

Analysis of Factors Affecting the Development and Growth of SMEs in Pakistan

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Abstract

The purpose of this study is to understand and analyze the factors that affect development and growth of SMEs in Pakistan. Particularly we are interested in the factors; Lack of Finance, Laws and Regulations, Competition, Lack of Motivation and Poor Management. Total 100 participants completed the questionnaire that contained two sections. Section I contained 5 questions for data collection regarding demographics of the participants, Section II contained 18 different statements related to Development and Growth of SMEs, Lack of Finance, Laws and Regulations, Competition, Lack of Motivation and Poor Management. The results supported the entire developed hypothesis in this study. According to results Lack of Finance, Lack of Motivation and Poor Management negatively affects the development and growth of SMEs in Pakistan, while Laws and Regulations and Competition affects positively the development and growth of SMEs in Pakistan. A more appropriate and effective method will be the data collection from the individuals who are planning to start their own businesses and the government's department employees who are directly engaged in formulating policies regarding SMEs, as it will give relatively more accurate and effective picture. Also, this study was restricted to the examination of limited factors that had showed some kind of significant influence on the development and growth of SMEs in Pakistan. Future research should examine both the internal and external factors in such a way that it should focus on relative internal and external factor simultaneously i.e. Govt. laws and regulations and managing finance inside the organization or competition, Lack of finance and managing internally the financing activities, study of environmental factors and management inside the organization etc. It is situational analysis; as it comprises such variables which are having most of affect on the development and growth of SMEs in Pakistan.

Keywords: Development and Growth of SMEs, Lack of Finance, Laws and Regulations, Competition, Poor Management and Lack of Motivation.

Introduction

Prior researches are strong evidence of SMEs vital role in the economic growth of a country. The Importance of SMEs is not just considered in developing economies, but had a great impact upon the developed economies. Importance of SMEs is recognized all over the globe as they increase the productivity growth in the economy which results in welfare of the people and eradication of poverty. SMEs not just play an important complementary role in the industrialization of the economy but also act as a driver of structural change. The growth in productivity not only implies the innovation in the economy but also enhances the degree of specialization. SMEs are no longer viewed as stepping stones to real business but as a sources of industrial and economic growth and as well as means of poverty alleviation (ILO, 1986). According to OECD (Organization of Economic Cooperation and Development) (2004), SMEs are contributing 55% of GDP and 65% percent of total employment in high income countries; and contribute 60% of GDP and 70% of total employment in low income countries.

Defining SMEs is a complex matter, as different authors defined it differently. Authors gave definitions of SME using the SME's gross asset value, employment, turnover and some defined SMEs in terms of Skill of Labour (Nieman 2006). The Bolton Committee (1971) gave an economic and statistical definition of SMEs. According to economic definition a firm is considered to be small which has relatively small market share and have a close ownership or managed by part-owners personally and there is not a well defined hierarchy structure of the firm. According to statistical definition small sized firms are recognized on the basis of their contribution to GDP, exports, turnover and the employment opportunities provided by them. Another definition given by Jordan et al (1998) that the firms having less than 100 employees and a turnover of 15 million Euros are considered as SMEs. The SMEs having labour Size up to 250 and paid up capital up to Rs. 25 million and yearly revenue up to Rs. 250 million are Small & standard Enterprises , as accepted in SME Policy 2007 (SMEDA, 2007). According to a report

issued by UNIDO (National Industrial Development Organization) (2002) SMEs are defined in terms of number of employees and classifies these SMEs in developed and developing economies separately (Abor and Quarty 2010). The classification of SMEs in developed and developing countries is as follows.

	Developed Countries	Developing Countries
Micro Firms		Less than 5 employees
Small Firms	99 or less employees	5 to 19 employees
Medium Firms	100 to 500 employees	20 to 99 employees
Large Firms	500 or more employees	100 or more employees

Pakistan is situated at a region which has great political, strategic and economic location. Pakistan is located at the joining point of great powers like Russia and China. If there becomes any sort of alliance it enhances the significance of Pakistan's location. Pakistan has the potential to develop transit economy on account of its strategic location. Land locked Afghanistan now at the reconstruction phase, finds its ways through Pakistan. China with its fastest economy growth rate of 9% uses developing southern provinces due to its own part is 4500 km away from Sinkiang but Gwadar is 2500 km away. Moreover, Pakistan provides central Asian regions the shortest route of 2600 km as compared to Iran 4500 km or turkey 5000 km. Gwadar port with its deep waters attracts the trade ships of china, CAR and south east Asian countries., also the coastal belt of Balochistan can provide out-way to china's western provinces to have access to middles eastern markets with the development of coastal highways and motorways.

