

Financial Pattern of Small and Medium Enterprises (SMEs) of Pakistan

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Abstract

The study explores the financial pattern of Small and Medium Enterprises (SMEs) in Khyber Pakhtunkhwa (KP) province of Pakistan. Financial pattern including overall management of sources of financing, the obstacles in financing and to identify the most lucrative sources of financing. The data is gathered through 200 questionnaires distributed in four districts, namely, Peshawar, Mardan, Swat and Haripur of Khyber Pakhtunkhwa using the snowball sampling technique. The reason for choosing KP province is that it has a meager proportion of about 5% in total 3.2 million SMEs in Pakistan. The research explores the financial reasons for such a low number of SMEs in KP. The results of the study show that major problem to SMEs is an access to formal financing sector including high interest rate, high collateral requirements and the complex documentation process to get loans. The major source of financing in KP is equity capital and re-invested profit made by business. The findings also indicate that majority of managers and owners of SMEs are dissatisfied from the banks and policies of Small and Medium Enterprises Development Authority (SMEDA). The study suggests that SMEDA should have clear and transparent policies and vision to fulfill the financial needs of SMEs from the formal financial Institutions. Similarly, banks should tailor their products and services according to the needs of SMEs.

Keywords: Financial Pattern, Small and Medium Enterprises (SMEs), Questionnaire Survey, Pakistan, Khyber Pakhtunkhwa (KP).

1. Introduction

Financial pattern comprises of all those activities which are related with the overall management of finances (Liu & Xu, 2021). Financial pattern should be distinguished from financing patterns which refer to those sources through which an organization fulfills financial needs (Liu & Xu, 2021). In this study, financial pattern has broader

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scope including financing pattern, the hurdles in financing and to identify the most profitable source of financing. A variety of definitions exist for SMEs and this study adopts the definition of SMEDA which categorizes business as SME having maximum employees up to 250, with a paid up capital or total assets up to Rs. 25 million while turnover/sale up to Rs. 250 million (Rasool, Dars & Shah, 2013). The SMEs play important role in the development of world economy which comprises 90% of SMEs, contribution up to 70% in employment and 55% to GDP (Rao, Kumar, Chavan & Lim, 2021). However, when it comes to getting external finances, the larger businesses take precedence (Haleem, Jehangir & Ullah, 2019). Recently published systematic literature review paper by Rao et al., (2021) and bibliometric analysis by Baker, Kumar and Pandey (2021) document that “access to finance” is the most important issues of SMEs in the last four decades or so. Hence it is important to analyze the financial pattern of SMEs in Pakistan.

According to the State Bank of Pakistan (SBP), the percentage of SMEs getting formal credit is only 8.5% with 181,000 borrowers at the end of year 2018.⁴ The majority of SMEs rely on owner equity, retained earnings or informal sources of financing. The main constraints in getting loan from formal financial institutions are high administrative costs, massive collateral requirement along with low exposure of SMEs to formal sector creditors (Kumar, Sureka & Colombage, 2020); Ali, Jabeen, & Khattak, 2021; Rao et al., 2021). Therefore, financial obstacles are the major constraints in limiting the growth of SMEs (Cummings, Rawhouser, Vismara, & Hamilton (2020). There is limited research available in developing economies that documents financial constraints faced by SMEs (Kumar et al., 2020; Ali et al., 2021). The contribution of SMEs sector outweighs large businesses in terms of production, employment generation, and innovation, therefore, it is pertinent to identify the financial patterns with main focus on constraints and sources of financing of SMEs. The objectives of the study are: (1) To explore the sources of financing for the SMEs sector of Khyber Pakhtunkhwa, Pakistan, and (2) To explore the major obstacles in the financing of SMEs in Khyber Pakhtunkhwa, Pakistan.

