

# FACTORS CONTRIBUTING TO THE BUSINESS GROWTH OF SMALL AND MEDIUM DAIRY ENTERPRISES IN SRILANKA

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## ABSTRACT

**Purpose:** The aim of this study was to investigate factors contribute to the business growth of Small and Medium Dairy Enterprises in the Eastern Province. The study was guided by the following research question: What are the factors that contribute to the Business growth of Small and Medium Dairy enterprises in the eastern Province?

**Design/Methodology/Approach:** The research adopted a descriptive design with a target population of 1300 SMEs from which a sample size of 270 respondents from the Eastern province using a structured questionnaire. Every factor was tested for reliability and validity using factor analysis and structural equation modelling with Smart-PLS was also used to establish the relationship between independent variables and business growth of SMEs.

**Findings:** The study revealed that Entrepreneurial skill, Access to financial services are highly positively correlated to the business growth of SME in dairy sector, and Access to market is significantly positively correlated to the business growth and Access to institutional support is also significantly correlated to the business growth of SMEs in the Eastern Province.

**Originality/value:** The study recommends a multi facet model to increase the performance of entrepreneurs in the dairy industry.

**Keywords:** Small and Medium Dairy Enterprises, Eastern Province, Business Growth

## 1. INTRODUCTION

### 1.1 Background to the Study

Small and medium dairy enterprises is one of the most important industries in Sri Lanka to develop the economy. Prior to adopt the open economic policies, the domestic sources of milk provided about 80% of consumption needs of the country. After the 1977, the consumption of dairy products has increased. At present Sri Lanka is self-sufficient about 40% with domestic milk products and import about 60% of milk products to fulfill the domestic requirements. Range of milk products, packaging and availability has increased, and their low material costs enable them to be extensively promoted (Pathumsha, 2016).

Dairy production is viewed as a unique position compared with other sectors of Agriculture. Milk is harvested daily basis and a regular source of income to the producers. Milk production is labor-intensive and provides employment opportunities globally. There is a growing demand for dairy protein and products among an increasing human

population worldwide. The dairy industry has several features that distinguish it from the other sectors of Agriculture (Sikawel & Mugish, 2018).

The dairy industry highly contributes to the socioeconomic position of dairy producers. Most global farmers are small-scale producers, with a weak and vulnerable position on the dairy market. The nature of the market is able to adjust to market changes in a limited, slow, and gradual way (Bus & Worley, 2003). Since its economically vulnerable position (dairy producers are price takers not price setters), the dairy industry in many countries often enjoys the highest degree of economic protection. Additionally, dairy farming in several countries has come to be regarded as increasingly valuable.

In Sri Lanka, current fresh milk consumption is not much significant. There is a higher demand for powdered milk since fresh milk is more expensive and difficult to get from the dairy farms and there are huge campaigns to promote the imported milk powder in different brand names. Therefore, majority of the consumers depends on the imported milk products, and it is caused to leak huge foreign exchange from the country. Hence it is essential to promote the domestic milk and milk products to improve the dairy industry in Sri Lanka towards development of the economy. Dairy industry has created employment opportunities extensively and highly contribute to reduce the rural poverty and nutritional problems. Therefore, development of the dairy industry has been a paramount importance.

**Table 1: Level of production 2012**

District	Milk (Ltr/Day)				Curd (Ltr/Day)		
	Home consumption	Local Sale	Supply to marketing channel	Total milk collection per day	Home consumption	Sales other district province	Total production
Ampara	9,678	6,579	39,400	61,378	3,385	901	4,286
Batticaloa	8,767	14,780	29,738.43	53,285	3,809	2,000	5,809
Trinco	8,228	7,741	31,359	47,328	2,515	4,518	7,033

*Source: Livestock statistics-2012*

**Table 2: Level of production -2017**

District	Milk (Ltr/Day)				Curd (Ltr/Day)		
	Home consumption	Local Sale	Supply to marketing channel	Total milk collection per day	Home consumption	Sales to other district province	Total production
Ampara	9,000	11,240	23,768	51,773	9,943	4,855	14,798
Batticaloa	11,580	19,071	20,478	78,017	3,766	7,601	11,367
Trinco	8,764	7,050	16,739	34,623	2,755	3,845	6,600