An active and efficient network of SMEs in Pakistan is a necessary condition for the robust of industrialization. Pakistan’s government has declared SMEs as one of the four important determinant of economic growth. SMEs play their role in value addition and employment generation in Pakistan. SMEs in Pakistan is highly labour intensive and this sector provides employment opportunities to the major part of non-agricultural labour force, Economic Survey (2004-05), issued by Ministry of Finance, Government of Pakistan. Pakistan’s SMEs sector comprises of 90 % of the total businesses. This sector generates 80% of the employment opportunities to non-agricultural labour force. SMEs in Pakistan contributes approximately 25% of the total exports, 35% of the manufacturing value addition and adds up more than 30% to the GDP of the economy, Economic Survey (2009-10). 25% of the exports earnings are generated by the output of this sector, Economic Survey (2001-02). This sector constitutes cotton weaving, wood and furniture, metal products, art silk, grain milling, jewelry, carpets, sports goods, pottery, dairy and poultry, fisheries, food, catering and slaughtering.

The following table shows the participation of Pakistan and other Asian and Developed countries towards GDP manufacturing. **(Reported by Small and Medium Enterprises Development Authority).**

	1960	1965	1970	1977	1980	1985	1990	2000	2002
Pakistan	12%	14%	16%	16%	16%	18%	17.6%	16.7%	18%
Indonesia	8%	8%	10%	9%	13%	24%	21%	26%	25.1%
Malaysia	9%	9%	12%	18%	21%	29%	24%	28%	30%
Korea	12%	18%	21%	25%	28%	30%	29%	33%	41%
Sweden	27%	28%		24%			26%	28.2%	
Germany	40%		38%	38%		26%	28%	29.6%	
U.K	32%	32%	33%				25%	26.4%	
Japan	33%	32%	36%	33%	29%		24%	32.3%	

Developing countries are facing a lot of constraints regarding development and growth of SMEs. I.e. Lack of finance, competition, globalization, business location, laws and regulations, political stability, inflation, training and education, poor management, lack of motivation and stress on employees etc. The purpose of this study is to understand and analyze the factors that affect the development and growth of SMEs in Pakistan. The factors of particular interest are Lack of finance, Laws and regulations, Competition, Lack of motivation and Poor management.

SMEs do not have adequate access to finance for start up of the businesses. Almost all the new enterprises which have difficulty to access external financing, start their businesses with financing from their internal resources.

Government policies, laws and regulations affect the development and growth of SMEs in an economy. Corruption, un-fair competition and in-efficient judicial system are seen as hurdles to doing business according to World Bank report, (WB, 2012). Competition among the businesses producing homogeneous products and services affect the growth of SMEs involved in manufacturing or producing similar products and services. Although the consumer's perception about the local product being associated with lack of confidence in the quality of the products and services is a negative phenomena in the development and growth of SMEs. Lack of motivation is another factor which affects the growth of SMEs. The Employees with low morale do not go for initiatives or innovations for expansion purposes. They are just busy with their routine operations. Hence the growth rate is just dependent upon the marketing activities which in turn enhances the sales or price appreciation.

Another factor that is poor management directly affects the growth of SMEs. An efficient and a well designed standards of procedures (SOP) and its implementation can enhance the growth of SMEs.

Literature Review

Lack of Finance

According to Guffey a business plan is necessary when you go for start-up of a new business. Unless you can count on the bank of your relatives you will need financial backing such as a bank loan or venture capital supplied by investors. A business plan is critical for securing financial support. (Guffey, 2008, 401).

SMEs do not have an easy access to financing from financial institutions. This is mainly because of in-efficient and weak financial market and the weak legal system for credit and collateral. Financing a business start-up is a critical issue, as it is a basic source of generating the resources of the planned business. A business can manage its financial requirements both for development and growth through various ways but the basic decision is whether or not accept the external financing as it would result in to creation of share in the business in the form of interest or profit. Loss of control over business activities may be a consequence of external financing. Financing the firm is a necessary and having access to finance plays an important role on firm's growth process. For many financial institutions it is almost impossible to assess the risks of an investment, this is mainly because of the high level of uncertainty. (World Bank 2001, 77).