One of the contributions of the study is in terms of the established SMEs in KP vis-à-vis other provinces. The statistics show that more than 90 percent SMEs are located in Punjab and Sindh provinces and the same percentage of lending from SBP goes to SME sector of these two provinces (Ul Haq, 2019; Bhatti, Rehman, & Rumman, 2020). The KP province has about 5% of the total number of SMEs in Pakistan (Ul Haq, 2019). Why so small number of SMEs in KP province? We hypothesize that financial pattern might play a major role in determining the number of

⁴ The SBP projected to increase the percentage to 17% with 700,000 SMEs' borrowers at the end of 2023. However, due to Covid-19, the percentage of SMEs borrowing has dropped to 6.51% as of December 2021 against 7.25% in December 2020 (SBP, December 2021).

SMEs in KP. Another contribution of the research is to use primary data collection instead secondary data. The use of questionnaires provide more recent experiences of owners/employees about financial pattern of SMEs in KP.

Section 1 introduces the study, followed by Section 2 of literature review. Section 3 discusses Methodology and data analysis is written in the Section 4. Finally Section 5 consists of discussion, conclusion and future implications.

2. Literature Review

The growth of SMEs is associated with many economic advantages such as improved productivity, employment generation, rising tax to GDP ratio, and giving competitive edge to the economy (Baker et al., 2021; Bhatti et al., 2020). The financing pattern of SMEs ranges from initial internal sources such as owner personal savings and retained profit (Rao et al., 2021), informal external sources such as friends and family (Ali et al., 2021), trade credit, venture capital and business angel (Khan, Khan & Hameed, 2020; Khan, Khan, Hameed & Zada, 2021), to formal external sources such as banks and other financial institutions and capital markets (Ul Haq, 2019; Cumming et al., 2020). Keeping in view the objectives of the study, the literature consists of two main categories i.e., (1) Sources and Financial Constraints to SMEs' financing, and (2) Other Constraints to SMEs' financing.

2.1.Sources and financial constraints Of SMEs' financing

The sources identified for SMEs' financing are equity capital, debt financing, bank financing, government assistance and initiatives (Kumar et al., 2020; Ul Haq, 2019; Bhatti et al., 2020; Ali et al., 2021; Rao et al., 2021). The financing needs of SMEs also vary throughout the different phases of firm's life cycle. This life cycle paradigm asserts that during the start-up phase where usually information is inadequate, high risk of failure, and lack of trading history led SMEs to depend on internal funding sources. Studies also associate financial requirements of SMEs with certain characteristics such as age of the firm, size, profitability, asset structure, growth and risk (Wang, 2016; Cumming et al., 2020).

Equity financing is the amount of money invested in the business without any specific date of repayment. It can be obtained equally from inside and outside sources where internal sources include the owner of the business, family members, friends and the profit made by the business, whereas external sources include the sources other than explained above (Rao et al., 2021). Venture capital and business angels are also the sources of equity financing (Cummings et al., 2020; Khan et al., 2020; Khan et al., 2021). The first advantage of this type of financing is that "it offers long-

term financing with minimum cash outflow in the form of interest” and the second advantage of it is that “it helps to improve the new/fresh firm’s creditability by representing that the firm has the authorization of sophisticated financial specialists” (Ou & Haynes, 2006, p. 156).

