The impact of finance, infrastructure and training on the performance of SMEs in Pakistan

ABSTRACT

Aims: The aim of this paper is to determine the impact of infrastructure, finance and training on the performance of Pakistani SMEs, using micro level data.
Study Design: Quantitative descriptive
Place and Duration of Study: World Bank Enterprise survey of 1247 Pakistani manufacturing SMEs is used.
Methodology: To test the hypothesis of this study, descriptive and regression analysis is used to regress firm performance variable on finance, infrastructure and training.
Results: The principle finding of this paper shows that finance is highly significant and positive relationship with SMEs performance. In comparison, infrastructure and training did not significant impact on performance of SMEs.
Conclusion: through infrastructure, finance and training, SMEs can achieve better performance.

***Keywords*:** *Infrastructure, finance, training, SMEs, performance, Pakistan.*

1. INTRODUCTION

Small and medium enterprises (SMEs) are considered to be an important sector for economic growth and sustainable development because it contributes significantly to employment and alleviate poverty (Ariyo, 2005). SMEs growth is linked with formalizing of an economy. It provides employment at a lower cost since the unit cost employed is lower for SMEs than the large size firm (Rehman, *et al*, 2012). Strategically SMEs are crucial in many developing countries, especially in Asian region. Usually, the SMEs sector made up of more than 90% of all firms outside the agricultural sector in the region (wattanapruttipaisan, 2003). They are the primary source by which new entrepreneurs provide the economy with a continuous supply of skills, idea and innovation (CACCI, 2003). In the world, SMEs are being supported on the grounds that they make substantial contributions to productivity growth and therefore, competitiveness and aggregate economic growth.

In Pakistan SMEs are contributed to more than 95% of the total establishment and of the 80% of the workforce is employed in the business sector (SMEDA, 2007). In South Asia SMEs contributed highly in terms of overall economic growth and GDP. In Bangladesh SMEs shared 50% annual to GDP and engaged 82% of the total industrial sector employment, in Nepal SMEs contributed to more than 98% of all establishment and shared 63% to GDP, while in India SMEs shared to 30% GDP.

SMEs comprise a very large portion of Pakistan's economy as their contribution to GDP 40%. According to Federal Bureau of Statistics of Pakistan, 3.2 million establishments that fall under the category of SMEs, shared exports 46.5% and constitute of all 80% of non-agriculture labour force. All these evidences clearly show the crucial role of SMEs in economic growth of Pakistan.

However, due to their size SMEs face many problems that make them vulnerable and prevent them from achieving growth. These problems are mainly important in the area of access to financing, infrastructure and training (Kihimbo*et al*, 2012). All these problems, unable the SMEs to meet the challenges created due to liberalization and globalization of markets. This lead the research question, how can SMEs performance improved by finance, infrastructure and training? this research question is answered by this empirical study. Previously very little research available on Pakistani manufacturing SMEs (Rehman, 2016; Abrar-ul-haq*et al,* 2015). For example Rehman (2016) investigated the Network alliances and firm's performance; a paneldata in Pakistan, but their study show limitation in terms of cross sectional data study as well as by the independent variables such as finance, infrastructure and training. Similarly, Abrar-ul-haq*et al,* 2015) investigated the factors effecting the development of SMEs in Pakistan, but they conducted only on twin cities Islamabad and Rawalpindi. So this study fills the gap by examining the impact of finance, infrastructure and training on SMEs performance in Pakistan, because the above mentioned variables are important for identifying the SMEs performance. This study based on examines the manufacturing sector of 1247 firms in

Pakistan in 2014. The findings of this paper are that finance is highly significant and positive relationship with SMEs performance. In comparison, infrastructure and training did not significant impact on performance of SMEs.

The remaining paper is structured: section 2 shows literature review, section 3 shows data and methodology, section 4 estimate OLS model, section 5 shows conclusion, policy implication, limitation and future research.