*Source: Livestock statistics-2017*

The Livestock statistical data from 2012 -2017 of the Department of Animal Production and Health pertaining to the Eastern Province shows that there is a considerable business growth in dairy products among the small and medium enterprises in the Eastern province in recent years though there has been not facilitated for the large investment for

the livestock and dairy sector due to the lack of financial services and poor support of the state (Pathumsha, 2016) and there is a great potential to develop this sector. Based on the above broad problem the study is to determine the factors contributing to the business growth of SMEs in dairy sector.

### **1.2 Research Question**

What factors contribute to the business growth of the small and medium dairy enterprises in the Eastern Province?

### **1.3 General Research Objective**

The general objective of the study is to determine the factors contributing to the business growth of SMEs dairy sector.

Hence, the following specific objectives were derived;

1. To determine whether entrepreneurial skills influences the growth of SMEs in dairy sector.
2. To establish whether access to financial services influences the growth of SMEs in dairy sector.
3. To evaluate how the access to markets affects the business growth of SMEs in dairy sector.
4. To assess whether the Institutional support has influence on the business growth of SMEs in dairy sector in the EP.

## **2. LITERATURE REVIEW**

### **2.1 Nature of Dairy Entrepreneurship and Global Dairy Trends**

The dairy sector is very important in its contribution to the economies of both the developed and developing countries of the world. The structure of dairy farming varies enormously from country to country. In many developing countries, the owner of the holding has just one cow, while in commercial dairying enterprises the worldwide average herd size is typically more than 100 animals. According to Food and Agriculture Organization (2009), in the United States, many of Californian herds have more than 1,000 animals. About 90% of California's milk is produced in herds of more than 500 animals. In 2007 there were some 670 million head of milking animals in the world. About one-third of these are cows which produced more than 80% of the world's milk output (Food and Agriculture Organization, 2009). The total world production of all kinds of milk amounts to some 670 million tons/year. Relatively little is produced in Africa and Oceania, even though Australia and New Zealand are two of the most important countries for world dairy trade (Food and Agriculture Organization, 2009).

Some countries such as Canada and EU nations have developed supply management programs to minimize farm price fluctuations and guarantee access to domestic markets. According to the International Farm Comparison Network (IFCN), the top five milk processing countries in terms of volume of milked processed globally are the United States, Germany, China, France, and India. Lastly, and most certainly not of lesser importance, dairy production is unique in that dairy cattle are efficient converters of crops such as grasses and fodder that are not suitable for human consumption into a high-quality, nutritious food product for human consumption. Too often ruminant animals such as dairy cows (Sikawel & Mugish, 2018).

In India, the results of Operation Flood (an appraisal of current Indian Dairy Policy) are well known for dairy development in the developing world. The principal features of this model are: a three-tier structure owned by the dairy farmers through their cooperatives, namely village societies which collect the milk and provide inputs and

services, district cooperative unions (which collect milk from the village societies and process and market it) and state federations (which coordinate marketing and promote dairy development). These organizations have high-level political support and control the import of dairy product donated milk powder and butter oil used to finance infrastructure for milk processing and marketing and not for on-farm investments and most dairy equipment produced in the country (Sikawel & Mugish, 2018).

Regions with the highest cumulative average growth in cow milk production from 2000–2014 were Asia (4.9%), Africa (4.4%) and South America (3.1%), mainly due to increases in the number of dairy animals and farms. In 2014, as in previous years, the top milk-producing regions were Asia (28%), EU (24%) and North and Central America (18%). (Mpofu & Sauti, 2014).

## **2.2 Dairy Production in Sri Lanka**

In Sri Lanka, the dairy industry has potential to contribute considerably to Sri Lanka's economic development. A traditional industry surviving thousands of years, milk production also plays an important role in alleviating nutritional poverty in all age groups. And it is a source of extensive employment opportunities.

