

Application of Differentiation Strategy on the Profitability of SMEs

(Evidence from Western Province in Sri Lanka)

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Abstract

Differentiation strategy is being used fully or partially by many enterprises operated in the Small and medium scale. Adaptation of differentiation strategies supports the SMEs on their sustainability. The study aims to investigate the influence of the differentiation strategy on the performance of the enterprises in terms of profitability and sustainability. 750 sample enterprises were selected using stratified random sample throughout three districts secretariats in western province in Sri Lanka. Primary data collection methods were used along with descriptive and inferential techniques. Confirmatory factor analysis along the structural model has been used. The Study highlights the differentiation towards profit maximization. Enterprises can focus much on green concerns in differentiating the products as the alternatives for obstacles faced through finance and resources. Better understanding of differentiation with sustainable values would distinct the product in earning competitive advantage as well as business existence.

Keywords-: Differentiation strategy, Business Performance, Sustainability

1. INTRODUCTION

1.1 Background of the study

Limited resources and unlimited wants create the trading era with tremendous changes which occur frequently. The scarcity of the resources stresses on strategic alternatives available to small firms. Hence the resource utilization is possessed by larger scale firms, the smaller scale firms need to evaluate the potential marketing strategies to recognize the distinctive competencies. This is a part of the ground theory of Porter's generic strategy which is introduced by Michal Porter during 1980's (Yoan, 2018). According to Jimnah (2020) the business strategy is mandatory as to run business operation beyond operational efficiency. A successful business strategy like differentiation strategy helps in measuring the growth and success of the business and increase adaptability. Similar to Michal porter's theory Edward Chamberlin (1993) implied the theory of monopolistic market completion regarding the market structures and functions of economic units. In the theory he has stated that the imperfect marker such as monopolistic ought to partially or slightly differentiate the product as to gain over the economical advantage in the market. Further he argues that differentiation is the effective mechanism in a market where large buyers and sellers are applicable in trading activities in gaining financial benefits. Even in

agriculture markets the watermelons are differentiated with the shape and size using genetically modified crops technology (Praiz, 2021). Adopting the differentiation strategy requires technology, set of specialized assets, and high intellectual workers to distinguish their products from their competitors. Differentiation strategy is able to add to profitability of a firm from the high profit margin made by providing firm's products (Retnaningtyas, 2018). The strategy of differentiation means course of action in distinguish the product, process or conduct of a business from its rivals as to make uniqueness for itself. This strategy would bring firms to upgrade the economical performance and to exist in the industry for a long run. Firms that use differentiation strategy as their business strategies will be able to reach certain financial gains due to their premium profit margin and competitive advantages constructed by the firms. In deed firms generally pursue differentiation strategy less forced to use real earnings management.

According to porter (1994) the differentiation strategy, the organization attempts to be unique in its industry in several scopes generally valued by consumers. The organization chooses single or multiple attributes that are observed important by many consumers within the frame work of the industry and uniquely puts it to

meet those requirements. The organization then rewarded with premium price because of its exceptionality and uniqueness. The technique to distinct is dissimilarity for each industry. According to Roy (2018) Differentiation can be based on the product, product delivery methods, marketing approach, and other a range of aspects. Further he states that the major types of the differentiation strategies in to product, service and brand differentiation.

Exploiting differentiation strategy works out when the firms themselves realize as inimitableness with respect to the others in its particular industry. According to Dickson (2018) there is a difference between market segmentation and product differentiation and found that even marketers are unable to agree on what the distinctions are, or which specific element placed in first at sustain the brand or a firm. When it applied to the small businesses, they need to refrain being pre occupied with attempting to identify market segment and they will not have the resources to be able to explore all of the alternatives for prospective market segmentation. With a lack of identification, the firms will need to choose mass marketing. This adversely impacts the small firms in finding and growing the unit of economy (Roy A. Cook, 2012).

Formulating a differentiation strategy is an effectual way of coordinating and evaluating the internal and external factors. The insight of the enterprise needs to be capable enough to adopt the requirements of customer and the attributed perceived from the market (Grant, 2002).

