

Factors Affecting Small and Medium Enterprises (SMES) Development in Pakistan

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Abstract: The purpose of this study is to analyze the factors affecting Small and Medium Enterprises (SMEs) development in Pakistan. The data for this study was obtained from face to face interviews with 124 respondents using structured questionnaire. The study used descriptive statistics and regression technique to determine the important factors affecting the SMEs in Pakistan. The regression results show that financial access, managerial skills and government support are the most important factors contributing to SMEs development in Pakistan. The results indicate that the SMEs in Pakistan are not technology oriented. The findings of the study might help the businessmen to understand the important factors that play significant role to develop their businesses. The study suggests that policy makers can consider the findings in formulating policy which may create an environment that is feasible for the development of SMEs in Pakistan.

Key words: Small and Medium Enterprises • Marketing • Financial Access • Government Support • Skills • Education • Technology • Development

INTRODUCTION

The Small and medium enterprises (SMEs) are the engine of growth for developing economies. Extensive research has been done on the importance of the SME sector globally. However, there is dearth of information available about the issue and progress of this SME sector in Pakistan. The small and medium enterprises development authority (SMEDA) is a government organization in Pakistan which has been working for the development of this sector over the last decades. Most of the Small enterprises in Pakistan are not registered with government agencies and they do not have access to SMEDA to obtain its support. Although the SMEDA has been working over the years, the progress towards SME development has been limited. This study will provide insights of the importance of SMEs and will investigate the important factors that contribute to the development of SMEs in Pakistan.

In Pakistan, the SMEs have potentials in the growth of food and agricultural sector as they can efficiently make use of limited resources and capable of producing products that are acceptable internationally, giving way to foreign exchange earnings. SMEs in Pakistan are running through a number of problems like access to finance, lack of technological knowhow, training of human

resource and marketing. These problems raises the need of sufficient support to the development of SMEs [1]. The SMEDA has been working in Pakistan to support this sector, however it mainly focused on the upper bracket firms (defining SME in terms of revenue and manpower) while most Pakistani SMEs comes in the category of lower bracket [2]. The SMEDA and SBFC are supporting SMEs in Pakistan in accessing credit support but it was inadequate inappropriate government policies and ineffective taxation rules are the main hindrances for the limited progress [3].

Most previous studies thoroughly examined the factors which affects SMEs development in other developing countries like Indonesia and Bangladesh. The literature available in Pakistan examined the role of several factors on individual basis in the overall evaluation for the development of SMEs in Pakistan. Some studies have examined whether the main contributing factors are industry specific or they are related with firm characteristics. This paper highlights the importance of SMEs for the development of Pakistan and will examine the factors that contribute to the development of SMEs in Pakistan.

This study will capture the essence of examining the factors that affects SMEs development in Pakistan. The results of the study will facilitates policy makers to build

positive environment by formulating policies that will encourage the development of SMEs in Pakistan. Secondly, it is an attempt to add new knowledge related to scientific data for the SME sector in Pakistan. This study will also help owners of SMEs to understand the factors that are effecting their business development so that they can take positive steps for improvement. Small and medium enterprises in Pakistan are very important for the growth of its economy. However, they do not get the required support because of limited access and lack of information. Research evidences on the development of SMEs in Pakistan are limited and various works is needed to be done on this sector. The policy makers should understand thoroughly about the factors that are affecting the development of SMEs in Pakistan. The study focuses to identify the factors that affects the development of Small and medium enterprises (SMEs) in Pakistan. The present study also investigates the effects of education, marketing challenges and adoption of new technology in the development of SMEs Sectors.

Literature Review: The importance of SMEs role in terms of the growth of developing countries is indispensable. As in the developing Asian economies, SMEs accounts for make major portion of industry and constitute 50 to 80% of total employment [4]. SMEs growth potential is higher compared to the large scale industrial sector. Although, SMEs do not show high contribution to GDP but its role is very substantial in terms of creating jobs, efficient utilization of limited resources, capability of earning foreign exchange and acting as institution to upcoming entrepreneur [1]. SMEs are sacred with such exclusive nature as less investment, flexible operation, rapid yield and immediate compliance to market changes. They can only gain vigorous development if the government follow the fair laws of the market economy, bring the role of the market in allocating resources into full play, consider the development needs of SMEs and guide them to the sound track centering on the light and tertiary industries [5]. The SMEs are gaining more importance in developing countries because of their huge dispersion in rural areas and in creating significant employment [6].

