BARRIERS TO THE INTERNATIONALIZATION OF SMALL AND MEDIUM ENTERPRISES (SMES) IN SRI LANKA

Packeer Mohideeen Mohamed Zameem[1] and Thangamani Bhavan[2]
[1]MPhil Research Scholar, Faculty of Commerce and Management, Eastern University, Sri Lanka and Sri Lanka Export Development Board, Sri Lanka
[2]Department of Economics, Faculty of Commerce and Management, Eastern University, Sri Lanka
zameem@edb.gov.lk

Abstract

During the internationalization of Sri Lankan, small and medium enterprises (SMEs) through exporting has been facing various exporting barriers that influence their firms' export performance and consequently the country's economy growth. Therefore, this research aims to identify the exporting barriers that exist in SME firms' internal and external environments. 165 Sri Lanka's SMEs exporting processed food and beverage products participated in this study. Data were collected through a structured questionnaire and analyzed using mixed methods. Export sales performance was as a dependent variable with internal and external export barriers as independent variables. Internal export barriers were categorized as informational, functional, financial, and marketing barriers, while external export barriers were identified as procedural, governmental, task, and environmental barriers. The results derived from the study indicate that four internal export barriers; functional, informational, financial, and marketing barriers significantly hinder Sri Lanka's SMEs' internationalization, whereas one external export barrier that is procedural barriers have a positive impact. It is recommended that necessary policy measures to be implemented to address these barriers, which would benefit both SME firms and the Sri Lankan economy.

1. Introduction

Sri Lanka's GDP has been severely affected by the Covid-19 pandemic, the Easter attacks, and the financial crisis in recent years. This hinders entrepreneurs' income, especially in export industries. Further, rising trade deficits also become crucial and requires the involvement of the SME owners to actively engage in exporting. Exporting is the easiest access for SMEs to tap into foreign markets and contributes to job creation, innovation, and economic stability of a country. SMEs frequently face many barriers that impede their operations in foreign markets (Wijayarathne and Perera, 2018). These barriers arise from internal institutional weakness, strategic business shortcomings, domestic issues, and target market challenges. Many of barriers cause SMEs suspicious of exports and impede their entry into foreign markets. Also, they prevent new SMEs from joining the export market and discourage experienced exporters from trying to succeed in international markets. Thus, barriers to exporting can be internal, concerning issues within a firm, or external, concerning issues in a firm's external environment (Wijayarathne and Perera, 2018 and Biswas et al., 2017). Therefore, it is crucial to consider both internal and external export barriers when studying barriers impeding SMEs' internationalization. Due to the limited research from Sri Lanka in this field, there is a curiosity to study the barriers faced by Sri Lankan SMEs while expanding internationally.

This study, centered on Sri Lanka's processed food and beverage industry due to its numerous export-oriented firms in Sri Lanka (National Export Strategy of Sri Lanka, 2018), offers useful information for new SMEs, and

policymakers, potentially enhancing performance and influencing the country's macroeconomic environment. Therefore, this study aims to investigate export barriers hindering Sri Lankan SMEs' internationalization in the processed food and beverage industry.

2. Literature Review

Theoretical Background

Internationalization is the expansion of economic activity over a country's national boundaries, involving export, trade, cross-border collaboration, alliances, subsidiaries, and joint ventures (Fernando and Samarakoon, 2021). The internationalization of firms involves traditional, network, born global, and international entrepreneurship theories. The Uppsala model and the Innovation model are traditional theories promoting internationalization in local companies. The Uppsala model suggests successful local companies gradually internationalize using international market knowledge (Kunday and Senguler, 2015; Lakew, 2015), overcoming barriers like lack of knowledge, risk aversion, and psychic distance (Paul et al., 2017). The Innovation-related model suggests companies adopt innovative strategies at each stage of internationalization (Kunday and Senguler, 2015; Lakew, 2015), gradually or incrementally exporting to both local and distant countries (Roque et al., 2019; Lakew, 2015), but Sri Lankan SMEs' success relies on innovation and geographical proximity. The Uppsala model is more suitable due to cultural similarity and limited psychic distance. The network approach, developed by Johanson and Mattsson in 1988, is a crucial factor in the internationalization of SMEs and international entrepreneurship. Network relationships allow companies to gain knowledge about overseas markets, expand their operations, and increase net income (Lakew, 2015). The network approach emphasizes the importance of interconnected contacts between companies and the exchange of resources between different overseas clients (Kunday and Senguler, 2015; Roque et al., 2019). The born global theory, developed by McKinsey Co. and Rennie in the early 1990s, refers to the internationalization of SMEs (Kunday and Senguler, 2015). The companies, known as "born globals", are involved in international markets from the start (Kunday and Senguler, 2015). They use intangible resources like new technologies and international market knowledge in a cost-effective way, competing quickly due to their entrepreneurial vision and commitment (Kunday and Senguler, 2015). Entrepreneurship is an important activity for companies that aim to expand their activities across national boundaries. International entrepreneurship, defined by McDougall & Oviatt in 2000, involves innovative, risk-seeking behaviours that cross national borders to form value within a company (Kim, 2018). International entrepreneurship focuses on entrepreneurial capabilities such as networking, marketing, innovation, learning, and experience, which enhance business performance and maintain a competitive advantage in overseas markets (Kunday and Senguler, 2015).

