

Barriers constraining the growth of and potential solutions for emerging entrepreneurial SMEs

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Abstract

Purpose – Pakistan has marvellous growth and development capacity, and entrepreneurial small- and medium-sized enterprises (SMEs) play a key role in its development. As it is believed that entrepreneurial SMEs make an important contribution to the economy by providing employment and soaring production capacity, the purpose of this study is to investigate the hurdles that affect their performance.

Design/methodology/approach – A questionnaire-based survey was used to collect data from 225 entrepreneurial SMEs owners and managers in the southern region of Pakistan. Statistical analysis in SPSS was conducted to determine the barriers that limit the growth and development of SMEs.

Findings – The findings show that factors affecting entrepreneurial SMEs' performance in Pakistan are lack of finance and infrastructure as well as economic barriers, corruption and management issues. These obstacles are positively and significantly associated with entrepreneurial SMEs' failure.

Originality/value – This study's significance lies in its identification of the barriers that affect the performance of entrepreneurial SMEs in Pakistan. The author also suggests how policymakers can devise better policies for SME growth.

Keywords Barriers, Entrepreneurial SME failure, Pakistan

Paper type Research paper

1. Introduction

Across the world, entrepreneurial small- and medium-sized enterprises (SMEs) contribute greatly to national economies. A wide range of studies has indicated the crucial contribution of entrepreneurial SMEs as drivers of social and economic development. The pivotal role of SMEs in gross domestic product (GDP) growth, innovation and job creation is recognized and well noted. A strong entrepreneurial SME sector significantly contributes to a country's economy, adding to GDP by lowering the concentration of poverty and reducing the level of unemployment, and entrepreneurial SMEs play a vital role in developing a country (Sarwar *et al.*, 2021; Bayati and Taghavi, 2007).

Although the importance of entrepreneurial SMEs is recognized globally, their role is particularly important in developing economies (Karadag, 2016). In spite of the importance and significance of SMEs and their contribution to economic development, however,



entrepreneurs face multiple barriers restricting their survival and development, and small business growth research has shown that the rate of failure is higher in developing countries than in developed ones (Arinaitwe, 2006). Beck *et al.* (2005) stated that one of the major roles played by entrepreneurial SMEs is helping in the transformation process of transition economies. SMEs in transition economies shrink the surplus in labour development, restructure the economies in different sectors and transform the social structure. It is important to acknowledge the problems facing growth among entrepreneurial SMEs businesses in developing countries such as Pakistan, because they are substantially different from those faced in developed countries. The obstacles hindering entrepreneurial SME success can be classified in two categories: financial and non-financial constraints.

Financial constraints include environmental factors such as economic climate, poor access to financing and unfavourable market conditions, as SMEs do not work in a vacuum. Financial constraints are financial and economic obstacles. Among other challenges related to the economic climate, financing constraints drastically impede the development of SMEs (Beck and Demircuc-Kunt, 2006). The absence of funding prevents entrepreneurial SMEs from realising their full potential as an economic engine. Access to finance helps businesses to expand and develop a favourable market climate, and a stable overall economic environment as a whole is a strong predictor of success, as SMEs do not work in a vacuum. Other problems affecting SMEs' growth and efficiency are unfavourable market conditions and other environmental factors. Higher transaction costs related to smaller loans sought by SMEs, information asymmetry, higher risk premiums because of the opaque existence of smaller enterprises and the inability of SMEs to meet creditors' collateral criteria are key firm-level determinants of difficulties experienced by entrepreneurial SMEs in accessing external funds (Beck *et al.*, 2008). Obstacles such as the country's economic situation have a negative impact on SMEs' growth. A high rate of inflation decreases the buying ability of the individual.

Non-financial constraints can play equally important roles in limiting the success of SMEs. Such as corruption and infrastructure obstacles have limited the survival of SMEs, whereas management obstacles play a key role in limiting SME growth, and highly educated and skillful management is important if SMEs are to survive in this competitive environment.

This study addresses a topic of immense importance to the development of the entrepreneurial SME sector in developing economies such as Pakistan: it focuses on the determinants of SMEs' financial and non-financial constraints and investigates the factors that limit the growth of SMEs in such economies. The rest of the study is organised as follows: a literature review of research variables is followed by a description of the methodology, after which the results and conclusion are presented and, finally, recommendations are made to remove the identified barriers.