SMEDA has been working over the last 10 years for the progress of SME sector but it could not generate sufficient growth on the development. The ministries and other government authorities need to formulate effective strategies that should go along with SMEDA vision to promote this sector. It will lead to the reduction in poverty by introducing entrepreneurial activities and also could results in increased foreign exchange earnings.

The SMEs in Pakistan are currently performing poor and contingent about their future activities. Quality assurance of products can lead them to be successful domestically as well as globally by providing competitiveness. There exists a gap between knowledge of quality management techniques and their implementation in Pakistan. The firms who use quality management techniques are optimistic about the effectiveness of these techniques. Moreover the non-adopters are not much interested in using these techniques. Most Pakistani SMEs have not put much attention towards bringing quality management practices in their businesses because of their resource constraints. This problem can be solved by formulating government regulations that support SMEs in developing quality systems. Several studies highlighted that government support is the main factor for the development of this sector in Pakistan. [2]. Shah *et al.*, [3] found that government corruption is the major problem affecting to the development of SMEs in Pakistan.

Most of the firms among the informal sector in Pakistan are characterized as micro and small comprises who hired less than 50 employees because they failed to upgrade their operation so that they can improve their status of being medium sized firms. The major reason behind this problem is the lack of financial institutions for the SMEs in Pakistan. The most dedicated institution working for financing SMEs is the SME bank [7]. The major problem for the development of SMEs is the limited access to financial credit. The SMEDA or SBFC are the only source for providing credit which is insufficient. The main factors for the limited access in the credit markets are the high interest rates, high collateral requirements and lack of proper coordination [1]. Shah *et al.*, [3] argued that the main reason for the limited development of SMEs is not accessing credit only but the strict government tax policy is also an important factor. Naqvi [8] highlighted that the high risk fee returns attached to SMEs results into high cost of borrowing financial credit.

The implementation of advance manufacturing technologies could be a solution to fulfill the demand of products through increase in productivity. Mechanisms like increased output per machine and reduction in inventories by enhanced operating speeds through adoption of AMT has been identified in this regard. The increase in production and on-time delivery is necessary for firms to enhance their competitiveness. The study has also mentioned possibility of failure of these technologies in Pakistan due to lack of training, education, support, finance and management commitment towards adopting

them [9]. Various support programme from the government in gaining access to finance and adopting new technology would also foster the development of SMEs [4]. Service providers should foster the innovation and production capabilities of local firms making goods and rational use of external sources i.e. facilitating the transfer and use of appropriate technology in SMEs that would result in development of SMEs [1].

The difference between owner characteristics of low performing and high performing firms has been investigated by the researcher by using health indicators like sales of produce. The results showed that education, family to family transfer businesses, habits that encompass information media (computer, newspaper, watching television etc.) and level of investment positively affect the firm's health. But the education level is the most viable owner characteristic that serve as promoting factor for SMEs in Pakistan [10]. Education and skills about how to run the business and entrepreneurial activities will also contribute to the development of this sector [4]. Training centers need to be built to provide knowledge about management, quality controls and marketing issues. [1]. The investigation from the firm owners showed that most of them possess lack the skills and knowledge to manage and run the business. So lack of skills for managing business is the major constraint in the development of SMEs in Nigeria [11]. The implementation of technology also depends upon education and training of the workers so proper education and training is important to avoid resistance of employees toward adoption of new things for SMEs to develop [9].