2. LITERATURE REVIEW

2.1. Finance and SMEs performance

Access to finance is important to the survival and performance of any business. As it is the life-blood of any business enterprise, no matter how well managed, can survive without enough funds for working capital, fixed assets investment, employment of skilled employees and development of markets and new development of products and the availability of finance is positively related with productivity and growth (GPFI,2011). Elsenhardt and Martin (2000) made use of the resource-based theory of the firm to reveal the impact of financial capital on the performance of SMEs. Access to finance or capital to purchase fixed and current assets are important to maintain a firm's competitive advantage. Abdullahi *et al,* (2015) investigated the effect of finance, infrastructure and training on performance of SMEs in Nigeria. Studying a sample of 310, analysing by descriptive statistics and Structural Equation Modeling and found that finance, infrastructure and training have a positive and significant impact on SMEs performance. In another empirical studies carried by Wiklund and Shephered (2005) hypothesized that SMEs require financial capital to gain physical resources in order to take advantage of business opportunities and lack of physical resources is a crucial failure factor on the performance of SMEs, which clearly illustrate that financial resources have impact on firm performance. Recent study of Kersten (2017) noted that finance programs such as capital investment and employment has a positive and statistically significant effect on SMEs performance. In the prior study conducted by Sha (2006) review that access to finance strongly affected the performance of SMEs, these show that firms with access to funding, will perform better than those without access to finance. Moreover, some studies such as (Chittithaworn,2011; Fatoki, 2011; Ahmad *et al*, 2012; Machirori*et al*,2012; Nabintu, 2013; Kinyua, 2014; Ojokuku, 2014) investigated that finance has a significant impact on the performance of SMEs, while studies conducted out by (Philip, 2011; Okpara, 2011) found inverse results. As a result, to show the impact of finance on the performance of SMEs the following hypothesis was formulated:

Hypothesis 1: *Finance has a significant impact on the performance of SMEs in Pakistan.*

2.2. Infrastructure and SMEs performance

Infrastructure refers to technical structures that guide and support the society, in terms of water supply, electricity grids, bridges, roads, telecommunications, sewers, and also infrastructure is explain as the physical components of interconnected system that presents product and services vital to sustain, enable, or increase societal living conditions (Fulmer, 2009). Beyene (2002) investigated that the availability of good infrastructure facilities provides a conductive environment for SMEs to facilitate and flourish the creation of economic growth. They are no way SMEs performance can be maximized in the lack of enough power supply, water supply transportation and effective telecommunication system on ground. Successful competition in the regional and global market pivot on the availability of asuitable and efficient infrastructure. Low cost and high-quality infrastructure services tend to develop the performance of SMEs, and the study find that infrastructure influence the performance of SMEs. Abdullahi *et al,* (2015) investigated the effect of finance, infrastructure and training on performance of SMEs in Nigeria. Studying a sample of 310, analysing by descriptive statistics and Structural Equation Modeling and found that finance, infrastructure and training have a positive and significant impact on SMEs performance. In a survey carried outby Ogunmola (2012) reviewed that the role play by infrastructure in SMEs performance cannot be ignored because infrastructure such as power, good road network, balanced water supply, efficient communication system and market are referred to as essence on performance of SMEs. The absent of the aforesaid facilities in the life of Enterprises acts as a catalyst to some of the Enterprises less performance which consistently can result in winding up of the business if on time urgent steps are not taken. On the impact of infrastructure on firm performance, Ebert and Memillen (1999) showed that firms are more productive in environment where

stocks of public infrastructure are available, with evidence they examined that infrastructure provides the source by which the close spatial proximity of SMEs performance will be achieved, and economic activities can lead to increased productivity for all parties. In the rescent of (Rehman *et al*, 2019)reported that SMEs requires efficient infrastructures like as telecommunications, electricity, roads and other facilities. Additionally, some studies such as (Ahmad*et al,* 2012; Okeyo *et al,* 2014; and Amwele, 2013), examined that infrastructure effect the performance of SMEs, while (Okpara, 2011; Olugbenga,2012; Kinyua, 2014) showed that infrastructure did not affect the performance of SMEs. Therefore, based on the above evidence the following hypothesis was formulated:

Hypothesis 2: *Infrastructure has a significant effect on the performance of SMEs in Pakistan.*

