

## **DETERMINANTS OF BUSINESS SUCCESS OF SMALL AND MEDIUM ENTERPRISES**

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### **Abstract**

*The small and medium enterprises (SMEs) play critical role in the development of the country. The success of SMEs depends on number of factors. This study examines the role of key factors in the success of SMEs in Pakistan. The study also investigates the relationship between SMEs success and its determinants. Target population of the study was SMEs operating in different lines of business from service to manufacturing. Sample size of this study was 520 small and medium lines of businesses. Responses of the subjects were collected through questionnaires. SPSS software is used for analysis. This study concludes that there is a significant relationship between business success and its determinants. The result also shows that financial resources are the most important factor in the success of business perceived by small and medium enterprises. The success of small and medium enterprises can contribute significantly in the development of the country.*

**Keywords:** Business success, financial resources, marketing strategy, technological resources.

### **1. Introduction**

Small and medium enterprises (SMEs) are those enterprises that employ not more than 250 employees and work on small scale. The technical definition varies from country to country but is usually based on employment, assets, or a combination of the two (State Bank of Pakistan). Most of the foreign countries are realizing the fact that SMEs contribute a major portion of the country's GDP and economic activity and they hold an important place and get the similar effects when a business policy is laid by the government for larger businesses. Most of the south eastern countries have realized the importance of the SME's towards the productivity of the country and for this reason most of the countries are keeping vigilant eye on the growth and interest of the people running these small and medium enterprise.

The small and medium enterprises are being considered as engines of economic growth world wide. One of the most important roles of SMEs in this context includes poverty alleviation through job creation. The developed as well as developing countries are taking extreme benefits from SMEs and that are capable to accelerate the economy of any country. It plays considerable responsibility in providing further employment and conversion of economy. It is also implicit that sectors conquered by SMEs are better able to develop dynamic economies of scale. The roles of SMEs in the creation of productive employment are concerned with its position in the center of the range of sizes and resources intensities in a rising economy. Developing economies have started to focus on the crucial role that SMEs can play in their development (Maad, 2008).

Enterprises qualify as small and medium-sized enterprises (SMEs) if they fulfill any of the following criteria laid down in the table 1.1.

**Table 1: Definition of SMEs**

<b>Enterprise category</b>	<b>Employees</b>	<b>Turnover</b>	<b>Balance sheet total</b>
medium-sized	< 250	≤ € 50 million	≤ € 43 million
Small	< 50	≤ € 10 million	≤ €10 million

(European Commission Report, 2005)

Most of the current larger enterprises have their origin in small and medium enterprises. SMEs are different from large scale enterprises in three main aspects; uncertainty, innovation and evolution. The SME sector itself can be classified into micro enterprises, small enterprises and medium enterprises. SMEs are the starting point of development in the economies towards industrialization. However, SMEs have their significant effect on the income distribution, tax revenue, and employment, efficient utilization of resources and stability of family income. SMEs have a propensity to employ more labor-intensive production processes than large enterprises. Consequently, they contribute significantly to the provision of productive employment opportunities, the generation of income and, eventually, the reduction of poverty. SMEs play significant contribution in the transition of agriculture-led economies to industrial ones furnishing plain opportunities for processing activities which can generate sustainable source of revenue and enhance the development process. SMEs shore up the expansion of systemic productive capability.

The only way to reduce poverty in a sustainable way is to promote economic growth, through wealth and employment creation. In developing countries, SMEs are the major source of income, a breeding ground for entrepreneurs and a provider of employment (UNIDO Report, 2003)

**Table 2: Importance of SMEs to the National Economies**

<b>Country</b>	<b>SMEs as % of all enterprises</b>	<b>SME employees as % of total employees population</b>
<b>Hong Kong</b>	98.0	60.0
<b>Thailand</b>	99.7	58.0
<b>Philippines</b>	99.6	70.0
<b>Japan</b>	98.9	69.2
<b>Malaysia</b>	96.1	45.0
<b>Singapore</b>	99.7	57.0
<b>Taiwan</b>	97.7	68.8

