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SME ACCESS TO FINANCE IN EMERGING ECONOMIES: A COMPARATIVE STUDY OF PAKISTAN AND MALAYSIA

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ABSTRACT. It has been widely accepted that SMEs make a significant contribution to the socio-economic and political infrastructure in both developed and developing countries. SMEs make up more than 96% of all businesses in emerging economies that provide two out of three private sector jobs. Yet, the importance of SMEs notwithstanding as confronted with several hindrances which impede their development. In emerging economies access to finance has been found as one of the major constraints to SMEs growth. In Malaysia and Pakistan SMEs contributing towards economic growth, however huge finance gap for SME sector exist in both countries. By summarizing current data this paper highlights the share of SME sector towards economic growth, financing gap and supply/demand side challenges towards access to finance in Malaysia and Pakistan. The comparison of both countries revealed that challenges are more severe in lower-middle income country (Pakistan) because of inappropriate policies and their implementation. However, the upper-middle income country (Malaysia) consistent growth can minimize the finance gap for SME sector quickly.

Keywords: SME, Pakistan, Malaysia, access to finance, emerging economies

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Introduction

Small and medium enterprises (SMEs) in most economies particularly in emerging markets are widely believed to be the engine of growth. It has been widely accepted that SMEs make a significant contribution to the socio-economic and political infrastructure in both developed and developing countries. There are around 125 million formal micro, small and medium enterprises (MSMEs) in 132 covered economies, which are 90 to 95 percent - of global entrepreneurs and out of these; 89 million are in developing countries (Robu, 2013). SMEs are generating 50 to 60 percent of employment globally and their contribution towards poverty alleviation and economic growth cannot be denied. Yet, the importance of SMEs notwithstanding as confronted with several hindrances which impede their development. In emerging economies access to finance has been found as one of the major constraints to SMEs growth (IFC, 2017).

SMEs experience numerous hurdles towards accessing finance because of small, unstructured setups and less diversification (Ayadi & Gadi, 2013). A number of studies reported that small firms experience higher financing hindrances as compare to large firms (Beck, 2007; Khan, 2015; Ramlee & Berma, 2013). Studies also discussed that the effect of these obstacles on SMEs development have almost double than corporate firms. Banks feel hesitant towards financing to small firms because of various risk factors. Moreover, to fulfill collateral requirements of financial institutes and to ensure transparency in their creditworthiness are difficult tasks for SMEs in developing countries. In addition, export, leasing and long term finance are also uncommon for SMEs in emerging economies. Resulted SMEs majorly rely on informal finance and trade credit sources because limited resources and weaker financial structures do not allow them to take formal finance (IFC, 2017).

A recent study of Wang, (2016) investigated the biggest obstacles SMEs experience by using enterprise survey of World Bank which covered 119 developing countries. Wang found access to finance as most significant obstacle which hinders the SMEs growth in developing countries. International Finance Corporation (IFC), (2014) report estimated the finance gap of around USD2.1-2.6 trillion in developing countries. In addition, around 45 to 55 percent of formal SMEs do not have access to formal institutional loans or overdraft and 55-68 percent firms are either underserved firms those have loan or overdraft, however still facing the challenge of access to finance. This paper aims to discuss the SMEs importance towards development in emerging economies (Pakistan and Malaysia). Moreover, the challenges facing by SMEs in a lower-middle income (Pakistan) and upper-middle income (Malaysia) countries towards accessing finance.

By considering SMEs important towards economic development and job creation, financing for SMEs has emerged as a popular topic of discussion and research (Hallberg & Konisi, 2003). Researchers and academics have tried to analyze the issue of SMEs access to finance, emphasizing their dependence on credit and cash flows, however focus on emerging economies still needed (Hussain et al., 2015). Current study has compared the hindrances SMEs facing towards the issue of access to finance in Pakistan and Malaysia as both are placed in emerging economies list but with different income level. Also discussed the financing gap in Pakistan and Malaysia and the difference between current supply and demand which can potentially be addressed by financial institutions.

Economic Development – SMEs Contribution - Malaysia

Since 1990s SMEs have been at the core of Malaysia's economic transformation to an upper-middle income nation and are an important driver of employment and growth. According to the economic census, (2016) department of statistics, Malaysia 98.5 percent of business firms are small and medium enterprises. The service sector specifically wholesale and retail trade are on the top in the list followed by manufacturing, construction, agriculture and mining. The GDP growth of SMEs has consistently outperformed the growth of overall GDP. As the average annual growth rate of SMEs from the period of 2011 – 2016 was 6.5 percent. It was higher than the average growth of the overall economy of 5.1 percent which led to major contribution to overall GDP from 32.2 percent in 2010 to 36.6 percent in 2016. In 2016, exports of SMEs increased by 6.6 percent, moreover, contributed around 18.6 percent towards total exports which was 17.7 percent in 2015. Despite the challenging economic environment, the SMEs strong export performance supported by growth in agriculture 35 percent, services 7.8 percent and manufacturing 4.6 percent (Haniff, Akma & Lee, 2017).

