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## Working Paper

# Tourism and SME development: Performance of tourism SMEs in coastal tourist destinations in southern Sri Lanka

ADBI Working Paper Series, No. 1164

## Provided in Cooperation with:

Asian Development Bank Institute (ADBI), Tokyo

*Suggested Citation:* Deyschappriya, N. P. Ravindra; Nawarathna, A. M. D. B. (2020) : Tourism and SME development: Performance of tourism SMEs in coastal tourist destinations in southern Sri Lanka, ADBI Working Paper Series, No. 1164, Asian Development Bank Institute (ADBI), Tokyo

This Version is available at:

<https://hdl.handle.net/10419/238521>

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**ADB Working Paper Series**

**TOURISM AND SME DEVELOPMENT:  
PERFORMANCE OF TOURISM SMES  
IN COASTAL TOURIST DESTINATIONS  
IN SOUTHERN SRI LANKA**

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and A. M. D. B. Nawarathna

No. 1164  
July 2020

**Asian Development Bank Institute**

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Suggested citation:

Deyshappriya, N. P. R. and Nawarathna, A. M. D. B. 2020. Tourism and SME Development: Performance of Tourism SMEs in Coastal Tourist Destinations in Southern Sri Lanka. ADBI Working Paper 1164. Tokyo: Asian Development Bank Institute. Available: <https://www.adb.org/publications/tourism-sme-development-southern-sri-lanka>

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**Abstract**

The current study investigated whether tourism-related small and medium-sized enterprises (SMEs) perform better than non-tourism-related SMEs in the four main coastal tourist destinations—Hikkaduwa, Galle, Mirissa, and Tangalle—in the Southern Province of Sri Lanka. The authors used the survey-based quantitative research methodology to accomplish the objectives of the research. More specifically, they surveyed 200 SMEs, of which 117 were related to tourism and 83 were not, to collect the data required for the study. As the survey findings highlight, the majority of SME owners are male, irrespective of the SME type. Moreover, the survey recognized six main business types of non-tourism SMEs: agriculture, farming, and dairy; arts and crafts; apparel and bags; auto parts and maintenance; household items; and cement and metalwork. Conversely, it recognized businesses such as hotels and homestays; spas and ayurveda; cafes, food, and beverages; traveling and guiding; surfing and diving; and souvenirs and handicrafts as common business types of tourism-related SMEs. Moreover, the average profit of tourism-related SMEs is considerably higher than both the average profit of non-tourism SMEs and the average profit of the entire sample of SMEs. However, the education level of tourism-related SME owners is slightly lower than that of non-tourism-related SME owners.

The econometric analysis confirmed that tourism-related SMEs have higher profit and higher productivity than non-tourism-related SMEs. The estimated models also confirmed that factors such as firms' capital assets, number of workers, sales revenue, level of human capital, and size positively affect SMEs' profit and productivity. Hence, the current study strongly recommends motivating people who are interested in creating a tourism-related SME in the studied areas by providing the necessary training and initial capital for them to start their business.

**Keywords:** small and medium-sized enterprises, ocean tourism, tourism-related SMEs, coastal tourism destinations

**JEL Classification:** O27, L83, M30, Q01

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# 1. INTRODUCTION

## 1.1 Tourism as One of the Key Drivers of the Sri Lankan Economy

People around the world consider tourism to be an important economic activity due to its direct economic impact as well as its significant indirect and induced impacts. According to the World Travel and Tourism Council (2017), the travel and tourism industry is one of the largest economic sectors in the world, accounting for 10.4% of the global gross domestic product (GDP) and 313 million jobs or 9.9% of the total employment. Its direct and indirect impacts on real estate development across the world are tremendous in terms of accommodation, food and beverage catering, leisure, pleasure, and relaxation. The rapid growth of tourism in the 20th century produced both problems and benefits for destination countries. It had a visible impact on the sociocultural and socioeconomic environment. Although tourism can generate economic advantages for a destination country, it also brings serious long-term problems (McIntosh et al. 2009).

Tourism is the third-largest foreign income earner in Sri Lanka, and, during the last decade, there has been unprecedented growth in the industry, especially after the civil war ended in 2009. It has contributed more than \$2,980 million to the economy, second only to remittances and textiles and garments. According to the 2017 Annual Statistical Report of the Sri Lanka Tourism Development Authority (SLTDA), the tourism sector contributes 14.2% of the total foreign exchange earnings of Sri Lanka. At present Sri Lanka is experiencing unprecedented growth in the number of visitors, averaging more than 22% year on year. In 2016, for the first time, tourism in Sri Lanka surged to reach a milestone of over 2 million tourist arrivals, which is a remarkable increase of 14% over 1.8 million tourist arrivals in 2015. In 2016, international visitors stayed for an average of 10.2 nights and generated \$3.5 billion. Asian visitors continued to be the main source of tourism to Sri Lanka, accounting for 45.1% of the total share, followed by Western Europe, with a share of 31.4%. The occupancy rate of graded accommodation was 74.76%, and the total guest nights recorded in tourist hotels increased to 10.6 million nights in 2016, which is 18.4% growth compared with 2015 (SLTDS 2017).