Internal Export Barriers

The knowledge and information of an employee is crucial for firms' competitiveness in foreign markets and innovation through international interaction (Pena-Vinces et al., 2016; Mupenga, 2016). Thus, employees' export-related knowledge and information positively impacts a firm's internationalization (Mupenga, 2016; Madushanga and Sachitra, 2021), but it is insignificant (Pena-Vinches et al., 2016; Gebrewahid, 2016). Technology gives SMEs an edge in developed nations, while low prices help in developing countries (Fernando and Samarakoon, 2021). It improves product quality, operational accuracy, reduces costs, and allows access to markets (Nishantha, 2018). Technology abilities have an insignificant impact on SME exports performance (Fernando and Samarakoon, 2021; Mupenga, 2016). SMEs need ample funds for internationalization to cover costs like market research, trade fairs, etc. (Madushanga and Sachitra, 2021). Good financial condition increases firms' exports, but shortage of financial resources significantly hinder their export competitiveness (Madushanga and Sachitra, 2021). Marketing information influences SMEs' internationalization (Handoyo et al., 2021), but lack of market knowledge hinders

export activities in developing countries (Biswas et al., 2017). Marketing information has an insignificant impact on SMEs' internationalization (Madushanka and Sachitra, 2021).

External Export Barriers

SMEs face challenges in foreign market environments due to various procedural factors like business registration, regulations, and product requirements that make a significant effect on the export performance (Fernando and Samarakoon, 2021; Mupemhi et al., 2013). Thus, procedural factors positively impact on SME firms' export performance during internationalization (Mupenga, 2016), though they have negative impact (Fernando and Samarakoon, 2021; Gebrewahid, 2016). Though SMEs get aids and guidelines from government for their growth (Madushanka and Sachitra, 2021), they face challenges due to lack of awareness programs on exporting (Fernando and Samarakoon, 2021). However, government support positively impacts SMEs' export performance (Madushanka and Sachitra, 2021). Since SMEs in foreign markets have diversification, differentiation, and meeting quality standards, their task related factors positively impact their export performance in international markets (Fernando and Samarakoon, 2021; Gebrewahid, 2016). Environmental factors, such as economic, political, legal, and socio-cultural factors, hinder a company's export performance, and entrepreneurs need to adapt strategies to international consumers' characteristics (Pena-Vinces et al., 2016). According to Gabrewahid (2016), environmental factors negatively impact the export performance of SMEs.

3. Methodology

Data

A structured questionnaire in this study for the period from 2019 to 2021 was used to collect primary data using purposive sampling from 165 exporting SMEs engaged in the processed food and beverage industry in 18 Districts in Sri Lanka. The respondents in this study were owners or managers of SMEs.

Conceptual Framework

Figure 1 shows the conceptual frame of the study. SMEs' internationalization measured by export performance is the dependent variable, which includes four indicators such as export sales performance, total sales performance, export profitability, and exports as a percentage of production, and these indicators were measured qualitatively using a five-point Likert Scale from very poor (1) to very high (5). The independent variables are internal and external export barriers, and they each have four indicators as shown in Figure 1. These indicators altogether consist of 36 sub-indicators, which were measured using a five-point Likert Scale from least barriers (1) to major barriers (5) and their decision rule is that $Ho_i: \mu_i \leq 3$ (which relates to the medium point in the scale) indicating that all sub-indicators of internal and external export barriers considered by respondents are not significantly perceived barriers for their respective SME firms' internationalization. Where, i denotes sub-indicators of internal and external export barriers from 1 to 36 as shown in Table 1 and Table 2.