The share of SMEs towards overall employment was 64.5 percent in 2015 and recorded 65.3 percent in 2016. This was also the achievement of SME Masterplan target of 65.0 percent for SME employment to total employment by year 2020. The service sector has contributed the highest with 63 percent of share towards employment generation followed by manufacturing with 16.5 percent and construction 10.4 percent (SME annual report, 2016). Similarly, services, manufacturing and construction sectors shows higher contribution towards labour productivity. As it was measured RM 59,073 by real value-added per worker in 2015 which increased in 2016 to RM 60,844, shows growth of around 3 percent. However, large firms share was slight high with 3.3 percent of growth because SMEs highly relied on labour input, particularly from the services sector (Haniff, Akma & Lee, 2017).

According to Malaysia Masterplan 2012-2020 their aim is to increase SMEs' contribution towards GDP to 41 percent, further, the share towards exports should be 23 percent till 2020. For continuous growth and higher contribution to boost up the Malaysian economy its compulsory to encourage private sector to adapt changes as well as to be globally competitive should have a pool of skilled personnel said by CEO of SME Corporation Malaysia, (2016).

SMEs in Pakistan

Pakistan economy heavily relies on SMEs for employment creation, productivity of industries, export earnings, foreign investments, and for overall economic prosperity. In 1972, government of Pakistan has establishment Small Business Finance Corporation (SBFC) to support SMEs (Qureshi, 2012; Chugtai, 2014). However, because of several issues such as corruption and lack of trained staff, SBFC failed and was merged into SME bank in 2002. Later, government has established specialized institute Small and Medium Enterprises Development Authority (SMEDA) to provide services to SMEs nationwide in all disciplines (SMEDA, 2009).

According to the statistics approximately 3.2 million (99 percent) enterprises in Pakistan are SMEs (Hussain, Ismail & Akhtar, 2015). SMEs contribution towards GDP estimated around 30 percent, further, 25 percent to manufactured goods export and 78 percent in non-agriculture workforce employment, respectively (Chugtai, 2014).Geographically, major firms are placed in Punjab with 65 percent of population followed by Sindh 18 percent, Khyber Pakhtunkhwa (KPK) 14 percent and Baluchistan 2 percent.

The province of Punjab and Sindh have a dense concentration of SMEs. Moreover, greater government schemes and services penetration and large industrial clusters presence as well as better access to finance. Sector wise the manufacturing units are dominating with 49 percent of share followed by services 40 percent and wholesale retail trade 7 percent (Khan, 2014c; IFC, 2014b). In terms of value addition, employment generation and export contribution manufacturing firms have a higher impact on the economy. Around 74 percent of firms belongs to single owner-manager in Pakistan which represents that because of minimum regulatory requirements towards establishment of firm most preferable ownership pattern is sole-proprietorship (IFC, 2014a). In revitalizing the economy of Pakistan and ensuring inclusive growth in long run SME sector can play an important role.

The current concentration pattern is not ideal and needs to be corrected in the long run. This is because in fostering regional development and inclusive growth across various stakeholders SMEs play an important role in the local economy by using local resources. Pakistan listed in the lower-middle income level countries where SMEs facing several challenges such as corruption, low level of skills/training and inadequate access to finance. However, to promote SMEs if the gap will be greater towards provision of support services through government schemes, it will create the larger development gap between various regions in the country which ultimately affect the long-term economic prospects of country.

Access to Finance – Malaysia

SMEs are contributing more than a third of gross domestic product (GDP) towards Malaysian economy. Moreover providing job opportunities to more than four million workers in Malaysia which indicates that SMEs are critical component of Malaysian economy. SMEs in Malaysia prefer five types of financing sources (Zabri, et al., 2011);

- Internal Financing Sources – Retained Earnings
  (Net income retained for re-investment)
  Shareholder's own fund/contribution
- External Financing Sources – Banking Institutions
  Trade/Supplier Credit
  Government funds/schemes

SMEs move towards internal financing options when they experience difficulty in getting formal financing from external sources. Also, in emerging there are numerous demand side issues have strong impact on SMEs financial decision making such as collateral to obtain formal finance, process and procedures of financial institutes for credit approvals and lower level of financial knowledge etc. Similarly, supply side issues also exists as banking institutions consider SMEs as the riskier sector to finance as compare to large firms (Ramlee & Berma, 2013). Furthermore, banks feel reluctant to serve SMEs because of insufficient profit margins and high transaction cost. Banks also refuse to facilitate because most of the time SMEs failed to show their creditworthiness and to provide enough evidences. These issues collectively creates the huge financing gap as in 2015 RM21.8 billion of gap has been estimated in Malaysia. As banks rejected RM 25.1 billion of SMEs applications for financing (Khan & Khalique, 2014; BNM report, 2016).

