

Financing Patterns of Small and Medium Enterprises in Sri Lanka

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Background

Small and medium enterprises (SMEs) played a remarkable role in the development of many countries. Therefore, the expansion of the SME sector accelerates the economic development of the economy of the country by significantly involving with the country's Gross Domestic Production (GDP). Ayyagari (2007) highlighted almost 50 percent of the GDP of high income countries are contributed by formal SMEs. For an example Taiwan, Japan and Columbia have high economic growth led by the SMEs (Pandul, 2011). Financing decision which mainly depends on availability, accessibility and preferences of owners is vital for SMEs on their way to facilitating this economic development as finance is one of a major obstacle that they are facing even today.

Research Problem

Berensmann et al. (2002) found that Sri Lankan SME owners have very diverse financial relations with different financial institutions. As a result, some SME owners may have use only one source of finance nonetheless some have three or four different sources representing both formal and informal. Moreover, some has preferred one type of finance over another and avoid some forms of financing methods entirely even though availability and accessibility is there. According to the literature, different factors may determine the financial preferences of SME owners, which are sometimes inherent to a specific country or an economy (Surangi 2012).

Objectives

Therefore, objectives of this study are,

- To identify the different sources of financing methods used by Sri Lankan SMEs.
- To find out the factors that has an impact on financial preferences of SME owners in Sri Lanka.

Research Methodology

Sri Lankan SMEs which have number of employees in between 10 – 99 considered as the population and 1000 of SMEs were selected by employing random sampling technique. A questionnaire survey was used in data gathering (Geburu, 2009, Gajanayake, 2012) in year 2014, January cross sectional in time horizon. Questions which previous studies have used to analyze related topics were used in this study and a pilot study was carried out and got feedback from the respondents on the understandability and quality of the questions. Data was analyzed using descriptive statistics and ordinal regression model.

Key Findings

Under the sources of financing, 95.1% of total respondents did not use share capital and 40% of the respondents considered venture capital. Own savings was selected by 92% and 75% has selected retained earnings as their sources of finance. First choice of the SME owners under debt financing was commercial bank loans. Second place has recorded by savings and loan company and third place for the informal sector personal contact loans. Next preference was noncommercial bank loans and then government loans under debt financing. Bootstrap financing which is the special source of financing method available for SME owners, identified lease & hire purchase as first choice. Second selection was trade credit; third place was funds from relatives and finally pawning.

Ordinal regression results has shown that two factors were found significant at startup stage namely, education (first degree), $p = 0.05 \leq 0.05$ and ownership 2 (partnership), $p = 0.026 < 0.05$. Therefore, the estimated $p \leq 0.05$ the null hypothesis is rejected. Therefore, the regression coefficients for the two predictor variables were found to be statistically different from zero in estimating the general question in the presence of other independent variables. Moreover, five factors were found to influence the financial preferences at their future financing need, education (first degree), $p = 0.013 < 0.05$, experience (had experience), $p = 0.014 < 0.05$, business sector (wholesale), $p = 0.032 < 0.05$, size (31 to 50 employees), $p = 0.031 < 0.05$, asset (301 to 500 thousand), $p = 0.037 < 0.05$ and asset (501 to 700 thousand), $p = 0.038 < 0.05$. The regression coefficients for the five predictor variables were found to be statistically different from zero in estimating the general question in the presence of other independent variables.

Conclusion

This paper analyze how small and medium enterprises finance themselves and investigate the factors influencing their financing preferences. Sri Lankan SME owners prefer own savings as their most preferred sources of finance under equity financing. Retained earnings which were the second highest

preference and venture capital also contributed significantly. Even though share capital was not provided any significant contribution to Sri Lankan SME finance, debt financing were mainly contributed through commercial bank loans. Savings and Loan companies and Non-commercial bank loans were also played significant role in financing SMEs. Even though there was developed and competitive financial market, Sri Lankan SME owners still prefer informal debt financing such as personal contacts loans. Moreover, government also trying to provide some assistance in terms of loans to SMEs even though it was insignificant compared to other sources. Bootstrap Finance which was also popular among Sri Lankan SME comprises money from relatives which was the highest preference followed by lease and hires purchases, and trade credit. Under the different factors affecting on financial preferences, it can be concluded that education, experience, business sector, asset value and size of the business have shown significant effect to Sri Lankan SME owner's financial preferences.

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