

## The Effect of Organizational Structure on Performance: an Empirical Study of Small and Medium Enterprises in Sri Lanka

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### ABSTRACT :

**Purpose** – The objective of this article is to investigate the effect of organizational structure on performance of Small and Medium Enterprises in Sri Lanka.

**Design/methodology/approach** – This study examines the impact with respect to the different theories, models and approaches. Taking into account the Lumpkin and Dess model as well as the Resource-Based View of the establishment, a conceptual model was formulated. A structured survey questionnaire was used to collect data from a sample of 383 Small and Medium Enterprise holders. On collecting empirical survey data within the Sri Lankan Small and Medium Scale industry, a structural equation modeling was done to evaluate the measures and test the hypotheses formed on the impact of the main two constructs.

**Findings** – The present research perspective descriptive and inferential statistics were included in the analysis. Organization structure was represented by seven dimensions to study the impact and the findings denoted that only five dimensions namely Specialization, Departmentalization, Span of Management, Hierarchy, Delegation were positively linked to business performance: Formalization and Coordination have insignificant impact on business performance. Therefore, a statistically significant impact was shown by the five dimensions of the organizational structure on Performance of Small and Medium Enterprises while statistically insignificant effect was illustrated by the dimensions of Formalization and Coordination.

**Research limitations/implications** – The study was carried out in the small and medium industry in Sri Lanka and effort was taken to improve the validity of the study by removing external factors. Hence, the study results need to be inferred and practiced carefully while future research needs to replicate the tests in diverse circumstances or encompass the present research to incorporate other pertinent aspects.

**Practical implications** – In the present context small businesses in Sri Lanka are very much hesitant to recognize the importance of structure of the establishment which is a primary concern for differentiation. It is crucial for small businesses to convert to large category and accomplish a manageable organizational structure to increase the business performance in order to achieve improved prosperity for the country.

**Originality/value** – This research would add to the existing, limited knowledge on the appropriate organizational structures for improving performance of the businesses.

**KEYWORDS:** Sri Lanka, Organizational structures, Growth of the business, Performance of SME sector, Profitability

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### I. INTRODUCTION

The organizational structure (OS) has formed a major implication in the existing research and development in many disciplines and attracting much attention. OS exhibits a widespread inference in relation to the diverse systems of activities in the institute; types of handling the limited resources; and delegation of authority between key persons in a systematic method enabling harmonization with the aim to reach the common objective. Literature suggests that many research in relation to business emphasize on new markets of business hoping to access market share, the customers' assets and the employees of current low profile businesses (Lackeus, 2018). Due to the limited studies available it is not easy to generalize accurate outcomes with regard to impact of OS on performance of SMEs in different circumstances of developing countries in the world. However, several research indicate that OS is regarded as a major factor responsible for the performance of SME [6]. It is prominent that businesses conducted with regular data collection and analysis, apart from goal setting and human resource processes aimed at performance of SMEs, exhibited increased output as well as reaching higher status and growth in contrast to businesses that are restricted to few prescribed management activities [10]. Although this assumption can be observed in manufacturing industries due to the much research done in this

field, this feature could also be seen in the service industries. The purpose of this article is mainly to investigate the impact of OS on performance of SMEs in diverse fields that can direct to further studies in the future considering the role of the SMEs in various parts of the world. Seven elements of organizational structure have been recognized for studying with regard to the performance of SMEs. Based on the significance of the dimensions of OS the research question is developed as “How is the impact of Organizational Structure over the Performance of SMEs in Sri Lanka”? At present if due attention is not given to the difficulties and failures confronted by the SMEs in conducting their businesses, these might become critical concerns to the structures of the establishments. SMEs have the objective of acquiring proper knowledge and skills which are beneficial to their businesses. Therefore, the need to keep the strategic type of SME attitude to create a characteristic structure and a higher level of environment showing the SMEs behavior is essential.

The theories of OS are assumed to be relevant to the formation of an internal situation within the SMEs allowing planned procedures, activities and decision-making actions in the business establishment [11]. The manner exhibited in business approach is the aspect of OS as all such activities are associated with SME traits, attitudes and behaviors [12]. Hence, OS is a vital element required for SME to run a business to perform successfully. OS indicated a positive impact on performance of SMEs [13] and similar relationships observed for OS dimensions of Specialization, Departmentalization, Span of Management, Hierarchy, Delegation, Formalization, and Coordination. The major emphasis of existing literature on OS is restricted to internal processes of the business of the SME sector and a scarcity of research investigating OS at diverse levels is seen. It is essential to examine OS at the level of SME since it is related to the person’s decisions which affect the Performance of SMEs. The fewer number of research carried out on OS at dimension [16] level is a serious situation and the scarcity of studies based on OS is evident [17], [18].

