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The Determinant Factors of Negligence of Formal Financing Sources: Special Reference to SMEs in Gampaha District

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ABSTRACT

Small and Medium Enterprises (SMEs) play very vital role in Sri Lankan economy. It can be seen that Small and Medium Enterprise (SMEs) are the backbone of all economies and a key source of economic growth. The important contribution of SMEs in Sri Lanka's economy, employment generation is well established. Although, their role in the economy is vital, many SMEs are facing difficulties to access to financing. Therefore, they are facing many difficulties while getting the financing from formal financial sources. Like, many financial institutions are asking many documents, collaterals when they are accessing to formal financing sources. It has become a major issue for them start a business and it tends to neglect the formal financial sources.one of the main reasons why banking and financial institutions are reluctant to give funds to the SMEs is due to lack of collateral and good track record of the company .with this matter they are neglected formal financing source from formal financial institutions. The objective of this study is to analyze the determinant factors of negligence of formal financing sources that influence to SMEs owners financial decisions. The data were collected by issuing questionnaires to the 60 SMEs owners in Gampaha district. The researcher analyzed the collected data by using SPSS .Correlation analysis and regression analysis were used to check the relationship and impact of the characteristics of SMEs Owners, Firm's dynamics and SMEs Owners' formal financial decisions and identified that the positive correlation between two variables. Therefore, the researcher found that there is a positive correlation between characteristics of SMEs owners', firm's dynamics and SMEs owners' formal financial decisions and gives recommendations in this study to formal financial institutions to reduce regulations for accessing the funds.

Index Terms—Collateral, formal financing sources, formal financial decisions, Small medium sized-Enterprises, Sri Lanka

INTRODUCTION

Sri Lanka is a lower-middle income country with one of the highest per capita income in the South Asian region(World Bank Classification,2016).Like, in the most of South Asia, Sri Lanka too has a majority of the population living in rural areas the rural population in estimated to be 84.9% of the country's total population. Many of their villages mainly are engaged SMEs. Because, small industries in the rural areas are the major source of employment and production are food. The SMEs account for about 80-90 percent of the total number of enterprises in Sri Lanka and 75% of the employment in the private sector (ADB report, 2016).Further the contribution of the SME sector has increased from 40% in 2015 to 52% in 2016.All these evidences show the significance of the SME sector in Sri Lanka. (Ministry of Finance and Planning Annual report, 2015).

Cottage and Small Scale Industries (CSSI) sector plays an important role in economic development through the creation of employment opportunities, the mobilization of domestic savings, poverty alleviation, income distribution ,regional development, training of workers and entrepreneurs, creating an economic in which large firms flourish and contribute to export earnings. Therefore, this sector is said to be the backbone of all developed and developing nations. SMEs have a definite economic importance to almost all economies in the world but particularly to those in the developing countries who face challenges in employment creation and income distribution. Having understood the positive impact of SMEs development and economic growth, the successive government in Sri Lanka has taken place various steps to develop this vital sector. However when analyzing the present contribution of the sector to the national economy, it seems that it has not yet produced desired results when compared with other developed and developing countries in the region. Hence, it seems that there is a vast opportunity for Sri Lanka to develop this sector, there by harnessing the benefits deriving from it.

LITERATURE REVIEW

SMEs are companies where personnel numbers fall below certain numbers, amount of capital invested or annual turnover within the certain standard amount (Gamage and Gamage, 2003).While the importance of the SME sector and the formal sector is acknowledged internationally, defining an SME is a challenging task, as every country has its own definition. Firms differ in their levels of capitalization, sales and employment. Hence, definitions which employ measures of size when applied to one sector might lead to all firms being classified as small, while the same size definition when applied to a different sector might lead to a different result (Mahembe, 2011).

For Sri Lankan context, has considered by scholars, as Gamage,(2003) illustrates that using the size of capital and the number of employees as the criteria, the Industrial Development Board (IDB) defines a small industry 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 persons (Central bank of Sri Lanaka,1998).The Department of Small Industries (DSI) classifies enterprises with capital investment of less than Rs.5 million and fewer than 50 employees as SMEs (Ponnamperuma,2000).