Internal Export Barriers • Informational Barriers • Functional Barriers • Financial Barriers • Marketing Barriers	→	Internationalization of SMEs	←	External Export Barriers • Procedural Barriers • Governmental Barriers • Task Barriers • Environmental Barriers

Figure 1. Conceptual Framework

Table 1. Perception of Sri Lankan SMEs on Internal Exporting Barriers

Indicators of Internal Exporting Barriers	Mean	p*
Informational barriers		
Availability of adequate skilled manpower in improving the competitiveness of companies in overseas markets	2.27	1.00
Adequate information of understanding about overseas markets	2.76	0.10
Availability of adequate manager's knowledge of internationalization	2.52	1.00
Availability of adequate staff with international experience to deal with export and export related activities	3.32	0.00
Functional barriers		
Adapting the latest production techniques, introducing innovative products and increasing productivity enhance export performance	2.45	1.00
Meeting high production costs and declining market competitiveness by using low production technology	2.50	1.00
Utilization of ICT is important to grow for long term business success	2.73	1.00
ICT capability supports to detect and monitor remote and foreign markets	2.75	1.00
Facing many challenges in adopting new technologies (implementation cost, security, customer readiness, inadequate knowledge of ICT)	2.78	0.10
Technology is important in connecting with partners, suppliers and overseas customers	3.31	0.00
Financial barriers		
Availability of adequate capital to finance exports, cover export related costs and conduct market research etc. in foreign markets	2.35	1.00
Availability of adequate cash flow to manage with entry costs and access to overseas markets	2.41	1.00
Sufficient knowledge about banking facilities and procedures	2.69	1.00
Ability to provide collateral to get loans from banks	3.35	0.00
Marketing barriers		
Sufficient knowledge of international markets related to the cultures, traditions and values of certain communities in foreign countries enabling in understanding foreign markets	2.67	1.00
Sufficient knowledge of international markets enabling SMEs to connect with foreign business partners and enhance product innovation capabilities	2.77	0.99
Sufficient knowledge in conducting research in foreign markets to identify potential market opportunities	3.70	0.00
Specific data sources about marketing are easily accessible	3.78	0.00
Adaptation of proper management strategies to achieve the right balance both domestic and international market	2.93	0.92

Source: Authors' Calculation

Note: *indicate the level of significant at 5%

Factor Analysis

Factor analysis in this study was used to reduce the indicators of export performance, internal and external export barriers. Accordingly, Principal component analysis was applied to reduce the indicators into a small and meaningful factor with support of Stata software.

Econometric Model

This study applied the econometric model presented below to assess the impact of internal and external export barriers on Sri Lankan SMEs' internationalization.

$$\text{Ln } Y_i = \beta_0 + \beta_1 \sum_{h=1}^{m} A_{ih} + \beta_2 \sum_{j=1}^{n} B_{ij} + \varepsilon_i \qquad (1)$$

Where, $\text{Ln } Y_i$ indicates SMEs' internationalization in terms of export sales performance (i = firm 1 to 165), A_{ih} denotes the vector of factor scores of condensed internal export barriers (includes functional, informational and functional, marketing, financial and marketing new barriers), B_{ij} denotes the vector of factor scores of condensed external export barriers (includes procedural, task and environmental, and governmental barriers), and ε_i indicates error term.