## **II. LITERATURE REVIEW**

Establishments in the SME sector are primarily reflected as the backbone of national economy of a country [23] and said to be the dynamic power of progress in the developed and developing countries [24]. Many academics identify the factors responsible for SME performance in a wide range as indicated in the literature. The impact of these factors are differ between nations based on the geographical, economic and cultural aspects and is imperative that the determinants are classified in dissimilar manner. In the present context Performance of SMEs, is known to be determined largely by the internal factors of the establishment and OS is regarded as one of those [25]. OS is primarily identified as the method distribution of work, resources and authority, organized and synchronized in order to achieve the common objective. Many scholars are in agreement with this concept based on their research findings. [26]. Several SMEs having entrepreneurial attitude, shows the combination of the real effect of market and others exhibit the adequate level of businesses. The theoretical opinion expressed by Lumpkin and Dess model exhibiting realistic deliberation for selected variables including OS and Performance of SMEs [30] is the basis for this article. At first the OS is explained with definitions and descriptions along with its components, determinants and the mechanistic and the organic models.

Scholars unswervingly accept the impact of OS on SME performance. The method objectives and policies are organized and resource allocation procedure are reflected by the structure of an organization and primarily focused on OS [33]. Hence, any shortcomings to connect structure appropriately with policies could have severe effect on implementation of the strategies of the organization as a result of the direct impact, the structure of an organization has on the competitive advantage element [34]. Distribution of labour, departmentalization, hierarchy of power, span of control, and delegation have been identified as structural dimensions by several research studies [32]. Some other evaluations indicate work specialty, departmentalization, chain of command, span of control, delegation of power and formalization as five requirements to be the components of OS [15]. Earlier research suggests that different instruments were used as adaptations for Performance of SMEs [37]. Mostly, measuring BP in small businesses were done according to economic point of view. Performance of the SME sector can be measured by many different methods. Academics and other interested persons examine this notion in numerous ways. Goal Approach and System Approach in their theoretical frameworks agree with determining the efficiency in order to measure the consumption of resources in a business. Further, as literature indicates traditional and new methods are being used for measuring Performance of SMEs in Sri Lanka[38]. Conventional methods of measuring the performance of SME cannot be used to evaluate variations that occurs in a competitive environment and strategies of ongoing businesses, and the requirement of special application systems is emphasized [38]. The results of an empirical study on the financial literacy and Performance of SME in free economy businesses, that was carried out in Ecuador using a sample of 750 microenterprises indicated that both financial literacy and role models are essential for evaluating Performance of SME for some but not all [41]. Another research done in the USA with a sample of 300 new establishments revealed that the link

between OS and Performance of SME is affected by political networking negatively in a moderating way while financial networking showed a reverted U-shaped link and business networking displays an obvious link. These findings elaborate the effect of managerial networking on the performance of new establishments and the importance practice of the structural form with different managerial networking systems in new businesses to improve the growth in the varying economy in China[42].

### Relationship of Organizational Structure on Performance of SMEs

Literature exposed the effect of OS on Performance of SMEs as the outcome of using different methods of perspectives. Small businesses carryout simple systems illustrated by few specialty fields; smaller number of departments; greater scope of management; increased centralization; a lesser number of hierarchical levels; and little formalization [6]. Nevertheless, it is vital to have this structural system restyled to incorporate unhindered performance as a business develops. It is the view of some authors that structure should be in relation to strategy which is an elementary principle in OS and policies of modern business establishments need to be accompanied with innovation, cost-minimization and imitation [6]. It is apparent that these strategies are primarily comparable to OS dimensions used in this research study. Consequently, this explanation confirms the association between OS on Performance of SME. Further, in view of several arguments it is possible to establish that OS shows a positive link with suitable business performance of SME [6]. In order to get optimum progress, it is necessary to have suitable mix between OS on Performance of SME [43]. These research findings demonstrate that OS-Performance association is positively affected by organic structure, and mechanistic structure has a negative influence on this link. Nevertheless, it is established that mechanistic structures could support enhanced performance for conservative, non-entrepreneurial establishments. Further, it has also been proved that OS boosts performance of large scale businesses in addition to SMEs as supported by organic structures [44]. Henceforth, as literature indicates the effect of OS on Performance of SMEs is demonstrated with the use of different types of views.