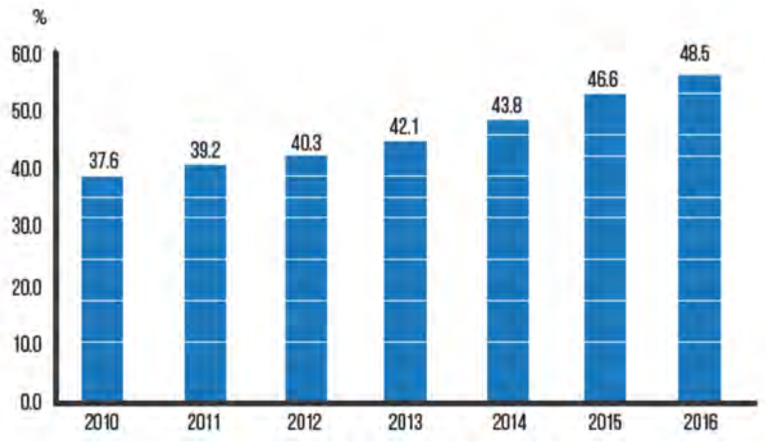

Figure 1 – Share of SME Financing
Source: Bank Negara Malaysia, 2016

Despite these facts, banking institutions are the main source of financing, providing more than 90% of total financing to SMEs in Malaysia. The financing provision to SMEs also complemented by Government Funds, Bank Negara Malaysia's Funds for SMEs and Development Financial Institutions. SMEs financing share has been increased to 48.5 percent in 2016 as compared to last year 46.6 percent represented in Figure 1 also it shows the continuous growth since 2010. In 2016, around RM75.2 billion of credit approved by banking institutions. The total financing increased to RM 302.9 billion as highlighted in the quarterly March-2017 report of Bank Negara Malaysia (SME Corporation, 2016).

In addition, government have plan to cover the current financing gap by using alternative financing channels such as crowdfunding, peer-to-peer lending, leasing and factoring. As the experts suggested that it's better to provide alternative financing options to those firms which seems to erode the profitability of banking institutions. According to the central bank of Malaysia, (2017) the factoring and leasing volume is quite low towards GDP - 0.64 and 0.69 percent respectively, however, in developed countries it is much higher (4.55 and 1.55 percent). Thus, government has planned to outline the factoring and leasing financing opportunities for SMEs around RM48 billion to facilitate Malaysian SMEs (Raganathini, 2017).

Access to Finance – Pakistan

Experts and practitioners considered access to finance as a path to reduction in poverty and inclusive growth. Government strategies towards financial inclusion of SMEs in Pakistan have taken time to bear fruit. Nevertheless, financial strategies measures cannot single-handedly resolve the issue of access to finance. The willingness of financial institutions to expand access in Pakistan has been stinted by weak legal foundations, technological barriers and unsuitable financial processes and products. In addition, some other factors like gender bias, poor socioeconomic conditions, low levels of basic education and financial knowledge remain barriers. There are three main sources of finance for SMEs in Pakistan:

- Formal Sources - Banks and non-banking financial institution
- Informal Sources – Family and friends, advance payments from customers and credit from suppliers
- Personal Savings – Internal funds, retained earnings and equity (Khan, 2015b)

SMEs mostly prefer informal sources and personal savings to fulfill their financial needs. There are various reasons behind this financial preference of SMEs. The reluctant behavior of banking and non-banking financial institutions to facilitate SMEs financially halt SMEs to take formal credit. (Sherazi et al, 2013; Khan, 2015a). Moreover, banks have very lengthy procedures towards credit approval, as they take around 2-10 months in credit approvals.

The strict policies and regulations of central bank of Pakistan also one of the reasons in this delay because banking institutions are not permissible to provide financing to SMEs on an unsecured basis. Besides, banking institutions hesitant behavior towards credit approval also because of SMEs informal business set ups, most of the enterprises are quite young and unable to meet compliance requirements (Khan, 2015b).

Such limitations place this sector as a high risk borrower and the banks show reserved behavior in lending to SMEs. Despite policy reforms, the major obstacles towards financial access arise from the high levels of poverty and low awareness about financial products, already exists in the market. Furthermore, lower technology level and gender bias halt the expansion towards geographical outreach.

In 2010 statistics of Pakistan's central bank revealed that only 6 percent of SMEs obtained formal credit (Khan, 2015a). However, the situation is much better than 8 years ago, as the 2016-17 report of State Bank of Pakistan shows 27 percent of increase towards SME financial access.