2. Literature review and hypotheses development

Entrepreneurial SME growth is associated with the business environment. If the business environment is not promising, SME growth is constrained (Herrera and Kouame, 2017). Igwe (2016) defined the business environment as the set of circumstances, policies and strategies that trigger firms' growth and job creation. The Organisation for Economic Co-operation and Development stressed that a proper understanding of the tie between entrepreneurial SME strategies and development aspects will result in a better outcome. The policies followed by different governments, particularly Communist governments (McMillan and Woodruff, 2002), do not always favour SMEs, whereas Biggs (2002) stated

that the business environment of different economies had shown factors that prevent entrepreneurial SME growth.

2.1 Financial obstacles

Entrepreneurial SMEs' performance mainly depends upon financial resources, as these create the possibility of business expansion, and many studies have shown that financing obstacles such as lack of capital and finance severely affect the growth of entrepreneurial SMEs (Beck and Demircug-Kunt, 2006; Wang, 2016; Mohammed and Bunyaminu, 2021). Higher transaction costs on smaller loans requested by SMEs, the unavailability of information and the inability of SMEs' assets to meet the collateral requirements of creditors are the main reasons that SMEs cannot obtain loans from an external source (Beck *et al.*, 2005). Hussain *et al.* (2018) found that financial literacy and reduced monetary cost positively impact entrepreneurial SME growth. Mishra *et al.* (2014) stated that firms need funds to make an investment, but they do not obtain the required funds if they lack detailed financial records; hence, SMEs are considered riskier than large firms. Hutchinson and Xavier (2006) studied SMEs in transition countries and found that they operate under internal financing because, as the financial system of such countries is little developed, Similarly entrepreneurial SME faced problems in obtaining loans from an external source, commercial banks (Khan *et al.*, 2020). Fisman and Love (2004) stated that large firms mainly rely on an external source of financing because their environment is good for this kind of financing. According to Bilal *et al.* (2016), access to finance is the main obstacle for SME growth in developing countries. Keyser *et al.* (2000) concluded from their study that lack of capital was the main hurdle for SMEs, as only 24% of SMEs had received a loan to start their business. Koop *et al.* (2000) found that there was a positive relationship between business success and start-up capital. Overall, therefore, entrepreneurial SMEs cannot meet the requirements of commercial loans because of lack of collateral (Gray *et al.*, 1997).

Therefore, the following hypothesis was formulated:

- H1. Financial obstacles have a significant relationship with the failure of entrepreneurial SMEs.

2.2 Economic obstacles

SMEs in developed countries face fewer financial and economic obstacles to their development. Economic obstacles are weak economy, tax burden, high exchange rate and lower purchasing power of consumer and high inflation rate. Doan *et al.* (2020) found that an increase in economic uncertainty has a negative effect on entrepreneurial SMEs' performance. With higher GDP per capita and a strong and developed financial system, developed countries report fewer financial and economic obstacles to entrepreneurial SMEs' growth than less developed countries (Moder and Bonifai, 2017). The inflation rate in a country affects the buying power of the customer. In an economic recession, the customer avoids buying goods and services. As a result, demand for goods and services decreases, which has an effect on entrepreneurial SMEs' business. The tax rate imposed by the government has a negative impact on SME growth. Previous studies have shown that a high tax rate discourages the growth of the informal economy. A similar complex tax system in Austria has strongly influenced taxpayer behaviour because of the complexity of the tax system. Venter *et al.* (2003) stated that the inflation rate, interest rate and unemployment rate were the main obstacles to SME success. Cant and Wiid (2013) stated

that the inflation rate affects not only SMEs' success but also their consumers, as the cost of production increases and reduces disposable income.

Therefore, the following hypothesis was formulated:

H2. Economic obstacles have a significant relationship with entrepreneurial SMEs' failure.