Consumption of dairy products has increased dramatically since the 1970s when the Government adopted open economic policies and Sri Lanka is largely self-sufficient in most animal products – apart from dairy. However, the. Currently, Sri Lanka is about 35–40 percent self-sufficient with its milk products, though that level has been achieved mostly with imported milk powder. The Government's ambitious target for growth in dairy production is an increase towards 50 percent self-sufficiency in milk products by 2020. At the current growth rate of 1–2 percent, with no increase in total consumption. This is a challenging task, where currently, dairy industry, which only supplies approximately 40 percent of the domestic requirements. In contrast, with two decades ago when, prior to the open economy in 1977, domestic milk production provided nearly 80 percent of Sri Lanka's consumption needs. Given the current levels of malnutrition, particularly among pre-school children and pregnant mothers, production of milk and dairy products is an important activity for improving the nutritional level of Sri Lanka (Mendis & Edirisinghe, 2014).

The contribution of the agriculture sector, including livestock, forestry and fisheries to GDP was 7.5 percent in 2016, having dropped from 8.5 percent in 2010 (Department of censuses, 2017) with almost 90 percent of the population considered rural (Central Bank of Sri Lanka, 2017) data show that agriculture provided employment to 30.7 percent of the population. Livestock accounts for only about 1.2 percent of GDP, but it is an integral part of many other agricultural enterprises providing draught power, transport and dung for fertilizer.

Total milk production in 2014 was an estimated 281010 MT, up 3 percent from the previous year, with approximately 230500MT supplied by dairy cows. Of this growth, 47 percent of local milk entered the formal market. (Department of Censuses and Statistics, 2017).

**Table 3: Production and availability of milk, 2007–2017**

Year	Fresh milk			Per capita availability (kg/yr)
	Cow milk ('000tonnes)	Buffalo milk ('000tonnes)	Total milk ('000tonnes)	
2007	143.35	27.26	170.61	5.65
2008	145.64	30.11	175.75	5.85
2009	155.46	41.60	197.06	6.03
2010	191.9	55.6	247.55	6.05
2011	203.45	54.8	258.3	6.29
2012	237.6	61.6	299.25	8.06
2013	265.16	64	329.16	8.73
2014	272.9	60.99	333.9	9.27
2015	305.39	69.05	374.44	9.46
2016	317.88	66.13	384.01	10.02
2017	327.60	68.59	396.20	10.56

*Source: Department of Census and Statistics, Sri Lanka, 2017*

Most dairy cattle are reared in small-scale, intensive farming system. Many factors influence the distribution of dairy cattle in Sri Lanka; dominant among them are agro-ecological zoning and proximity to markets and feed resources.

### 2.3 Empirical Findings of the Factors Affecting the Business Growth

Munyori (2014) studied to determine the factors affecting the growth of small and micro enterprises dairy farmers in Kenya. It was found that the factors were the entrepreneurial skill, access to financial services, social network and access to market. Muriuki (2014) studied to establish factors influencing business growth of smallholder dairy farming enterprises in Kenya. The study established that business management skills influence growth of dairy enterprises and that interaction with extension service providers positively impacted on the earnings of the dairy farmers.

Asiseh et al. (2010) studied to find the factors influencing the growth of the number of dairy product manufacturing establishments in the United States. The empirical findings suggest that the growth of the number of small-size dairy product manufacturing establishments is strongly affected by the proximity of both input and output markets as well as by the presence of competition from medium-large-size establishments. Sikawel & Mugish, (2018) studied to find the factors effecting Small and medium-sized enterprises (SMEs). The research reveals that there are several significant factors affecting Kosovar SMEs growth. The major factors being lack of access to finance, competition, corruption, globalization, laws and regulations, management competence, lack of skilled labor, and low investment in innovation, technology and marketing. De Silva & Sandika (202) studied that insitutional support is vital for business growth.