The case study in Bangladesh also found that infrastructure (load shedding, poor transport etc.), financial problems, government and legal support, political, cultural, education and training were the main constraints to develop the SMEs and the study has suggested a framework to overcome these development constraints. The study also suggested that it is necessary to minimize the corruption to build a positive environment for SMEs to work and grow in a stable market economy [4]. The case study in Indonesia has identified business know-how, technology, skilled human resource, supporting government regulations, sufficient capital and marketing challenges as the main promoting factors for development of SMEs in Indonesia. The findings of this study are also important for developing countries other than Indonesia because small and medium enterprises provide indispensable growth to the economy of any developing country and also the results will help policy makers to develop policies that would foster the

Framework

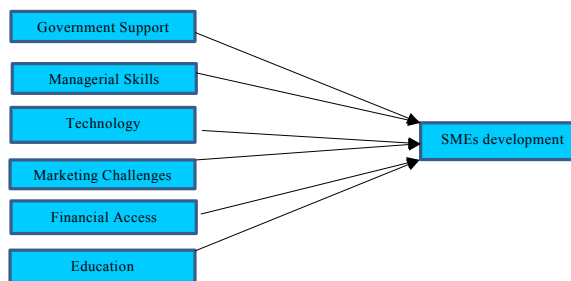


Fig 1: Theoretical framework for promotion of SMEs development

development of SME sector in their country [6]. The study has also identified that the psychological and personal skills (attitude toward risk, innovation and independence), management skills and training (management of finance and employees) and external environment (access to finance and government support) are critical success factors for SMEs [12]. The corruption resulting from low quality service and non-reliability also results in failure of SMEs while Naqvi [8] has stressed that low level of training, lack of technical knowhow and education results into high growth cost. Therefore, the policy makers must find the balance between the challenges that SMEs are facing and the support provided to them. Currently, SMEs in Pakistan are facing high challenges and low support [1].

Theoretical Framework: The framework for this study is developed based on reviewing the literature presented in Figure 1. The framework has suggested a market oriented economy based on stable legal and regulatory framework where businesses can run freely. In this way, risk aversion attribute of the SMEs would decrease. Education about how to run the business and entrepreneurial activities will also contribute to the development of this sector and finally, government support and assistance program in getting access to finance and adopting new technology would also foster the development of SMEs [4]. Another important variable has been identified through literature review. The literature is also added to the framework which includes marketing challenges that will focus on proper marketing needs to be fulfilled for promotion of SMEs globally to earn foreign exchange. Government support refers to as policies and regulations that promote SMEs development. The assistance program encompasses easy availability and access to finance and also adoption of new technology. Legal and regulatory framework includes control of corruption and political stability to support SMEs.

Hypothesis

- H1:** Marketing challenges are positively affecting SMEs development.
- H2:** There is positive relationship between adoption of new technology and SMEs development.
- H3:** Financial access positively and significantly effects SMEs development.
- H4:** Managerial skills positively and significantly effects SMEs development.
- H5:** There is positive relationship between government support and SMEs development.
- H6:** There is positive relationship between education and SMEs development.

Research Methodology: This research was conducted to check empirically the above model and the main objective of this study is to analyze the factors affecting SMEs development in Pakistan. This study obtains information based on primary data. The instrument used for the purpose of data collection is questionnaire which is adapted from the Indonesian study [13]. The questionnaire for this study is divided into two sections. Section one include several indicators to elicit local people’s perceptions on the development of business and Section two include various explanatory factors that might contribute to the development of SMEs. The population frame of this study was derived based on the twin cities of Pakistan which are Islamabad and Rawalpindi. The sample is selected using random sample technique. A total of 150 questionnaires were floated but received completed responses from 124 respondents. In order to determine the significant factors affecting the development of SMEs in Pakistan an econometric regression and Ordinary Least Square (OLS) method is used as specified in Equation 1.

$$SMED = \beta_0 + \beta_1MKT + \beta_2TEC + \beta_3FIN + \beta_4MS + \beta_5GOV + \beta_6EDU + \mu_i(1)$$

Where, Y_i is dependent variable that indicates the measure of SMEs Development, X_i is explanatory variables, β_i are the parameters to be estimated and μ_i is the stochastic error term. In current model, the Ordinary Least Square model is used to estimate the SMEs development. Model is given as,

The Operational Definitions of the Variables Included in the Model Are Defined as Follows:

SMED = Development of SMEs calculated through adding the values of four indicators namely; Satisfaction

with growth of net income, satisfaction with the time needed to reach breakeven point, consider business is successful and consider business is growing. Likert scale is used to measure all these indicators. Ranging from 1 to 5. 1 denotes for strongly disagree and 5 for strongly agree.