H1: Lack of finance negatively affects the development and growth of SMEs.

Laws and Regulations

The World Bank researchers argued that constraints that SMEs are facing are complex tax systems. (World Bank 2000, 77) Also another shortcoming is low level of trust in the court system to enforce claims, and the need to pay heavy amount of bribes for access to basic public services.

The degree of importance of SMEs in an economy can clearly be seen through the laws and regulations that are supportive in nature and enable them to operate efficiently and the regulations that reduce administrative costs (Harvie and Lee, 2005). No doubt the government of Pakistan has taken initiatives to promote and support SMEs in order to enhance their development and reduce poverty, but still there is a lack of laws and real administrative procedures such as accessibility to assistance at the end of government agencies (Harvie, 2005). Steps need to be taken in order to improve infrastructure, costs and IT training and in information relating to the business opportunities, i.e. e-commerce can generate (Harvie & Lee 2005, 11).

H2: Laws and regulations positively affects the development and growth of SMEs.

Competition

Competition can be defined in several ways. It is important that in any discussion of competition is to recognize that, entering into competition and organization is to seek competitive advantage; this competitive advantage is the key of business success. (Walley 1998, 186).

According to the survey made by World Bank, competition poses a threat to survival to any individual firm. Even the competition being a threat to survival, it also drives firms to improve productivity and therefore drives the growth. SMEs, usually are not very competitive in terms of market knowledge, innovation, prudent investment, business operations and good management. These factors are very important in order to improve the quality (OSMEP, 2007).

Due to globalization and increased trade, developing countries compete with other countries. However barriers and other constraints generally favour them (Lind, 2009). Free trade agreements between the countries have increased the competition by international companies (OSMEP, 2007).

H3: Competition affects positively the development and growth of SMEs.

Lack of Motivation

Individuals go for new businesses with different motives. Some of them will enter the businesses because they have identified an opportunity in the market and they think that they can utilize their skills; some of them enter to generate income, while other enter into business due to the desire of independence to be one's own boss (McCormick and Pedersen, 1996; Dutta, 2009). There may be some other factors that attract an individual towards a business are financial benefits. These factors may a hobby, prior work experience and family culture acting as a role model (DATI, 2000). On the other hand Shapero postulates that factors such as lack of employment, retrenchment, retirement are likely to push one into business.

Employees lacking motivation can be destructive to an organization. Decrease in production, self-esteem, and customers are just a few of the disgusting factors that affect the organization. On the other hand, annoyed workers can have just the conflicting consequence. Motivated workers are more probable to include superior confidence and self-efficacy. Self-efficacy is the confidence that one can perform a definite job effectively. Having motivated employees increases spirits in a business (Roberts, 2010).

H4: Lack of motivation negatively affects the development and growth of SMEs.

Poor Management

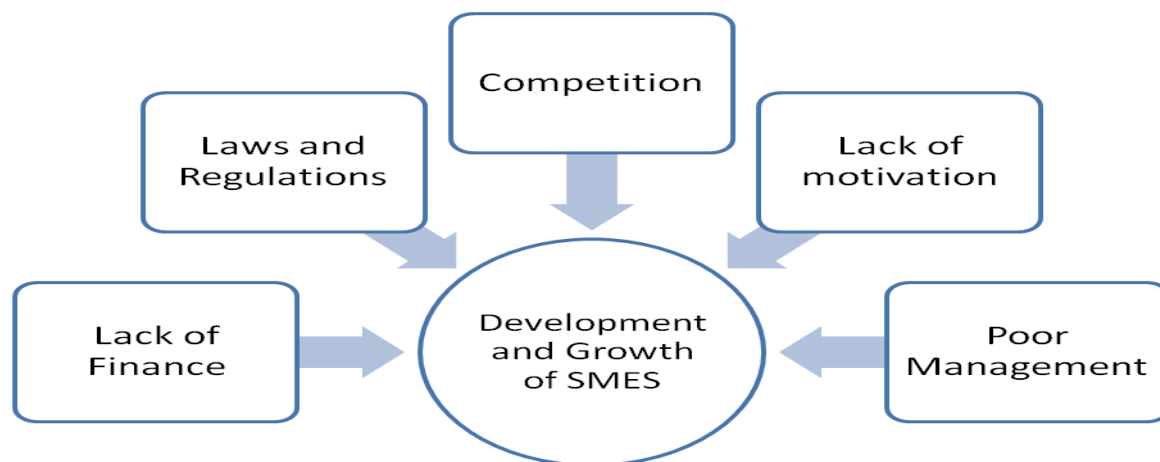
Managerial competencies are sets of facts, skills, behaviors and approaches that contribute to individual worth. Managerial competencies play a vital role to the continued existence and enlargement of new SMEs. Lack of education and training has concentrated management aptitude in new firms. This is one of the reasons for the low

level of entrepreneurial structure and the high collapse rate of new business enterprises (Olawale, 2010).

