

## **Impact of Financial constraint on Growth and Development of Small and Medium Enterprises in Quetta Balochistan**

**Management Sciences**

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### **Abstract**

*Purpose of study is to identify financial constraints creating hurdles in the growth and development of the SMEs in Quetta. Small and Medium Enterprises play a vital role to promote the innovation, competitiveness and productivity in various sectors of a county's domestic economy. Across the world, SMEs have been played an efficient role to achieve the socio-economic objectives such as poverty reduction, unemployment reduction, equal distribution of national wealth, elevating innovation, and uplifting institutional competitiveness. The main purpose of this study is to experimentally examine the limits to which SMEs growth is hampered by financial constraints in Quetta, Balochistan, Pakistan. Primary data was collected by survey questionnaires to distribute 50 SMEs from various economic regions and registered in the Chamber of Commerce Offices in Quetta. Five (5) serious financial constraints to Small and Medium Enterprises were determined through the literature and included in the questionnaire. The data have been analyzed through descriptive analysis and correlation techniques. The results which have been drawn represent that Small and Medium Enterprises in Pakistan are critically constrained by financing, especially by external equity. Financial ecosystem for Small and Medium Enterprises in Pakistan is not friendly and one-size fits all rules and regulations may not sufficient for financing requirements of Small and Medium Enterprises in Pakistan. It has been observed that due to higher*

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*interest rate, lack of legal structure, lack of collateral, lack of concessionary loan and government institutional weaknesses and banks hard rules and regulation aggravate the financial constraints of Small Medium Enterprises. The government should develop flexible policies and soft rules and regulation to the financing requirements of SMEs in their different stages of the business cycle.*

**Keywords:** SMEs, Financial Constraints, Growth and Development, Pakistan, Quetta

### **Introduction**

A firm as defined to be financially constraint or credit rationing means that the supply of external funds are restricted to an entity, project or system such as manufacturing or decision making process from achieving its potential or high level of output with reference to its object due to some factors, elements or subsystem that works as a bottleneck. Moreover, small and medium size enterprises (SMEs) denote importantly more financial constraints as compare to large firms (Beck.et.al, 2014). SMEs defined as any enterprise that busy in manufacturing, trading or providing services, which play very important role in the development of an economy and reduce unemployment, poverty and play crucial role in the improvement of GDP. SMEs considered as backbone of any economy in the world, therefore, many ventures have narrow way to grow their business into vast enterprises but there are many financial frictions to hindering their growth. Approximately, 3.2 million SMEs are operating in the Pakistan, such as, 65.26% in Punjab, 17.83% in Sindh, 14.21% in Khyber Pakhtunkhwa and 2.18% in Balochistan and their contribution in GDP is 40% (SMEDA, 2016). The term SMEs are meant for those enterprises and organizations which come under home offices, small offices and large enterprises (Tanveer Bagh et al, 2017). Small scale enterprises have number of employees between 5-24 and productive assets 0.5-10 million PKR while total assets is less than 50 million PKR and the enterprises have the employees between 25-99 and their useful assets worth Rs. 10 to 40 (M) PKR and total assets over Rs. 50 (M) PKR known as medium enterprises (SMEDA, 2016). SMEs are the vital source of job creation and reduction of unemployment in the country. All the small industries are working and located in Quetta, the information provided by the

directory of industries established in 1994. At least 20 types of industries are active in the Quetta which employing 1,992 persons, these industries are almost small and labor intensive in nature. According to the labour department 1993-1994, there are large number of informal sectors which are operating in Quetta. According to this source, there were more than 100 establishment and there total number was 19,063 and these units were provided job 20,756 persons (BLAOCHISTAN.GOV.PK, 2017).