2.3 Corruption obstacles

Corruption, which is the misuse of public office for personal gain, has affected entrepreneurial SMEs, which are mostly practised by concerned individuals because of SME registration procedures and weak corruption eradication institutions (Williams *et al.*, 2017). Budak and Rajh (2014) stated that the main hurdle to doing business is corruption. Barkemeyer *et al.* (2018) found that developing nations such as Pakistan are rife with corruption, which affects SMEs and their business, whereas El Alaoui *et al.* (2016) found that corruption was one of the main factors affecting SME growth in Morocco, Albania and Nigeria, alongside SME policies, the tax system and political instability. The World Economic Forum's Global Competitiveness Report (2007–2008) stated that in Pakistan, the main hurdles affecting the business of SMEs are government, bureaucracy and corruption. Corruption in the form of bribery affects entrepreneurial SMEs business very badly (Doan *et al.*, 2021). SMEs face the problem of making extra payments and charges to different persons for their legal registration of SME. This way of behaving affects the businesses that operate honestly and fairly, and this kind of extra payment results in barriers to SMEs' growth and development.

However, Xheneti and Bartlett (2012) stated that corruption has a positive impact on SMEs' growth because it enables the obstacles that affect SME growth to be dealt with faster. According to Méon and Weill (2010) and Kalyuzhnova and Belitski (2019), similarly, corruption has a "greasing the wheels" effect that increases firms' growth and performance.

Therefore, the following hypothesis has been formulated:

H3. Corruption obstacles have a significant relationship with entrepreneurial SMEs' failure.

2.4 Infrastructure obstacles

Infrastructure conditions are the main determinants of firm performance (Džafić *et al.*, 2011); hence, the infrastructure of a country plays a key role in enhancing the growth of entrepreneurial SMEs and can increase or hinder their performance (Stam, 2015; Spigel, 2017). SME development needs certain infrastructure, such as roads, electricity, telecommunications and other facilities (Ur Rehman *et al.*, 2019). Poor infrastructure, conversely, has a negative effect on entrepreneurial SMEs' profit (Obokoh and Goldman, 2016). According to Kubičková *et al.* (2017), infrastructure-related hurdles are a greater problem for SMEs in rural areas, where the poor conditions of different elements affect the cost of input goods and shipping of products. In relation to infrastructure, power and energy are the main obstacles to the development of SMEs in Pakistan, where about 6% of GDP is lost because of a poor and insufficient transport system. Moreover, the infrastructure is not very developed, which means SMEs face high costs doing business.

Therefore, the following hypothesis has been formulated:

H4. Infrastructure obstacles have a significant relationship with entrepreneurial SMEs' failure.

2.5 Management obstacles

Managerial skills also affect the performance of entrepreneurial SMEs (Khan and Burki, 2020). The main problems related to management are financing issues, personal issues, leadership, technical and lack of experience, which have been considered the principal obstacles to the success of businesses, particularly small business. Tushabomwe-Kazooba (2006) stated that poor record-keeping and lack of management skills are key contributors to SMEs' failure. Lussier (1996) and Mahadea (1997), similarly, stated that a lack of management skills has a negative impact on SMEs' growth. Managers in entrepreneurial SMEs do not possess enough knowledge of how to manage financial matters, which results in the underutilisation of resources and even failure (Jennings and Beaver, 1995). SME business is risky, but efficient managerial knowledge and skills can bring success. Ramis (2002) found that management training is important for entrepreneurial SMEs in Peru; moreover, it is even more important when SMEs have high growth ability than when their growth potential is low.

Therefore, the following hypothesis has been formulated:

H5. Management obstacles have a significant relationship with entrepreneurial SMEs' failure.

3. Research design and method

3.1 Research design

The conceptual framework used for this study is based on various studies already conducted (Ansoff, 1965; Van Eeden *et al.*, 2004; Harris and Gibson, 2006; Okpara and Wynn, 2007). The framework was used for types of decisions needed by SMEs to start a business and maintain it successfully and also to study problems faced by the entrepreneur. Ansoff (1965) classified obstacles into different types, such as administrative, strategic, operating and exogenous. Administrative obstacles concern the organisation's structure and ability to develop and maintain resources. These obstacles are financial, personal and management issues. Strategic obstacles concern the ability of the firm owner or manager to provide the goods and services that meet the demands of the customer. Operating obstacles concern the issues of effective and efficient resource allocation so as to attain organisational goals. The core resource allocation may be operation, marketing or inventory management. The other problems faced by entrepreneurial SMEs in Pakistan are exogenous obstacles, namely, corruption issues, infrastructure issues and the tax system (Figure 1).