In Sri Lankan context, there are different definitions for SMEs as different government agencies use different criteria to identify SMEs. Among these criteria are the number of employees, the size of fixed investment, and the nature of the business and the sector, formal or informal, in which the industry operates. There are different terms used in different documents to identify this sector. Small and Medium Industries or Enterprises, Micro Enterprises, Rural Enterprises, Small and Medium activities, Cottage and Small Scale Industry, are some of the terms frequently used.

There are reasons affecting for SMEs to neglect financial aids from banks**.** According to (Lemuel,2009) identifies problems when SMEs seeks financing through Banks, under three major categories called a poor macroeconomic environment, lack of basic infrastructure facilities, and internal structuring problems of SMEs. There are number of factors within macroeconomic environment high interest rates, exchange rate disparity, unavailability, and dominance of the government sector in the economy (Lemuel, 2009).

Conceptual Model

After investigating the literature, researcher identified two main variables as the independent variables. These are come under what are the determinant factors of formal financing sources to neglect by SMEs. Further conceptual model is constructed to make insight in to Preference to take the risk, Attitudes, Awareness and Owner's experience as two ways and also Plans to expand, Buying and selling procedure, compliance with tax authorities those were included. The following model suggest that the Characteristics of the SMEs owners and Firm's dynamics as the independent variables and SMEs owners' formal financial decisions as the dependent variable. Thus conceptual model clarifies the four proxies Time consumed, Opening hours and days, Basic requirements and Repay conditions.

Independent Variable   **Dependent Variable**
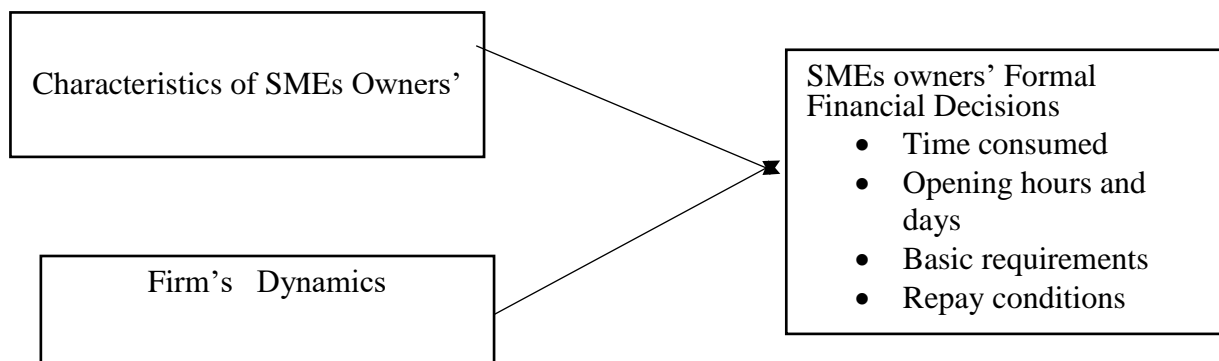
DATA ANALYSIS

Reliability analysis

In order to understand whether the questions in the questionnaire all reliably measure the same latent variable from "strongly disagree to strongly agree" reliability analysis can be used. Cronbach's Alpha is the most common measure of internal consistency when we have multiple Likert questions in a questionnaire. If the Cronbach's Alpha value is more than 0.7, the questionnaire is more reliable. The following table shows the reliability of the questionnaire of the present study

Cronbach's Alpha	N of Items
.797	48

According to above table, the Cronbach's Alpha value is 0.797. So, the questionnaire of the present study is more reliable.

For testing the hypotheses the researcher uses correlation analysis. Before analyzing the correlation, researcher was checked the fitness of the research model by using following Table 4.8, which describes the model summary. The adjusted r2 should be more than 0.5 for the model fitness.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.956ª	.915	.912	22.31634

a. Predictors: (Constant), Firm's dynamics,
b. Characteristics OF SMEs owners

Source: survey data

In the above model summary, adjusted r2 is 0.912. The SME owner's financial decision is explained by SME owner's characteristics and firm's dynamics by 91%. Hence, this model has good fitness.