Table 2. Perception of Sri Lankan SMEs on External Exporting Barriers

Indicators of External Exporting Barriers	Mean	p*
Procedural barriers		
Sufficient knowledge on the requirements of export documentations	2.06	1.00
Availability of proper business support organizations to help in preparing documents for exports	2.51	1.00
Availability of common foreign trade agreements to assist in entering the international markets	4.23	0.00
Availability of smooth and easy procedures for SMEs in Sri Lanka to start businesses and obtain export accreditation	2.08	1.00
Meeting various restrictions on selling goods in foreign markets (entry restrictions, price restrictions, special taxes and exchange restricts)	2.32	1.00
Meeting the requirements of patents and trademarks in foreign country	2.82	0.95
Meeting tariffs that restrict imports, make local goods more attractive and increase government revenue	2.48	1.00
Meeting custom procedures, product requirements and financial restrictions that prevent profitable business transaction in foreign markets	2.39	1.00
Governmental barriers		
Availability of favourable domestic rules and regulations for exports	2.63	1.00
Availability of adequate government assistance programmes to overcome export obstacles	2.76	1.00
Availability of adequate financial institutions to facilitate the export operations	3.00	0.50
Availability of adequate institutional support for awareness programmes and export promotional activities	3.31	0.00
Availability of a stable national policy for the development of SMEs in Sri Lanka	3.92	0.00
Task barriers		
Meeting keen competition in foreign markets such as productivity, quality standard of products, cost, smooth flow of operations and time to launch their products etc.	4.18	0.00
Environmental barriers		
Meeting currency fluctuations, supply and demand fluctuations of companies that competing in the new market	4.26	0.00
Meeting socio-cultural differences of foreign consumers (culture, language, religion, attitudes, customs, educational status, race, etc.)	4.29	0.00
Availability of adequate infrastructure facilities (road networks, power supply etc.)	3.81	0.00

Source: Authors' Calculation

Note: *indicate the level of significant at 5%

4.   Results and Discussions

Table 1 shows the perceptions of Sri Lankan SMEs on internal export barriers. According to Table 1, only five indicators of internal export barriers were significantly perceived as internal barriers for SMEs' internationalization in Sri Lanka ($\mu_i > 3$, p-values < 0.05).

Table 2 shows the perceptions of Sri Lanka SMEs on external export barriers. According to Table 2, only seven indicators of external export barriers are significantly perceived as external barriers for SMEs' internationalization in Sri Lanka ($\mu_i > 3$, p-values < 0.05). Therefore, according to Table 1 and Table 2, only twelve (12) indicators of internal and external export barriers were significantly perceived as barriers in this study and these barriers have negative influences on the internationalization of Sri Lankan exporting SMEs. The extent of impact of these indicators will be discussed in the subsequent econometric model.

Table 3 and Table 4 show the results of the principal component analysis with orthogonal Varimax rotation to condense 19 internal export barriers and 17 external export barriers to a small number of underlying groups of factors in order to utilize them as independent variables in the subsequent econometric model to demonstrate their impact on the internationalization of SMEs in Sri Lanka.

Table 3. Rotated Component Matrix of Internal Export Barriers

Factor Groups	Mean	1	2	3	4	5
Functional barriers						
ICT capability supports to detect and monitor remote and foreign markets	2.75	0.93				
Utilization of ICT is important to grow for long term business success	2.73	0.91				
Facing many challenges in adopting new technologies (implementation cost, security, customer readiness, inadequate knowledge of ICT)	2.78	0.90				
Technology is important in connecting with partners, suppliers and overseas customers	3.31	0.68				
Meeting high production costs and declining market competitiveness by using low production technology	2.50	0.52				
Informational and functional barriers						
Availability of adequate skilled manpower in improving the competitiveness of companies in overseas markets	2.27		0.78			
Availability of adequate manager's knowledge of internationalization	2.52		0.77			
Adequate information of understanding about overseas markets	2.76		0.74			
Availability of adequate staff with international experience to deal with export and export related activities	3.32		0.72			
Adapting the latest production techniques, introducing innovative products and increasing productivity enhance export performance	2.45		0.56			
Marketing barriers						

	Mean					
Sufficient knowledge of international markets related to the cultures, traditions and values of certain communities in foreign countries enabling in understanding foreign markets	2.67			0.84		
Sufficient knowledge of international markets enabling SMEs to connect with foreign business partners and enhance product innovation capabilities	2.77			0.83		
Adaptation of proper management strategies to achieve the right balance both domestic and international market	2.93			0.57		
Financial barriers						
Sufficient knowledge about banking facilities and procedures	2.69				0.78	
Ability to provide collateral to get loans from banks	3.35				0.76	
Availability of adequate cash flow to manage with entry costs and access to overseas markets	2.41				0.66	
Availability of adequate capital to finance exports, cover export related costs and conduct market research etc. in foreign markets	2.35				0.61	
Marketing new barriers						
Specific data sources about marketing are easily accessible	3.78					0.90
Sufficient knowledge in conducting research in foreign markets to identify potential market opportunities	3.70					0.86
Eigen value		8.73	2.18	1.48	1.36	1.22
Variance explained in %		21.6	16.7	16.2	13.5	10.7
Cumulative variance in %		21.6	38.3	54.5	68.0	78.7
Kaiser-Meyer-Olkin measure of sampling adequacy 0.844 Bartlett test of sphericity Approximate Chi-square 2955.945, Degrees of freedom 171, Sig. 0.000 Extraction method: Principal component factors, Rotation method: Orthogonal varimax						

