

Internal Factors Influencing the Growth of Small and Medium Enterprises: Evidence from Pakistan

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Abstract: The purpose of this study is to identify the perceived critical internal factors affecting the growth of Small and Medium Enterprises in Pakistan. This research topic is designed to study factors influencing growth of Small and Medium Enterprises (SMEs) and how growth can be measured in Pakistan. The major source of data collection was survey questionnaire. Inferential statistics were used to present and analyze data. Findings show that important relationship exists between identified factors and growth. Research influencing factors of growth is scarce in Pakistan. This research is an addition to existing limited literature. This paper reveals considerable evidence to triumph over obstacles of Small and Medium Enterprises (SMEs) in Pakistan. Study concludes with recommendations in this direction.

Keywords: Innovation, Small & medium enterprises, growth.

1. Introduction

The Small and Medium Enterprises considered as backbone of modern economies due to their remarkable contribution in job creation, help to earn foreign exchange, exports and innovation. Small and Medium Enterprises considered as a major driver of growth in Pakistan which reflects significant beneficence in worse economical situations.

Small and Medium Enterprises on the grounds of development reported 80% of financial development [1]. SME sector in Pakistan play a vital role and considered as a backbone in economy [2].

Small and Medium Enterprises constitutes major portion of all business sectors in Pakistan. It contributes 40% in annual GDP. It provides 80% of unskilled labour jobs which represent 35% value addition and SME sector produces 30% of export income [3]. As stated by Economic survey of Pakistan 3.2 million Small and Medium Enterprises are operating in nation and contributes a major part in GDP.

Regardless of all these importance and vital contribution in economy SME sector could not receive adequate attention to enhance growth of Small and Medium Enterprises. For the growth of economy it is necessary to flourish business sector especially SME. The purpose of this study is to identify the inner factors causes' failure of Small and Medium Enterprises and

create hindrance in growth. Growth has been measured through innovation. Due to a wide spectrum of factors causes hindrance in growth only specific few factors are discussed in this study which plays a vital role in Small and Medium Enterprises failure.

The arrangement of study is present as section 2 explains literature review, section 3 illustrate methodology and data analysis, section 4 represent conclusion and suggestions.

2. Literature Review

While exploring the obstructing factors for SME's to grow it is essential to describe how the growth can be measured for firms. For measuring growth of firms there is not a tool for evaluating or measuring development; various researchers used different growth signs during research in respective field [4]. Market share, physical output, profit and assets are range of diverse indicators used by researchers [5]. But these indicators are not frequently exercised due to their limited applicability. As assets worth depends upon capital intensity. Physical output and market share differs within the firms and remains quite complicated to compare, profit is only applicable to evaluate size over a long phase [5].

Influence of age on growth has been examined and scrutinized adverse response on growth of firms and

development decreases with age of firm [6]. A survey focusing on Small and Medium Enterprises holds across various industries state that product innovation is the absolute most acclaimed strategy for development [7]. Product innovation have positive whilst process innovation have negative impact on employment [8]. Financial performance does not seem a most important determinant of growth [9]. Ownership could be a relevant factor of growth; multi-plant firms have higher growth rates than single-plant firms. Growth has not been affected by exports [10].

Primary difference among growth of small and large firms that could not be ignored, this section of study elaborates these differences.

The development of small firms is unpredictable. Large numbers of these entrants are expected to fail despite within a few years that entry rates are high. After examination of post entrance execution of new contestants in 7 OECD nations it is observed 20-40% of firms are failed within two years and 40-50% carry on further [11]. A small business faces severe competition in market. And it is evident competition is mainstream element prohibits small business growth [12]. Despite all these facts small businesses tends to grow faster than large business for as much of facing difficulties in financing their growth [9]. The growth of small firms always remains a part of policy intervention. Its role has been characterized as vibrant and innovative that creates new employment opportunities. In contrast very few small firms are innovative and jobs offered by them are often disappearing afterwards [9].

Very limited progress has been made in finding the determinants of firm's growth. Growth is an unsystematic process and an element of uncertainty is always predominant in firm growth.