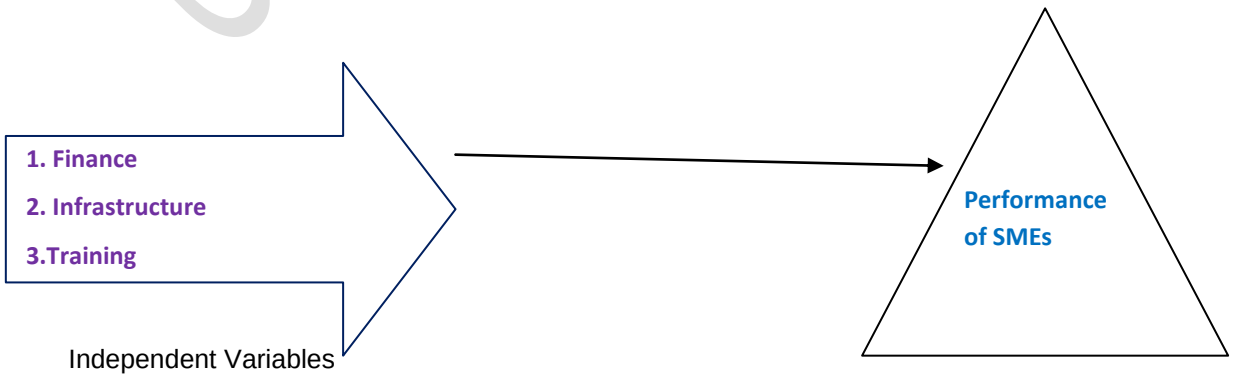
2.3.Training and SMEs performance

The impact of training programmes to the overall firm's performance has been emphasized by numerous researchers (Arago'n*et al,* 2003; Garci'a, 2005). Human capital theory stressed that implementation of training programsincrease employee's skills and competencies, which in resulting increase firm's productivity or performance, indicating a strong effect of training on the performance of SMEs (Snell & Dean, 1992; Lepak& Snell, 1999). Empirical research conducted by (Baever and Hutchngs, 2005) investigated that implementation of various training programs enhance learning, and also improve the whole competence of the organization employees, and it is assumed that training implementation leads higher performance of SMEs. Abdullahi *et al,* (2015) investigated the effect of finance, infrastructure and training on performance of SMEs in Nigeria. Studying a sample of 310, analysing by descriptive statistics and Structural Equation Modeling and found that finance, infrastructure and training have a positive and significant impact on SMEs performance. Furthermore, significant resources based theorists propose that the implementation of training programmes can be considered as a strategic goal that make sure and improve lasting competitiveness (Wernerfelt, 1984; Barney, 1986). If the training programmes are reliable with on the whole business strategy, the training programmes will increase and encourage employees to achieve strategic objectives, and thereby leads to superior firm's performance (Arther, 1994; Garci'a 2005). Although several studies have presented that training implementation has significant affect on SMEs performance (Snell & Dean, 1992; Lepak & Snell, 1999; De Kok 2002; Ng & Siu, 2004; Garci'a 2005; Mako, 2005; Del Valle *et al,* 2009; Olsen &Eikebrokk, 2009; Yahya *et al,* 2012; Ubeda *et al,* 2013; Thaimuta&Moronge, 2014). It has been investigated that some studies ascertain inverse results (Westheld& Storey, 1997; Cosh *et al,* 1998; Ojokuku*et al,* 2014). Therefore, based on the aboveliterature evidence the following hypothesis was formulated:

Hypothesis 3: *Training has a significant effect on the performance of SMEs in Pakistan.*

2.4. CONCEPTUAL FRAMEWORK

This study identified three major factors that seem to have a relationship with the performance of SMEs, namely: finance, infrastructure and training. The variables were identifiedbased on the literature review and the theories guiding the study ranging from Pecking Order Theory opined by Myer's and Majluf in 1984, Government Expenditure Theory develop by Keynes in 1936 and Human Capital theory purports by Schultz in 1961. Therefore, this paper integrates their works and develops model that serve as a guide or direction to the study.



Independent Variables

Dependent Variable

Fig. 1. CONCEPTUAL FRAMEWORK

3. METHODOLOGY

3.1. Data

The data used in this study was obtained from "World Bank Enterprise Survey"carried out by Pakistan Bureau of Statistics in 2014. The aim of Enterprise Survey is to gain information of what firms experience in the private sector. The data set contains information on 1247 manufacturing SMEs that indicates stratified random sampling, stratified by geographic region, firm size and sector. The data was collected by intensive interviews with owners and managers of firms. The data set thus provides key information of our interested variables, such as finance, infrastructure, training and firm's performance as measured by (total sales/total employees in 2014).

However, the survey data has certain limitations because present study uses cross-sectional data which is not enough to find the causal relationship between the concerned variables i.e. finance, infrastructure, training and firm performance. Additionally, for financial measurement no information of return on assets and firm profitability was found. Regression analysis was used to test the hypothesis under the study through SPSS 20 software.