### **Literature Review**

The identification of those factors that hamper on growth of SMEs in Quetta, which colonize their expansion and also obstruction of concessionary loans and posture of financial position is the crux of this study. In Quetta the magnitude of dilemma on which firms face access to finance is known as financial constrain. The industrial cities heavily depend on SMEs which have being face same problem. That's why the study include both qualitative and quantitative data. So that a framework construct to examine and establish consequences based on statistics tools which ensure the reliability of data. The study will be consist on dependent variable such as growth and development of SMEs, and government support, financial constraints, low business output, credit rationes, collaterals and inner barriers are Independent Variables.

SMEs play a healthy role in expansion of GDP, cash inflow in form of taxes, increase in entrepreneur turnover, increase in wealth, improve quality of life, improve credit crunch, increase the performance of human resource, reduce unemployment, decrease poverty and financial friction (Tanveer Bagh et al, 2017).SMEs do play the role of lifeblood in the economy of developing countries, While SMEs are suffer from financing problems that barred the growth and development (Wagenvoort, 2003). SMEs are considered as an important engine in the grooming of economic development, which increase in the employment growth but financial constraint effect the infant firms growth and profitability (Banerjee, 2014).There is no doubt SMEs play a crucial role in the development of countries amid in this situation face problem which effect the expected rate of growth and contribution in the national GDP (Quader, 2009).SMEs play very important role in economic development in Pakistan and other countries like south Asia, Japan, South America and Taiwan are working hard to improve this sector which contribute to reduce unemployment than large sectors because involvement of

labor more in it (Tanveer Bagh et al, 2017), therefore, more likely firms use credit rations and self-rationing for increase the loan which is high lending cost (O'Toole, 2014). Banks are the main source which provide external finance (Irwin, 2010), although SMEs are more financial constraints faced by financial institutions than large enterprises in many developing countries (Beck.et.al, 2014).Quetta city is the capital of Balochistan which easily approach to link the borders of Iran and Afghanistan for the business perspective, therefore, SMEs play very important role in contribution of GDP, but due to financing constraints, lack of skills and technological innovations are the hurdles to reduce the flourishing of SMEs in the region. Financing problem impede the growth and development of firms in all other cities of Pakistan, which face the financing problem, that's why in this regard government has restructured the Small and Medium Enterprises Development Authority (SMEDA) and SME banks for the grooming of SMEs (Herani, 2011).

SME banking and other financial institution play an amazing roll in the economic boost and reduce the unemployment circle. SMEs provide best training ground for those who have innovative mind and flourished the entrepreneurship, self-develop managerial skills, flexible environment to create a supportive environment which helps to ease and change the structure of business. SMEs create job opportunities for jobless and the most amazing benefit is the SMEs become the future big firms (Tanveer Bagh et al, 2017).

#### Financial constraints

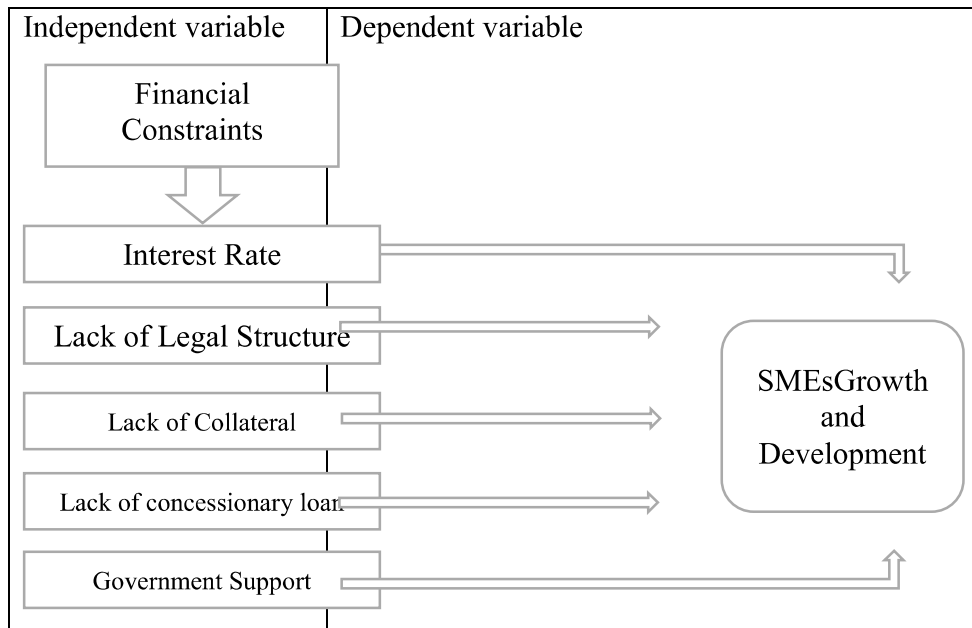
Finance is the major problem of SMEs of the world which creates obstacle to their grooming. Thus, a survey comprises a hug number of questions on the severity and nature of constraints such as, corruption, infrastructure, crime, microfinance policies and legal system deficiencies (Beck.et.al, 2014). In this context EU has also been conducted an observatory survey over 7,600 SMEs in 19 European countries that indicates the 15% of the enterprise less than 50 employees and 9% of medium size firms 50 to 249 employees perceive that the outsource of finance is the crucial problem to restraint the growth and development of their business (Wagenvoort, 2003).