MKT = Marketing calculated through adding the values of four indicators namely; Distribution channel, Market potential, Searching new market is not difficult and well-planned Marketing. Likert scale is used to measure all these indicators. Ranging from 1 to 5. 1 denotes for strongly disagree and 5 for strongly agree.

TEC = Technology calculated through adding the values of five indicators namely; Existing technology suffices to support all production processes, Existing technology supports innovation, Existing technologies easily maintainable, New technology to support innovativeness in the business is attainable and Adoption of new technology increases output. Likert scale is used to measure all these indicators. Ranging from 1 to 5. 1 denotes for strongly disagree and 5 for strongly agree.

FIN = Finance calculated through adding the values of four indicators namely; Existing capital is sufficient to maintain and expand the business, can additional capital easy to get and have accessible alternatives of capital sources if needed. Likert scale is used to measure all these indicators. Ranging from 1 to 5. 1 denotes for strongly disagree and 5 for strongly agree.

MS = Managerial Skills calculated through adding the values of four indicators namely; Managerial skills are important for running a successful business, have good leadership skills, have good communication skills and Decision making skills are very important for the success of business. Likert scale is used to measure all these indicators. Ranging from 1 to 5. 1 denotes for strongly disagree and 5 for strongly agree.

GOV = Government support calculated through adding the values of four indicators namely; Support of Government is satisfactory, got business permit easily, have no problems when contact with government and Does government policies affect your business positively. Likert scale is used to measure all these indicators. Ranging from 1 to 5. 1 denotes for strongly disagree and 5 for strongly agree.

EDU = Education calculated through adding the values of four indicators namely; Does formal education is essential for development of business, Does formal education helps in taking good decisions and Does formal education improves understanding of business. Likert scale is used to measure all these indicators. Ranging from 1 to 5. 1 denotes for strongly disagree and 5 for strongly agree.

RESULTS AND DISCUSSION

The responsiveness of items is measured on five point Likert-scale followed by strongly disagree to strongly agree. Value 1 denotes for strongly disagree and value 5 denotes for strongly agree.

The internal reliability of instrument has been ensured by computing Cronbach’s alpha for each construct. The estimated values show the internal consistency of data. The alpha values for marketing, technology, financial access, managerial skills, government support and education are 0.669, 0.660, 0.720, 0.809, 0.750 and 0.869 respectively. Likewise Cronbach’s alpha for SME development is 0.817. These results show that all the items are internally consistent as the values are in acceptance region.

Descriptive Analysis: The demographic data showed that 79% respondents were males and only 21% were females. The age of 19% businessman was between 20 and 30, 35% was between 30 and 40, 36% was between 40 and 50 and only 10% were above 50. The origin of most SMEs is established (66%) according to the results. 24% SMEs were inherited. The education level shows that 40% respondents completed graduation, 20% completed master’s level and 40% enrolled higher secondary or secondary levels. The mean value and standard deviation of the variables are discussed below in Table 1.

Correlations are computed to analyze the dependent and independent variables. The correlation results shows and discuss in below Table 2. All correlation coefficients were far below 0.70, indicating that no significant multicollinearity existed in the data [14]

Regression Results: Table 3 shows the regression results. A set of explanatory variables were included in the OLS model estimation. The step-wise regression analysis is used to find significant factors that affect development of SMEs. This study used two-tailed test of significance or t-statistic to determine the acceptance or rejection of null hypothesis to check the reliability of the point estimates.