Utilization of resources and usage of appropriate strategies can be known as critical factor for not only profitability but also sustainability of the business. In context of Asian countries its evident full that differentiating the core item than the substitutes would improve the financial performances (Nijuhan, 2015). The resource-based theory also ropes the ideology of the financial performance and differentiation strategy. In fact the usage of differentiation positively impact on financial as well as economic performance of the industries like manufacturing (Jimnah, 2021). However adopting and implying the differentiation strategy would be challengeable for the firms especially like small and medium scale enterprises. There are limitations in applying differentiation strategy; those are capital, not having an effective distribution channel, mindset in doing business, and lack of technology (Joy, 2021).

The main center of attention of firm that uses differentiation strategy is customer satisfaction and successful products' performance, rather leading to earnings management (David,

2020). The firms do undertake differentiation strategy by forming a perception of certain values such as product performance, product innovation, product durability, and brand recognition to its customers.

Every organization that competes in a market has a willingness to be superior to its competitors. In common context the organizations apply this competitive strategy through the functions of various existing firms located in the market. The basic concept of the formulation of a competitive strategy begins with the development of a general formula on how a business would grow and the policies along the approaches required reaching the targets (Bayal, 2021).

Approximately 90% of entities would belong to SMEs where it creates 45% job opportunities and 52% on economic growth (Shares of economic sectors, 2019). Generating employment opportunity would diminish the unemployment as well as poverty of the nation (Central Bank of Sri Lanka 2018). The small and medium scale enterprises are the execution of the entrepreneurship of a society. Defining SME would be distinct since the measures are varying from country to country according to the socio-economic nature. Basically number of labours employed, amount of capital employed and the annual turnover earned would be the common measures in framing SME. According to Sri Lankan context, the enterprises that

gratifies the annual turnover not exceeding Rs.750 million and employing lesser than 300 employees can be categorized in to small and medium scale business (Sri Lanka National policy frame work 2015).

1.2Research problem

According to Porter (1990) suggested four "generic" business strategies that could be adopted in order to gain competitive advantage based on cost leadership and the product differentiation. According to CMA (2020) 75% of the enterprises operated in Sri Lanka represent SME's and they contribute 45% of the total employment of the country where 52% of the GDP driven through these productive units. The SME's that are practicing self directed culture and dynamic learning show approximately 30% to 50% of sustaining rate compared to the other enterprises in the market. At the same time those organizations reflect higher productivity of 52% other than the substitutes in the industry (Most admired companies of Sri Lanka, 2019). The challenges experienced by many SME's are relevant to the labour training, technology adaptation, asymmetric information and the high competition in the market. Due to some dynamic obstacles some ventures fall on to the shutdown stage too (National human resource & employment policy, 2021). Therefore, the study intends to investigate the significance of profitability of SMEs to identify the influence of

the strategies such as differentiation on the entrepreneurial and business functions towards the operational efficiency.

1.3 Research questions

- Does the differentiation strategy positively influence the business performance?
- Does innovation process impact on the operational efficiency of the business?
- Does differentiation of goods, services and process contribute to the competitive advantage of SMEs?

1.4 Research objectives

- To identify the relationship between the differentiation strategy and business profitability.
- To examine the influence of differentiation strategies on the existence of the firms.
- To evaluate the role of differentiation on the customer value proposition of SMEs.

Therefore, the study aims to address the issues related to the adaptation of differentiation strategy among the SMEs.

2. METHODS

The conceptual model focuses on theoretical reflection of the concepts relevant to the research on the influence of differentiation strategies towards the profitability and sustainability of enterprises.

The conceptual frame work has been developed as the empirical model which elaborates the clear cut ideology supported through the pragmatic evidences from the literatures and the former studies. The study provides the overall knowledge on strategy adaptation towards success entities. The study is carried out based on confirmatory factor based and the sample frame work has been drawn the population in the western province through 40 different divisional secretariats and 03 district secretariats. The data collection is use through primary data collection method. Reliability and validity testing done along with regression analysis are expressed in deriving the hypothetical testing. According to the definition formulated by the OECD (OECD, 2011a), green growth

means taking measures conducive to growth and economic development, while ensuring that natural assets continue to provide the resources and environmental services which contribute to the country's prosperity. Green growth focuses on accelerating investments and innovations that will underpin sustainable development and provide new economic opportunities. Reilly (2012) states that the push for green economic growth expresses the intention to direct the economy towards technologies

and consumption patterns that create jobs and economic growth as well as reduce the impact on the environment

2.1 Location of the study

The study concerns the area of western province comprises through 40 divisional secretariats. These divisional secretariats are including 20450 (Gampaha DS statistics, 2019) registered and existing small and medium scale enterprises.

