

DO STRATEGIES IMPROVE SME PERFORMANCE? AN EMPIRICAL ANALYSIS OF JAPAN AND SRI LANKA

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Abstract

The relationship between business strategy and organizational performance has been a subject of growing interest in the field of strategic management. Despite this trend, there has been little attention given to a comparative analysis of this relationship between two different economies. The aim of this study is to empirically investigate the performance differences and business strategy orientation of small and medium sized Enterprises (SMEs) in two Asian economies. Data for the research were obtained from a survey of SMEs in manufacturing industry in Japan and Sri Lanka. Results indicate that the performance of SMEs varies with the choice of strategy orientation that owner-managers adopt. The findings and implications of this study would be useful to owners and managers of SMEs, while contributing to the literature on SMEs as well.

KEY WORDS : SMEs, Business Strategy, Performance

1. Introduction

The small and medium sized sector is increasingly recognized as the prime vehicle for economic development in both developed and developing nations¹. It is a major source of employment, revenue generation, innovation and technological advancement². Therefore, SMEs have become a major asset in the economy. In most of the countries in the world, the level of economic dependence on small and medium enterprises has increased in recent years. The individual performance of each enterprise determines economic development.

Strategy plays a crucial role in the firms' performance³. Strategy gives the direction that a firm has in mind and in which way they want to achieve their goals. The performance of an enterprise is determined by the business strategy it adopts^{4,5}. Many researchers have associated business strategies with performance, distinguishing between strategies associated with high and low performance^{6,7,8,9}. Further, in literature, it also investigates the different strategy typologies and firm performance and determines which strategy typologies lead to best performances for firms^{10,2}.

The impact of business strategy on organizational performance has been a subject of growing interest in the field of strategic management. However, almost all these studies

are limited to large enterprises and carried out in a western context. Despite this trend, the literature suggests that a few studies have addressed this issue in the SME sector^{11,12}. However, little research has been done to compare the strategy-performance relationship in a context of two different economies. Therefore, the current study fills the void in the literature by investigating the strategy-performance relationship in SMEs of two different economies. Such an approach would certainly help in enhancing knowledge of the business strategy and performance relationships in SMEs.

In particular, this study fills in the gaps in regard to empirical research on the strategy and performance of SMEs in two Asian economies. As such, this study is an attempt to examine and compare the relationship between strategy and business performance using a sample of manufacturing SMEs that are operating in the developed Asian economy of Japan and the developing Asian economy of Sri Lanka.

SMEs play a major role in every area of the national economy in Japan and Sri Lanka. Their importance is indicated by the very large share of the economy that they occupy, whether in terms of number of enterprises, total number of employees, or export earnings. In the county of Japan, in 2006, SMEs numbered 4.2 million and accounted for 99.7% of all firms comparing to the 0.3% of large firms. SMEs employed 42 million people, which is 78% of total employment. SMEs ac-

counted for 47.7% of total manufacturing shipment volume in 2006¹³). However, the exit rate of SMEs has had an upward trend in recent years and it has risen by an annual average of 6.2% (based on the number of enterprises) between 2004 and 2006 compared to 5.1% of entry rate. Compared to this, in the country of Sri Lanka, in 1996, small and medium Scale Industries (SMIs) account for 85.4% of all businesses and 36.3% of employees are employed by them¹⁴). Further, it is noted that manufacturing SMEs play a vital role in socio economic development in Japan as well as in Sri Lanka, even though these two countries have two very different economic levels.

The remainder of this paper is organized as follows. Section 2 is a review of the literature related to the concepts of business strategy, performance, and the relationship between strategy and performance. The methodology used in this study, including sample characteristics, data collection and data analyses used to investigate the research problem are discussed in section 3. The results are reported in part 4, followed by the conclusions drawn from the study in part 5.

2. Literature Review

2.1 Business Strategy

In the literature on SMEs, there is yet no clear consensus on what strategy is, rather there are many definitions. Strategy is frequently described as a deliberate set of actions to achieve competitive advantage, giving coherence and direction to the organization¹⁵). The literature suggests that firms can have a single strategy or multiple strategies and these strategies are likely to exist at three levels. They are the corporate level, business unit level and functional level business strategies. The present study focuses on business functional level strategies.

A business strategy is an overall plan of action which defines the competitive position of a firm¹⁶). For example, a firm may choose to compete by producing high quality goods or by producing at low cost.

Business strategies are implemented through the major functional areas in finance, production, marketing, human resource management (HRM), and research and development (R&D). In turn each functional strategy is made up of several activities. Therefore, activities act as guides to the realization of the overall business strategy¹⁷). Activities which comprise the various functional strategies centre around the following;

◇ Finance – capital structure; methods of raising capital:

capital expenditure: levels of profit distribution and retention: working capital: and liquidity level¹⁸).

- ◇ Production – selection of suppliers: inventory and productivity levels: production technology and plant size and capacity as well as levels of efficiency in production.
- ◇ HRM – staff recruitment and selection, employee training, performance and remuneration, reward and disciplinary systems, industrial relations and levels of employee participation in decision making¹⁹).
- ◇ Marketing – product quality, pricing and promotion, customer target groups, choice of distribution channels, provision of customer service and support, and identification with brand names¹⁸).
- ◇ R&D – new product development, new production technologies and marketing techniques, patent acquisition, basic versus applied research and levels of limitation¹⁸).

The effectiveness of the overall business strategy depends substantially on how well activities in the various functional areas are integrated to form a pattern^{20,21}). This pattern defines the firm's business strategy and therefore competitive position within the industry¹⁶). Several researchers have highlighted different business strategies by which firms compete^{10,22,23,20,21,24}). However, research in this area is limited to be descriptive and centers on orientations of owner/managers to certain functional activities.

The essence of strategy is to understand why organizations perform differently, and how performance can be directed and controlled²⁵). Indeed, the relationship between strategy and performance has concerned researchers for years and these efforts have fallen into two separate but interrelated streams like process and content²⁶).

Three basic factors influence managements' choice of strategy; management, environmental variables, and the firm's internal resources²⁷). The degree to which management and environmental variables influence business strategy has been debated by a number of researchers. Montanari (1978) stated that the greater the influence of environmental variables on business strategy, the less will be the impact of management²⁸). Qualifying support comes from Miller and Toulouse (1986) who noted that management has greatest influence in dynamic, unpredictable, and changing environments²⁹).