### III. DATA AND METHODOLOGY

Research procedure for developing the research objectives and research questions led to research strategy and the research instruments. The major focal point of this study is the methods used to evaluate the research problem as mentioned in the synopsis. This segment suggests to bring about how and to what extent OS impacts on Performance of SMEs. The research study engaged 35 indicators for OS, out of which only 29 remained for the final analysis, and and 11 indicators for Performance of SMEs. Structured Survey Questionnaire (SSQ) method of data collection was carried out. Through this questionnaire, which was the survey instrument, the respondents' awareness of OS on Performance of SMEs was obtained. Simple random sampling method was used to select the sample of 383 SMEs in the Western Province of Sri Lanka, and the unit of analysis was the entrepreneur who runs his/ her businesses. The data were analyzed using SPSS and Structural Equation Modeling (SEM) technique as well as AMOS.

**Proposed Conceptual Model:** At the inception scientific research based on a theoretical framework were mainly referred in order to develop the hypotheses. Theoretical framework consists the researcher's point of view on the relationship of the variables in the conceptual model which is the basis of hypothetico-deductive research, and the researcher's justification of theoretical link of the variables (Sekaran & Bougie, 2013). This research study attempts to examine the SME performance with assistance of some variables of OS that can be organized, in the conceptual framework. Fig. 1 denotes the conceptual framework prepared for this research based on the literature.

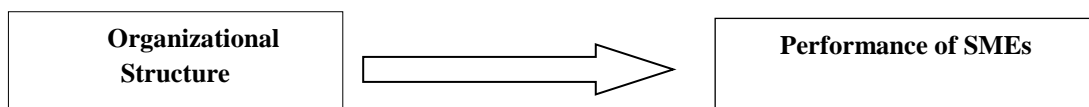


Figure.1: The Conceptual Framework

**Research Hypotheses:** In respect to the relationships demonstrated in the theoretical framework, the hypotheses were developed for this research study. Theory-based evidences arising from the literature survey led the path for the conceptual framework and for the potential relationships among the two variables of OS on Performance of SMEs while it authenticates these links between the variables.

The following hypotheses were formulated as per the conceptual framework of the study for empirical testing:

**Hypothesis 1:** There is an association between Specializations on the Business Performance of SMEs

**Hypothesis 2:** There is an association between Departmentalization on the Business Performance of SMEs

**Hypothesis 3:** There is an association between Span of Control on the Business Performance of SMEs

**Hypothesis 4:** There is an association between Hierarchy on the Business Performance of SMEs

**Hypothesis 5:** There is an association between Delegation on the Business Performance of SMEs

**Hypothesis 6:** There is an association between Formalization on the Business Performance of SMEs

**Hypothesis 7:** There is an association between Coordination on the Business Performance of SMEs

**Data Collection Process:** Data collection, data coding, and data analysis are the three processes included in the data analysis process and statistical technique of data analysis, and ethical consideration were given due consideration. Planning of the data collection procedure was done carefully paying attention to access of exact data, method of data collection, and the process of data collection [45]. Primary and secondary data were used for this study, and primary data on OS and business performance of SMEs were collected through a structured questionnaire. In addition, demographic information of individual SMEs too was obtained. Secondary data were assembled with the use of on-line empirical and conceptual studies and published journals, reports of local and foreign institutes.

**Test Procedures for Instrument Development:** The stages of assessing a thesis for the reliability and validity measurements of the instrument, are pilot-test and actual test in a sequence. The measurement of data was carried out with statistical techniques during these stages for various tests.