2.2 Development of hypothesis

Based on the summary of referred literatures and the general observation there are four basic hypothesis used to explore the influence among the factors on business performance.

H1: Products innovation positively contribute to the performance of enterprises

H2: Product uniqueness positively contribute to the performance of the enterprises

H3: Product image positively contribute to the performance of the enterprises

H4: Product design attributes positively contribute to the performance of the enterprises

H5: Product value creations positively contribute to the performance of the enterprises

2.3 Conceptual framework

Conceptual frame work of this study expresses the major five forms of differentiation approach that are influencing on the performance level of SMEs. According to the literatures and

the observation the critical and most common practices that have been used in differentiating the goods, services and the process are associated with the performance level of the enterprises (Figure 01).

2.4 Sample framework

There are approximately 20450 registered ventures of small and medium scale up to 2019 throughout 40 divisional secretariats and 3 district secretariats in the western province (District secretariat statistics, 2018). The enterprises are taken from the different sectors such as food and beverage, cosmetics and herbal, house hold groceries, farm and agricultural items, clothing and apparel and handmade crafts & souvenirs. Stratified random sample technique has been used to testify the influence of differentiating practices to the enterprises' success. Similarly in determining the sample size requirement non proportionate sampling technique is being used (Table 1).

2.5 Data collection instrument

The study uses the data collection basically from primary sources through self-administered close ended question.

Reliability and validity test has been done through Alpha Cronbatch to ensure the accuracy of factor variables along the model. The results are expressed through descriptive as well as inferential ways. Illustrative figures and tables, central

tendency are used to reflect the descriptivemanner. Regression analysis and Pearson correlation test are being to reflect inferential manner. According to thehypothetical test the results are interpreted and generalized.

2.6 Variables of the study

Performance of enterprises is being the dependent variable there are 5 independent variables such as Innovation, image, uniqueness, design attributes and value are used to examine the influence resting on the performance of enterprises. The performance is measured through the profitability and sustainability (Table 2).

3. RESULTS & DISCUSSION

According to the former findings and the reviews taken from the literature the most prominent factors are identified and associated with the theoretical concepts as to testify the generic practices of differentiation. Regression analyses along with Pearson correlation test have been conducted as to testify the validity of formed hypothesis to generalize the results findings.

3.1 Results of reliability & validity

There are major five major factors that have been resulted out from the fifteen elements. Reliability was measured through CR and tested by convergent validity via AVE. CR values of the factors is above 0.70 which is at the satisfactory level. As a result reliability and validity of the

variance were up to the satisfaction as illustrated in the table 03.

3.2 Results of confirmatory factor analysis

This study basically examines the remarkable differentiation factors that are highly essential to be considered on operational efficiency such as maximizing profit of enterprises.

There are five critical factors loaded along with 15 elements (variables) forming a well-fitted measurement structure. Product innovative factors (variable 01) derived from three elements such as novelty, demand and business knowledge notified from element 01-03. Product image factors (variable 02) derived from three elements such as awareness, recognition and admiration comprised from the elements 4-6. Product uniqueness factors derived from the elements of customer value, customer loyalty and competency of firms are loaded from elements 7-9. Product attributes factors are comprised of the elements of aesthetic, performance and the affordability tagged through the elements 10 to 12. Product value creation factor includes the elements from 13-15 such as Green concerns, profit margins and green technology. The model summarizes that the Number of parameters was 57, the values of indices GFI and AGFI were 0.88 and 0.85 respectively in adducing that model is fit along the data (Urbach&Ahlemann, 2010)

3.3 Results of the structural model

Application of the structural model to this study represents the relationship of the latent variables from 1-15 that are hypothesized to the major 5 factors in the model of exploration. The main thumb rules for this model are the R2 measures and the significance level of the coefficient (Duarte & Raposo, 2015).