Miller (1988) noted that managers have greater influence on business strategy in small firms, where the manager is also the owner of the firm, than in large firms³⁰). He explained that owner-managers are powerful enough to override obstacles to the successful realization of their business strategies. They

have enormous impact on their enterprises through their power of ownership and face to face contact with employees²⁹. The owner-manager is thus at the centre of all enterprise behaviour⁹.

2.2 Performance in SMEs

Research has established the important role that small enterprises play in economic development^{31,32}. The role is dependent on the individual performance of each enterprise.

In research concerned with SMEs, assessing performance has become a critical issue. It is suggested that the treatment of performance in research settings is one of the difficult tasks confronting academic researchers³³. One of the reasons for this is that, it is not always clear what performance means or what are appropriate operational definitions. In the discussion of entrepreneurship research, a wide variety of definitions and variables are used to define and measure the terms of performance in a business³⁴. Similar to this, the developed conceptual frameworks for assessing performance in small firms are also reflected by a multi dimensional nature. According to Keats and Bracker (1988), performance has a different set of meanings for small firms as opposed to large firms and it is represented as an undifferentiated, one dimensional concept which implies a number of interpretations and appropriate measurements³⁵.

This diverse nature of the performance construct is reflected in the variety of operational definitions and measurements used in past research studies in literature related to SMEs and performance. Earlier, many studies emphasised traditional accounting measures for performance such as sales growth, market share, and profitability as well as with other indicators of stakeholder satisfaction³⁶. Murphy, Trailer and Hill (1996) provide an analysis of 51 articles and found 71 different operational measures of performance that they grouped in eight major dimensions of which efficiency, growth, and profit were most frequently used³⁴.

However, within this context, it can be seen in the literature, most of research considered the performance in the small firms and was limited to financial measures alone³⁷. The performance is measured in terms of various financial measurements based on sales revenue, profits, return on investment/equity etc^{37,38,39}. The applied financial performance measures are sales level, sales growth rate, cash flow, return on shareholder equity, gross profit margin, net profit from operations, profit to sales ratio, return on investment, and ability to fund business growth from profits⁹. Few research

studies considered the industry specific financial performance data as dependent variables to identify the performance in SMEs^{38,40,41,42,39}.

Later, in addressing the limitations associated with the use of financial data in measuring performance in small firms, non financial measures of performance were used^{43,44,45}. Further, performance measured by this method has been found to have high reliability and validity rates and to reflect accurately the firm's objective performance⁴⁴. Ramanujam, Venkatraman and Camillus (1986) and Reid and Smith (2000) suggest that the effectiveness of performance must be measured according to what goals a firm has set, and then enquires into the extent to which these goals have been achieved^{46,47}.

In short, it shows that various measures are used in determining the performance level of firms. When used singly, these different measures are bound to give conflicting results, because they measure different performance aspects of the firm. Gibson and Cassar (2005) concentrated economic success to measure the performance of SMEs and used both financial indicators (sales and income measures) and non financial indicators (number of employees)⁴⁵. Further, a range of other operational measures have also been used. They include new product success, market share, and the firm's life cycle. Some studies attempted to assess performance on the basis of a general measure of effectiveness and Kotey and Meredith (1997) and Blackman (2003) used this similar approach including variables as high productivity, industry leadership, creating new jobs, business stability, high profit rates, lower cost of production, community development and business growth^{2,48}.

Moreover, in recognizing the problem of using financial measurements alone, Ramanujam, Venkatraman and Camillus (1986), Tosi and Gomez-Mejia (1994), Yusuf and Saffu (2005) recommended that performance should be measured with both financial and non-financial criteria, employing objective and subjective data^{46,49,50}. Because of the difficulty in obtaining reliable information and the inherent reluctance of small business people to disclose financial information, researchers asked the respondents to indicate the direction of their companies over the past few years³⁹. Pushpakumari and Wijewickrama (2008) used both financial and non-financial measures such as annual sales, annual profits, number of employees, market share and reinvestment in the business to measure the business performance of SMEs⁵¹.

The above literature review related to the performance of SMEs suggests that different measures are identified and

applied, but there is no any accepted set of best standard measurements. Therefore, in the current study, business performance is identified in terms of including financial and non-financial measures of annual sales, annual profits, number of employees, market share and reinvestment in the business.

2.3 Business Strategy and Performance

The performance of an enterprise is determined by the business strategy it adopts^{4,5}. Many researchers have associated business strategies with performance, distinguishing between strategies associated with high and low performance^{6,7,8,9}. Strategies which result in high performance are identified with activities that generally lead to success in the industry; that is key success factors²³. These activities are associated with initiatives in industry⁵². Researchers have identified such initiatives to include emphasis on product quality, product and service innovations, development of new operating technologies, and discovery of new markets²¹. Activities associated with high performing strategies also include emphasis on customer service and support, extensive advertising, and use of external finance⁸. Further, because high performing strategies involve initiative-taking, they are often referred to as proactive strategies⁵³. All the activities of a proactive strategy are well integrated²⁰.

Firms which perform below average tend to follow others in the industry and to react to events in their environment. Such firms are characterized by strategies which emphasize risk avoidance and involve little innovation⁵⁴. Strategies of low performing firms include limitations of more successful firms in the industry, but usually fall short in some important respect²³. The activities that comprise these strategies are often not well integrated and are mismatched with the demands of the environment²³. They are often referred to as reactive strategies because they are characterized by reactions to events rather than by initiative-taking⁵³. In reality, the two strategies may not be so clearly distinguishable. Firms pursuing proactive strategies may sometimes conform to industry norms and adopt standardized strategies. However, they do this not out of tradition, as with low performing reactive strategies, but because that is the best strategy at the time. Strategies with varying degrees of proactivity and reactivity lie along the proactive-reactive continuum.