#### IV. FINDINGS AND DISCUSSIONS

The primary objective of this article is to examine the relevant data to find the effect of a few selected dimensions of OS on Performance of SMEs in the Western province of Sri Lanka. Data collection was carried out by distributing the structured questionnaire among 383 SMEs holders of the sample. The Software Package of Social Sciences (SPSS- version 23) and Structural Equation Modeling (SEM) as well as AMOS techniques were used for analysis of data. Evaluating the impact of dimensions of OS on the Performance of SMEs of the selected sample was led by quantitative analysis carried out to test the hypotheses. Multivariate data analysis technique of testing the Measurement Model and the Structural Model in order to evaluate the relationship are the two major step of SEM. [46] The seven dimensions of OS that were selected to assess the impact of OS on Performance of SMEs are Specializations, Departmentalization, Span of Management, Hierarchy, Delegation, Formalization, and Coordination (Lumpkin & Dess, 2005), and 35 indicators were used to measure these. The dependent variable was Performance of SMEs evaluated by taking into account Profitability, Growth and Owner Satisfaction which were measured by 11 indicators.

Five point Likert scale was used to obtain the responses from the sample. The reliability of the instrument was tested through Cronbach's Alpha, and the validity was assessed by factor analysis. Initial data screening was conducted on getting the completed questionnaires, in order to have an accurate data set for the analysis. Based on the outcomes of the Pre-test the questionnaire was revised to be used for the pilot test. The 62 answers obtained at the pilot test were analyzed using Cronbach's Alpha for reliability ( $> 0.7$ ) and Factor analysis to assess validity ( $> 0.5$ ). Subsequently, final test was conducted for the sample of 383 SMEs in the Western province of Sri Lanka to obtain responses which were analysed. Construct validity was calculated and factor analysis was deliberated as the most appropriate validity test, in this process of the analysis. Exploratory Factor Analysis (EFA) was done for this purpose. The results for the KMO value indicated as 0.830 and 0.921 for Business Performance and Organizational Structure respectively with significant is 0.001 for both constructs. Values higher than 0.7, which is the threshold point of KMO, were obtained of the variables, establishing factor analysis to satisfy sample adequacy. Since all the variables show significant value of 0.001 at Bartlett's test of Sphericity the variables are correlated. Since EFA values are greater than the threshold of 0.5, the interrelationship between the Performance of SMEs and its selected dimensions along with indicators are exhibited. This is satisfactory level under the decision criteria. At the end, based on the EFA value, forty two items out of forty six were acceptable. Performance of SMEs was confirmed by three factor loadings and seven factor loadings interpreted OS. Further, it has indicated that values higher than 0.7 were shown for dimensions at the reliability analysis of Performance of SMEs.

The two main criteria, validity and the reliability represented satisfactory level of measurement for the instrument to be used at the actual test of the study. As descriptive statistics indicated nearly 50% of the medium values for profitability, growth, owner satisfaction, specialization, and departmentalization, span of management, hierarchy, delegation, formalization and coordination were higher than the mean value. In



addition, the SEM technique was done for the data analysis process as a combination of path analysis and factor analysis. Therefore, the two steps of validating measurement models using confirmatory factor analysis (CFA) and fitting a structural model through path analysis are involved in the SEM process.

**Reliability in Measurement Model:** This analysis involved Reliability of the latent construct. In order to be entitled to be considered as the assumed criteria for the measurement, Internal reliability of Alpha value should be 0.7 or higher while Composite or Construct Reliability (CR) value be 0.7 or above and AVE value 0.5 or more. This study incorporates 46 measured indicators with 10 variables. Test of validity and reliability indicated the numbers of indicators as BP contained within 11 indicators and OS limited to 31 indicators by removing the 4 indicators: SM4, SM5, FO5 and CO4 of OS.

**Measurement Model for Performance of SMEs:** The three performance dimensions were tested using first model. The initially analyzed model indicated MM in three parts as PF, GR and OW as an individual. The need to modify the model was suggested by initial MM of Performance of SMEs. The critical value for multivariate kurtosis was 46.571 as regression weights, and CR values showed in the multivariate normality test. Since this is higher than 5 a modification is required as the assumption of multivariate normality is not fulfilled.