Innovation is an important determinant of growth [13]. Innovation and growth represent positive relationship with regular supply of financing [14]. Innovation activities are driving force for business growth and economic growth [15]. And innovation leads to an increase in profit which can be measured by raise in market share and reduction of material cost. Small and Medium Enterprises represent higher growth rate with compare to non innovative in terms of sales turnover, investment and employment [16]. Technological innovation is most likely to urge growth of an individual business at micro level and has potential to give new dimension to industry at macro level [17].

According to study conducted by PWC British firms that adopted innovation grow faster than their rivals with higher profit margin. In examining financial

results of 399 companies it is recognized most innovative firms gain more than 75 percent return on products and services within last five years. The study has some more findings like innovative firms more likely to benefit high growth than a stagnated firm does. Boston Consulting Group with Business week collected a list of World's 25 most innovative companies like Apple, Google, Microsoft, Nokia, Starbuck etc [18].

Innovation

Innovation means offering something new to customers and solving their problems in a unique way. To bring growth from innovation it is necessary that your idea generate new and unique value for customers. Innovation has been an imperative subject of study for different disciplines. There is a different opinion among academics what innovation really means. One of the definitions taken from oxford dictionary that fits the concept used in this research is

"Making changes to something established by introducing something new".

This is the general concept of Innovation we are going to discuss in this research. Considering above discussion regarding selection of growth indicators author decided to use technological innovation to measure growth.

Internal Barriers Obstructing Growth of SME's

Internal factors in organizations disclose how management decision and features of business can influence on judgment concerning firm's growth [19].

Marketing: Marketing competencies for Small and Medium Enterprises suggested a continual development is necessary in the perspective of environmental changes and competitive environment [20]. Collective entrance of new groups changed marketing infrastructure overdramatically which affects suppliers, customers, distributors and Small and Medium Enterprises are not aware how to deal with this situation [21]. Obstructing factors of Small and Medium Enterprises marketing are poor cash flow, tactical and strategic customer related problems, size of business [22]. There is lack of internal communication with disability of evaluating customer's complaints in Small and Medium Enterprises [23].

Management Competencies: SME managers, absenteeism in professionalism, and lack of dealing with business proceedings and importance of emerging issues, desperateness of losing control of management,

financial deficiency, and inefficiency of providing help by governmental bodies, reliance on government subsidy is major issues with respect to management [24]. With respect to Pakistan economy energy management emerged as a big challenge for Small and Medium Enterprises. Lack of knowledge is a major constraint in application of energy management practices [25]. Lack of managerial skills has great influence on SME attainment in developing countries [26]. To manage Small and Medium Enterprises entrepreneurs must be experienced, knowledgeable, and highly motivated [27]. Small and Medium Enterprises should focus on managerial competencies of human capital and relational proficiency because managerial competence is a capacity of relationship quality and competitive advantage [28].

Technology: Small and Medium Enterprises fails investment in IT sector will not be able to compete with others and fail in expanding their core capabilities. Small and Medium Enterprises links IT with their competencies can get competitive advantage over their competitors [29]. Availability of information about markets and technology are found main obstacles in innovation process of Small and Medium Enterprises [30]. Financial support from government plays a vital role in achieving technological innovation to foster SME competitiveness [31].

Lack of skilled labour: There is serious skill crisis in labour market that has significant effect on the growth and development of business as well as quality of production [31]. Labour productivity could be influenced by useful government policy action [33]. Govt. of Pakistan should encourage graduates to get jobs in Small and Medium Enterprises through different programmes. Valuable impacts of graduate placement have been found in Small and Medium Enterprises [34].

Lack of access to finance: Lack of access to finance is one of the major obstacles of Small and Medium Enterprises which restricts them to grow. In Pakistan Small and Medium Enterprises facing lack of access to finance because of high interest rates, lengthy loan application process, collateral unavailability, financial illiteracy [35]. Scholars recommended different suggestions to address the issue launching SME banks [36], introducing schemes i.e. mudarabah and musarakah [37]. By providing guidance on obtaining loan, banks should develop collateral free loan, cluster based financing products to minimize cost of lending [35].

