermore, according to the “r” value (0.727), there is a strong positive linear relationship between the two variables.

### Regression

**Table 7: Model Summary political relations and sustainability**

<b>Model Summary</b>				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.659 <sup>a</sup>	.435	.431	.46046

a. Predictors: (Constant), Political Relations

Source: SPSS Data analysis (2022)

According to table 7, the political relations variable has a 43.5%% impact on sustainability of small business based on the R2 value.

**Table 8: Anova of political relations and sustainability**

<b>ANOVA<sup>a</sup></b>						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	29.001	1	29.001	136.781	.000 <sup>b</sup>
	Residual	37.741	178	.212		
	Total	66.742	179			

a. Dependent Variable: Sustainability

b. Predictors: (Constant), Political Relations

Source: SPSS Data analysis (2022)

The suitability of regression data is displayed in the table and according to table 8, the data is suited well as the significance of the data is displayed as  $0.000 < 0.05$ . Hence political relations is statistically significant for Sustainability.

**Table 9: Coefficient table of political relations and sustainability**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.925	.204		4.535	.000
	Political Relations	.749	.064	.659	11.695	.000

a. Dependent Variable: Sustainability

Source: SPSS Data analysis (2022)

There is a 5% threshold value as the significant level in table 5 is less than 0.05. This impact is considered as significant as  $p=0.000$ .

$Y = a + b$

Sustainability = 0.925 (Constant) + 0.749 (political relations)

The above mentioned study result clearly indicate that both perceived inflation and political relations have significant relationship with sustainability of SMEs.

**Table 10: Entire Model summary of the study**

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.730 <sup>a</sup>	.534	.528	.41936

a. Predictors: (Constant), Inflation, Political Relations

Source: SPSS Data analysis

As per the data analysis, the data in the study is fairly suited. The consistency in the study is meaningfully high as the "R" value is at 0.730. Moreover, the R square value indicates that both independent variables have only 53.4 % impact towards the sustainability small enterprises.

SMEs are vital to the national economy. These businesses, which account for 52% of GDP and 45% of national employment, offer many opportunities for economic growth. SMEs are labor-intensive and require less capital than larger enterprises. Growth in the SME sector can create new jobs and spread income across rural and regional communities. They can increase tax bases faster than larger companies, boosting government revenue (Haresankar, et al., 2018).

The results of this research indicated that there's a significant impact of perceived inflation and perceived political relations on the sustainability of SMEs in Sri Lanka during the ongoing economic crisis. The results matched the previous findings of

Haresankar (2018) and Aberathne (2005) and proved the hypotheses of this study. Hence, it's obvious that the inflation affects factors like maintaining resources, management of costs and inputs, tax rates, issues related to logistics etc. while perceived political relations can affect the smooth functioning of operations, stability and maintaining a sound and safe environment in terms of the future sustainability of small and medium businesses.

## 5. Conclusion and Implications

Given the current situation, it's imperative to understand that Sri Lanka is undergoing a critical phase in terms of economy and serious concern must be given to sustain SMEs as it can affect the GDP. As per the revelations of the study, perceived political relations and inflation significantly impact the sustainability. Hence, the government has a crucial role in controlling the crisis situation as SMEs are not in a position beyond control to find solutions alone. Hence, better business prospects and strategic planning, providing monitoring guidance and support to sustain, making policy reforms to strengthen SME business owners could be considered. Furthermore, ministries related to SMEs and supportive organizations should work towards maintaining a protective, supportive and a sustainable environment to SMEs in surviving the prevailing crisis.

Sri Lanka lags behind regional neighbors in SME share of total enterprises. In India, Malaysia, and Singapore, SMEs make up 95-99% of all businesses, but in Sri Lanka, they're only 80%. (Taghizadeh-Hesary, 2018). Despite their major contribution to the economy, SMEs in Sri Lanka still account for a small part of overall national exports, demonstrating a fundamental divergence between their desire to expand beyond the home market and their ability to do so.

The narrative around SME growth must alter. SMEs are the backbone of the economy, but they need help to grow. Regulatory restrictions and insufficient information access hinder SME growth. Over 20 ministries serve Sri Lanka's business sector, each having many departments, authorities, and councils. This causes government fragmentation, information gaps, and poor private-public synergy. The government must improve access to funding and streamline its SME policy to help entrepreneurs (Mel, et al., 2013). SME reforms should reflect SMEs' aspirations to expand into international competitors. One suggestion is that SMEs should partner with foreign companies to gain cash and skills. These constraints hinder retail SME expansion (Ruwanpura & Wrigley, 2011).

Sri Lanka should mimic developed-world SME success stories if it wants to progress beyond middle-income status. The startups and SMEs are more dependent on their business ecosystem and more prone to market failures, policy inefficiencies, and inconsistencies owing to internal constraints. A transparent regulatory environment, effective bankruptcy regulation, and judicial system are vital for start-ups and SMEs, especially in innovative, high-risk sectors.

The findings of this research will be useful for business environment analysts, administrators, policy makers, researchers, entrepreneurs in getting a better understanding and finding solutions and making decisions in the prevailing crisis. In future similar researches, the researcher can focus on the environmental factors that

impact learning the Sustainability of the small business. The survey distributed through social media platforms required constant reminders made the whole process slow down. A mixed methodology of the research would have given more insightful information on this as well as an equivalent topic.

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