Correlation analysis

The coefficient of correlation is a measure of the strength of the relationship between the variables; that is, how well changes in one variable can be predicted by changes in another variable. In this study, the researcher uses Pearson Correlation coefficient (r) to determine the strength and direction of the two continuous variables. Pearson Correlation coefficient (r) can take values from -1 to +1 and size of the value of the coefficient indicates the strength of the relationship and sign (- or +) indicates the direction. If the correlation coefficient is 0, there is no relationship between the variables

Correlations

		Characteristics OF SMEs owners	Firms dynamics	Formal financial decisions
Characteristics OF SMEs owners	Pearson Correlation	1	.937**	.955**
	Sig. (2-tailed)		.000	.000
	N	60	60	60
Firms dynamics	Pearson Correlation	.937**	1	.915**
	Sig. (2-tailed)	.000		.000
	N	60	60	60
Formal financial decisions	Pearson Correlation	.955**	.915**	1
	Sig. (2-tailed)	.000	.000	
	N	60	60	60

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

In above table shows the significant values of SMEs owners' characteristics and firm's dynamics. If these are less than 0.01, the researcher can identify a relationship between the Characteristics of SMEs owners', firm's dynamics and SMEs owners' formal financial decisions. According to the details in above table, the significant value is 0.000 in all two independent variables. So, the researcher can identify that there is a relationship between the SMEs owners' characteristics, firm's dynamics and SMEs owners' formal financial decisions in Gampaha District. If the Pearson correlation value is plus value, there is a positive relationship between the variables. By seeing the Pearson correlation values, researcher can identify that there is a positive relationship between the characteristics of SMEs owners' and SMEs owners' formal financial decisions. The characteristics of SMEs owners' and SMEs owners' formal financial decisions have positive correlation (r = 0.955). Firm's dynamics and SMEs owners' formal financial decisions have positive correlation (r = 0.915). So, the researcher identifies the characteristics of SMEs owners' and firm's dynamics have positive relationship with SMEs owners' formal financial decisions.

Hypotheses testing of relationship between characteristics of SMEs owners', firm's dynamics and SMEs owners' formal financial decisions

Hypotheses	Independent Variable	Dependent Variable	Beta value	Adjusted R squire	Significant value	Result
H1:	Characteristics of SMEs owners	Formal Financial decisions	.955	.912	.000	Accepted
H2:	Firm's dynamics	Formal Financial decisions	.915	.912	.000	Accepted

3 Regression analysis

Regression results of characteristics of the SMEs owners' and SMEs owners' formal financial decisions.

Coefficients ª

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.515	8.994		.057	.955
	Characteristics OF SMEs owners	.322	.013	.955	24.444	.000

a. Dependent Variable: Formal financial decisions

According to the Table, the significant value of characteristics of SMEs owners' is 0.000 (p<0.01). The beta value (β) is 0.955. If the SMEs owners' characteristics increased by 1 SMEs owners' formal financial decisions increases by 0.955.

Regression results of firm's dynamics and SMEs owners' formal financial decisions

Coefficients [a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	25.939	11.296		2.296	.025
	Firm's dynamics	.857	.050	.915	17.255	.000

Dependent Variable: Formal financial decisions

Source: survey data.

According to the Table, the significant value of Firm's dynamics is 0.000 (p<0.01). The beta value (β) is 0.915. If the Firm's dynamics increased by 1 SMEs owners' formal financial decisions increases by 0.915.

Conclusions

- There is a positive relationship between the SME owner's characteristics and SME owner's formal financial decisions. The SME owner's characteristics and SME owner's formal financial decisions have positive correlation (r = 0.955).

- Firm's dynamics and SME owner's formal financial decisions have positive correlation (r = 0.915). So, the researcher identifies the SME owner's characteristics and firm's dynamics have positive relationship with SME owner's formal financial decisions.

- According to the study, the relationship between SME owner's characteristics and SME owner's formal financial decisions, have positive correlation (r = 0.955).Therefore, the researcher identified correlation value is 0.955.It shows high positive relationship between two variables.

- Firm's dynamics and SME owner's formal financial decisions have positive correlation (r = 0.915). So, the researcher identifies the firm's dynamics have positive relationship with SME owner's formal financial decisions

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