## 1.2 Small and Medium-Sized Enterprises) in Sri Lanka: The Concept of SMEs and Their Contribution to the Sri Lankan Economy

Small and medium-sized enterprises (SMEs) play a crucial role in every economy, irrespective of their development status. SMEs' contribution to the economy is multidimensional, consisting of output growth, employment generation, poverty alleviation, economic empowerment, and export growth, among others (Harvie 2002; Asasen, Asasen, and Chuangcham 2003). As Abe et al. (2012) indicated, SMEs in Asia account for more than 95% of private enterprises and generate more than 50% of employment. In particular, in Sri Lanka, as of 2014, SMEs made up nearly 90% of enterprises (over 1 million SMEs), contributed 52% to the country's GDP, and produced 45% of its employment.

**Table 1: Number of Persons and Percentage Distribution across Economic Sectors**

Scale of the Establishment	Persons Engaged		Sector-Wise Distribution, Percentages		
	No.	Percentage	Industry	Trade	Services
Total	3,003,119	100	100	100	100
Micro	1,338,675	44.6	29.7	68.1	44.6
Small	529,751	17.6	14.0	16.8	22.6
Medium	386,756	12.9	16.7	5.5	13.9
Large	747,937	24.9	39.6	9.5	18.9

Source: Authors' creation based on Ministry of Industry and Commerce (2016).

Table 1 indicates the number of persons engaged in each type of SME and the sector-wise percentage distribution. The total number employed on the micro scale is 1.3 million, which is 45% of the total, although the micro scale represents almost 92% of the establishments. The large-scale business sector represents almost 25% of the employment despite the fact that large businesses account for only 0.2% of the establishments as the number of employees per establishment is high.

Countries define SMEs using different bases and dimensions and therefore have different definitions of SMEs. In the United States (US), the definition of SMEs varies by industry as well. SMEs in the manufacturing sector should have 500 or fewer employees, while those in the trade and wholesale sectors should have 100 or fewer employees. In contrast, SMEs in the mining, quarrying, and oil and gas extraction sectors can have up to 1,500 employees while SMEs in silver ore mining can have 250 employees (Ward 2018). The Industry of Canada (2017) identified four types of SMEs considering the number of employees. It defined industries with 1–4, 5–99, and 100–499 employees as micro, small, and medium industries, while it considered industries with more than 500 employees to be large industries. The People's Republic of China defines SMEs using the number of employees, annual revenue, and assets. The EU has a similar system for defining small to medium-sized enterprises. It classifies a business with a headcount lower than 250 as a medium-sized business, a business with a headcount lower than 50 as a small business, and a business with a headcount lower than 10 as a micro-business. The European system also takes into account a business's turnover rate and its balance sheet. In fact, the European Commission considers three dimensions, specifically the number of employees, annual turnover, and total balance sheet, to classify SMEs (European Commission 2005).

However, it is crucial to focus on the Sri Lankan definition of SMEs as this study concentrates on SMEs in Sri Lanka. As indicated in Table 2, Sri Lanka also considers two dimensions: the number of employees and the annual turnover, in classifying SMEs into micro, small, and medium categories. Under the present SME policy framework in Sri Lanka, it defines SMEs based on the number of employees and annual turnover. To qualify as an SME, an enterprise must employ fewer than 300 people and generate an annual turnover of less than LKR7,50 million.

**Table 2: SME Classification in Sri Lanka**

Company Category	Manufacturing Sector		Service Sector	
	Number of Employees	Annual Turnover (Million)	Number of Employees	Annual Turnover (Million)
Micro	1–10	≤ LKR 15	1–10	≤ LKR 15
Small	11–50	≤ LKR 16–250	11–50	≤ LKR 16–250
Medium	51–300	≤ LKR 251–750	51–200	≤ LKR 251–750

Source: Ministry of Industry and Commerce, Sri Lanka (2002).

Sri Lanka has also identified slightly different thresholds in terms of the number of employees for the manufacturing and service sectors. The current study applied the SME classification indicated in Table 2.

### Recent Government Incentives for SMEs in Sri Lanka

Considering the benefits of promoting SMEs, almost all elected governments have adopted policies to boost SMEs to the international level. “Enterprise Sri Lanka” is one of the well-known programs that the previous Government of Sri Lanka launched. Under this scheme, it provided SMEs with both financial and non-financial support. As financial support, it offered interest subsidy loan schemes, donor-funded refinancing schemes, other loan schemes specific to different types of SMEs, such as *Ran Aswenna* (small-scale farmers and farming organizations, floriculture farmers, and entrepreneurs in ornamental fish-related businesses), *Govi Navoda* (small-scale farmers and farmers’ organizations for mechanizing cultivation activities), and *Green Loan* (micro enterprises, the self-employed, and small-scale tourist service providers). In addition, Enterprise Sri Lanka provided non-financial support, such as an awareness program for grassroots-level SMEs, business development services (BDSs) for different categories of SMEs, and technical support.

In addition, the present government started ruling in 2019 and declared that it would offer several benefits to encourage SMEs. The government together with the Central Bank decided to extend the freeze on capital repayment for one year for loans to SMEs below LKR300 million. Moreover, some banks and financial institutions took legal action against non-performing loans and decided to sell the assets of such SMEs. However, the present government directed them to suspend such legal action if the SMEs have been servicing the interest regularly. The government also decided to reduce most taxes, such as value-added tax (VAT) and nation building tax (NBT), to rid SMEs of an unnecessary tax burden. In addition to such financial support, SMEs receive substantial benefits and motivation from state organizations such as the National Enterprise Development Authority (NEDA), Industrial Development Board (IDB), and Department of Small Business (DSB). In fact, these organizations provide technical knowhow, market information and linkages, financial facilities, business development services, and awareness programs. Moreover, most universities have formed an entrepreneurial center called “University Business Linkages,” which promotes university students as entrepreneurs while supporting the SMEs in the society. There are high expectations that the Government of Sri Lanka will continue to provide such incentives to boost the SME sector in Sri Lanka while linking it with the global value chain.