**Source:** White paper on small and medium enterprises in Taiwan, 2006.

### **SME Sector in Pakistan**

Pakistan is not an exception to this as the Government and State Bank of Pakistan have been trying to give forward potential motion to their efforts to develop SME sector in Pakistan. But there is always a gap for the further improvement that can only be filled by the intensive research by the scholars and entrepreneurs to support the business activities so that economy can grow faster. State Bank of Pakistan has defined the SMEs in these words. Small and Medium Enterprise (SME) means an entity, not a public limited company, which has less than 250 employees in the organization of manufacturing and services provider and same are (trading concern) and fulfills any two of the following criteria of either a and c or b and c as relevant: (a) A trading / service concern having total assets at cost in which land and building up to Rs 50 million is not included. (b) A manufacturing unit having of total assets at cost up to Rs 100 million without land and building.(c) Any concern of service, trading or manufacturing) with net sales less than Rs 300 million as per current financial statements. (State bank of Pakistan) SME Banks are trying to bridge the gap between the financing needs of SMEs and their access to financial resources. Six SME banks were established by government in different cities with the objectives to support and develop the SME sector by providing necessary financial and technical assistance on a sustainable basis.

SME Business Support Fund (BSF) is a company owned by the ministry of finance. BSF is a non profit organization created to assist both the SMEs and the business development services providers (BDSP's).The objectives of the BSF are to assist in the improvement of the competitiveness of SMEs and to enhance the revenue-generating capacity and profitability of emerging businesses.

It is a financial support scheme, established for small and medium sized companies (SMEs) to enhance their competitiveness & profitability, through the increased use of business development services (BDS). Small and Medium Enterprises Development Authority (SMEDA) was established in October 1998 to coop up the challenges of developing small & medium units in the Pakistan. The point of view was to develop professional management structure with futuristic approach and, focused on providing a fruitful environment and business development opportunities and financial services to small and medium enterprises. Small and Medium Enterprises Development Authority (SMEDA) is the flagship organization of Pakistan that is providing the necessary services to help SME's to overcome the weaknesses. This entity is operating under the ministry of industries & production and it contribute towards the growth and development of SME's in Pakistan through, the creation of a encouraging and providing regulatory environment and development of industrial sector, and the provision of business development services to SME's in all areas of business management.

**Table 3: Province wise distribution of SMEs**

Name of Area	SMEs Unit
Pakistan	6.96 million
Punjab	65.26%
Sindh	17.82%
NWFP	14.21%
Balochistan	2.71%

(The Economic Survey of Pakistan Report, 2009)

Small and medium enterprises (SMEs) comprises more than 99 percent having huge share in country's industrial employment and manufacturing exports In manufacturing and other sectors, 87% of SME employ less than five people while a stunning 98% employ either 10 persons or less than it 25% of SMEs in Pakistan are related to manufacturing sector while it allocate 28% of growth. The government officials claim that Pakistan SME sector recorded growth of 14.7% during 1987/88 and 1996/97 when the output amplified from Rs.19, 683 million to Rs.67, 541 million. The number of small and household manufacturing industries recorded a growth rate of 5.8% and their contribution in the GDP is 30% that means 140 billion rupees to exports and generate 25% of exported good.

**Table 4: SME' Share in sub – sector**

S.No	Sub – Sectors	Percentage share of SMEs
1	Cotton weaving	18%
2	Wood and Furniture	8%
3	Metal Products	20%
4	Carpets	24%
5	Art Silk	5%
6	Grain Milling	8%
7	Jewelry	6%
8	Other Textiles	4%
9	Others	7%

(The Economic Survey of Pakistan Report, 2009)

Employment in the informal manufacturing sector is estimated at 3 million persons, with a share of 23 per cent of the total employment in the informal non-agricultural sector. Thus, 77 per cent of non-agricultural informal employment is being generated by micro enterprises in the services and trade sectors. The objectives of this study are to analyze the SME sector in Pakistan. To investigate the relationship between business success and its determinant and to suggest certain measures to stakeholders for the growth of SME sector in Pakistan

## 2. Research Theory

For all businesses to be successful require ever demanding efforts in all areas that affects the business success. Increasing business competition, in particular against large and medium competitors puts SME's in a vulnerable position. As SMEs operates around the traditional lines, and a lot of factors increases their influence and causing a huge affect on the success of SME's no matter what is location of SME's and how strong is the market conditions are, influencing factor is always there for the small businessmen to anticipate these factors while doing the business. The literature is based on the success factors affecting the success of SMEs.