All the factor loadings were higher than 0.5 as the results revealed. Further, AVE values too were greater than 0.5 which is higher than the relevant AVE values while the CR values were higher than 0.7. MM output has Chi-square value of 1733.58 which should be stated as  $p > 0.05$  was estimated by modified measurement model of the OS. The obtained RMSEA value was 0.076 which should be less than 0.08. Further GFI value indicated to be 0.801 and AGFI was 0.767 which need to be higher than 0.09 while Chi/df was 3.216 which required are less than 0.5 that suggest the necessity to modify the MM. The projected modified measurement model for the construct of OS is presented. The modified MM obtained an output of a Chi-square value of 1156.52 which need be presented as  $p > 0.05$ . RMSEA value was gained as 0.066 which should be less than 0.08. Value of 0.850 was obtained for GFI, 0.816 for AGFI which should be greater than 0.09 and the value for Chi/df was 2.677 which need to be less than 0.5. Values higher than 0.5 were gained for all the factor loadings and and the AVE values were greater than 0.5. Values of the CR were higher than 0.7 and the CR values reflected greater than respective AVE values. Considering the modified measurement model with the correlations  $> 0.7$  a strong positive link between OS and performance of SMEs can be seen. The seven sub dimensions of OS which were analyzed to find the effect of the variables in the Hypotheses are Specialization, Departmentalization, Hierarchy, Span of Management, Delegation, Formalization and Coordination.

**The Impact of Dimensions of Organizational Structure on Performance of SMEs :** The validity of OS was measured with seven selected dimensions of OS and the impact of SP, DP, HI, SM and DL dimensions supported towards an impact on Performance of SMEs. However FO and CO did not support. The relationships between the dimensions of OS and Performance of SMEs as indicated by the hypotheses were computed. Only five dimensions of OS illustrates consistent values of path coefficient that have an impact on Performance of SMEs with statistically significant strong positive associations. However Formulation and Coordination dimensions showed an insignificant impact.

**Hypotheses Testing :** This study attempts to evaluate impact of OS dimensions on business performance of SMEs in the Western province of Sri Lanka. Therefore seven selected dimensions of OS were examined to evaluate its impact on Performance of SMEs, using the sample. Subsequently, an evaluation was conducted on the seven hypotheses, H1 to H7 that were developed taking into account the seven dimensions corresponding to OS construct.

***H1: Specialization has a significant impact over the Business Performance***

The effect of Specialization (SP) on Performance of SMEs is stressed by hypothesis one. A positive impact between these two variables are observed as the path coefficient value is 0.030. Further, a statistically significant impact of SP on Performance of SMEs can be seen as CR value was 3.882 and P value was less than 0.05. Henceforth, a positive effect between these two variables is demonstrated. This finding is compatible with previous research [14],[31],[32]. A large number of researches confirm a direct impact of SP on Performance of SMEs [14]. This indicates that SP is a vital constituent on Performance of SMEs business in the Sri Lankan context too. This highlights that SMEs are attentive to this fact that SP in the Sri Lankan context has an effect on Performance of business environment which can improve the capability of managing the businesses successfully

***H2: Departmentalization has a significant impact over the Business Performance***

Hypothesis two emphasizes on the effect of Departmentalization (DP) on Performance of SMEs. A path coefficient value of 0.035 indicates a positive impact by DP on Performance of SMEs. A statistically significant impact between the two variables can be seen as the P value obtained was less than 0.05. Hence, a positive impact of DP on Performance of SMEs was exhibited. This finding is in agreement with earlier research [6]. A direct impact of DP on Performance of SMEs has been demonstrated by numerous research [14].

This demonstrated **that in the Sri Lankan context too DP plays an important role on** Performance of SMEs. Therefore, SMEs have the awareness that DP in the Sri Lankan context has an effect on Performance of business environment which can lead to promote the businesses successfully.

### ***H3: Hierarchy has a significant impact over the Business Performance***

The impact of Hierarchy (HI) on Performance of SMEs is the basis of Hypothesis three. Having a path coefficient of -0.024 indicates that HI has a negative impact on Performance of SMEs. The CR value of -4.398 and P value which is less than 0.05 shows that this impact is statistically significant. Henceforth, Hierarchy has a negative effect on Performance of SMEs. This finding is comparable with previous research [6] which revealed a direct effect of Hierarchy on Performance of SMEs [6]. This **demonstrates that HI is an essential component for the Performance of a business in the Sri Lankan context too**. Hence SMEs believe that HI has an impact on the performance of business environment in the Sri Lankan context which can guide to manage businesses effectively.

### ***H4: Span of Management has a significant impact over the Business Performance***

Hypothesis four discusses about the impact of Span of Management (SM) on Performance of SMEs. A positive impact between these two variables is indicated by the path coefficient value of 0.010. Since the P value was 0.033 which is less than 0.05 a statistically significant impact is demonstrated. Hence, Span of Management has a positive impact on Performance of SMEs. It is evident that earlier research [14] is similar to this outcome and several studies prove that SM has a direct effect on Performance of SMEs in [47].