Focusing on business strategy items and performance, some studies have identified that there are some relationships between strategy activities and performance. The activities of improving existing products to meet changing customer

needs, developing new products and emphasizing product quality are associated with market share increases by attracting new customers and retaining existing ones^{55,21}. In contrast, low performing firms are likely to ignore these innovative and risk taking activities. High performing firms are implementing new production technologies, emphasizing cost effectiveness and concerned with employee productivity to compete with competitors within the industry more so than the low performing firms^{56,57}. Furthermore, Kotey and Meredith (1997) pointed out that when firms are advertising more, identifying brand names for products, greater emphasizing customer service and credit, exploring marketing techniques, it leads to an increase in high performance². As far as financial strategic activities are concerned, they also stated that high performing firms use more debt financing and assessment of costs and benefits associated with alternative sources of external funding than the low performing firms. As mentioned in the literature, SMEs are more labour intensive than the large firms. Within their research, it is also found that assessment of employee performance, concern with employees' well being and job satisfaction, involving employees in decision making are more common in high performing firms than low performing firms. Research shows that owner-managers, who seek the assistance of experts and make networks within the industry, perform better than those who do not⁵⁸.

Particularly, some empirical studies investigated the different strategy typology (orientation) and performance of firms. In considering the two groups of strategy orientation of proactive and reactive strategies, research which was done in the furniture industry related to business strategies and performance by Kotey and Meredith (1997) demonstrated that high performers pursue proactive strategies and low performers pursue reactive strategies². Average performing firms exhibit a combination of proactive and reactive strategies. Similar to this, they investigated four different strategy typologies and performances and concluded that prospector strategy (proactive strategy) influences the growth of the company¹⁰. This idea is also supported by Matsuno and Mentzer (2000)⁵⁹.

From a review of the above literature and to investigate the research objective, the following conceptualized research model (Figure 1) was developed to test the business strategies and their relationship with enterprise performance. Business strategies were defined in terms of twenty five (25) strategy items which is developed based on the literature from five business functional areas such as finance, production, HRM, marketing and (R&D)^{2,48}. Business performance of SMEs

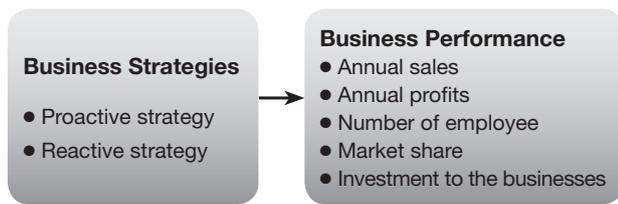


Figure 1: Conceptualized Model for Association between Business Strategy of SMEs and Enterprise performance

was measured in terms of mixed financial and non-financial measures including increased annual profits, annual sales, market share, number of employees and reinvestment in the business.

The research methodology which was applied to investigate the conceptualized model is presented as follows.

3. Methodology

3.1 Sample

For the purpose of achieving the main research objective of examining the relationship between business strategies and business performance, a total number of five hundred and fifty (550) SMEs in Aichi Prefecture in Japan and five hundred (500) in Western province in Sri Lanka were selected from manufacturing SMEs. Aichi Prefecture is the third largest prefecture in terms of number of establishments of SMEs and also produced the highest shipment in Japan⁶⁰. Therefore, this prefecture has a high industrial contribution to the GDP and plays a crucial role in economic development. Similar to this, Western province has the highest number of industrial establishments in Sri Lanka and also a high contribution to the GDP⁶¹. The electronic databases maintained by the Aichi Association of Small Business Entrepreneurs (from 2005 to 2007) and Government of Aichi Prefecture were used to draw the sample in Japan and a database maintained by the National Chamber of Commerce was used to draw the sample in Sri Lanka. Within these databases, only registered *manufacturing* SMEs were considered among all registered SMEs. It is noted that, manufacturing SMEs employ the largest number of employees compared with other SME industries in Japan as well as in Sri Lanka. Further, SMEs whose employees are less than 300 were included in the sample as they are considered to be “SMEs” according to the Small and Medium Enterprise Basic Law of defining manufacturing SMEs in Japan¹³. Similarly, this criterion was also applied in the Sri Lankan context as there is no standard definition.

3.2 Data Collection

The researcher collected primary data pertaining to business strategies and performance and a mail survey was conducted to collect them from the two samples in Japan and Sri Lanka. Furthermore, the questionnaire method was chosen as a principal technique of data collection, because it afforded the advantages of vast coverage, speed, cost, less pressure and versatility.

A comprehensive questionnaire was developed that was comprised of four major parts. The first part included seven questions related to owner-manager characteristics: age, sex, marital status, educational qualifications, experience, most important reason for entering business and whether the individual had a family member who owned a business. The second part included questions related to the firm/business characteristics, including industry, age, number of employees, source of resources, market for production, whether the business is a family business and number of managers and supervisors. These data were utilised to identify a more meaningful profile for the sample.

The third part followed the questions related to the business strategies of the firm. A total of twenty five (25) operational strategic activities were developed covering five major areas of finance, production, HRM, marketing and R&D. Particularly, under business strategies, the first four questions were related with the finance strategic activities of the firm including use of outside borrowed funds, searching for sources of finance, reinvesting profits earned and maintaining large cash balances. Next activities from no. 5 to 9 were followed by the production strategies. Such as changing or reinvesting production methods, improving existing products to meet changing customer needs, developing new products, emphasizing product quality, and emphasizing cost reduction in all areas of the business. Activities no. 10 to 15 were focused on the HRM strategies, asking about the activities from respondents, involving employees in decision making, using clear personal policies in reward and punishment of employees, emphasizing employee welfare, assessing employee performance, assessing employee job satisfaction, and emphasizing employee productivity. Marketing strategies are included (activity no. 16 to 22) the activities such as using brand names, advertising products, extending customer credits, pricing products at market price, emphasizing customer service, selling products direct to end users, and selling through distribution channels. The last three activities illustrated the R&D strategies such as consulting technical experts, taking part in activities related

to trade or industry associations and attempting to predict industry trends and acquiring knowledge of competitors' activities. Within the questionnaire, in this part, participants were asked to rate the degree of extent to which each activity is undertaken in the operation of the firm on a five-point Lickert scale ranging from "never use" (score 1) to "always use" (score 5).