3.2 Methodology

To understand the various obstacles that affect entrepreneurial SMEs' performance, a questionnaire-based research was conducted. The sample for this study was collected from decision-makers in entrepreneurial SMEs, such as owners and managers, located in the southern region of Khyber Pakhtunkhwa, Pakistan. The research questionnaire was used to collect data from the respondents by using the random sampling technique. The total sample size was 225. The data were collected by using a Likert scale of 5 points (1 = strongly disagree, 5 = strongly agree). The first part of the questionnaire addressed the demographic characteristics of SMEs, and the second part addressed the various hurdles faced by SMEs in Pakistan. The scale for measuring obstacles faced by SMEs was adopted from different

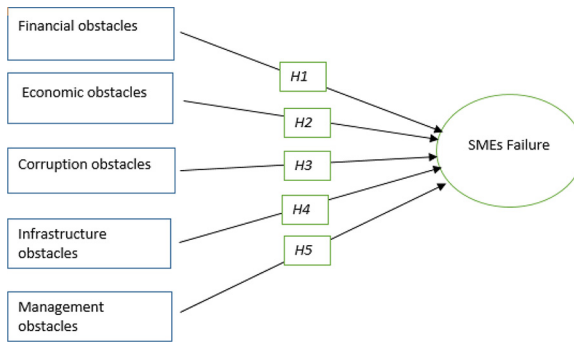


Figure 1.
Conceptual
framework

studies, such as Okpara and Wynn (2007) and Olawale and Garwe (2010). A total of six items addressed financial obstacles, five addressed economic, corruption, management and infrastructure obstacles, and six items were used to measure SME failure. The Cronbach's alpha of the questionnaire was 0.79, which shows that questionnaire is reliable. The validity of all the items used in this study was above 0.60.

4. Findings and results

4.1 Description statistics

Table 1 shows the descriptive statistics of the research variables. A total of 225 observations were made. The mean value for financial obstacles is 3.64, with a standard deviation (SD) of 0.595. For economic barriers, the mean is 3.96 and the SD is 0.615. The SD for corruption obstacles is 0.533 and its mean value is 4.17. The mean values for infrastructure obstacles and management obstacles are 3.57 and 3.65 and their SDs are 0.680 and 0.612, respectively. Hence, the results show that all the variables have a significant impact on SMEs' performance, with corruption obstacles having the highest impact.

Table 2 shows the demographic statistics of the study. The findings show that the majority of SMEs are run by single, educated individuals. Only 96 of the 225 respondents were married. The number of respondents who had had more than 14 years of schooling was 165, which shows that young people involved in entrepreneurial SME businesses tend to be educated and energetic. The majority of SMEs were run by the real owner (143). The majority of the firms were newly established and had been operating for less than five years.

Table 3 shows the correlation results between independent and dependent variables. The results show that all the obstacles have a positive association with poor firm performance.

Variables	N	Minimum	Maximum	Mean	SD
FO	225	1.50	4.67	3.642	0.595
EO	225	1.80	5.00	3.962	0.615
CO	225	2.00	4.80	4.176	0.533
IO	225	2.20	4.80	3.573	0.680
MO	225	1.40	4.60	3.654	0.612
FF	225	1.67	5.00	3.879	0.611

Notes: FO = financial obstacles, EO = economic obstacles, CO = corruption obstacles, IO = infrastructure obstacles, MO = management obstacles, FF = firm failure

Table 1.
Descriptive statistics

Table 3 indicates that there is a strong significant association between poor entrepreneurial SME performance and financial obstacles ($r = 0.542$, $**P < 0.01$), economic obstacles ($r = 0.642$, $**P < 0.01$), corruption ($r = 0.703$, $**P < 0.01$), infrastructure ($r = 0.365$, $**P < 0.01$) and management hurdles ($r = 0.164$, $**P < 0.01$). Among these variables, the corruption obstacles have the strongest effect on poor entrepreneurial SME performance. The outcome of this study is similar to that of studies by Mahadea (1997), who stated that these factors affect entrepreneurial SME performance.