From those empirical findings the factors such as entrepreneurial skills, access to market, access to finance, and institutional support would influence the business growth of dairy enterprises in Sri Lanka which are discussed in the following sub headings.

### **2.3.1 Entrepreneurship Skills**

Entrepreneurial skills are very much important for the growth and sustainable development of the small and medium scale enterprises. Skills are the knowledge demonstrated through actions or a unique performance in certain situations. Skills are attained and developed through training. Nevertheless, reaching maintainable business growth is a task that requires special skills (Smith & Perks, 2006). In this context, it is most likely for a business to be succeeded more if business owners could have sufficient entrepreneurial skills.

According to Omolara (2018), that entrepreneurial skills have a significant influence on the growth of SMEs in Nigeria and the UK. However, the respondent in Nigeria and the UK agreed that creative thinking, Problem solving, and communication skills are critical for increase sales and competitive advantage. There is correlation between experience and level of education of entrepreneurs which can contribute in better human capital, growth and expansion. (Chachar et al., 2015). Mpofu & Sauti (2014) found that informal management structure and the owner – manager’s personal control of strategic and operating decisions hinder MSEs output growth significantly.

As empirical studies of (Whetten & Cameron, 2005) have reviewed that entrepreneurial skills influence the growth and operations of SMEs, the success of entrepreneurs rely on the identification of competencies for start-ups and established businesses, as well as their survival and early-year growth. Managerial level personnel are more adaptive and use social support constructively (Sikawel & Mugish, 2018). Hence, entrepreneurship skills are vital to the growth and survival of Small and medium scale enterprise. Therefore, skills are expected to influence on the performance of dairy entrepreneurs.

### **2.3.2 Access to Markets**

Marketing access refer to services related to the selection, pricing, sale and distribution of products, advertising or promotional activities, and acquiring access to raw materials, inputs, and equipment. Business access plays a pivotal role in overcoming the cost of information-seeking activities. Intermediaries play a significant role in facilitating the exports of small enterprises. Other aspects related to this such as networks, access to customers, and others play an equally important role in expanding the export volumes of small enterprises (Riley & Steel, 2002). According to Muruthi et al (2014), SMEs cannot compete against large enterprises with marketing artifices, since they lack the resources necessary for a balanced competition. Therefore, researchers have questioned whether SMEs use any kind of formal set of marketing rules at all.

Hence, effective marketing was vital to the future growth of any business. Therefore, access to market is expected to increase the performance of dairy businesses too.

### **2.3.3 Access to Financial Services**

All business organizations regardless of their size require finances from the beginning and throughout their operation. The size of the venture greatly depends on the amount invested, which in turn determines the early

survival of an enterprise where the other factors are held constant. The entrepreneur will require seed capital to start the business, to operate and manage the business enterprise.

Smith & Perk (2006) noted that unavailability or lack of information about alternative sources of finances and inability of SMEs to evaluate financing option were some of the major problems facing the SMEs. Lack of access to finances as the main bottleneck facing MSE growth and found that start-up capital is a barrier to entry in most entrepreneurial activities and that lack of capital was cited by 80% of all respondents as the greatest start-up problem (Mayori, 2014). The financial structure of small firms with an emphasis on growth and access to capital markets.

#### **2.3.4 Institutional Support**

The Department of Animal Production and Health, Eastern Province, currently plays a pivotal role in providing tremendous services to the small and medium dairy entrepreneurs to enhance their process and marketing of dairy products through a funding system of Provincial Sectoral Development Grant(PSDG) to establish dairy sector significantly involving in dairy businesses that bring in sufficient income to the dairy entrepreneurs. There are several programmes in the perspective of supporting to the dairy SMEs, of them, five are described below.

**1. Value Addition Center:** The Department of Animal Production & Health (DAPH), Eastern Province has financially provided assistance to the dairy processing societies which have/possess own land to construct buildings, called as value addition centers, under subsidy scheme which the department bears 50% of the cost of the building other 50% the society does. This society runs the business with their own dairy products, in this juncture, DAPH facilitates them for marketing and development. These value addition centers are especially located in towns and urban areas for the easy access. (PSDG-2016).