Finally, business performance was measured in terms of annual sales, annual profits, number of employees, market share (local and international), and investment in the business. The respondents were asked to rate the *trends* for the above performance metrics over the last three years (2005 to 2007) on a five-point Likert scale ranging from "highly decreased" (score 1) to "highly increased" (score 5). All of the questions developed were closed-ended and multiple choice, and simply required ticking or circling the appropriate answer, thus minimising the completion time. The data collection started after employing a pilot study. Based on the findings of the pilot study, some minor changes in the questionnaire were made. The questionnaire was initially prepared in English, and it was later translated into Japanese and Sinhala.

The reliability of the business strategies and performance measures were evaluated and found to be acceptable, respectively, with a *Cronbach's alpha* of 0.73 and 0.84 for Japan and 0.84 and 0.94 for Sri Lanka. This self-administered questionnaire was sent by postal mail with a return stamped envelope to the owner-managers of SMEs in both countries in the middle of the 2008 fiscal year.

3.3 Data Analysis

In this study, for the purpose of achieving the main research objective and based on the nature of the data collected, non-parametric statistical techniques for data analysis were employed. Non-parametric techniques are ideal for this use because; the data were measured using nominal (categorical) and ordinal (ranked) scales, the distribution of the population scores was not normal, the violation of the assumption of homogeneity of variance. Therefore, a non-parametric technique, the chi-square independence test, was applied to measure the relationship between business strategies and business performance. The primary objective of the chi-square independence test is to determine whether two variables are related or not. The value was calculated using business strategies as the independent variable and various aspects of business performance, including elements such as annual sales, annual profits, number of employees, market share and

reinvestment into the business, as the dependent variables. The Pearson's chi-square value was calculated to determine the level of significance. In this test, if the calculated value (p) is less than 0.05, the relationship between two variables is significant. Statistical calculations were made using SPSS software⁶².

4. Results and Analysis

4.1 Sample Characteristics

A total of 231 SMEs in Japan and 224 SMEs in Sri Lanka responded to the survey. The response rate for the distributed questionnaire was 42% in Japan and 45% in Sri Lanka. Due to issues with incomplete data, 16 and 10 questionnaires from Japan and Sri Lanka, respectively, were disregarded. The remaining 215 in Japan and 214 in Sri Lanka were included in the data analysis. The characteristics of the two samples are presented in the following sections.

4.1.1 Owner-Manager Characteristics

As for the owner-manager characteristics of the samples from the two countries, their most important features are summarised in Table 1.

As shown in Table 1, over half of the Japanese owner-managers (55%) were over fifty years old, whereas 83.3% of managers were less than fifty one years old in Sri Lanka. This shows that, on average, owner-managers of SMEs in Japan are older than in Sri Lanka. Based on the data regarding educational qualifications in Japan, 66.8% of owner managers have obtained a university degree. In contrast, most of the owner-managers in Sri Lanka have only attained a high-school

Table 1: Owner-Manager Characteristics of SMEs

| Owner-Manager Characteristic | | Japan % | Sri Lanka % |
|------------------------------|---------------------|---------|-------------|
| Age (Years) | 20-30 | 1.4 | 15.7 |
| | 31-40 | 15.2 | 28.7 |
| | 41-50 | 28.4 | 38.9 |
| | 51-60 | 30.8 | 15.7 |
| | 61-70 | 19.0 | 1.0 |
| | Over 70 | 5.2 | — |
| Education | Middle School | 3.3 | 17.6 |
| | Middle School | 21.3 | 41.7 |
| | High School | 66.8 | 17.6 |
| | University Graduate | 4.8 | — |
| | Professional | 3.8 | 21.3 |
| | Others | — | 1.9 |
| Experience | Yes | 72.0 | 34.3 |
| | No | 28.0 | 65.7 |

Source: Survey data, 2008

level of education. This indicates a lower level of education among Sri Lankan managers than among the managers in Japan. Before entering the business, 72% of Japanese owner-managers had prior experience owning a similar business, while only 34.3% of managers had prior experience in Sri Lanka. In addition to the data in Table 1, we can note that in Japan, 96.2% of managers are males and 3.8% are females. In Sri Lanka, the percentages are 88% and 12% for males and females, respectively. Furthermore, 92.9% of managers are married in Japan, while this figure is 84.3% in Sri Lanka. The most important reason for entering the business in Japan is that the firm in question is a family business (70.4%), whereas

personal interest (41.7%) is most important in Sri Lanka. 74.8% of Japanese owner-managers' family members have owned a business, compared to only 25% in Sri Lanka.

4.1.2 Firm Characteristics

In terms of firm characteristics within the two countries, the most important features are summarised in Table 2.

As the table indicates, the majority of firms in the Japanese sample are older, as over 62% of SMEs are more than 41 years old. In contrast, half of the SMEs in Sri Lanka fall into the category of 11-20 years of operation. Interestingly, most of the firms in Japan operate as joint-stock corporations (84.7%), while in Sri Lanka, they operate as sole proprietorships (67.6%). One of the salient features of the majority of SMEs in both countries is that they employ fewer than 100 employees. These percentages are 78.5% of firms in Japan and 91.7% of firms in Sri Lanka.

In addition to considering the above data, we can also look to the fact that the major source of financing in Sri Lanka for these enterprises came from a mix of personal savings, family loans and bank loans (51.9%), while personal savings financed 45.8% of Japanese firms. Firms produced goods equally for local and international markets in Japan, whereas in Sri Lanka, 82.4% of production was for the local market. Presently, 42.7% of firms in Japan and 36.1% of firms in Sri Lanka operate as family businesses, while the others are non-family businesses. Most firms in both countries have two to five managers each who operate these organisations.