4.2 Regression analysis

Table 4 shows the regression results to determine the outcome of the various researched obstacles, namely, financial, economic, corruption, infrastructure and management, on entrepreneurial SME development. The table shows that all the obstacles play a significant role in entrepreneurial SME failure. The R^2 value is 0.66, which confirms that 66% of SME

Table 2.
Demographic statistics

Variables	Category	Frequency
Marital status	Single	129
	Married	96
Education	<14 years of schooling	60
	>14 years of schooling	165
Firm age	<5 years	148
	>5 years	77
Respondent	Owners	143
	Managers	82

Table 3.
Correlation results

Variables	FO	EO	CO	IO	MO	FF
FO	1	–	–	–	–	–
EO	0.544**	1	–	–	–	–
CO	0.376**	0.468**	1	–	–	–
IO	0.323**	0.334**	0.263**	1	–	–
MO	0.308**	0.216**	0.209**	0.511**	1	–
FF	0.542**	0.643**	0.703**	0.365**	0.164**	1

Note: **Correlation is significant at the 0.01 level

Table 4.
Regression results

Model 1	Unstandardised coefficients			
	B	Standard error	t-value	Significant value
Constant	0.287	0.229	1.254	0.211
FO	0.202	0.050	4.045	0.000
EO	0.289	0.050	5.768	0.000
CO	0.553	0.052	10.664	0.000
IO	0.132	0.043	3.095	0.002
MO	0.136	0.046	2.926	0.004

Note: $R^2 = 0.66$, adjusted $R^2 = 0.64$

failures are affected by a lack of financial resources, economic obstacles, corruption, infrastructure and management hurdles.

4.3 Discussion

This study adds to our knowledge of the factors which affect entrepreneurial SMEs' growth and development. The scale was formulated for different obstacles so it can be used and tested in developing and emerging countries such as Pakistan. The main objective of this study was to find the impact of financial, economic, corruption, infrastructure and management obstacles on entrepreneurial SMEs' growth and development. The outcome of this study shows that all the barriers have a positive impact on SME failure, which is similar to the results of [Koop et al. \(2000\)](#) and [Okpara and Wynn \(2007\)](#). The correlation matrix shows that all the variables are positive and significantly correlated with each other.

Outcomes show that financial hurdles, such as lack of capital to meet financial requirements, are among the major problems faced by entrepreneurial SMEs. The results revealed that there is a positive and significant relationship between financial obstacles and entrepreneurial SME failure ($\beta = 0.20, p = 0.00$), thus supporting *H1*. Entrepreneurial SMEs face a lack of finance from banks because of the unavailability of collateral to use against loans. This outcome is similar to the finding of [Okpara and Wynn \(2007\)](#). [Table 4](#) shows that there is a significant relationship between economic obstacles and business performance failure ($\beta = 0.28, p = 0.00$), which shows that inflation level and other economic indicators level have a significant impact on SMEs' business. The outcome shows that corruption has a positive impact on entrepreneurial SMEs' failure ($\beta = 0.55, p = 0.00$). The corruption level in Pakistan is higher than in developed countries ([Transparency International, 2018](#)). One of the major concerns about corruption in regard to SMEs is that it affects their growth and development. The outcome of this study is similar to the result of [Hashi and Krasniqi \(2011\)](#), who stated that corruption has a negative impact on entrepreneurial SMEs' performance.

The results also reveal that poor infrastructural conditions have a positive impact on entrepreneurial SMEs' failure ($\beta = 0.13, p = 0.00$). The poor condition of infrastructure significantly affects the cost and performance of SMEs, and this has become a great problem for entrepreneurial SMEs in Pakistan. This result is consistent with the results of [Obokoh and Goldman \(2016\)](#) and [Kubičková et al. \(2017\)](#). The availability of different services, such as electricity, water and transportation, plays a vital role in country growth and is also directly linked with SMEs' success. Regular power breakages affect the production of goods and services, and a poor road system increases the cost of transportation and disturbs the distribution of goods and services. It is very difficult to operate SMEs in rural areas, as their inaccessibility means it is difficult to meet a high level of demand for their products to transport from rural to urban areas.

[Table 4](#) shows that there is a positive relationship between management obstacles and business failure ($\beta = 0.13, p = 0.00$), which confirms that lack of management skills is the major hurdle in business performance. Lack of management skills and experience has a negative impact on entrepreneurial SMEs' performance and leads to their failure ([Tushabomwe-Kazooba, 2006](#)). Lack of management skills such as bookkeeping, marketing skills, inventory management and resource management leads to poor business performance, and these problems have resulted in business closure and had a significant impact on business failure.