It is obvious that hurdles in the business success are far more than it was in previous. The environments as well as and some other factors that are very complex and dynamic. The only thing that is more concerned to the entrepreneur is what he should do to survive in a competitive market. The factors which we are concerned more in the literature are financial resources marketing strategy, technological resources, information access, and government support and business plan. Audretsch (2005) showed the relationship between ownership, decision making and employee deployment and the performances of the firm. Their finding shows that ownership profile is key factors in the success of an SME. Business plan it holds its vital importance as better business planning reduces the risks associated with any business activity. Insufficient awareness of the need for a business plan was identified as one problem at the start up phase among SME's (Chami, 2006). Business information of relevance for the perception of ability to success and thereby for intention is relevant sources of inputs, markets and, technological solutions, and government rules as well as regulators policies. The availability of the information is found to be dependent on characteristics of the level of education, infrastructure qualities and media coverage and telecommunication systems, and on social capital side as networks and never the least the entrepreneurial skills (Deakins, 2006).

Financial resources are of vital importance for a business to run operations profitably. SMEs have comparatively limited resources and greater difficulty in accessing to funding sources, are more dependant on a single product, have less adequate budget control system, lack economies of scale (Thurik, 2007). In a recent research study on SME's in Indonesia founded that SMEs operate on traditional lines in marketing. Strict reaction on account of competition should be responded proactively by SMEs by doing business development and research (Robert, 2007). Information access it stands for the availability of business information is also important to initiate new enterprises and to run the existing enterprise profitably. Information refers to the frequency of contact which an individual makes with different sources of information. Relation building is one of key factors in every society and it has its applications in Pakistan too. The result of this activity is dependent on information accessibility, is vital for the survival and growth of firms (Curran, 2007). Technology is also play an important role in this respect. Technology has a close relationship with improvement of production process.

Different studies have also revealed the similar results that lack of new technology and equipment are hindrances of SME development (Swierczek & Ha, 2007). Hence the government support is one the major variable that ensures the business success of the SME's. One of the significant characteristics of a flourishing and growing economy is a booming and blooming small and medium enterprises (SMEs) sector. Small and medium enterprises play an important role in the development of a country (Curran, 2007). SMEs contribute to economic development in various ways: by creating employment for rural and urban growing labor force, providing desirable sustainability and innovation in the economy as a whole. In addition to that, large number of people relies on the small and medium enterprises directly or indirectly (Curran, 2007).

However it is believed that well-planned business activities as manifested in a business plan will yield a better business performance. In Indonesian study it was revealed that business has no sufficient relation with the success of an SME (Huggins, 2007). All the above mentioned variables have vital importance in the business success of SMEs as many previous researches have supported these variables and found a deep connection between these variables and business success of an SME. Similarly some of these variables are not supported by the recent empirical study conducted by (Indarti and Langenberg, 2007). That is why in this research all these variables are considered for further research in Pakistan to verify that either it holds a positive, negative relationship with the business success of an SME.

Government support, most of the governments in the world is focusing on their support programs for the SME sector development, in order to sustain a stable national economy (Butler, 2008). Technological resources, is one the most important element in the success of any business. Firm that uses the latest technology tends to captures its customers more than its competitors. Although technology has its cost but in the end business usually recover this cost as they operate. Still they are able to get an edge over its competitors by application of new technology. In the third world countries most of the SME's are not able to install new technology due to its higher cost. But from previous researches it is founded that technology has its deep roots in the business success of the SMEs and positively correlated with the business success of an SME founded by (Cartsson, 2008). SMEs have limited funds for R&D or to speed-up products. In the most recent study on the SME's it was founded that financial flexibility was significant correlated to business success. SME's that took the advantage of gaining the capital from a third party usually enjoy the better chances for its success (Pitman, 2008).