Mostly, SMEs do not contain clear tactics for growth prospects, production procedures, marketing, monetary behaviors etc. Owners of most of SMEs act as managers and perform all the everyday jobs, which are not delectated to others. Therefore, the most of the SMEs do not perform at their best due to the holdup of decision-making method, deprived association, poor employment, weak scheming and directing. Financial management of the majority of the SMEs is established to be very weak. Most SMEs do not work out total expenses, total revenues, earnings etc, for they do not keep the comprehensive records. (H.M.S.Priyanath, 2006). A successful manager always understands the business environment, both internal and external. He or she does not only understand, but is ready, well-equipped and prepared to handle any issue due to change in the environment. These changes can be occur due to competitors, suppliers, customers, government agencies, labour organizations, and financial institutions etc. (Hisrich et al, 2010, Certo and Peter, 1993).

H5: Poor management negatively affects the development and growth of SMEs.

Conceptual Research Model



Research Methodology

According to the nature this research falls in the category of Descriptive Research. It can be explained as describing something, some idea, some phenomenon or any particular situation. Descriptive researches are the researches which describe the prevailing situation instead of interpreting and making judgments (Creswell, 1994). The verification of the developed hypotheses that reflect the current situation is the main purpose of the descriptive research. Along with that this sort of research also provides information about the current study scenario and focus on past or present.

Sample Data

For the collection of data for the understanding the factors affecting the development and growth of SMEs, a sample of 100 respondents will ask to participate in a self-administered questionnaire. The population for this research is the ultimate consumers in Pakistan.

Non-probability sampling technique is utilized in this study, which is convenience sampling. Convenience sampling is a sampling technique that obtains and collects the relevant information from the sample that is conveniently available (Zikmund, 1997).

Instrument and Measures

The survey instrument of the study was a self administered questionnaire. The purpose of this survey instrument is to make an analysis of relationship of different variables with the development and growth of SMEs.

The questionnaire comprises of two sections. Section 1 includes different personal and demographic variables. This section will gather the respondent's information about gender, age, income, education and status, while Section 2 includes the different variables important in the current study. These variables include Development and

Growth of SMEs, Lack of finance, Laws and regulations, Competition, Lack of Motivation and Poor management. The scales of the study were self-designed. The first four variables were Development and Growth of SMEs, Lack of Finance, Laws and Regulations, Competition and Lack of Motivation. Each variable have three items. The next variable Poor Management comprises of three items.

Procedure

The survey instrument was distributed among 120 respondents in Bahawalpur. More than 95% of respondents were related with the business sector in Bahawalpur and nearby areas. These respondents were selected upon the basis of criteria above mentioned. The purpose of study and the questions regarding different variables were explained to the respondents before giving the questionnaire. Out of 120 questionnaires 100 were selected and the remaining was not included in the further analysis because of incomplete and invalid responses. These questionnaires were then coded and entered in to SPSS sheet for analysis.

Data Analysis

Chronbach's Alpha of the development and growth of SMEs questionnaire items is more than recommended and acceptable value 0.50 by Nunnally (1970) and 0.6 by Moss et al. (1998). This shows that all 16 items were reliable and valid to measure the opinions of development and growth of SMEs in Pakistan.

Reliability of Measurement instrument

Scales	Items	Cronbach Alpha
Development and Growth of SMEs	3	0.840
Lack of Finance	3	0.616

Laws and Regulations	3	0.704
Competition	3	0.630
Lack of Motivation	3	0.676
Poor Management	3	0.676

Results and Analysis

Profile of Respondents

Demographic and Personal information such as gender, age, income, education and status level are presented in the following table.