As indicated by results of structural model (table 4) out of the five key factors the product innovation factors, product uniqueness factors and product value creation factors are significantly correlated on the performance of enterprises in terms of profitability or operational efficiency. Among the formed five hypotheses, the first hypothesis (product innovation factors) effects on the productivity of business performance and accepted ($p=0.008$). Also the third hypothesis (product uniqueness factors) has the direct collision on profitability of the enterprises and accepted ($p= 0.001$). Hypothesis five (product value creation) showing a momentous relationship to the enterprises' performance and accepted from the testing value ($p= 0.019$) conversely the second hypothesis (product image factor) reflects the inconsequential relationship on business performance thus rejected with the value ($p=0.114$). Finally, the fourth hypothesis (product attributes factor) implies the insignificant relations towards the performance level of the

enterprises ($p= 0.066$).

3.4 Results of coefficient analysis

The Un-standardized coefficient exemplifies to what extent the dependent variable is varying along the independent variable while other all independent variables are remaining constant. As per the significance value there are nine differentiation aspects were showing the significance where the coefficients are implying the significant different to zero and bring to a close that the phases of differentiation approaches such as the novelty, demand for the product, business knowledge, customer loyalty, product valuable, competency of the firm, green perceptions of the firm, profit margin, and the usage of green technology are positively associated to the performance of the enterprises. Table 5 illustrates the implication of coefficient analysis.

3.5 Discussion of the results

The study was targeted with the 750 sampled SMEs from different stratum. From the responds given through the questionnaires 18 were rejected due to the lack of reliability of the response. Therefore the study associates with only 732 questionnaires which is 98% in response rate. In general over view many enterprises confess that the application of differentiation strategy would stimulate the performance level of their businesses. 98% of the enterprises agree in adopting the differentiation process in benefiting the enterprises (Figure 2).

As per the results of the study it has been proven that production innovative factors ($p= 0.008$) product uniqueness factors ($p= 0.001$), and product value creation factors ($p=0.019$) are significantly associated with the business performance. Whereas the enterprises are showing that product image factors ($p= 0.114$) and product attributes factors ($p= 0.066$) are having insignificant association towards the business performance. The study has revealed that Enterprises are fully or partially adopting the differentiation approach in their products would experience the efficiency throughout the business operations. Since novelty is the process of an introduction of the item which has never been there in the market would gain the competitive advantage thus it allows the enterprises to earn more revenue through the incremental volume of sales. According to the study 66% of the enterprises confess that through the innovation and novelty they experience the profitability of their enterprises. There is a significance relationship seen among the novelty of the item and the performance of a business ($p= 0.09$).

Differentiating a product will be as a push factor in increasing the demand in the market. This is proven in the study as well and the response rate revealed that 87 % of the enterprises believe on differentiation as to boost the demand than the existing situation and 50.5% of the enterprises highly agree upon the product

differentiation. The study encounters a positive relationship between the demand after differentiation and the business performance ($p=0.015$). To differentiate the product, the business enterprises, need to adjoin the business experience gained through the operations for so long in bringing up the product as to match the customer requirements and opinion. This is factual in the study as well. 85.3% of the enterprises in the survey admitted that the business knowledge is advantageous in product differentiation towards the profit and existence. There is a significant relationship shown between business knowledge and the business performance ($p=0.007$).

According to Miller (2016) Differentiation strategy is the potential to present inimitable and superior value to the consumer in terms of product quality, exceptional characteristic and variation. This is supported from the findings of the study where 72.5 % of the enterprises confess that making the unique product would gain profitability. And this is shown through the significant association among unique value towards the operational efficiency ($p=0.021$). Differentiation is a feasible approach for SMEs. This is possible since the enterprises are diminutive to abide a cost strategy (Beal, 2000). The view of the consumers might differ from person to person and the sensitivity on the manner in which the enterprise offers the consumers the

heterogeneous item at reasonable price in making consumers pride while using the item. (Peter, 2017) indeed the survey validate the nature where 91.5% of the enterprises believe that the differentiation makes adequate profit in real scenario as well there is a positive relationship shown on the customer loyalty towards business betterment ($p=0.010$). According to Naushua, (2015) Product differentiation is not limited only to the visual aspect of the products. Even the way of advertising or marketing the product comes with the differentiation of the product among the substitutes and the market.

The study has shown that perceived competencies such as ability to compete and resilience would impact on the business performance and 54.3% of the enterprises strongly agree on this. Business competency and the business performance is significantly related ($p=0.015$).