Since tourism is a growing industry in Sri Lanka, the contribution of the tourism sector to the Sri Lankan economy is vital. Hence, studies have widely tested the tourism-led growth hypothesis in the context of Sri Lanka. Despite the significant number of tourism-related SMEs that have started operation, especially in tourist destinations, micro-level analyses of tourism and SMEs are considerably rare. The SMEs related to the tourism



industry are highly diverse, and tourist hotels, homestays, spas and ayurveda, cafes and food, traveling and guiding, surfing and diving, and souvenirs and handicrafts are recognizable as key business sectors for tourism-related SMEs. People generally accept that most tourism-related SMEs perform better than non-tourism-related SMEs, especially in peak seasons in tourist destinations. However, no systematic empirical studies have focused on comparing the performance of tourism-related SMEs and non-tourism-related SMEs in the context of Sri Lanka. Therefore, the present study forms a hypothesis that the performance of tourism-related SMEs is better than that of non-tourism-related SMEs. Thus, it aims to test the aforementioned hypothesis through a comparison of the performance of tourism-related and non-tourism-related SMEs in Sri Lanka.

### **1.3 Objectives and Structure of the Study**

The main objective of the study is to determine whether tourism-related SMEs perform better than non-tourism-related SMEs; it uses the profit and sales revenue per worker of SMEs to measure their performance and productivity, respectively. However, the specific objectives of the study are as follows:

1. To investigate whether the profit and sales revenue per worker of tourism-related SMEs are higher than those of non-tourism-related SMEs.
2. To recognize and profile the tourism-related and non-tourism-related SMEs located in Hikkaduwa, Galle, Mirissa, and Tangalle in the Southern Province of Sri Lanka.

## **2. LITERATURE REVIEW**

There has long been a belief that SMEs are important in supporting the economic development of a country (Mazzarol et al. 1999). In Sri Lanka, SMEs make up more than 80% of all businesses and account for about 35% of employment and about 20% of the total industrial value added (Ishii 2008). There is no universally agreed definition of SMEs. Some analyses define them in terms of their total revenue, while others use the number of employees as an indicator (WBCSD 2007).

There is no uniform definition of micro, small, and medium-sized enterprises (SMEs) due to the differing characteristics of SMEs across countries, covering 120 different economies all over the world. Certain countries use the term MSMEs while others use the term SMEs to refer to micro, small, and medium-sized enterprises. The variables that countries use to define MSMEs or SMEs commonly include the total number of employees, assets, turnover, capital, and investment; it is possible to differentiate these variables by industry in some cases (Kushnir 2010).

The role of small businesses is crucial for the economies of all countries around the world. Many studies have reported that economic growth requires participation from small business units (Battilana and Casciaro 2012). They play a fundamental role by stimulating domestic and regional economic growth, reducing unemployment, improving market effectiveness, and fulfilling innovation-based customer needs (Kaur and Sharma 2014).

SMEs supply tourism services, resulting in huge growth of SMEs in tourist destinations (Michael 2003). Tourism creates opportunities for small enterprises because the start-up costs and barriers to entry in this sector are relatively low and it is even accessible to the poor. Tourism promotion is synonymous with small business promotion, and small, family-centered enterprises strongly characterize the industry (Fleisher and Pizam 1997).

In the context of developing countries, SMEs are the lifeblood of the travel and tourism industry and strongly influence the development of a region (Erkkila 2004). The expansion of the tourism sector mainly relies on small and medium-sized enterprises existing in various related sectors. The development of tourism depends on SMEs to fulfill the needs and wants of tourists (Mastura and Siti 2011). With tourism development, local people have golden opportunities to offer services or sell products to local and foreign tourists (Dickman 1992; Rogerson 2004).

For tourism to be beneficial in terms of economic development, income earning, poverty diminution, and the improvement of rural livelihoods, it should have a link with the local economy activities, for example agricultural and micro- and small-scale enterprises (Mshenga and Owuor 2009). In consonance with Avcikurt (2003), tourism is conservatively a small and medium-sized enterprise industry due to the fact that most tourist facilities are run by small and medium-sized businesses.

SMEs inevitably dominate the tourism sector in Sri Lanka, and each tourist destination represents an amalgam of SMEs providing tourists with products and services. People consider SMEs to be a key factor in the development of tourist destinations, but they face a number of challenges (Shaw 2014). As far as their suitability for tourism is concerned, small business owners have personal contact with their customers and are therefore able to respond rapidly to customer needs and demands (Beaver, Lashley, and Stewart, 1998). They provide an interface and contact between the local culture and the tourists and thereby contribute to communicating the particular characteristics of the destination (Middleton 1997; Shaw and Williams 2002). As SMEs are flexible due to their size, they are also able to provide customized products and services (Buhalis 1999). In addition, through SMEs, tourism expenditure reaches the local economy rapidly. Further, Kozak and Rimmington (1998) mentioned that small businesses have a great influence on how tourists perceive destinations as well as on the destinations' image.