3. Methodology

Data is collected through questionnaire which is designed on basis of 5 item Likert scale. Secondary data is collected from different sources i.e books, research papers, internet sources etc. to get superior vision of Small and Medium Enterprises in Pakistan. Primary data is collected by questionnaire with firm's manager and senior employees to get better insight of firm business.

300 firms considered which were involved in trading business, manufacturing, and services in Pakistan. Specific respondents considered in this study are senior managers and owner managers as they possess the adequate to answer the question. Broad literature argues managerial insight is suitable to yield trustworthy responses [38].

4. Data Analysis

The aim of this study is to determine those variables which extensively effect the technological innovation in Small and Medium Enterprises.

Table 1: Model Summary

Model	R	R square	Adjusted r square	Std. error of estimation
1	.440	.194	.163	.56430

- Predictors: (Constant), Lack of skilled labour, M, Tech, MC
- Dependent: Innovation $R^2=.194$ provides 19.4% variation in innovation is attributable to the selected independent variables i.e. (M, MC, Tech, & LSL) while 80.6% attributable to the further variable not incorporated in the model. Low value of R-square shows likeness of similar kind of studies [39]. Large value of R^2 does not determines the suitability of regression model [40].

Hypothesis

Equation for the hypothesis testing

$$\text{Inn} = \alpha + \beta_m + \beta_{MC} + \beta_{Tech} + \beta_{LSL} + \epsilon$$

Inn stands for Innovation M stands for Marketing

MC stands for Management Competencies

LSL stands for Lack of skilled labour

ϵ represent the error term

Table 2 Regression results

Independent Variables	β	t-values	Sig
Marketing	.005	.046	.964
Management Competency	.248	2.669	.009
Technology	.167	1.796	.075
Lack of skilled Labour	.101	2.060	.042

H1: There is no relation between marketing and innovation

There is a positive relation between marketing and innovation ($\beta=.005$), however relationship found insignificant ($p > 0.05$). Therefore we accept null hypothesis. This result contradicts the findings of past research that proves innovative marketing is key factor for long term growth and profitability.

H2: There is no relation between management competencies and innovation

It states that management competencies is positively related to innovation ($\beta= .248$, $p < 0.01$). We reject null hypothesis. Technological absence in managerial skills effects performance of Small and Medium Enterprises [24]. This argument supports our study.

H3: There is no relation between technology and innovation

Technological advancement is positively related to innovation ($\beta= .167$). The outcome shows that t-test found beta coefficient was found statistically significant at the 5% level with the conclusion that beta coefficient for technology was not equal to zero therefore we reject null hypothesis. Small and Medium Enterprises links IT with their competencies can get competitive advantage over their competitors [29].

H4: There is no relation between Lack of skilled labour and innovation

Lack of skilled labour is positively related to firm innovation ($\beta= .101$, $p > 0.05$). The results indicate that t-test found beta coefficient was found statistically significant therefore we reject null hypothesis. Skill crisis in labour market has significant impact on the growth and development of business as well as quality of production supports findings of this study [32].

5. Conclusion

Considering that all respondents in this research have comparable observation and encounters with respect to elements influencing organizations, the author have

identified these issues as the major or serious obstructions restraining the growth of Small and Medium Enterprises in Pakistan. Results from Multiple regression analysis indicated that there is a positive but insignificant relationship between marketing and innovation. And positive significant relationship exists between management competencies, technology and lack of skilled labour. With respect to inadequate technical innovation interest in education must be expanded, training institutions should be enhanced, and staff training, must be reinforced to enhance the general nature of technical staff. The relationship between the business, government, academy and research institutions ought to be reinforced and the long term collaboration between the four must be established to advance the industrialization of scientific and technological accomplishments, to advance industrial innovation of Pakistan. This research is limited to internal factors which effects growth of Small and Medium Enterprises. It is suggested further research should take into account external obstructing factors that effects growth.

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