	Category	Frequency	Percentage
Variable			
Gender	Male	73	73%
	Female	27	27%
Age	15-20 Years	02	02%
	20-25 Years	10	10%
	25-30 Years	20	20%
	30-35 Years	35	35%
	35-40 Years	25	25%
	Above 40 Years	08	08%
Income	Below 15000	05	05%
	15000-25000	50	50%
	25000-35000	25	25%

	35000-45000	15	15%
	45000-55000	05	05%
	Above 50000	00	00%
Education	Matriculation	00	00%
	Inter	02	02%
	Bachelor	45	45%
	Master	35	35%
	MS/ M.Phil	10	10%
	PHD	08	08%
Status	Student	10	10%
	Employed	50	50%
	Businessman	40	40%
	Unemployed	00	00%
	Housewife	00	00%

Hypothesis Testing

Lack of Finance, Development and Growth of SMEs

According to outcomes of study, the variable of Lack of Finance have a significant positive relationship with Development and Growth of SMEs with ($\beta = 0.048$) and ($p = 0.022$). It means the Lack of Finance affects negatively more than 4.8% to Development and Growth of SMEs. Thus the results validate **H1**.

Laws and Regulations, Development and Growth of SMEs

While considering the relationship between Laws and Regulations and Development and Growth of SMEs , the results of current study shows a positive and significant relationship between these two variables with ($\beta = 0.517$) and ($p = 0.00$). Thus, according to results we accept **H2** and concluded that the study found a negative and significant relationship of Laws and Regulations and Development and Growth of SMEs.

Competition, Development and Growth of SMEs

Regression Analysis of the Development and Growth of SMEs model shows that there is a significant positive relationship between Competition and Purchase Intention with ($\beta = 0.205$) and ($p < 0.05$). The results suggest that the Competition contributes almost 20.5% to Development and Growth of SMES. Hence, the results support **H3**.

Lack of Motivation, Development and Growth of SMEs

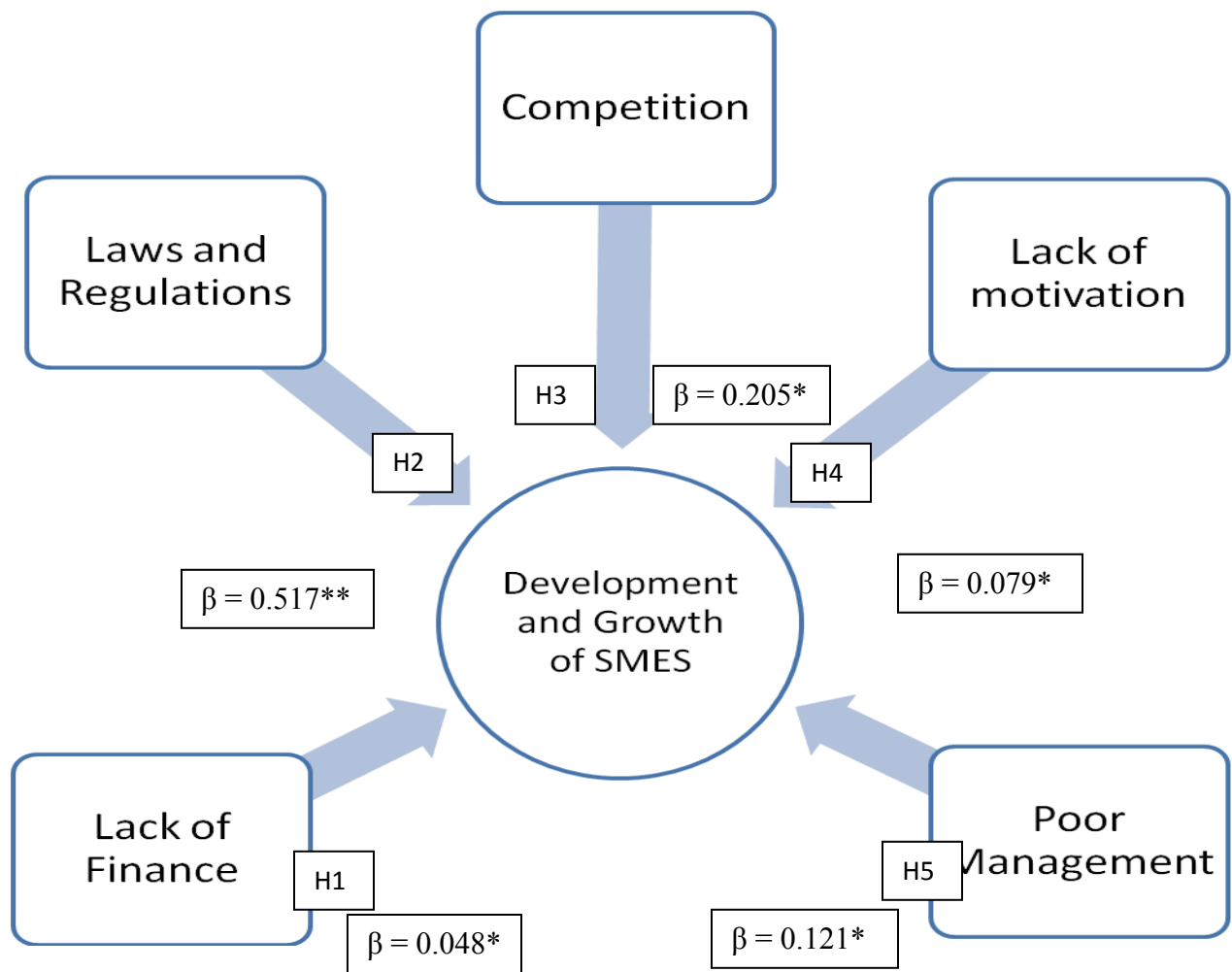
According to the regression estimate results the independent variable Lack of Motivation have a significant and positive relationship with Development and Growth of SMEs with ($\beta = 0.079$) and ($p = 0.031$). So, it means Lack of Motivation negatively affects more than 3.1% to Development and Growth of SMEs. Thus the results validate **H4**.