Using eco-friendly materials and energies would differentiate the product in competitive edge. Perceptions of the consumers are towards sustainability in the contemporary situation. Therefore making a different through sustainable materials would help the venture to succeed. The study has shown that 84% of the enterprises believe in using green based resources in making profits. The study shows the significant relationship between the sustainable concerns and performance ($p=0.020$). Modes of distinctions can be perceived by

the consumers valuing the rational concern which positions itself to meet the formed requirements. This would be resulted in skimming prices and the supernormal profit. In deed this is adducible from the findings of the survey. 95.3% of the enterprises have the same opinion where producing or distributing some this unique and distinct would make the enterprises in better economic returns. The study has shown the significant relationship between product differentiation and rising profit margins ($p= 0.003$). the result of the survey verdict that 53% of the respondents have confessed that usage of sustainable technology and green process would gain them the competitive advantage as to utilize the operational efficiency. This is reflected from the study among there significant co relationship ($p=0.52$).

On the other hand, many literatures have supported the differentiation takes place through brand image would improve the business performance. Numbers of enterprises do offer trial products, in order to create an attention for the consumers to identify and distinguish the product from other rivals 'offerings. The ways of branding the product would be critical since economic agents such as producers, consumers, mediatory are acting in ways of weaken brands instead of building the brands. Therefore this branding technique would serves to differentiate products and creates a basis for forming brand

reputation through consumer trust (Nausha, 2015). But the results of the survey indicate that product image and the business performance have insignificant relationship ($p= 0.114$). Simultaneously the purpose of branding is not only to differentiate the product from the rivals but also to create the unique selling point in making the existing products salable (Robert, 2017). As to support this 62.2% of the enterprises do not believe that the product awareness guarantees the profit. Also 47.4% of the enterprises confront as product admiration towards the profitability.

Amoako (2008) investigated the interaction among the production design mix covering aesthetic appearance, cost, and the performance of the product towards the performance of the firm. The positive relationship has been victimized among the two variables and the approaches of manufacturing comprises with quality, cost, flexibility, and the aesthetic appearance. Addition to that the findings of the study shows that the product modification and quality stress on the competitive edge of an enterprise which is a simple and flexible technique for SME's even to adopt at lower trade off. In contrast the study reveals that there is an insignificant correlation between the product attributes and the business performance ($p= 0.066$) and also the enterprises used in the survey confessed that 45% of them are in confrontation with the product performance and the profitability

of the firms. The study of Susan (2017) states that the phase of product differentiation comprises with set of components such as product innovation, quality of the product, product design, and consumer unique value not basically the image created by the community of the product.

4. CONCLUSION

Differentiation strategy would offer superior extent for the organizations to produce and distribute goods and services with advantageous aspects as a way of competing the market covering existing and the new consumers. It is adducible that competitive advantage can be gained through differentiating the product strategy and impact on the operations of the organization similar to consumer goods manufacturing enterprises. Efficiency increases essentially out of worth a firm is able to create for its consumers which exceeds the enterprises' cost of forming the new value. Product differentiation strategy can be a device of competitive advantage which is agreed to by the firms with the intention of provide products which satisfies individual customer's needs. In that angel valuing their expectations in offering the product value without compromising the cost advantage is fundamental.

Based on rational concept the valuable root of differentiation of products would facilitate an enterprise to increase its total revenues and to counterbalance

market threats, uncertainties as to take advantage of opportunities and trends in the industry.

Therefore differentiating the product not actually creating a novel item and its some modification made on the existing products. Further creating product image through advertisements and awareness campaigns will not advantageous in the prevailing context. But when ventures are differentiating the products through creating value with sustainable materials, resources and process would enhance the awareness and the customer attraction. Therefore, the SMEs need to focus more on differentiation the items through

the less costly sources in including the eco friendliness and the innovation as much as simple and flexible in minimizing cost and maximizing profit.

In fact, when the SMEs are focusing much on the innovation, uniqueness and value creation would better them off other than considering the image and aesthetic related factors. This would gain them not only the operational efficiency but also the long term sustainability of the enterprises.