It is possible to maximize tourism's potential for economic development by enhancing the linkages between tourism and other sectors through agricultural and micro and small enterprises (MSEs). The sector can also minimize foreign exchange leakage by stimulating local entrepreneurs to start tourist establishments and encouraging local entrepreneurial activities (Joosten and Marwijk 2003). It is likely that, by stressing smaller-scale and local ownership, tourism will increase its multiplier and spread effects within host communities since local entrepreneurs not only raise the tolerance limits of host communities toward tourist activities but also enhance community stability by empowering local people and giving them a stake in tourism development.

According to Mathieson and Wall (1982), whether the tourism sector can establish linkages with local entrepreneurs depends on the types of suppliers and producers linked to the industry's demands, the capacity of local suppliers to meet these demands, the historical development of tourism in the destination areas, and the type of tourism development. Furthermore, the speed of hotel growth has been significant in generating local entrepreneurial activity, and that rapid growth of hotels has led to an increased demand for agricultural products (Lundgren 1973). The SME businesses in the hospitality and tourism industry include local restaurants that provide for the needs of tourists; accommodation in the form of homestays, budget hotels, and boutique hotels;

transportation; and other necessities (Rashid, Jaafar, and Dahalan 2013; Konrad and Bongkochmas 2011). In addition, Othman and Rosli (2011) classified SME business activities in the hospitality and tourism into food and accommodation services, retail and souvenirs, travel agents, transport and tour guides, and other services that satisfy the demands of visitors. Tourism SMEs can also be a source of innovation and help to shape destination development.

### 3. METHODOLOGY

#### 3.1 Study Area and Data Collection

The present study focused on the four main coastal tourist destinations located in the Southern Province of Sri Lanka. More specifically, the authors selected Hikkaduwa, Galle, Mirissa, and Tangalle as study locations, all four of which are key coastal tourist destinations in the Southern Province. They conducted an enterprise survey with 200 SMEs (50 from each location) to collect quantitative data, employing the snowball sampling technique to select 200 SMEs and surveying both tourism-related and non-tourism-related SMEs using a structured questionnaire. Altogether, five focus group discussions (FGDs) and five key informant interviews (KIIs) (one from each location) provided qualitative information.

#### 3.2 Data Analysis Techniques

The authors conducted both econometric and descriptive analyses of the collected data. The econometric analysis mainly aimed to determine whether tourism-related SMEs perform better than non-tourism-related SMEs. The authors estimated the empirical models in equations (1) and (2) to accomplish the main objectives of the study. Moreover, they used the logarithmic values of all the continuous variables to reduce unnecessary variation of the variables. Similarly, they considered the profit of firms and sales revenue per worker as proxies for the performance of SMEs and assigned them to equations (1) and (2), respectively. In fact, the analysis used the sales revenue per worker as a proxy for the productivity of SMEs. Most tourism-related SMEs are service oriented; therefore, it is difficult to collect output data. Hence, the study used the sales revenue per worker as an indicator of productivity while measuring performance with the profit of SMEs. Both models used robust standard errors to avoid the heteroscedasticity issue.

$$\ln Profit_i = \beta_0 + \beta_1 TOURISM_i + \beta_2 \ln SL_i + \beta_3 \ln TR_i + \beta_4 \ln RD_i + \beta_5 \ln K_i + \beta_6 \ln L_i + \beta_7 \ln HC_i + \beta_8 \ln AGE_i + \beta_9 TYPE_i + U_i \quad (1)$$

$$\ln Sales Per Worker_i = \beta_0 + \beta_1 TOURISM_i + \beta_2 \ln TR_i + \beta_3 \ln RD_i + \beta_4 \ln K_i + \beta_5 \ln HC_i + \beta_6 \ln AGE_i + \beta_7 TYPE_i + U_i \quad (2)$$

The variables in the empirical model are explained in Table 3 below.

**Table 3: Operationalization and Explanation of the Variables**

Variable Name	Explanation	Expected Sign
Profit	Annual profit of the firm	
TOURISM	Dummy variable to represent SMEs related to tourism TOURISM = 1 for tourism-related SMEs TOURISM = 0 for non-tourism-related SMEs	Positive when TOURISM = 1
lnSL	Log of annual sales revenue	Positive
lnTR	Log of the number of employees trained annually	Positive
lnRD	Log of R&D expenditure	Positive
lnK	Log of the total capital of the firm	Positive
lnL	Log of the number of workers	Positive
lnHC	Log of the level of education of the SME owner	Positive
lnAGE	Log of the number of years in the industry	Positive
TYPE	Dummy variable for the type of SME TYPE = 1 for small TYPE = 0 otherwise (medium and large)	Negative when TYPE = 1

Source: Authors' creation.

In addition to the econometric analysis, the authors utilized a descriptive analysis to support the objectives of the research.

## 4. RESULTS AND DISCUSSION

### 4.1 Recognizing and Profiling the SMEs in the Coastal Areas of the Southern Province of Sri Lanka

This section mainly focuses on recognizing the key business types of both tourism-related and non-tourism-related SMEs located in four coastal tourist destinations—Hikkaduwa, Galle, Mirissa, and Tangalle—in the Southern Province of Sri Lanka. It also elaborates the characteristics of the both tourism-related and non-tourism-related SMEs to provide a better understanding of them.