Poor Management, Development and Growth of SMEs

There found a positive significant relationship between Poor Management and Development and Growth of SMEs with the ($\beta = 0.121$) and ($p = 0.012$). That means the independent variable Poor Management negatively affects more than 12.1% to Development and Growth of SMEs. Thus the results of the study support **H5**.

Regression Results

Hypothesis	Model Variables	Estimate	S.E.	P	Results
H1	L. of Finance → D& G SMEs	0.048	0.073	0.022	Supported
H2	Laws & Reg. → D& G SMEs	0.517	0.070	0.00	Supported
H3	Competition → D& G SMEs	0.205	0.085	0.049	Supported
H4	L. of Motivation → D& G SMEs	0.079	0.103	0.031	Supported
H5	P. Management → D& G SMEs	0.121	0.078	0.012	Supported



**p<0.01; *p<0.005

Conclusion

The purpose of this study was to understand and analyze the factors which affect the development and growth of SMEs in Pakistan. A major implication for the findings of this study is that the outcomes will be able to give better understanding for entrepreneurs, business owners and government policy makers in addressing the factors which will significantly affect the business development and growth. The study of the factors affecting the development and growth of SMEs are important for understanding the business continuity and growth. Hence it would help supporting economic development in the state. The results of this study may also be utilized as reference for anyone who is particularly interested to start his/her own business which will provide insights into decision making and initiating a business and also for the organizations which are interested to develop new businesses and to expand the current business.

For business development and growth, many factors should be optimal simultaneously, since SMEs growth is a multidimensional phenomena. Both SMEs internal and external factors affect SMEs development and growth. Successful entrepreneurs and the individuals who are planning to start a new business must consider the factors discussed in this study while going for expansion or a start-up. The study focused on the factors which are mostly a cause of success or failure in the development and growth of businesses especially in case of Pakistan. These factors include Lack of finance, Laws and Regulations, Competition, Lack of Motivation and Poor Management.

The results supported all the developed hypothesis in this study. According to results Lack of Finance, Lack of Motivation and Poor Management negatively affects the development and growth of SMEs in Pakistan, while Laws and Regulations and Competition affects positively the development and growth of SMEs in Pakistan.

Hence there should be such steps taken at the end of the government and organization and individuals, so that financing problems, regulatory issues to the SMEs are

mitigated; and the firms should motivate their employees and manage their operations to compete with the other businesses to get a competitive advantage.

Government should formulate such policies which facilitate the development and growth of SMEs like making easy and understandable tax structure and tax exemptions to SMEs. Financial institutions must understand the importance of SMEs and should work on the financing to SMEs. Organizations should go for incentives to employees who work with hard efforts, so that their performance can be increased with time to time. Managers must understand the internal and external influencing factors in order to cope with the market changes and to compete with the other firms in the market in order to survive and grow further.

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