**2. Technological Transfer and Demonstration:** Dairy farmers, processors, entrepreneurs and other stakeholders are periodically trained on the background of transferring modern technology by this department with theoretical and practical orientation through a panel of experts of staff of this Department, on the protocols and procedures on dairy processing and marketing, providing well prepared modules, hand bills, booklets and notes or in some instances internet access, which are very effective mode of transferring practical technology to motivate the processors to start up with new establishments. In this context, training is scheduled to be conducted on theoretical basis and practical procedures at the premises of the training center own to this Department. All these technological transfers/ trainings are conducted absolutely free of charge for the farmers with modern equipment.

**3. Providing Tools and Equipment:** The newly establishing dairy processors, entrepreneurs, and other dairy farmers are selected to be provided with yogurt incubators, ice cream machines, cream separators, pannier pressing machines, pasteurizing machines with chilling tank, ice packeting machines, milk boiling Jackets, milk boilers, milk cans, gas burner with other tools and utensils, and in some occasion Bio Gas units on the basis of individual needs and wants, with the prime objective of developing the dairy industry in the Eastern Province.

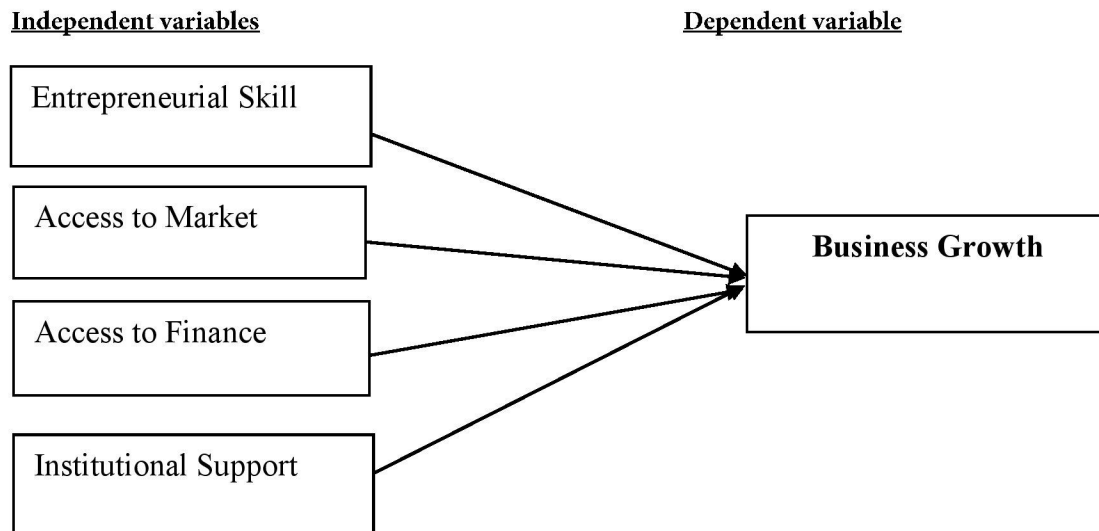
**4. Exposure Visits:** The DAPH has taken the whole responsibility to take some interested farmers to the commercially operating dairy plants to have an observation and a hand on experience involving in practical aspects and exposure them in to modern and bulk operating system Eg.Highland Milk powder Plant, Nestle condensed Milk processing Plant and Pelwatte Dairy Plant.

**5. Extension Services:** The staff members of DAPH who have special training on dairy processing visit these small and medium entrepreneurs and provide with necessary advices on need basis such as public health aspects with Join operation with officers of Health Department in the perspectives of encouraging hygienic operation and procedures, bio securities and HACCP protocols etc.(Provincial Sectorial Development Grant Annual reports, EP, and Progress report DAPH,EP-2016). Hence institutional support is also important to develop the diary industry (De Silva & Sandika, 2012).

Therefore, this literature review indicates that there is dearth of literature available on Small and Medium Dairy entrepreneurs in Sri Lankan context and significantly on the factors of institutional support contributing to the business growth of SMEs which in fact adds value to this study.