Infant SMEs considered as the crucial factor of the solution of development problems in the developing economy, however, if the infant industries would not groom then their impact would be negative on the growth and development (Garwe, 2010). So SMEs acknowledged as the back bone of

developing countries and their role always remain positive with growth and development. SMEs are large form of private sector of developing countries but due to some evidence SMEs have a great growth constraint and less access to external financial resources (beck, 2006).

#### Theoretical/Conceptual Framework

The lack of capital and access to financial resources are to be considered the basic hurdle for the growth and development of SMEs. Financial institutions and banks have a difficult and lengthy process of paper-work. Lack of collateral, high interest rates and credit rations cause the financial institutions to divert (Tanveer Bagh et al, 2017). SMEs require more finance to run their operations but due to lack of facilities are provided to them by financial institutions. Therefore, they cannot approach financial institutions to get financial resources. Lenders are reluctant to provide loans due to a higher risk, trustworthiness and credit policy, hence, demanding security. That's why, SMEs cannot afford it(Tanveer Bagh et al, 2017). Sometime high interest rate effect the business operations and over all the returns of business so that borrowers of loan cannot afford the burden of huge interest rate.This study will be required to find out the SMEs need great potential for improvement in GDP and industrial sector. but problem is also that lack of inclusive business trend than large sector have. It is required to construct an environment of trust worthiness among the buyer and lander of finance is also imperative. So that, finance consider as back bone of business operations and dearth of the finance can construct hurdle for the procedure. That's why, it is important to high light the significance of finance for entrepreneurs. The issue needs to be researched as there lies a gap. The Quetta has a large small and medium industrial sector and a number of stakeholders pertain to it and its contribution in economy of Pakistan is extensive, but the growth and development of this sector remains constant due to financial constraints. So, this study will help explore the current scenario operating in Quetta.



### Hypotheses

H1: Interest rate has a negative a relationship with growth and development of SMEs.

H2: There is a negative relationship between growth and development of SMEs and an insufficient legal structure.

H3: There exists a negative relationship between growth and development of SMEs and insufficient concessionary loans.

H4: A negative relationship exists between insufficient collaterals and growth and development of SMEs.

H5: Government support has a positive relation with growth and development of SMEs.

### 3. Research Methodology

#### 3.1 Research Design

The study regarded descriptive and causal. It focused to analyse the financial constraints faced by SMEs. The area of study is Small and Medium size Enterprises in Quetta district, the Quetta is capital of Balochistan province which considered the hub of business activities. The quantitative technique was used to modify methods to resolve the SMEs financial constraints which affect their growth and development. This study identified the relationship among variables, and provide recommendations from the findings to improve

the growth at firms' level. Structured questionnaire was used to collect primary data and to regulate the respondent. The data collected through the 50 respondents on the basis of questionnaire. Open and close ended questionnaire used to cover this gap which constraints the growth of SMEs.