Furthermore, Table 3 shows the categories of industries with which the SMEs within the two samples were involved. It shows that the majority of firms in Japan operated in fab-

Table 2: Firm Characteristics of SMEs

| Firm Characteristic | | Japan % | Sri Lanka % |
|---------------------|------------------------|-------------|-------------|
| Age (Years) | Not more than 4 | 1.9 | 12.0 |
| | 5-10 | 4.2 | 28.7 |
| | 11-20 | 3.7 | 50.0 |
| | 21-30 | 8.8 | 7.4 |
| | 31-40 | 19.1 | 0.9 |
| | More than 41 | 62.3 | 0.9 |
| Legal Form | Sole Proprietorship | 2.3 | 67.6 |
| | Partnership | 0.5 | 0.9 |
| | Limited company | 2.3 | 24.1 |
| | Join Stock Corporation | 84.7 | 7.4 |
| | Other | 10.2 | — |
| | No. of Employees | Less than 9 | 21.5 |
| | 10-19 | 14.0 | 12.0 |
| | 20-49 | 23.8 | 27.8 |
| | 50-99 | 19.2 | 17.6 |
| | 100-250 | 17.3 | 7.4 |
| | 250-300 | 4.2 | 0.9 |

Source: Survey data, 2008

Table 3: Involved Industry of the Sample in Japan and Sri Lanka

| Industry | No. of Firms % | |
|--|----------------|-----------|
| | Japan | Sri Lanka |
| Food and Beverages | 6.5 | 11.1 |
| Textile and Wearing Apparel | 5.1 | 14.8 |
| Furniture, Fixtures and Lumber and Wood | 5.6 | 11.1 |
| Paper, Printing, and Allied Products | 7.4 | 6.5 |
| Chemical, Petroleum, Rubber and Plastics Products | 12.1 | 13.9 |
| Leather | 3.7 | 3.7 |
| Ceramics, Stone, Clay, Glass, Concrete Products | 4.2 | 4.6 |
| Fabricated and Metal Products | 19.5 | 10.2 |
| Machinery (general, precision machines and others) | 13.5 | 1.0 |
| Electronic and Electric and Electrical Equipments | 4.2 | 8.3 |
| Automobile Parts (Motor Car) | 7.0 | 0.9 |
| Welding | — | 1.9 |
| Miscellaneous | 11.2 | 12.0 |
| Total | 100.0 | 100.0 |

Source: Survey data, 2008

ricated and metal products (19.5%) and machinery (13.5%) industries. In Sri Lanka, most firms produced textiles and apparel (14.8%) or chemical, petroleum, rubber and plastics products (13.9%) industries.

4.2 Business Strategies of SMEs

Responses for the items related to measure business strategies of SMEs in Part three of the questionnaire is presented as mean scores (\bar{x}) and standard deviation(s) values for each strategy item with the following Table 4 for both samples in Japan and Sri Lanka.

As mentioned in section 2.3, twenty-five strategy items are developed in five major business functional areas related with finance, production, HRM, marketing and R&D. According to the above table, under the finance strategies, the highest mean score in the sample from Japan records 3.62 with the strategy item of reinvestment of earned profits, whereas in Sri Lanka, the highest mean score is for searching for cheaper

sources of finance (\bar{x} = 4.08). It implies that these two strategies are commonly used in the respective country's SMEs. On the other hand, the lowest mean 2.68, related to maintaining large cash balances in the Sri Lankan sample, indicates that this strategic activity is rarely followed by firms. Except for this, other strategic items in the functional area of finance in both countries are being used by the firms, as all means recorded more than 3.5.

Items 5 to 9 are included in production strategies which are more important in the manufacturing industry. Based on the calculated mean values, in both samples, the similar feature which can be seen is that the highest mean is related with the strategy item of emphasizing product quality (4.46 in Japan and 4.36 in Sri Lanka). Furthermore, it is apparent that all production strategies are rated over 3.7 in both countries.

Items 10 to 15 are related with the firm's HRM strategies. Under this, the calculated means show that the highest mean score in the two samples is on emphasizing employee pro-

Table 4: Mean Scores for Business Strategies of Manufacturing SMEs in Japan and Sri Lanka

| Strategy Item | Japan | | Sri Lanka | |
|--|-----------|-------|-----------|-------|
| | \bar{x} | s | \bar{x} | s |
| Finance | | | | |
| Use of outside borrowed funds | 3.45 | 1.100 | 3.55 | 1.212 |
| Search for cheaper sources of finance | 3.51 | 1.027 | 4.08 | 0.921 |
| Reinvestment of earned profits | 3.62 | 0.927 | 3.92 | 0.879 |
| Maintaining large cash balances | 3.51 | 0.738 | 2.68 | 0.905 |
| Production | | | | |
| Changing or reinvesting production methods | 3.72 | 0.785 | 3.81 | 0.980 |
| Improving existing products to meet changing customer needs | 4.06 | 0.736 | 4.08 | 0.750 |
| Developing new products | 3.93 | 0.921 | 4.03 | 0.756 |
| Emphasizing product quality | 4.46 | 2.796 | 4.36 | 0.601 |
| Emphasizing cost reduction in all areas of the business. | 4.01 | 0.764 | 4.18 | 0.669 |
| HRM | | | | |
| Involving employees in decision making | 3.80 | 0.758 | 3.76 | 0.886 |
| Using clear personal policies in reward and punishment of employees | 3.41 | 0.775 | 3.42 | 0.881 |
| Emphasizing employee welfare | 3.71 | 0.692 | 3.98 | 0.741 |
| Assessing employee performance | 3.88 | 0.701 | 3.82 | 0.897 |
| Assessing employee job satisfaction | 3.78 | 0.717 | 4.05 | 0.755 |
| Emphasizing employee productivity | 3.92 | 0.660 | 4.13 | 0.713 |
| Marketing | | | | |
| Using brand name | 3.29 | 1.082 | 3.84 | 1.078 |
| Advertising products | 3.21 | 0.987 | 3.11 | 1.211 |
| Extending customer credits | 4.15 | 0.693 | 3.45 | 1.013 |
| Pricing products at market price | 3.73 | 0.806 | 4.11 | 0.706 |
| Emphasizing customer service | 4.00 | 0.768 | 4.47 | 0.805 |
| Selling products direct to end users | 3.26 | 1.299 | 3.59 | 1.278 |
| Selling through distribution channels | 3.18 | 1.092 | 3.20 | 1.324 |
| R&D | | | | |
| Consulting technical experts | 3.27 | 0.949 | 3.03 | 1.214 |
| Taking part in activities related to trade or industry associations | 3.56 | 0.894 | 2.86 | 1.092 |
| Attempting to predict industry trends and acquiring knowledge of competitors' activities | 3.78 | 0.783 | 3.97 | 0.781 |

\bar{x} = mean; s = standard deviation

Source: Survey data, 2008

ductivity (3.92 in Japan and 4.13 in Sri Lanka). However, it is clear, that the mean ranges of HRM strategy items in Japan (3.41 – 3.92) are lower than that in Sri Lanka (3.42 – 4.13). Standard deviation values in each item show that the deviation of mean in corresponding activities between the two samples does not show much variation.