(a) Dependent Variable

Various researchers used different indicators to measured performance of SMEs (Daft, 1998; Rauf, 2007; Kinyua, 2014). This empirical study used labour productivity as an indicator of SMEs performance that is also used by earlier researchers (i.e. Mahmood, 2008; Rehman, 2016). In the literature performance of SMEs is refer to labour productivity.

(b) Independent Variables

This empirical paper has used three independents variables such as Finance, infrastructure and training. In addition, various researchers (Fatoki, 2011; Ahmad *et al*, 2012; Nabintu, 2013; Kinyua, 2014) found that finance has significant impact on SMEs performance. Similarly, research done by (Ahmad *et al,* 2012; Okeyo *et al,* 2014; and Amwele, 2013), examined that infrastructure effect the performance of SMEs. Furthermore, (Yahya *et al,* 2012; Ubeda *et al,* 2013; Thaimuta&Moronge, 2014) described that training has significant effect on performance of SMEs.

(c) Control Variables

Previous studies show that there are certain indicators that affect the firm performance which needs to be controlled. For example, firm's age and size are important variables which influence the firm performance. Firm's age and size are included as continuous variables in logarithmic form.

3.2. MODEL

In this research paper, the researcher investigates the impact of finance, infrastructure and training on SMEs performance.In literature, a number of researchers have also investigated the impact of the abovementioned variables on SMEs performance (Abdullahi *et al,* 2015;Machirori*et al*,2012; Okeyo *et al,* 2014; De Kok 2002).

The model used in this study for empirical analysis is similar to the model of (Mahmood, 2008; Rehman, 2016) that is choose to investigate the factors that affecting the performance of SMEs.

$$log\ Labor\ productivity: \beta_o + \beta_1 Finance + \beta_2 Infrastructure + \beta_3 Training + \beta_4 size + \beta_5 age + \mu \ldots\ldots\ldots (1)$$

The above variables in the model aredefined in the following table 1. Table 1 also indicates the mean and standard deviations of the variables used in regression.

Table 1: Variables Definition and their descriptive statistics				
Name of variable	***n***	***Definition***	***Mean***	***Std.dev***
Labor productivity	1247	Log (sales/employees) in 2014	5.92	0.958
Finance	1247	Dummy variable assigned value 1 If firm financed its daily operations from internal and external resources, 0 otherwise	0.87	0.335
Infrastructure	1247	Dummy variable assigned value 1 if infrastructure facilities available to firm, 0 otherwise	0.51	0.500
Training	1247	Dummy variable assigned value 1 if firm have formal training programs for its employees, 0 otherwise	0.25	0.435
Log age	1247	Log (2014 minus age year of firm begin operation)	2.98	0.618
Log size	1247	Log(total employees in 2014)	1.47	0.658

Source: Author own calculation

4.1. EMPIRICAL RESULT

Before application of OLS regression, there are some aspects like multicollinearity that are to be considered when running regression. Table 2 indicates the correlation matrix of variables. On the basis of Pearson Correlation of the variables, to see whether the variables correlation greater than 0.80. If the value is equal or higher than 0.80, then we have Multicollinearity. When some or all explanatory variables are moderately or highly correlated with each other, then it create multycollinearity problem and it is hard to tell which variable affecting the dependent variable (Koop, 2004). All variables show that there is no multicollinearity exist in the variables of model. In addition, the financial information of the firm's i.e. productivity has been changed into international currency (US$). The average exchange rate has been calculated i.e.US$ 1= 104 PKR in the year 2014.

Table 2 presents correlation matrix of all variables

	LP	**Finance**	**Infrastructure**	**Training**	**Age**	**Size**
LP	1					
Finance	0.114	1				
Infrastructure	0.041	0.006	1			
Training	0.031	0.012	0.298	1		
Age	0.099	0.079	0.124	0.055	1	
Size	-0.023	-0.037	0.446	0.378	0.259	1

LP shows labor productivity

4.2. OLS RESULT

Regression result is given in the Table 3, which indicated the impact of finance, infrastructure and training on performance of Pakistani Manufacturing SMEs.

Table: 3 Dependent variable Log Labor productivity in 2014

Variables	**Coefficients**	**t-values**
Finance	0.596**	2.292
	(0.260)	
Infrastructure	0.100	1.084
	(0.092)	
Training	0.092	0.872

	(0.106)	
Log age	0.173**	2.309
	(0.075)	
Log size	-0.113	-1.554
	(0.073)	
Constant	4.915***	14.990
	(0.328)	

N=1247 R-squared= 0.26. Standard errors in parenthesis. *** and ** indicating a significant level of 1% and 5% respectively.