#### 4.1.1 Key Business Types of SMEs

The survey recognized 12 key business types (six each) of tourism-related SMEs and non-tourism-related SMEs. It collected data from 83 (41.5%) non-tourism-related SMEs and 117 (58.5%) tourism-related SMEs. As Table 4 indicates, the main business types of non-tourism-related SMEs include agriculture, farming, and dairy; arts and crafts; apparel and bags; auto parts and maintenance; household items; and cement and metalwork. Business types such as apparel and bags and agriculture, farming, and dairy dominate the non-tourism-related SME sector, accounting for 26.51% and 21.69% of non-tourism-related SMEs. The survey also recognized 12 (14.46%) arts and crafts firms and 11 (13.25%) and 10 (12.05%) SMEs providing household items and auto parts and maintenance, respectively.

**Table 4: Key Business Types of Tourism-Related and Non-Tourism-Related SMEs**

Type of Business	Number of SMEs	Percentage
<b>Non-tourism-related SMEs</b>		
Agriculture, farming, and dairy	18	21.69
Arts and crafts	12	14.46
Apparel and bags	22	26.51
Auto parts and maintenance	10	12.05
Household items	11	13.25
Cement and metalwork	8	9.64
Other	2	2.41
<b>Sub-total for non-tourism-related SMEs</b>	<b>83</b>	<b>41.50</b>
<b>Tourism-related SMEs</b>		
Hotels and homestay	39	33.33
Spas and ayurveda	21	17.95
Cafes, food, and beverages	15	12.82
Traveling and guiding	12	10.26
Surfing and diving	10	8.55
Souvenirs and handicrafts	17	14.53
Other	3	2.56
<b>Subtotal for tourism-related SMEs</b>	<b>117</b>	<b>58.50</b>

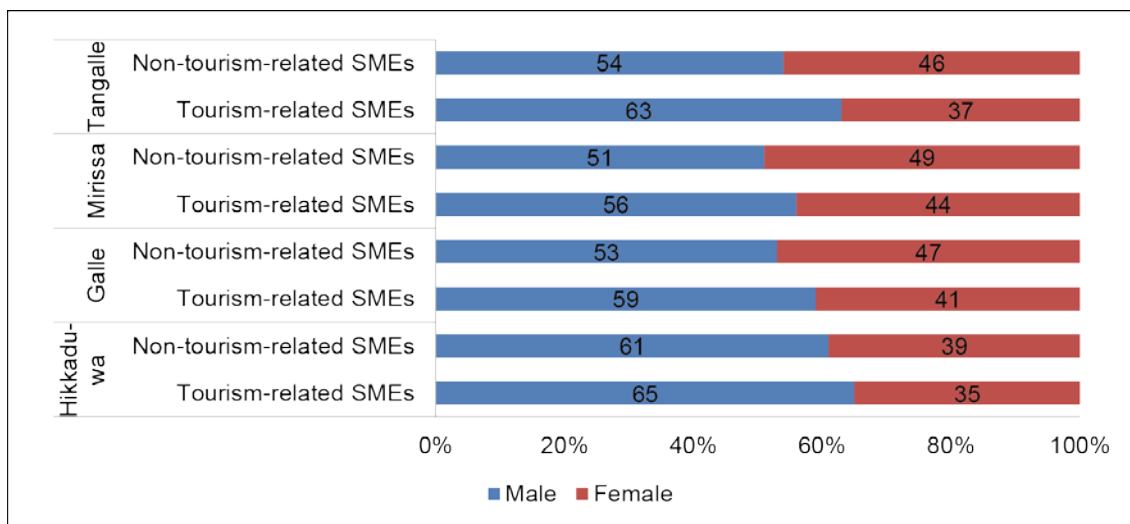
Source: Authors' creation based on the survey data.

Businesses such as hotels and homestays; spas and ayurveda; cafes, food, and beverages; traveling and guiding; surfing and diving; and souvenirs and handicrafts are common business types of tourism-related SMEs. In fact, 33.33% (39) of tourism-related SMEs are hotels and homestays, while spas and ayurveda recorded the second-largest proportion (17.95%). Souvenirs and handicrafts and cafes, food, and beverages accounted for 14.53% and 12.82% of tourism-related SMEs, respectively. More importantly, traveling and guiding firms and surfing and diving agencies are also common in all four surveyed destinations. It is worth concluding that the majority of the surveyed SMEs are tourism-related SMEs and that, among them, SMEs related to hotels and homestays and spas and ayurveda take the lead.

#### 4.1.2 Gender Composition of SMEs

Figure 1 depicts the gender composition of SMEs in the four tourism destinations in the Southern Province. It is obvious from Figure 1 that men dominate SMEs in all four destinations irrespective of the SMEs' nature. The male dominance of SME ownership is higher in tourism-related SMEs than in non-tourism-related SMEs. In general, male entrepreneurs head 56%–65% of tourism-related SMEs and 51%–61% of non-tourism-related SMEs. More specifically, women's engagement in tourism-related SMEs is significantly lower in Hikkaduwa and Tangalle, where women own only 35% and 37% of SMEs, respectively. In fact, traditional and cultural norms restrict women from engaging in tourism-related activities and businesses and therefore women have been avoiding the industry. However, irrespective of the type of SMEs, women in Mirissa have the highest level of women's SME ownership among the destinations. Specifically, 49% and 44% of non-tourism-related SMEs and tourism-related SMEs in Mirissa have female owners.