Items 16 to 22 in the above Table 4 are considered the marketing strategies. The means illustrate that the highest mean is related with extending customer credits in Japan (4.15) and emphasizing customer service in Sri Lanka (4.47). This implies that SMEs in both samples place more emphasis on their customers. However, on the whole, means of all strategy items under marketing are not less than 3.10.

Items 23 to 25 are related with R&D strategies and the calculated means show that the highest mean is related with the strategy item of attempting to predict industry trends and acquiring knowledge of competitors' activities in both samples (3.78 in Japan and 3.97 in Sri Lanka).

Overall, from the calculated means and standard deviations for strategic items, one of the salient features which can be shown is that many of the highest means are related with the production strategy items in manufacturing SMEs in both countries. It implies that the majority of firms are more concerned about production strategies than the other business functions as the two samples are related with the manufacturing industry.

4.3 Relationship between Business Strategy and Performance of SMEs

For investigating the relationship between business strategy and business performance, two categories of business strategy namely proactive and reactive and five performance variables are considered. To determine whether there is a statistically significant relationship between strategy and performance, a chi square test is conducted separately,

for two groups of strategy; proactive and reactive with five performance measures. To categorise proactive and reactive strategies, means are calculated based on the rating scores given by the respondents to each activity. Within these means scores, a decision rule is applied to determine whether proactive or reactive strategies are followed by the owner-managers. High mean score (equal or more than 3.5) is considered for determining proactive strategies and low mean score (less than 3.5) is considered for reactive strategies.

The following Table 5 illustrates the results of the chi-square test related with two categories of strategy and change in annual sales of manufacturing SMEs in two countries.

The results indicate a significant relationship between business strategy and change in annual sales in Japan and Sri Lanka at a 5% level. More specifically, in Japan, 42.7% of owner-mangers of SMEs who apply reactive strategies shows a significant decrease (13.5%) or decrease (29.2%) in annual sales, while 23.6% (22.5% increase and 1.1% high increase) shows a similar increase in sales. With regard to the category of applying proactive strategies, the respective percentages are 23% (6.3 and 16.7) and 46% (38.1 and 7.9). Similar to this, in Sri Lanka, the category of 13.4% owner-managers who apply reactive strategies shows a high decrease (6.7) and decrease (6.7) in annual sales, and 73.7% (72 and 1.7) shows a similar increase in sales. For the category of proactive strategy, the respective percentages are 16.9% (3.9 and 13.0) and 75.3% (50 and 25.3). In sum, 23.6% of the SMEs in Japan and 73.7% in Sri Lanka with reactive strategies are able to increase in sales over the last three years, whereas 46% and 75.3% in Japan and Sri Lanka, respectively, have achieved similar increases in sales by applying proactive strategies. Apparently, these results suggest that using proactive strategies leads to a greater increase in sales in both Japan and Sri Lanka. On the other hand, if using reactive strategies, the levels of sales deteriorate in both countries in the case of using

Table 5: Relationship between Business Strategy and Annual Sales in SMEs in Japan^a and Sri Lanka^b

| Strategy Type | Annual sales | | | | | | | | | |
|---------------|-----------------|-----------|-------------|-------------|-------------------------------|------------|-------------|-------------|-----------------|-------------|
| | Highly Decrease | | Decrease | | Neither Decrease nor increase | | Increase | | Highly Increase | |
| | J | SL | J | SL | J | SL | J | SL | J | SL |
| Proactive | 8 6.3% | 6 3.9% | 21 16.7% | 20 13.0% | 39 31.0% | 12 7.8% | 48 38.1% | 77 50.0% | 10 7.9% | 39 25.3% |
| Reactive | 12 13.5% | 4 6.7% | 26 29.2% | 4 6.7% | 30 33.7% | 6 10.0% | 20 22.5% | 45 72.0% | 1 1.1% | 1 1.7% |

J = Japan; SL = Sri Lanka; a = $\chi^2 (4, N = 211) = 15.490, p = .004$; b = $\chi^2 (4, N = 214) = 20.160, p = .000$
Source; Survey data, 2008

reactive strategies.

Table 6 presents the chi-square test results of the relationship between business strategy and change in profits for both countries.

As shown in Table 6, the results depict a significant relationship between business strategy and change in profits in both samples. In the sample of Japan, as shown in the above table, 42.7% (5.6 and 37.1) of owner-managers of SMEs who follow reactive strategies indicate a high decrease or decrease in annual profits respectively, while 24.7% (23.6 and 1.1) show a similar increase in annual profits. Contrasting to this, the use of proactive strategy category shows a 26.2% (7.9 and 18.3) and 38.9% (33.3 and 5.6) of a fall and a rise of profits, respectively.

In Sri Lanka, Table 6 shows that 23.3% (8.3 and 15.0) of owner-managers of SMEs who are applying reactive strategies report a high decrease or decrease in profits, while 60.0% (58.3 and 1.7) report a similar increase in profits. With regard to the category of applying proactive strategies, these values are 18.3% (6 and 12.3) and 74.0% (64.3 and 9.7), respectively. In Sri Lanka, it is apparent that applying proactive strategies, 74.0% of SMEs can achieve an annual profits increment in the last three years, whereas 60.0% of SMEs that apply reactive strategies are also able to increase annual profits.

Therefore, comparing the two samples, it is shown that applying proactive strategies leads to an increase in annual profits of SMEs in both countries.

Next, the following Table 7 presents the results of a chi square test related to the categories of proactive and reactive strategy and change in number of employees in the two countries.

It shows a significant relationship between business strategy and number of employees in Sri Lanka at $p = 0.05$.

In the sample of Sri Lanka as in Table 7, it depicts that 15.0% (5.0 and 10.0) of SMEs by employing reactive strategies have achieved a high decrease or decrease in their number of employees, while 26.7% (21.7 and 5.0) have achieved a similar increase in the number of employees. In the category of proactive strategy, 15.5% of SMEs (4.5 and 11) have achieved a high decrease or decrease in the number of employees, while 55.2% (48.1 and 7.1) have achieved a similar increase in the number of employees to the business.