### 3. RESEARCH MODEL AND HYPOTHESIS

#### 3.1 Conceptual frame work



**Figure 1: Conceptual Framework**

#### 3.2 Hypothesis

For this study the following hypothesis can be developed,

H1: Entrepreneurs' Skills will significantly contribute to the business growth of SMEs in Dairy Sector.

H2: Access to financial service will significantly contribute to the business growth of SMEs in Dairy Sector.

H3: Access to markets will significantly contribute to the business growth of SMEs in Dairy Sector.

H4: Institutional support will significantly contribute to the business growth of SMEs in Dairy Sector.

#### 3.3 Research Methods and Materials

The main objective of this study is to identify the factors which have a significant influence on the Dairy business growth. This research is an explanatory study. The investigation was the cross-sectional correlation examination. The study design was the questionnaire survey method and conducted among a sample of 270 of small and medium dairy entrepreneurs in the Eastern Province, both primary and secondary data were collected. The questionnaire was



designed with Likert scale response ranging from 1 to 5. The results were analyzed for 270 respondents. The primary data were collected through Pre-tested structured questionnaire during the period of six months. The SPSS 23.0 and Smart-PLS 3 were used to find impact of independent variables on business growth.

#### **4. DATA PRESENTATION AND ANALYSIS**

##### **4.1 PLS-SEM Model Assessment**

Partial Least Squares based Structural Equation Modelling (PLS-SEM) and Covariance-Based Structural Equation Modelling (CB-SEM) modelling are two well-known multivariate data analysis methods were used.

##### **4.2 Internal Consistency Reliability**

Reliability test that is used to access the consistency of results across items of the same variables. It determines whether the items measuring a variable are similar in their scores. Internal consistency reliability is accessed by using CR (Hair et al., 2012). Table 01 shows the CR values of all the latent variables used in this study. These values were found to be > 0.70 which establishes internal consistency.

**Table 4: Construct validity and discriminant validity – Fornell and Lacker Criterion**

	CR	AVE	Access to Finance	Access to Market	Business Growth	Institutional Support
Access to Finance	0.891	0.622	<b>0.788</b>			
Access to Market	0.900	0.693	0.208	<b>0.832</b>		
Business Growth	0.910	0.718	0.276	0.411	<b>0.847</b>	
Entrepreneurship Skill	0.940	0.661	0.244	0.018	0.189	
Institutional Support	0.934	0.641	0.207	0.192	0.244	<b>0.800</b>

Notes: AVE: Average Variance Extracted; CR: Composite Reliability

The off-diagonal values are the correlations between latent variables and the diagonal are the square root of AVE.

##### **4.3 Convergent Validity**

This refers to the extent to which a measure correlates positively with alternative measures of the same variable. AVE was calculated to access convergent validity. These values were found to be more than the prescribed value of 0.50 and therefore establish convergent validity.

##### **4.4 Structural Model Assessment**

After establishing the reliability and validity of the latent variables in the measurement model, we assess the structural model (also referred to as the inner model) to test the relationship between endogenous and exogenous

variables. In PLS-SEM, structural model assessment includes path coefficients to evaluate the significance and relevance of structural model relationships,  $R^2$  value to evaluate the model's predictive accuracy,  $Q^2$  to evaluate the model's predictive relevance and  $f^2$  to evaluate the substantial impact of the exogenous variable on an endogenous variable.

### Relationship between Business Growth and Identified Factors

The objective is to explore the factors contributing to the Dairy Business Growth. The factor analysis and the reliability tests are presented. These eight factors' relationship with the business growth was analyzed using PLS-SEM model.