**Figure 1: Gender Composition of SMEs in the Four Tourist Destinations**



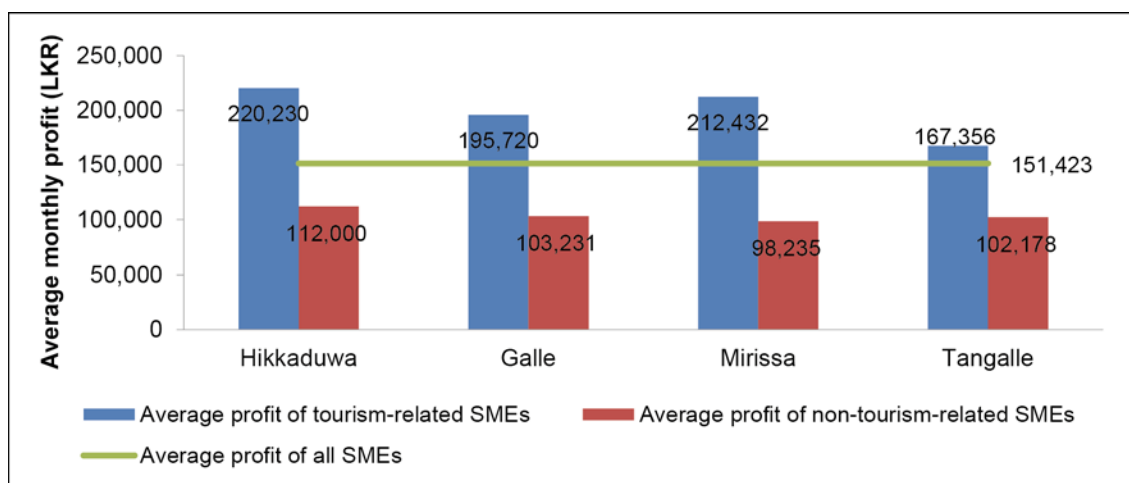
Source: Authors' creation based on the survey data.

### 4.1.3 Average Monthly Profit of SMEs

Figure 2 illustrates the average monthly profit of both tourism-related and non-tourism-related SMEs along with the average profit of the entire sample in the four destinations. It is notable that the profit is based on the income and expenditure data from SMEs, which could be extremely subjective; thus, it is necessary to use the data presented in this regard with prudence. As Figure 2 indicates, the profit of tourism-related SMEs is considerably higher than that of non-tourism-related SMEs. Tourism-related SMEs in Hikkaduwa account for the highest profit (Rs.220,230) per month, followed by those in Mirissa (Rs.212,482). In fact, Hikkaduwa has been a particularly popular destination, especially for beach and ocean tourism activities, for decades. In addition, Mirissa has been growing as a crucial destination for beach and ocean tourism since 2015. Hence, tourism-related SMEs in these two destinations have a greater chance of earning a higher profit than the other two destinations. Furthermore, the average profit of both categories of SMEs is Rs.151,423 and the average profits of tourism-related SMEs in all four destinations are higher than the average profit of Rs.151,423. In contrast, the average profit of non-tourism-related SMEs is significantly lower than that of the overall average profit of SMEs. Moreover, the average profit of non-tourism-related SMEs located in all four destinations varies from Rs.98,235 to Rs.112,000, with Mirissa reporting the lowest – Rs.98,235.

### 4.1.4 SME Owners' Level of Education

The study measured the education level of SME owners through the number of years of schooling. According to Table 5, the average years of education for owners of tourism-related SMEs vary between 10 and 13 years while the average is 12–13 years for non-tourism-related SMEs. Therefore, the education level of owners of tourism-related SMEs is slightly lower than that of owners of non-tourism-related SMEs. In fact, most of the tourism-related SME owners, perhaps with the exception of hotel owners, are less educated as they have been engaged in the tourism industry since school age.

**Figure 2: Average Monthly Profit of SMEs in the Four Destinations**

Source: Authors' creation based on survey data.

**Table 5: Education Level of SME Owners**

Destination	Years of Schooling in Tourism-Related SMEs			Years of Schooling in Non-Tourism-Related SMEs		
	Maximum	Minimum	Average	Maximum	Minimum	Average
Hikkaduwa	19	5	12	19	8	12
Galle	19	8	13	19	5	13
Mirissa	18	8	10	19	8	12
Tangalle	19	8	12	19	8	12

Source: Authors' creation based on the survey data.

Irrespective of the SME type, the most educated SME owners are in Galle, where SME owners of both types of SMEs have 13 years of education on average. Moreover, Mirissa (10) and Galle (13) reported the highest average level of education in terms of tourism-related SMEs; however, the disparity in the level of education is considerably lower among non-tourism-related SMEs.

## 4.2 Do Tourism-Related SMEs Perform Better than Non-Tourism-Related SMEs? Econometric Evidence

Table 6 provides the estimated results for the empirical model in equation (1) in the methodology section. The authors estimated three models by adding different independent variables gradually, along with TOURISM, to check the robustness between the variable TOURISM and the profit of SMEs. The key variable in the estimated model is TOURISM, which indicates whether tourism-related SMEs perform better than non-tourism-related SMEs. Model 1 has four independent variables altogether: dummy variables to represent tourism-related SMEs, capital, labor, and human capital related to SMEs. The second model includes variables such as the sales revenue, number of trained employees, and research and development expenditure in addition to the variables from model 1. Moreover, it is possible to consider the third model as the complete model as it also takes into account variables such as the number of years in the industry and the type of SMEs.