The above results suggest that applying proactive strategies affect the increase in the number of employees of SMEs in both countries, while it shows a non significant relationship in Japan. This is a vital difference between the two countries.

The following Table 8 presents the chi-square results between the business strategy and change of market share for

Table 6: Relationship between Business Strategy and Annual Profits of SMEs in Japan^a and Sri Lanka^b

| Strategy Type | Annual Profits | | | | | | | | | |
|---------------|-----------------|-----------|-------------|-------------|-------------------------------|-------------|-------------|-------------|-----------------|------------|
| | Highly Decrease | | Decrease | | Neither Decrease nor increase | | Increase | | Highly Increase | |
| | J | SL | J | SL | J | SL | J | SL | J | SL |
| Proactive | 10 7.9% | 1 6% | 23 18.3% | 19 12.3% | 44 34.9% | 20 13.0% | 42 33.3% | 99 64.3% | 7 5.6% | 15 9.7% |
| Reactive | 5 5.6% | 5 8.3% | 33 37.1% | 9 15.0% | 29 32.6% | 10 16.7% | 21 23.6% | 35 58.3% | 1 1.1% | 1 1.7% |

J = Japan; SL = Sri Lanka; a = $\chi^2 (4, N = 211) = 12.023, p = .01$; b = $\chi^2 (4, N = 214) = 13.752, p = .008$
 Source; Survey data, 2008

Table 7: Relationship between Business Strategy and Number of Employees of SMEs in Japan^a and Sri Lanka^b

| Strategy Type | Number of Employees | | | | | | | | | |
|---------------|---------------------|-----------|-------------|-------------|-------------------------------|-------------|-------------|-------------|-----------------|------------|
| | Highly Decrease | | Decrease | | Neither Decrease nor increase | | Increase | | Highly Increase | |
| | J | SL | J | SL | J | SL | J | SL | J | SL |
| Proactive | 7 5.6% | 7 4.5% | 17 13.5% | 17 11.0% | 53 42.1% | 45 29.2% | 40 31.7% | 74 48.1% | 9 7.1% | 11 7.1% |
| Reactive | 7 8.0% | 3 5.0% | 16 18.2% | 6 10.0% | 44 50.0% | 35 58.3% | 17 19.3% | 13 21.7% | 4 4.5% | 3 5.0% |

J = Japan; SL = Sri Lanka; a = $\chi^2 (4, N = 211) = 5.495, p = .240$; b = $\chi^2 (4, N = 214) = 17.549, p = .002$
 Source; Survey data, 2008

Japan and Sri Lanka.

The results depict a significant relationship between business strategy and change in market share in Japan. In Sri Lanka, this relationship is not statistically significant ($p > .05$). Furthermore, in Japan, 21.6% (2.3 and 19.3) of owner-managers of SMEs who follow reactive strategies report a high decrease or decrease in market share, while 15.9% (14.8 and 1.1) report an increase in market share. However, with respect to firms that follow proactive strategies, these percentages are 10.4% (0.8 and 9.6) and 36.0% (30.4 and 5.6), respectively. Therefore, it is evidenced that 15.9% of SMEs which apply reactive strategies are able to increase the market share over the last three years. Interestingly, this figure shows 36.0% of SMEs with respect to firms that applying proactive strategies.

On the other hand, in Sri Lanka, 10.0% (1.7 and 8.3) of SMEs that employ reactive strategies achieve a high decrease or decrease in market share, while 66.7% (60.0 and 6.7) achieve a similar increase in market share. 9.2% (3.3 and 5.9) of SMEs having a proactive strategy achieve a high decrease or decrease in market share, while 79.0% (67.8 and 11.2) of SMEs achieve a similar increase in market share.

Comparing the results of the above analysis, it suggests that applying proactive strategies leads to greater increase in

market share of SMEs in Japan and Sri Lanka, although the relationship is statistically not significant in Sri Lanka. This is a remarkable difference between Japan and Sri Lanka.

Finally, Table 9 presents the results of the test related with the two categories of strategy type - proactive and reactive and reinvestment in the business.

The results of Table 9 illustrate a significant relationship ($P < 0.05$) between strategy type of proactive and reactive and reinvestment in the business in Japan. In short, in Japan, 31.9% (23.9 and 8.0) of the SMEs that follow reactive strategies are able to increase or highly increase reinvestment in the business over the last three years, whereas 52.4% (41.3 and 11.1) of SMEs which apply proactive strategies can achieve an increment in investment back into the business. The respective percentages in Sri Lanka are 84% and 84.4%. Though, it can be shown that applying proactive strategies leads to increase in the level of reinvestment into the business of SMEs in both countries, the relationship is statistically not significant in Sri Lanka.

The suggested view in the literature is that business strategies determine the performance of an enterprise. The situation revealed by this study is consistent with the findings of the studies conducted by Pearce and Robinson (1985), Olson and Bokor (1995), Smith (1967), Covin and Slevin (1986),

Table 8: Relationship between Business Strategy and Market Share of SMEs in Japan^a and Sri Lanka^b

| Strategy Type | Market share | | | | | | | | | |
|---------------|-----------------|-----------|-------------|-----------|-------------------------------|-------------|-------------|--------------|-----------------|-------------|
| | Highly Decrease | | Decrease | | Neither Decrease nor increase | | Increase | | Highly Increase | |
| | J | SL | J | SL | J | SL | J | SL | J | SL |
| Proactive | 1 0.8% | 5 3.3% | 12 9.6% | 9 5.9% | 67 53.6% | 18 11.8% | 38 30.4% | 103 67.8% | 7 5.6% | 17 11.2% |
| Reactive | 2 2.3% | 1 1.7% | 17 19.3% | 5 8.3% | 55 62.5% | 14 23.3% | 13 14.8% | 36 60.0% | 1 1.1% | 4 6.7% |

J = Japan; SL = Sri Lanka; a = $\chi^2 (4, N = 211) = 13.099, p = .011$; b = $\chi^2 (4, N = 214) = 5.824, p = .213$
Source; Survey data, 2008