Table 1 – SME Financing

Category	Mar-17	Dec-16	Mar-16
Outstanding SME Financing	367.25	401.00	283.58
Private Sector Financing	4,461.05	4,359.19	3,828.62
SME Fin as %age of Pvt Sector Financing	**8.23%**	**9.20%**	**7.41%**
Total Financing	5,734.27	5,634.12	4,886.22
SME Fin as %age of Total Financing	**6.40%**	**7.12%**	**5.80%**
SME NPLs Ratio	**22.11%**	**20.28%**	**29.00%**
No. of SME Borrowers	176,004	177,595	163,604

Source: SME Quarterly Finance Review, March 2017

Table 1 shows the total SME financing in 2016 5.80 percent which increased to 6.40 percent in 2017, also the number of SME borrowers also increase from 163,604 to 176,004. The increase shows higher demand of formal finance among SMEs, however, better policies still needed to develop this sector.

Table 2 – Facility Wise Financing

Category/Quarters	Mar-17	Dec-16	Mar-16
Fixed Investment	87.55	88.52	68.78
Working Capital	232.94	263.03	186.52
Trade Finance	46.77	43.10	28.28
Total	**367.25**	**394.65**	**283.58**

Source: SME Quarterly Finance Review, March 2017

Working capital shows continuous increase and this has been a problem for the entire economy. The working capital consumes a large chunk of financing every year which means smaller amounts are being used for fixed investment. State bank of Pakistan emphasized the need for higher growth in the SME sector, however, commercial banks still avoid lending to SMEs because of their high default ratio. As SMEs have the highest default ratio among all segments which is the main hurdle towards growth of SME financing (NFIS, 2016).

To strengthen the SME sector the new approach such as bank digitization and to create awareness among owner-managers, suitable for smaller firms. Moreover, to design strategies for small firms which are not capable to bear higher costs can reduce the default ratio. Such tools can be workable tools to achieve the target of inclusive growth and sustainable small and medium enterprise (SME) lending products. Table 3 has summarized the details of both countries with respect to contribution, challenges and initiatives.

Table 3 – Comparison of Pakistan Malaysia

Emerging Economies			
Pakistan		**Malaysia**	
Economic Contribution		**Economic Contribution**	
GDP	30%	GDP	36.6%
Exports (manufactured goods)	25%	Exports	18.6%
Employment (non-agri workforce)	78%	Employment	65.3%

Emerging Economies			
Access to Formal Finance		**Access to Formal Finance**	
Formal Credit from Banks	6%	Formal Credit from Banks	48.5%
Challenges		**Challenges**	
Low level of Financial Knowledge		Financial Literacy	
Technology Constraints		Small business setups	
Poor Infrastructure		Collateral Requirements	
Corruption		Lack of skills and trainings	
Regulatory, documentation challenges			
Action Plans		**Action Plans**	
Awareness Campaigns		Alternative financing options for small firms; crowdfunding, factoring, leasing	
Development and support for an ecosystem of diverse products		Specialized training programs	
Expansion and Diversification in Access Points		Online Application Systems to enhance ease of access to financing for SMEs	
Financial Literacy initiatives		Complaint systems	

Source: Hanif, Akma & Lee, 2017; NFIS, 2016; Khan, 2015; Ramlee & Berma, 2013

Conclusion

Across the world SMEs significantly contribute to GDP growth, employment generation and exports, however, the importance of this sector much higher in emerging economies. In view of the aforesaid fact, national and international specialized institutes takes several initiatives for promotion and development of SME sector. These specialized institutes mainly tried to resolve the issues faced by SMEs. As several internal and external factors affect the growth of SME sector which varies country to country. In emerging economies, the issue of access to finance for SMEs has been discussed by various studies. As easy access to finance is crucial for the development of SME sector in any country. This paper has discussed the access to finance issue in emerging economies specifically in a lower-middle income country Pakistan and an upper-middle income country. The data shows that financing gap exist in both countries however, the factors which are influencing the access to finance for SMEs, the initiatives taking by the governments to cover the gap and implementation of policies in both countries are different.

According to the available data, there are major differences with respect to contribution, challenges, policy making and implementation in both countries SME sectors. As the challenges are severe in Pakistan as compare to Malaysia, resulted SMEs less contribution towards economic development. Moreover, SMEs in Pakistan not getting enough support to grow because of mismatch between demand and supply. Financial knowledge and inadequate policies might be the reason behind lower share of SMEs towards formal finance. The unstable growth of SMEs highlights that the action plans are not very effective or implementation not efficient. However, in Malaysia the policies are more accurate and supporting institutes achieving more than their targets. The constant growth trend shows better action plans and support to minimize the finance gap for SME sector to boost up Malaysian economy.

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