



**FACTORS AFFECTING TO NEGLECT FORMAL FINANCING
SOURCES BY THE SMES**

(WITH SPECIAL REFERENCE TO BADULLA DISTRICT)

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ABSTRACT

The achievement of better economic growth of developing countries can be sustained by the expansion of private sector, as they are the engine of growth. As a consequence, it is important to accelerate the growth of SMEs (Small and Medium Enterprises) in order to gain sustainable development in this era. SMEs play a pivotal role in the socio economic development and poverty reduction process of any economy in terms of employment generation, growth of GDP, innovation, equitable income distribution, resource utilization and regional development.

When developing this vital sector it is needed sufficient finance. The available financial sources for SMEs can be categorized into two categories as formal and informal. Although, there are available two approaches to obtain finance, most of the SMEs are failed due to lack of finance. Most of the SME owners are not willing to take financial aids from formal financial institutes and it has been a major barrier to the development of the sector. Hence, this study is focus to find the factors which affect to neglect the formal financial sources by the SME owners.

The objectives of the study aim to find the relationship between the formal financing dimensions of the SME owners' and formal financing decision, then, determine formal financing dimensions impact on SME owners' formal financing decision and finally, determine the most and least important formal financing dimension factor that influence to the SME owners' formal financing decision. The study conducted through SMEs which have been registered under Badulla District Chamber of Commerce and Industry. A structured questionnaire was designed and administered to collect the data and the sample consisted from 60 SME owners. It is used SME owners' demographic factors to increase the research scope. Research methodology consisted of a model constructed by the author to measure influencing factors for formal financing that includes characteristics of the SME owner, characteristics of the enterprise, and firm dynamics. The results from the study reveal that SME owners' formal financing decisions are highly affected by the characteristics of the microenterprise, and firm dynamics. When it is further describing, factors like, years in business, location of residence or operation, sector of operation, permanence in the sector, plans to expand, and compliance with tax authorities are mainly influenced to SME owners' formal financial decisions.

Therefore, based on above findings it can be suggested that formal finance institutes, should more close to SMEs, should reduce their processes and pre requirements when issuing credit and the repayment procedures should also be easy to SMEs. Hence, formal financial institutes should consider more regarding the above mentioned factors relating to SMEs. Similarly, government influence should more to increase the development of the sector.

Finally, these findings are assisted to the academies and to formal financial institutes' managers when they make decisions regarding SMEs.

Key words: Formal finance, negligence of formal finance, SME owners and SMEs