Table 9: Relationship between Business Strategy and Reinvestment to the Business of SMEs in Japan^a and Sri Lanka^b

| Strategy Type | Reinvestment to the Business | | | | | | | | | |
|---------------|------------------------------|-----------|-------------|------------|-------------------------------|------------|-------------|--------------|-----------------|-------------|
| | Highly Decrease | | Decrease | | Neither Decrease nor increase | | Increase | | Highly Increase | |
| | J | SL | J | SL | J | SL | J | SL | J | SL |
| Proactive | 5 4.0% | 5 3.2% | 8 6.3% | 9 5.8% | 47 37.3% | 10 6.5% | 52 41.3% | 112 72.7% | 14 11.1% | 18 11.7% |
| Reactive | 6 6.8% | 1 1.7% | 13 14.8% | 7 11.7% | 41 46.6% | 1 1.7% | 21 23.9% | 48 80.0% | 7 8.0% | 3 4.0% |

J = Japan; SL = Sri Lanka; a = $\chi^2 (4, N = 211) = 10.780, p = .029$; b = $\chi^2 (4, N = 214) = 5.573, p = .160$
Source; Survey data, 2008

Covin (1991), and Chell, Haworth and Brearley (1991)^{4,5,6,7,8,9}. However, in comparing the two countries, the findings related to each performance variable indicates some similarities and differences. The findings on relationship between strategy and annual sales and profits have a positive and significant relationship in both countries. It implies that functional level strategies; financial, production, HRM, marketing and R&D directly impact on the increase in sales and profits in manufacturing SMEs in Japan and Sri Lanka. But the finding on the relationship between strategy and the number of employees is rather surprising in the case of Japan. In Japan, strategies do not affect the number of employees. This is a remarkable difference between the two countries. The reason for this situation may be less job security, low salary, fewer welfare facilities, which may have an influence other than that of strategies, compared to large enterprises in Japan. But there is no prior research evidence to prove it. Therefore, this implies further research is needed to investigate this situation. On the other hand, the other dissimilarity between the two countries is that there is a strong positive influence of strategies on market share and reinvestment to the business in Japan, whereas in Sri Lanka, strategy does not affect this. The reasons for this situation may be the prevailing civil war during the last three decades, which created an uncertain environment and less business security in the country of Sri Lanka. At the same time, the major reason for increasing market share in Japan may be more related to production strategies, particularly, the high quality concerned and technology improves sales and widens the market more than that of Sri Lanka.

Furthermore, the literature shows that strategies which result in high performance are identified with activities associated with emphasis on product quality, product and service innovations, development of new operating technologies, emphasis on customer service and support, extensive advertising, and use of external finance and discovery of new markets^{21,52,8}. Some of these findings are also evidenced by current study revealing that most important strategic activities are derived from functional level strategies. The analyzed data reveals that in both samples, as overall, proactive strategies tend to increase in performance of manufacturing SMEs which is consistent with the studies done by Kotey and Meredith (1997)² and Covin (1991)⁹. Particularly, it indicates that there is a strong positive impact of proactive strategies on increasing business performance in terms of sales and profits in the two countries. A proactive strategic approach emphasizes more such activities as: searching for cheaper sources of finance,

changing production methods, developing new products, product quality, employee productivity, advertising, customer credits and customer service, which improves the sales and profits in manufacturing firms. This is also supported by the ideas provided by Covin (1991)⁹.

5. Conclusions

This study has achieved its purpose of filling the research gap and examining the relationship between strategy and performance of SMEs operating in an Asian context. Though, there have been certain limitations, important conclusions are drawn from the study which could provide some useful insights to owners and managers of SMEs. Overall, the main conclusion drawn from the study is that business strategies (proactive strategies) and performance of manufacturing SMEs in Japan and Sri Lanka are empirically related. In addition, based on the each finding of performance variables, the conclusion drawn is that there is a positive significant relationship between business strategy and sales and profits in both countries. Furthermore, business strategy and number of employees in Sri Lanka, business strategy and market share and reinvestment in the business in Japan. These findings reveal some similarities and differences between the two countries. Particularly, the findings also suggest that applying proactive strategies leads to a greater increase in annual sales, annual profits, the number of employees, market share and reinvestment into the business than that of applying reactive strategies of manufacturing SMEs in Japan and Sri Lanka. This is consistent with past studies which have been done in the western context.

This study also indicated that among all other business functional level strategies, production strategies are the most crucial to the manufacturing SMEs in Japan and Sri Lanka. Furthermore, the analysed business strategic activities conclude that emphasising product quality and customer service and acquiring knowledge of competitors' activities are the most important strategic activities for both countries. In addition, reinvestment of earned profits and assessing employee performance in Japan and search for sources of finance and emphasizing employee productivity in Sri Lanka are also vital for SMEs.

The results of this study must be interpreted in the light of obvious limitations. One limitation is that constrained by the vastness of the SME sector in both countries and the

limited time available. This study was confined to SMEs in the manufacturing industry only. Nevertheless, the results were also subject to the limitations commonly associated with questionnaire method and all mail surveys with respect to the reliability and accuracy of information. Particularly, it is noted here, in 2008 a global financial crisis occurred and it drastically affected some aspects of the SME sector.

In view of the fact that there has been no prior comparative research that has examined the business strategies and business performance among SMEs in the Asian context, the findings of the study provide an indication of possible directions for future research. First, it must be emphasised that, as the present study revealed, there are some important results and some similarities and differences of SMEs in developed and developing economies in the Asian context. Future research must investigate the same relationships in more Asian countries to generalize the findings.

On the other hand, because this study was confined to the manufacturing industry, further research should be done to replicate the above findings, employing wider coverage including other industries. The same study can also be carried out to see how the financial crisis affected the results. Another prospect for further research lies in the need to develop more tools for measuring key variables of business strategy and business performance and validate the same relationships which are investigated in this study. Furthermore, this study focused only on the influence of business strategies on the business performance of SMEs. But there are some other factors which influence performance. Hence, a detailed study considering all these factors would provide an insight to determine the most crucial factors that influence the performance of SMEs. Finally, it would be worthwhile to investigate the rational behind the existence of a non significant relationship between strategy and the number of employees of SMEs in Japan.

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