As Table 6 highlights, the estimated coefficient for the TOURISM variable is positive and statistically significant at the 1% level in all three models. It implies that tourism-related SMEs account for higher profit than non-tourism-related SMEs. The findings of the current study align with the empirical results of Al-Wahab and Al-Din (1975), Rogerson (2004), and Othman and Rosli (2011). More importantly, the estimated impact of the TOURISM variable is statistically significant even after controlling for other characteristics of SMEs, such as the sales revenue, number of trained employees, expenditure on research and development, number of years in the industry, and type of SME, therefore confirming the robustness of the aforementioned relationship. In fact, tourism-related SMEs located in the four surveyed tourism destinations in the Southern Province of Sri Lanka essentially capitalize on the demand from international tourists during the tourist arrival season while catering for local tourists during the rest of the year. Consequently, tourism-related SMEs face relatively low risk and earn a higher profit. In contrast, non-tourism-related SMEs located in the same destinations have regular local customers who are very sensitive to price and quality variations in products and services; hence, non-tourism-related SMEs located in tourism destinations have relatively low profit. In addition, tourism-related SMEs receive some special benefits, such as tax reductions, special loan schemes at low interest rates, and grace periods for paying back loans, to promote the tourism industry. These benefits may also have an influence on the higher profit of tourism-related SMEs.

**Table 6: Determinants of the Performance of Tourism-Related and Non-Tourism-Related SMEs (Profit as the Dependent Variable)**

Variable Name	Model 1	Model 2	Model 3
TOURISM	0.7215*** (0.2314)	0.6548*** (0.2114)	0.5861*** (0.1945)
lnK	0.5894*** (0.2014)	0.5104** (0.2358)	0.4896** (0.2251)
lnL	0.7415*** (0.2547)	0.4896*** (0.1589)	0.3548*** (0.1358)
lnHC	0.0954** (0.0451)	0.0876** (0.0372)	0.0741** (0.0351)
lnSL		0.7894*** (0.2541)	0.6987** (0.3198)
lnTR		0.0278** (0.0129)	0.0626** (0.0289)
lnRD		0.0548* (0.0288)	0.2027 (0.5481)
lnAGE			0.9841 (0.6841)
TYPE			-0.0765** (0.0325)
Constant	0.2101*** (0.0192)	0.2326*** (0.0204)	2.3531*** (0.1050)
Number of observations	200	200	200
R <sup>2</sup>	0.5272	0.6056	0.7962
Prob. on F	0.0000	0.0000	0.0000

\*\*\* – 1% significance level; \*\* – 5% significance level; \* – 10% significance level.

Note: Standard errors are in parentheses.

Source: Authors' estimation.



In addition to the key findings, the estimated models confirm that factors such as the capital assets, number of workers, and sales revenue of firms positively affect the profit of SMEs. More specifically, as the third model indicates, a 1% increase in capital and labor may increase the profit of the considered SMEs by 0.48% and 0.35%, respectively. Human capital is also recognizable as a factor in SMEs' profits, and a 1% increase in the human capital level causes an increase in the profit of SMEs of 0.07%. Furthermore, considering the estimated coefficient for the variable TYPE (−0.0765), it is apparent that the profits of small-scale SMEs are significantly lower than those of medium- and large-scale SMEs. The estimated models are statistically significant at the 1% level and have a higher R<sup>2</sup> value in model 3 (0.7962), representing a better goodness of fit.

In addition to the examination of the performance of both tourism-related and non-tourism-related SMEs, the study compared the productivity between the two categories of SMEs. It considered the sales revenue per worker as a proxy for the productivity of SMEs. Table 7 highlights the estimated results for the empirical model in equation (2) in the methodology section. Aligned with the estimation procedure of equation (1), the authors estimated three models by adding different independent variables gradually, along with TOURISM, to check the robustness between the variable TOURISM and the productivity (sales revenue per worker) of SMEs. The key variable in the estimated model is TOURISM, which shows how the productivity of tourism-related SMEs varies from that of non-tourism-related SMEs.

**Table 7: Determinants of the Productivity of Tourism-Related and Non-Tourism-Related SMEs (Sales Revenue per Worker as the Dependent Variable)**

Variable Name	Model 1	Model 2	Model 3
TOURISM	0.1229*** (0.0102)	0.0871*** (0.0242)	0.0765** (0.0233)
lnK	0.0138*** (0.0048)	0.0111** (0.0051)	0.0086** (0.0043)
lnHC	0.0504*** (0.0080)	0.0365*** (0.0048)	0.0264*** (0.0059)
lnTR		0.0166** (0.0081)	0.0124** (0.0049)
lnRD		0.0622* (0.0351)	0.0380* (0.0224)
lnAGE			0.0026*** (0.0007)
TYPE			−0.0146** (0.0076)
Constant	0.0800*** (0.0099)	0.0512*** (0.0081)	0.0630*** (0.0063)
Number of observations	200	200	200
R <sup>2</sup>	0.4974	0.6421	0.7761
Prob. on F	0.0000	0.0000	0.0000

\*\*\* – 1% significance level; \*\* – 5% significance level; \* – 10% significance level.