Hence it is clear that **SM is a key component that has as effect on Performance of a business in the Sri Lankan context too**. The SMEs view was that SM has an impact on Performance of business environment in the Sri Lankan context that promotes business management.

### ***H5: Delegation has a significant impact over the Business***

Hypothesis 3 refers to the effect of Delegation on Performance of SMEs. The path coefficient value of -0.022 indicate that these two variables exhibit a negative impact. Since the P value was less than 0.05 a statistically significant effect is seen. Hence, a negative effect of DL on the Performance of SMEs can be observed. Previous research is supports this finding [31],[48] and a direct impact of DL on Performance of SMEs is revealed by many scholars [49],[50].

**In the Sri Lankan context too DL appears to be a crucial element in the Performance of a business**. SMEs perception was that at DL has an effect on Performance of business in the Sri Lankan context which influences their power to managing the businesses.

### ***H6: Formalization has a significant impact over the Business Performance***

Hypotheses six is with reference to the impact of Formalization (FO) on Performance of SMEs. A positive impact between these two factors was shown by the path coefficient value of 0.013. The relationship was not statistically significant as the P value of 0.063 was greater than 0.05. Therefore, a positive impact of FO on Performance of SMEs is seen in relation to the above two variables. This finding is compatible with research done earlier [14] and several other research denoted a direct effect of FO on Performance of SMEs[14],[50].

Therefore, **FO can be regarded as a significant constituent of Performance of a business in the Sri Lankan context too**. SMEs have the point of view that FO endures an effect on Performance of businesses which enhanced the potential of managing businesses in the Sri Lankan context.

### ***H7: Coordinating has a significance over the Business Performance***

Hypotheses seven discusses with regard to the effect of Coordination (CO) on Performance of SMEs. A positive impact is indicated between these two variables as the path coefficient value is 0.003. A statistically insignificant impact was indicated with a CR value of 0.647 and P value of 0.517 which is higher than 0.05 .

Hence CO shows a positive impact on Performance of SMEs and this is consistent with former research findings[14],[50]. Several other research results indicated a direct effect of CO on Performance of SMEs [48],[49].

It is apparent that **CO is a crucial factor in Performance of a business in the Sri Lankan context too**. This reveals the SMEs opinion that the effect of CO on Performance of businesses influences their ability to manage businesses in the Sri Lankan context. The seven hypotheses of OS were evaluated based on the objective of this study and the above facts indicate the impact of each dimension of OS on Performance of SMEs. **Specialization required with the main characteristics:** Job Descriptions given to all employees/members who have regular duties to implement in the organization. **Departmentalization required with its main characteristics:** Accumulating jobs in to different sections and dispersing employees in to departments (Job Rotation). **Span of Management required with main characteristics:** The capability of the Managers / supervisors to supervise each and every employee under his / her direction. **Hierarchy required with the main characteristics:** The organization of positions of the organization in an order based on the level of authority. Instructions and communications conveyed through the hierarchy and formal channels contribute to implement the activities. **Delegation required with the main characteristics:** Power of decision making is passed on to the persons who are responsible for performing the tasks. **Formalization required with the main characteristics:** Includes standards such as rules, regulations, policies and procedures to guide the ways and means of conducting the regular work. **Coordination required with the main characteristics:** Availability of a common plan to lead the activities of each and every member. Freedom for employees to have direct links with relevant persons, irrespective of the departmental and hierarchical boundaries and harmonization are created through informal associations with cooperation.

## V. CONCLUSION

It is evident that the components of OS play a vital role in the SME sector, particularly in the case of persons who start new business establishments displaying entrepreneurial action. Therefore, improved knowledge of OS among them can be treated as a new inclination to accomplish the suitable mindset. SP, DE, SM, HI, and DL are the seven dimensions of OS that has a direct effect on Performance of SMEs and have a unique influence. The outcome of this study intensifies the pragmatic nature of OS construct with regard to Performance of SMEs. Hence, it is evident that business owners around the globe, exhibit entrepreneurial actions of SMEs in operating their own establishments and function as change agents in a country. This enlightens the need for the responsibility of the policymakers in the government and non-government institutes to emphasize on development with appropriate OS of businesses for economic advancement that have implications to the academics, entrepreneurs and the policy makers as well as regulators who are accountable for viable environment for the businesses in any country.

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