5. Conclusion, recommendations and limitation

This study has confirmed that several hurdles affect the performance of entrepreneurial SMEs. The factors responsible for the failure of entrepreneurial SMEs are financial and

economic obstacles, as well as infrastructure, management and corruption barriers. Lack of funds to operate or establish new entrepreneurial SMEs is the main hurdle to the success of entrepreneurial SMEs. In Pakistan, the high rate of interest on loans and collateral requirements imposed by financial institutions against loans are the major hurdle to entrepreneurial SMEs' growth. The strict rules and regulations of financial institutions and governments in regard to loans discourage owners from seeking funds for their business. In the past, there was a lack of government support for SMEs; hence, the gap in service provision was filled by the private financial institution. The inflation rate in the country has a negative impact on entrepreneurial SME business. If any country faces a period of inflation period, its people will avoid buying goods and services because the inflation rate affects their buying power. Hence, the economic situation of the country significantly affects entrepreneurial SMEs' performance. The Government of Pakistan should therefore provide some relief to SMEs to boost their business during recession.

The study also confirms that management skills have a positive impact on entrepreneurial SMEs' failure. The majority of SMEs are run by owners, who have little knowledge of management, leading to business failure. These owners have no knowledge of record-keeping or inventory management and lack awareness of rules and regulations related to SMEs, which affects their entrepreneurial SME's performance. Lack of proper business knowledge thus leads to business failure.

The results further confirm that entrepreneurial SMEs' business is affected by corruption obstacles. In Pakistan, the registration procedure for entrepreneurial SMEs is very complex, and the officers concerned make different kinds of financial demands during the registration process. The case of accessing finance is similar: when entrepreneurial SME owners or bosses request finance, corrupt practices have sometimes been seen in the granting licence. Hence, the corruption level in the country affects SMEs' performance.

Moreover, the results show that the lack of proper development of the infrastructure in the country is also responsible for SMEs' failure. In Pakistan, the roads, bridges, electricity systems and other telecommunication services are not always useable, which has a negative effect on entrepreneurial SMEs' performance. All these poor infrastructure systems add more to the cost of production of goods and services, which leads to entrepreneurial SMEs' failure.

In Pakistan, several factors restrict the success of entrepreneurial SMEs. Among these hurdles, the financial obstacle is key to the failure of SMEs, as we know that entrepreneurial SMEs are always looking for finance to meet their requirements. To remove financial obstacles, the manager or owner of the firm should try to obtain cheap, low-interest-rate loans from financial institutions and banks. Personal saving is also a good choice, or borrowing from friends and relatives, and financial problems can be solved by obtaining advance payment from customers. It is also recommended that the Government of Pakistan and policymakers consider the Grameen Bank model to solve the financial problems of entrepreneurial SMEs.

As the study also confirms that the economic situation of the country adversely affects entrepreneurial SMEs' performance and that when the inflation rate rises residents can only meet their basic needs, the government should provide subsidies to entrepreneurial SMEs at such times to give them relief. Furthermore, the government should maintain inflation at a low level, otherwise it will affect every kind of business. The State Bank of Pakistan has lowered its interest rate to boost entrepreneurial SMEs, which will have a positive impact on their performance.

Another obstacle to entrepreneurial SMEs' success is corruption. The Government of Pakistan should continue its anti-corruption operations to reduce the level of corruption and

bribery in the system. The study also confirms that the infrastructure is not very developed in Pakistan. Therefore, steps should be taken to improve the road system in the country. The government should provide a low rate of electricity to the SME sector, with no stoppages. The telecommunication system should be improved to increase interactions between customers and producers.

The management skills of owners and managers also play a key role in SME performance. Management should be trained in business. Workshops and seminars should be arranged by different organisations to give knowledge of management skills, such as record-keeping, marketing and accounting, to help them manage their business on a daily basis. These skills will enhance the overall performance of entrepreneurial SMEs. Entrepreneurial SME owners can also receive suggestions from more established firms about how to conduct their business, and management should hire skillful, trustworthy and educated people to run their business.

To sum up, for the success of SMEs, it is necessary to have a friendly business environment, better infrastructure and a corruption-free society, qualified management and a supportive government.

This study is limited to a specific area of Pakistan. Respondents were asked to respond at a specific time, so one may question whether they had enough time to respond. Future studies can be conducted in other developing countries to generalize the findings.

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