Note: Standard errors are in parentheses.

Source: Authors' estimation.

According to Table 7, the estimated coefficient for the TOURISM variable is positive and statistically significant at the 1% level across all three models. This confirms that the sales revenue per worker of tourism-related SMEs is higher than that of non-tourism-related SMEs. The findings of the current study align with the empirical results of Al-Wahab and Al-Din (1975) and Othman and Rosli (2011). Considering all three models, the estimated impact of the TOURISM variable is statistically significant even after controlling for other factors of the productivity of SMEs, such as the level of capital, number of trained employees, human capital, expenditure on research and development, number of years in the industry, and type of SME. Therefore, the study also confirms the robustness of this relationship. Having recognized the importance of tourism-related SMEs, the government and the Sri Lanka Tourism Development Authority (SLTDA) offered various incentives and financial packages, such as micro-credit packages, duty-free vehicles, tax concessions, and other facilities, to help people establish and develop their own businesses. After the Easter Sunday attack (21 April 2019), the Sri Lankan government informed banks that they should extend new loans of up to 300 million rupees to tourism-related SMEs. They offered the loans for 5 years, with a 1-year grace period and the average weighted prime lending rate. Additionally, it introduced a tourism loan scheme named *Sancharaka Poddoo* for SMEs and micro SMEs affiliated to the tourism sector that were facing economic hardship due to the terrorist attack on Easter Sunday. Borrowers have to repay this loan in 3 years and can adjust the initial installments to as little as Rs. 8,000 to Rs. 12,000 per year. Moreover, the government offered the loan scheme called *Travel Poddoo* to many small-scale hotels and inns as an interest-free loan of up to Rs. 500,000, taking into consideration the effect of the Easter Sunday attack. The expectation is that the businesses will repay this interest-free loan in 3 years with a grace period of 12 months. Similarly, loan schemes called *Ran Aswenna* and *Green Loan* focused on small hotels and homestays under the Enterprise Sri Lanka program. In addition, in the present COVID-19 pandemic situation, the Sri Lankan government has decided to suspend loan repayment related to the tourism industry temporarily, for 6 months, to protect tourism-related SMEs. However, it will take time for SMEs to gain the benefits from such programs as most of them started recently. Moreover, some inefficiencies attached to public and private institutions may further delay such impacts. Therefore, the results of the current study do not reflect the impact of such policies.

The analysis also recognized factors such as the level of capital, level of human capital, number of trained employees, expenditure on research and development, number of years in the industry, and type of SME as crucial determinants of SMEs' productivity. In fact, all the estimated coefficients related to these variables are statistically significant. Moreover, model 3 in Table 7 especially confirms the overall significance of the three estimated models with the 0.0000 (Prob on F) and higher  $R^2$  values (0.7761).

## 5. CONCLUSION AND RECOMMENDATIONS

The current study investigated whether tourism-related SMEs perform better than non-tourism-related SMEs in four of the main coastal tourism destinations—Hikkaduwa, Galle, Mirrissa, and Tangalle—in the Southern Province of Sri Lanka. The study also focused on profiling both tourism-related and non-tourism-related SMEs in the four destinations. The authors employed a survey-based quantitative research methodology to accomplish the objectives. More specifically, they surveyed 200 SMEs, consisting of 117 tourism-related SMEs and 83 non-tourism-related SMEs, to collect the data necessary for the study.

A regression analysis was the main analytical tool that the study used to analyze the collected data along with a descriptive analysis. The regression analysis used the profit of SMEs, which it assigned as the dependent variable, to represent the performance of SMEs. As the survey findings highlighted, the majority of SME holders are male, irrespective of the SME type. In addition, the survey identified six main business types of non-tourism-related SMEs: agriculture, farming, and dairy; arts and crafts; apparel and bags; auto parts and maintenance; household items; and cement and metalwork. Moreover, the survey recognized hotels and homestays; spas and ayurveda; cafes, food, and beverages; traveling and guiding; surfing and diving; and souvenirs and handicrafts as common business types of tourism-related SMEs. Moreover, the average profit of tourism-related SMEs is considerably higher than both the average profit of non-tourism-related SMEs and the average profit of the entire sample of SMEs. However, the education level of tourism-related SMEs' owners is slightly lower than that of non-tourism-related SMEs' owners.

The econometric analysis considered the profit of firms and the sales revenue per worker as proxies for firms' performance and productivity, respectively. The econometric analysis confirmed that tourism-related SMEs achieve higher profit and higher productivity than non-tourism-related SMEs. The findings of the current study align with the empirical results of Al-Wahab and Al-Din (1975), Rogerson (2004), and Othman and Rosli (2011). The estimated models also confirmed that factors such as the capital assets, number of workers, sales revenue, level of human capital, and being classed as a medium- or large-scale SME positively affect the profit and productivity of SMEs. Hence, the current study strongly recommends motivating people who are interested in setting up a tourism-related SME in the studied areas by providing the necessary training and initial capital for them to start their business. Moreover, it is essential to establish a proper mechanism for inspecting the service that such SMEs provide to ensure a quality service for tourists. Consequently, a solid public-private partnership is vital to facilitate both existing and new SMEs located in the key coastal tourist destinations in the Southern Province of Sri Lanka.

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