Source: Authors' Calculation

According to Table 3, the analysis produces five factor groups with eigenvalues greater than 1, accounting for 78.7% of the total variance in 19 indicators of internal export barriers, and their respective regression factor scores are used in the final econometric model as independent variables. The first factor related to functional barriers consists of five indicators, the second factor related to informational and functional barriers covers five indicators, the third factor is consisting of three indicators related to marketing barriers, the fourth factor includes four indicators that related to financial barriers, and the fifth factor consists of two indicators related to marketing new barriers.

According to Table 4, the analysis produces three factor groups with eigenvalues greater than 1, accounting for 67.7% of the total variance in 17 indicators of external export barriers, and their respective regression factor scores are used in the final econometric model as independent variables. The first factor related to procedural barriers consists of eight indicators, the second factor related to task and environmental barriers covers four indicators, and the third factor is consisting of five indicators related to governmental barriers.

Table 5 shows the results of the factor analysis used to condense the four indicators of export performance, such as export sales performance (factor 1), total sales performance (factor 2), export profitability (factor 3), and exports as a percentage of production (factor 4). According to Table 5, factor 1 explains 71.44% of the total variance, and its regression factor score is used as the dependent variable (export sales performance) in the subsequent analysis of the econometric model for the internationalization of Sri Lankan SMEs.

Table 4. Rotated Component Matrix of External Export Barriers

Factor Groups	Mean	1	2	3
Procedural barriers				
Meeting custom procedures, product requirements and financial restrictions that prevent profitable business transaction in foreign markets	2.39	0.89		
Meeting tariffs that restrict imports, make local goods more attractive and increase government revenue	2.48	0.86		
Meeting various restrictions on selling goods in foreign markets (entry restrictions, price restrictions, special taxes and exchange restricts)	2.32	0.84		
Availability of smooth and easy procedures for SMEs in Sri Lanka to start businesses and obtain export accreditation	2.08	0.81		
Sufficient knowledge on the requirements of export documentations	2.06	0.78		
Meeting the requirements of patents and trademarks in foreign country	2.82	0.78		
Availability of proper business support organizations to help in preparing documents for export	2.51	0.77		
Availability of common foreign trade agreements to assist in entering the international markets	4.23	0.53		
Task and environmental barriers				
Meeting socio-cultural differences of foreign consumers	4.29		0.90	
Meeting currency fluctuations, supply and demand fluctuations of companies that competing in the new market	4.26		0.82	
Meeting keen competition in foreign markets such as productivity, quality standard of products, cost, smooth flow of operations and time to launch their products etc.	4.18		0.76	
Availability of adequate infrastructure facilities	3.81		0.71	
Governmental barriers				
Availability of adequate financial institutions to facilitate the export operations	3.00			0.79
Availability of adequate institutional support for awareness programmes and export promotional activities	3.31			0.76
Availability of a stable national policy for the development of SMEs	3.92			0.63
Availability of adequate government assistance programmes to overcome export obstacles	2.76			0.63
Availability of favourable domestic rules and regulations for exports	2.63			0.59
Eigen value		7.90	2.11	1.49
Variance explained in %		34.6	17.3	15.8
Cumulative variance in %		34.6	51.9	67.7
Kaiser-Meyer-Olkin measure of sampling adequacy 0.889 Bartlett test of sphericity Approximate Chi-square 2050.223, Degrees of freedom 136, Sig. 0.000 Extraction method: Principal component factors, Rotation method: Orthogonal varimax				