Figure 2: Bootstrapping path Coefficient-Inner Model with t-values

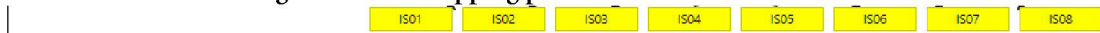


Figure 3: PLS Algorithm - Outer model with factor loadings

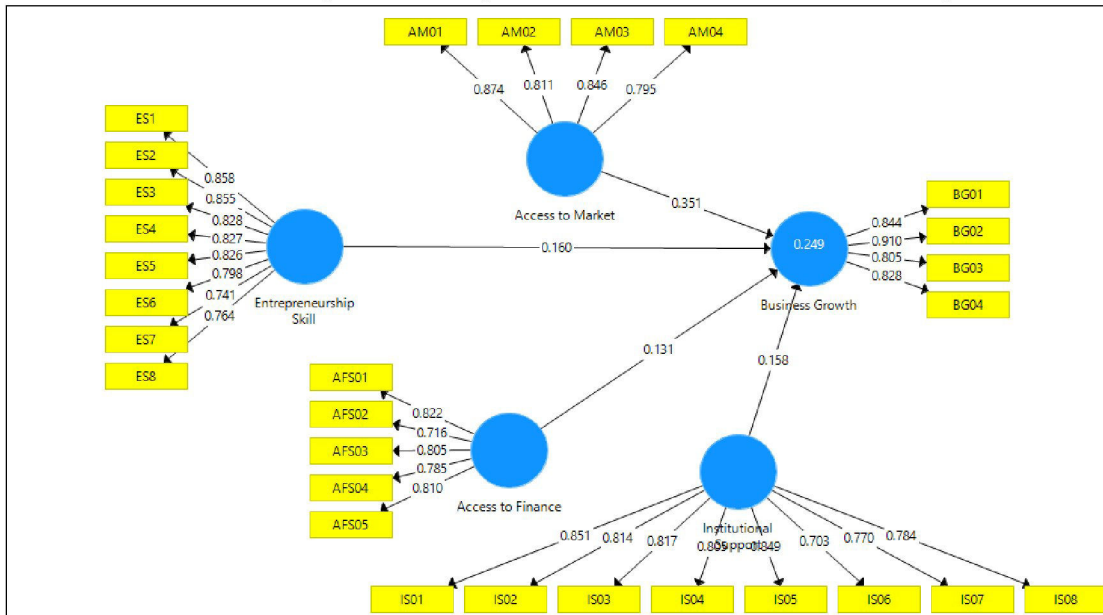


Table :5 Results of Hypothesis Testing and Structural Relationship

Hypotheses	Path	OS	SM	SD	t	P Values	Decision
H1	Entrepreneurship Skill -> Business Growth	0.160	0.168	0.051	3.149	0.002	Supported
H2	Access to Finance -> Business Growth	0.131	0.134	0.052	2.513	0.012	Supported
H3	Access to Market -> Business Growth	0.351	0.352	0.062	5.610	0.000	Supported
H4	Institutional Support -> Business Growth	0.158	0.164	0.060	2.646	0.008	Supported

OS=Original Sample/SM=Sample Mean/SD=Standard Dev

## **5. FINDINGS AND CONCLUSION**

The purpose of this study was to investigate factors contribute to the Business growth of Small and Medium Dairy Enterprises in the Eastern Province. The study was guided by the following research question: What are the factors contribute to the business growth of small and medium dairy enterprises in the Eastern Province? The contributing factors here refer to entrepreneurial skill, access to the market, access to the financial support and access to the institutional support.

Factors such as entrepreneurship skill, access to finance, access to market and access to institutional support were found to be significantly influencing the Dairy business growth in the Eastern Province. The study revealed that Entrepreneurial skill, Access to financial services, and Access to the market and Access to the institutional are positively correlated to the dairy business. The study recommends that Dairy SMEs need to consider the factors that influence Dairy Business growth. The Eastern Provincial council needs to develop strategies towards the development of dairySME. The study also recommends the need for SMEs to invest more in human capital in terms of training and capacity building and government ministries to come up with easier ways of doing business in the Eastern Region and especially so for SMEs. This study further recommends ministry to release more funds for certain projects and programs in order to facilitate business growth of SMEs dairy in the Eastern Province.

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