The above table shows the results of regression analysis with business success as dependent variables. The value of  $r$ -square=0.45,  $F$ -value=76.732 and  $p$ -value 0.000 show that the model is significant and independent variables have substantial impact on dependent variables. The  $t$  statistic is the coefficient divided by its standard error. The standard error is an estimate of the standard deviation of the coefficient, the amount it varies across cases. The  $r$ -square of the regression is the fraction of the variation in dependent variable that is accounted for (or predicted by) your independent variables. (In regression with a single independent variable, it is the same as the square of the correlation between dependent and independent variable.) The  $r$ -squared is generally of secondary importance, unless your main concern is using the regression equation to make accurate predictions. The  $p$  value tells you how confident you can be that each individual variable has some correlation with the dependent variable, which is the important thing.  $P$ - Value of financial resources is 0.000, marketing strategy 0.002, technological resources 0.000 information access 0.029, government support 0.001, business plan 0.004 and entrepreneur skill 0.000 shows the significant impact on business success.

### **5. Conclusions and Recommendations**

The small and medium enterprises have been believed as very important in accelerating the economic development of a country. That is why its role is becoming increasingly prominent through out the world. This study examines the factors which are exclusively contributing their role in the success of small and medium enterprises. These factors are financial resources, marketing strategy, technological resources and government support and entrepreneurial skill. This study also measures the relationship between SMEs success and its determinants. The study concludes that financial resources, technological resources, government support, marketing strategies and entrepreneurial skills have positive and significant impact on business success. This research also finds that financial resources are most important factor that affects the SMEs success. Financial resources are the key factor on which whole business is depending upon. Due to less Government financial support to entrepreneurs they are facing a lot of problems. Due to less financial resources entrepreneurs are not happy with the marketing activities of their product. First of all this is due to fact that SMEs have very small capital as compared to corporate sectors. Secondly SMEs have to face global competition. It has been seen in the research that technology plays vital role in the productivity of the firms.

The efficiency of production sector can be increased by using new technology. It is also cost saving. Business success is directly dependent upon technological factors. Pakistani entrepreneurs are satisfied with the present technology but one thing that is being conceived here is that they usually have very less information related to new technology. Also the SMEs owners who are doing traditional business are less adaptive to change. The research also conclude that leadership skills , decision making skills, management skills and professional affiliation with the business is also very important in achieving success of the business. If an entrepreneur is expert in above mentioned functions only then he can avail the opportunities in better way. Entrepreneurs are not satisfied with the government support. Keeping in view the prevailing and foreseeable economic conditions of the country, existing practices and other aspects of the SME sector, there are some of the recommendations based on findings of the study, Government should play a vital role by giving them favorable environment and creating favorable policies which lead to success of entrepreneurship i.e. easiness to get business permit, funding scheme from government. Now the world environment is rapidly changing due to technological change so businesses and manufacturers should be more innovative and creative in delivering product and service. Entrepreneurs should adapt new technology system in their business. Government should start training program at free of cost especially for small entrepreneurs. It is necessary for the enhancement of small entrepreneur's skill.

#### **5.1 Limitations and future research**

The survey in Pakistan was conducted in selected regions; therefore it may not reflect the views and practices of SMEs in other regions of Pakistan. This is necessary for exploratory study that requires a large scale confirmatory research to test the hypotheses which are suggested as result of the thesis. There is also a need of large scale survey to identify whether there is validate the results. The main implications of this research for scholars and policy makers are concerned with financing of SMEs in Pakistan to improve information flow, encourage transparency and consistency amongst banks at the time of evaluating loan applications and consider the effectiveness of excessive collateral on a business' success. It is evident that effects arising from the fundamental nature of the political, economic and financial system of Pakistan require better understanding before a reliable policy on SME financing can be proposed. Capital is very important for the businesses in which banks play very a significant role. The role of banking sector in Small and medium entrepreneurs financing can be investigated in future research

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