Table 1: Descriptive analysis

| | Mean | Std. Deviation |
|-----|--------|----------------|
| MKT | 3.7863 | 0.7405 |
| TEC | 3.2871 | 0.8173 |
| FIN | 3.1398 | 0.8701 |
| MS | 4.1371 | 0.7095 |
| GOV | 3.0403 | 0.9108 |
| EDU | 3.5753 | 0.8581 |
| DEV | 3.5418 | 0.5490 |

Table 2: Correlation of Variables

| | MKT | TEC | FIN | MS | GOV | EDU | DEV |
|-----|--------|--------|--------|--------|--------|--------|-----|
| MKT | 1 | - | - | - | - | - | - |
| TEC | .130 | 1 | - | - | - | - | - |
| FIN | .183* | .246** | 1 | - | - | - | - |
| MS | .198* | .241** | .109 | 1 | - | - | - |
| GOV | .075 | .170 | .639** | .010 | 1 | - | - |
| EDU | .112 | .671** | .239** | .172 | .202* | 1 | - |
| DEV | .273** | .366** | .777** | .526** | .687** | .363** | 1 |

* Correlation is significant at the 0.05 level (2-tailed).

** Correlation is significant at the 0.01 level (2-tailed).

Table 3: Regression Analysis

| Constructs | Coefficients | t-value |
|------------|--------------|---------|
| (Constant) | 0.145 | 1.078 |
| MKT | 0.051** | 2.086 |
| FIN | 0.290* | 11.346 |
| MS | 0.360* | 13.875 |
| GOV | 0.219* | 9.196 |
| EDU | 0.050** | 1.988 |

R²=0.893 F = 163.267 P=0.000

* significant at the 0.01 level

** significant at the 0.05 level

The value of constant is 0.145, having a positive impact on dependent variable and statistically it is insignificant. As R square of this study is 0.893 which show that the model is significant and explaining a good proportion of phenomenon and the variation in dependent variable due to independent variables is nearly 89 percent. In this case, about 0.893 SME development is determined by 6 independent variables (marketing, technology, Financial Access, Managerial Skills, Government Support and Education) and remaining percent is determined by other factors that current study unexplored.

The first hypothesis is accepted that marketing has positive and significant relationship with SMEs development as coefficient value of independent variable marketing is 0.046 and p value is 0.040. The only one hypothesis that rejected is technology (H₂) because the current study has found no significant relationship among technology and development of SMEs and dropped from model by using step-wise regression analysis. Financial access (H₃) is accepted and its coefficient value is 0.290 and p value is 0.000. The p value of independent variable finance shows that there is highly significant relationship between financial access and SMEs development. The fourth hypothesis about independent variable managerial access is accepted and its coefficient value is 0.340 and the result is significant at less than 1 percent level of significance. The H₅ about independent variable government support is also accepted and coefficient value is 0.219 that significant at less than 1 percent level of significance. That results shows highly positive relationship between government support and SMEs development. The last hypothesis about education is also accepted and it contributes 0.052 coefficient value that has significant effect on SMEs development at 5 percent level of significance.

Conclusion and Recommendations: Small and medium enterprises (SMEs) are engine of growth for developing economies like Pakistan. The SMEs contribute to employment generation that leads to poverty alleviation. The study examined factors affecting small and medium enterprises in Pakistan that includes marketing, technology, finance, managerial skills, government support and education. The results have supported that all the factors play significant role in development of SMEs except technology. Technology does not contribute much in development of SMEs in Pakistan because they are not technology oriented. The non-adoption of technology is due to electricity problems and

also because they do not use complex manufacturing operations. Managerial skills, financial access and government support turn out to be most important factors that contribute to development of SMEs. Pakistani SMEs do not focus much on marketing their product or services but the marketing do impact business development on today's competitive environment. Most of the owner of SMEs is poorly educated but it is believed that formal education has significant impact in developing a business. Most businessmen prefer using their own capital rather than using other alternatives. SMEs of Pakistan have great potential and it can be explored by giving them proper orientation regarding growth of business. Government can do this by introducing seminars on SMEs development to educate people about business more efficiently. As most SMEs in Pakistan are satisfied with their limited revenues and are not likely to expand their business due to the limited access to financial capital.

Future research can be done on this topic by taking larger sample size as results of this study are limited to respondents from Islamabad and Rawalpindi. Secondly other factors like legal, regulatory systems and corruption can also be explored that has not been analyzed due to limited resources.

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