Source: Authors' Calculation

Table 5. Factor Analysis of Export Performance Indicators

Factor	Eigen Value	% of Variance	Cumulative %	Extracted factor		
				Eigen Value	% of Variance	Cumulative %
1	2.858	71.44	71.44	2.858	71.44	71.44
2	0.811	20.27	91.72	-	-	-
3	0.246	6.14	97.86	-	-	-
4	0.086	2.14	100.00	-	-	-
Kaiser-Meyer-Olkin measure of sampling adequacy 0.757						
Bartlett test of sphericity						
Approximate Chi-square 488.789, Degrees of freedom 6, Sig. 0.000						
Extraction method: Principal component factors						

Source: Authors' Calculation

Table 6. Model for Internal and External Export Barriers to SMEs' Internationalization

Variables	Coef.	Robust Std. Err.	t	p	VIF	Tolerance
(Constant)	0.240***	.026	9.19	0.000	-	-
REGR factor score 1 of internal barriers (functional barriers)	-0.135***	.030	-4.51	0.000	1.26	0.796
REGR factor score 2 of internal barriers (informational and functional barriers)	-0.078*	.030	-2.60	0.010	1.25	0.801
REGR factor score 3 of internal barriers (marketing barriers)	-0.066	.036	-1.83	0.068	1.90	0.525
REGR factor score 4 of internal barriers (financial barriers)	-0.120***	.035	-3.44	0.001	1.20	0.830
REGR factor score 5 of internal barriers (marketing new barriers)	-0.076*	.030	-2.50	0.013	1.08	0.928
REGR factor score 1 of external barriers (procedural barriers)	0.118**	.041	2.90	0.004	2.31	0.434
REGR factor score 2 of external barriers (task and environmental barriers)	0.027	.033	0.83	0.409	1.16	0.860
REGR factor score 3 of external barriers (governmental barriers)	-0.023	.033	-0.69	0.492	1.20	0.837
Observations = 165, F (8, 156) = 6.95, p-value = 0.000, R-sq. = 0.222						
Dependent Variable: REGR factor score of SMEs' internationalization (export sales performance)						

Source: Authors' Calculation

Note: *, **, and *** indicate the level of significant at 5%, 10%, and 1% respectively

Table 6 shows the model for internal and external export barriers to SMEs' internationalization in Sri Lanka. The model revealed that four factor scores of condensed internal export barriers, including functional, informational and functional, financial, and marketing new barriers, are negatively related to Sri Lankan SMEs' internationalization. Accordingly, the negative relationship between functional barriers and SMEs' internationalization in Sri Lanka implies that SMEs are unaware of the significance of using technology to engage with partners, suppliers, overseas customers, which contradicts the findings of Fernando and Samarakoon (2021).

The negative relationship between informational and functional barriers and SMEs' internationalization in Sri Lanka indicates that SMEs lack adequate staff with international experience to handle export and export related activities, as opposed to the findings of Mupenga (2016) and Madushanga and Sachitra (2021). Also, the negative relationship between financial barriers and SMEs' internationalization suggests that SMEs lack the surplus ability to provide collateral for bank loans to grow their enterprises, which contradicts the findings of Madushanga and Sachitra (2021).

Further, because SMEs lack the necessary knowledge to conduct research in foreign markets to identify potential market opportunities, as well as easy access to specific data sources on marketing, there is a negative relationship between marketing new barriers and the internationalization of SMEs, which contradicts the findings of Madushanka and Sachitra (2021).

The model also revealed that one factor score of condensed external export barriers, such as procedural barriers, found to be positive and significant relationship with Sri Lankan SMEs' internationalization. This positive relationship implies that Sri Lankan SMEs have sufficient knowledge on export procedures, laws, and regulations that favour their entry into global markets, which is consistent with the findings of Mupenga (2016).

5. Conclusion and Recommendation

This study investigated how export barriers hinder Sri Lankan SMEs' internationalization. The findings revealed that four internal export barriers (functional, informational and functional, financial, and marketing new barriers) negatively related to SMEs' growth into foreign markets, causing to a decrease in their internationalization. However, one external export barrier (procedural barriers), positively helps their internationalization efforts.

Therefore, it is recommended that educating SMEs on utilizing current technology for communication and virtual interaction with their overseas customers, recruiting staff with global business expertise to grasp foreign markets, guiding public and private initiatives for financial support for export expansion, and utilizing online platforms for market research and understanding consumer behaviour, market trends, and competitor analysis can facilitate SMEs to enhance their performance in international markets, which positively impact the country's macroeconomic environment.

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