APPENDIX

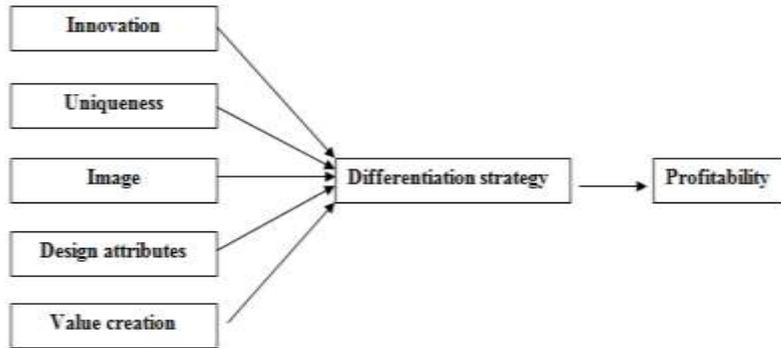


Figure 01: Conceptual framework

Source: Author's Empirical evidence

Table 01: Sample framework

Districts	Number of Divisional Secretariat	Number of SMEs	Sample
Gampaha	13	7012	250
Colombo	13	7418	250
Kalutara	14	6020	250
Total	40	20450	750

Source: Author's estimation from Gampaha secretariat data-2020

Table 02: Variables & measures

Factors	Types of variable	elements	Variables	Question number
Product innovation	Independent	01	Novelty	3 & 4
	Independent	02	Demand	5& 6
	Independent	03	Business knowledge	7&8
Product image	Independent	04	awareness	9 &10
	Independent	05	Recognition	11& 12
	Independent	06	Admiration	13 & 14
Product uniqueness	Independent	07	Valuable	15 &16
	Independent	08	Customer Loyalty	17& 18
	Independent	09	Competency	19 &20
Product attributes	Independent	10	Aesthetic attraction	21 & 22
	Independent	11	performance	23 & 24
	Independent	12	Affordability	25& 26
Product value creations	Independent	13	Green concerns	27 & 28
	Independent	14	Profit margin	29 &30
	Independent	15	Green technology	31 & 32
Business performance	Dependent	16	Business profitability	33

Author's Compilation

Table 03: Summary of factor loading measurement model

Factors	1	2	3	4	5	AVE	CR
01	0.906						
02	0.902						
03	0.900					0.902	0.922
04		0.810					
05		0.811					
06		0.831				0.817	0.913
07			0.884				
08			0.888				
08			0.804			0.858	0.902
10				0.820			
11				0.803			
12				0.909		0.846	0.901
13					0.904		
14					0.922		
15					0.890	0.905	0.908

Source: Author's estimated values from factor loading

Table 4: Results from structural model

H(s)	Factors	β	S.E	C.R	Sig
H1	Product innovation	0.252	0.08	2.127	0.008
H2	Product image	0.266	0.02	1.050	0.114
H3	Product uniqueness	0.400	0.09	1.251	0.001
H4	Product attributes	0.331	0.03	2.863	0.066
H5	Product value creation	0.420	0.07	2.980	0.019

Source: Author's estimated values from structural model

Table 5: Summary of coefficient analysis

	Un standardized coefficient		Standard coefficient	t	Sig
	B	Standard error		B	Standard error
Constant	-8.212	6.522		-1.652	0.122
Novelty	0.885	0.288	0.381	4.010	0.009
Demand	0.810	0.202	0.255	3.001	0.015
Business knowledge	0.802	0.221	0.243	3.901	0.007
awareness	0.020	0.121	0.090	0.552	0.100
Recognition	0.009	0.115	0.088	0.501	0.120
Admiration	0.017	0.297	0.072	0.221	0.051
Valuable	0.726	0.102	0.212	2.172	0.021
Customer Loyalty	0.877	0.211	0.344	4.011	0.010
Competency	0.882	0.228	0.392	3.991	0.015
Aesthetic attraction	0.080	0.110	0.043	0.442	0.066
performance	0.091	0.165	0.038	0.450	0.052
Affordability	(0.010)	0.210	(0.026)	(0.662)	0.122
Green concerns	0.801	0.130	0.352	3.820	0.020
Profit margin	0.790	0.142	0.310	3.600	0.003
Green technology	0.901	0.132	0.322	3.588	0.052

Source: Author's estimated values from coefficient analysis

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