### **3.3 Sampling Technique**

The followed a stratified random sampling technique for selecting the sample of firms. All small and medium size registered firms are included in the sampling frame. The stratification was done using size, activity and the geographical location of the firm. Stratification on the basis of size has divided the firms into small (5-19 employees) and medium (20-99 employees) sized firms. The research targeted on the SMEs within Quetta District and 50 registered SMEs was sampled by the stratified sampling technique. Sample was selected carefully that was comprised of SMEs to reach the final consequences with reliable information. It was regarded to include determinants of SMEs constraints and simple random sampling technique was used to collect the data from each stratum of SMEs in Quetta district.

### **3.5 Research Analysis Tools**

The cronbach alpha test was applied to check the reliability of data and statistical package for social sciences (SPSS) software used to analyse the data. Likert scale was selected to measure the degree of agreement or disagreement of respondents on a scale of five.

### **Results and Discussion**

This section of report shows the results and hypothesis test in detail.

Questionnaires were distributed to 50 respondents by hand and all the questionnaires filled completely. Total numbers of male respondents are 32 out of 50 respondents which is 64% of total questionnaire and the female respondents are 18 out of 50 respondents which is 36% of total sample size. The statics result represents that we have no missing respondent in the questionnaire that's why our valid percentage is equal to the percentage of our respondents. Maximum number of respondents whose ages are 21-30 years which is 46% of overall respondents in the questionnaire. The education table statistic indicates that majority of our respondents are masters 36 in number which is 72% of the total sample size. Remaining respondents includes 5 are Ms/M.Phil and 9% are others. The alpha coefficient for the 23 items is .858, which is suggesting that the items have high internal consistency. (Reliability coefficient of .70 or higher is considered "acceptable" in most spss.)

Testing of hypothesis	status
H1: Interest rate has a negative relationship with growth and development of SMEs.	Accept
H2: There is a negative relationship between growth and development of SMEs and an insufficient legal structure.	Accept
H3: There exists a negative relationship between growth and development of SMEs and insufficient concessionary loans.	Accept
H4: A negative relationship exists between insufficient collaterals and growth and development of SMEs.	Accept
H5: Government support has a positive relation with growth and development of SMEs	Accept

### 5. Summary and Conclusion

The significant association and the negative sign showed that constraints have an impact on the growth and development of SMEs in Quetta. Financial constraints are the biggest problem of SMEs because it directly influences the growth and development of business. Financial constraints mainly comprises of interest rates, lack in legal structure, lack of collaterals and government role. Banks and other lending institutes are charged a very high interest rate. Now a days interest rate is approximately near about 20%, which is very high a business man whose income is very low. As a highly significant study results shows that constraints have strong influencing on growth, legal structure of business is also disturbing the output. Mostly business does not registered under the required laws and regulations, banks feels hesitation in granting the loan. Awareness level of owners and managers are very low as compared to big business thus creating many hurdles. Form the study it also came to know that business is lacking in the collaterals and security. Banks demanded security on which they grant loans. But the ratio of security and amount of loan has a big difference, for example if a person go to bank for a loan of 1 lac banks demands a security of 2 lac. Thus business hesitates and feels insecure to apply for that money. Government role in overall SMEs



sector is not good. From the generated result of collected data we come to know that government is not doing a fair job for the betterment of this sector of economy. Government does not addresses financial institutions and banks for the efficient and attractive flow of funds to this sector. Other hurdles are also highlighted form the study which includes less information provided by banks, mostly businesses' owners does not prefer bank loans, some prefer relatives a good source of financing, paper work, poor book keeping, and venture capital a better mean of financing. Balochistan is the largest province of Pakistan in terms of area, that's why, the study will be conducted in Quetta region of Balochistan to be limited at time and cost. The study is exploratory in nature and qualitative techniques will be applied, so collecting data cannot be generalized due to limited resources.

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