Table 3 indicate the result of regression model. The coefficient of finance is positive and the proposed impact is statistically significant. The coefficient for the impact of finance on the SMEs performance was 0.596, which shows that every unit increase in finance raises SMEs performance by 0.596. The positive coefficient of regression indicated a positive impact of finance on SMEs performance as shown in hypothesis. Hence, our hypothesis is supported. The result of this study is similar to other several studies (Fatoki, 2011; Ahmad *et al*, 2012; *Nabintu*, 2013; Kinyua, 2014). This shows that finance has a positive and significant impact on performance of SMEs. This implies that finance is important for Pakistani SMEs, however without enough finance SMEs cannot attain its performance because finance is used to keep a lot of things in proper shape like it is used to purchase material for firm, pay employees, carry on with advertisement and daily activities that the SMEs are need for it to grow very well.

The coefficient of infrastructure is positive but statistically insignificant. This result is similar to the findings of(Okpara, 2011; Olugbenga, 2012; Kinyua, 2014) showed that infrastructure did not affect the performance of SMEs. This outcome suggests that majority of Pakistani SMEs in the sample are operated in rural areas that are not accessible, even though in the rural areas there may have high demand for their products. This limits the firm's ability to expand and the opportunity to produce profit in order to stay in business. Hence, the hypothesis that infrastructure has a significant impact on SMEs performance rejected.

Similarly, training also has a positive but insignificant effect on SMEs performance. This finding is consistent to the prier studies of (Westheld& Storey, 1997; Cosh *et al,* 1998; Ojokuku*et al,* 2014). They found that training has insignificant impact on SMEs performance. Firstly, this suggest that owner of SMEs are almost engaged in fire-fighting activities such as taxation issues, managing the cash flow, competition and fast-changing markets, and thus are not able to spare themselves or their employees for training activities. Secondly, managers of SMEs select those employees who have enough skills and no need for further training. Thirdly, SMEs do not need any training as most of their working was customized and could be learned only through experience on the job. Hence, this result reject our hypothesis of training has a significant impact on SMEs performance.

Age has a positive and significant impact on SMEs performance. This suggest that majority of Pakistani SMEs are older. This finding implies that older firms performance are more than younger firms Change *et al*., 2002). Similarly, size negative and insignificant impact on SMEs performance. This negative relationship suggests that small firms improve their performance as time goes by (Rehman, 2015). Moreover, small firms are more flexible in making decision and have higher efficiency level.

5.1. CONCLUSION

The purpose of this paper was to identify the impact of finance, infrastructure and training on performance of SMEs. In this paper OLS regression model have been used to examine the relationship between the variables. These results are similar to the prior expectation from the literature. Finance has increased SMEs performance. Interestingly, the insignificant relationship between infrastructure, training and performance of SMEs implies that firms owner engaged in informal ways of operation and that majority of Pakistani SMEs in the sample are operated in rural areas that are not accessible, even though in the rural areas there may

have high demand for their products. This limits the firm's ability to expand and the opportunity to produce profit in order to stay in business.

5.2. Policy implication

The aim of this study to examine the impact of finance, infrastructure and training on SMEs performance in Pakistan. The study therefore recommended that government should implement policies and development programme aimed to improve access to finance easier for SMEs with growth potential and decrease interest rate. The government should give priority to the provision of existing infrastructure facilities such as electricity, water connection and telecommunication at a high standard. In addition, the aimed to improving the skill level of Pakistani SMEs sector government should encourage the entrepreneurs of SMEs to make use of Entrepreneurial Development Programme, and the SMEs entrepreneurs should encourage the habit of training and developing their management and labour force in order to build a strong capacity for meeting these challenges.

5.3. Limitation and Future research

There are few limitations encounter in the study. The first limitation in this study was only taken manufacturing sector. Therefore, for future research more effort are needed to study different factors affecting the SMEs performance in Pakistan for mining, primary agriculture and service sector. The second limitation is that this study used three specific explanatory variables only. So, future researchers can increase the explanatory variables or adding moderating variables to the study so as to increase the result. Besides, this research is conducted based on cross-sectional data that are not draw causal relationship between the variables. For future research longitudinal study is recommended that allow the researchers to look at changes over time. Third limitation is total factor productivity is a better determinants than labor productivity.

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