Opting equity financing is not always a viable source of financing as this takes the organization towards dilution which will weaken their control and sense of ownership of the business. In order to have a full control and ownership of their business, they go for debt financing in the form of funds from non-financial institutions and trade credit (Abdulsaleh & Worthington, 2013). They choose short and long term debts when taking decisions regarding capital structure (Cummings et al., 2020; Molly, Uhlener, De Massis & Laveren, 2019). Short-term debts are very easy to obtain due to lower cost of floatation and a well-organized method to deal with irregularity of information (Rao et al., 2021). Bank is the most important source of debt financing for SMEs both in developed and less developed countries (Vera & Onji, 2010; Li, Wu & Zhang, 2020). They not only provide finances but also serve products and services to the firms. Banks monitor the activities of SMEs which compel them to function properly (Abdulsaleh & Worthington, 2013) in order to control the agency cost of debts (Khan, Burton & Power, 2011; Khan, Khan & Ullah, 2021). The banks provide loans to SMEs on competitive basis (Vera & Onji, 2010). In spite of being useful, banks are most expensive source of finance as compared to other sources (Vera & Onji, 2010; Li et al., 2020). There is a cumbersome procedure faced by SMEs to get financing from formal financial institutions in Pakistan such as collateral requirements because these institutions consider SMEs sector as risky and having uncertain business nature (Ul Haq, 2019; Bhatti et al., 2020; Ali et al, 2021). According to SMEDA, approval of loans from banks takes from 2 to 10 months due to red tapism and strict rules and regulations of SBP. This is also coupled by the business uncertainty in SMEs sector to refund the loan to banks upon maturity (Bhatti et al., 2020). Furthermore, the inefficiencies of SMEs for not keeping a well maintained documentary record of their business activities, which is often required by banks in order to evaluate their performance for advancing finances, becomes one of the hindrances (Rao et al., 2021). The afore-mentioned constraints compel SMEs sector to look for alternatives sources and to have less reliance on formal sector. Therefore, the owners of SMEs businesses also prefer to exploit their own savings as well as rely on friends and family because the opportunity cost of equity financing from formal sector is very high (Ali et al., 2021).

Government is also a vital source in financing small businesses. Government introduces schemes for SME sector to have easy access to finance either alone or in collaboration with donors (Amorós, Felzensztein & Gimmon, 2013). As government realizes the significance and key contribution of SMEs in the economic activities of a

country and respond to the same through various schemes such as credit guarantee loans, factoring programs and subsidized fees (Abdulsaleh & Worthington, 2013). For instance, in 2020-21, Pakistan's government initiated similar program of "Kamyab Jawan" to boost SME sector in country (SBP, 2021).⁵

2.2 Other constraints to SMEs' financing

Financial obstacles of SME sector in developing countries mostly resemble the developed countries such as the UK. For example, the SMEs in the UK rely more on short-term debts and face difficulty in attracting long-term loans possibly due to the reason that small businesses are not listed on stock market (García-Teruel & Martínez-Solano, 2007). In addition, the rate of survival of SMEs in developing countries is quite low compared to developed nations (Ullah, 2020). The reasons behind this failure are lack of governmental support, insufficient funds, shortage of trained manpower, low technological capabilities and non-competitive products (Baker et al., 2021; Rao et al., 2021). When registered and informal SMEs were compared, Distinguin, Rugemintwari and Tacneng (2016) documented that registered SMEs faced more constraints in getting finance in contrast to informal firms which were associated with countries bearing weak governance and bureaucratic structure. Wang (2016) documented five pivotal hurdles in financing of SMEs from the perspective of managers i.e., access to finance, tax rate, competition, electricity and political factors. However, the major constraints were 'access to finance' and 'competition' (Wang, 2016). The SMEs relied on external financing faced high interest rates, cumbersome application process and high collateral requirements (Wang, 2016; Lam & Liu, 2020).

In Pakistani context, location is a major issue in an unequal distribution SMEs portfolio in a country. From 3.2 million SMEs, Punjab and Sindh get majority proportion which is 65.28% and 25.75% respectively, while aggregate share of Khyber Pakhtunkhwa, Balochistan, FATA, Gilgit-Baltistan and AJK in total is merely 10% of the portfolio (Ul Haq, 2019). Interestingly, only Lahore, Karachi and Faisalabad get more than half of the SMEs financing and top 20 districts get 85% of overall SMEs funding, over-shadowing rest of the 110 districts. The concentration of SMEs activities is 96% in sole proprietorship, 2% in partnership while corporate SMEs are non-existent (Ali et al., 2021; Khan, Kamal, & Khan, 2020; Haleem et al., 2019; Ullah, 2020). Another reason for financing constraints documented by Khan et al., (2020) is the lack of ability of SMEs to issue Sukuks for fund generation due to high costs related to its issuance and management (Khan & Khan, 2015; Khan, Gul & Khan, 2018). Ullah (2020) also posited that financial constraints hampered sales and employment growth of SME sector.

5 Under the scheme, government assigned a budget of PKR. 100 Billion for startup for the year 2021-22.

3. Research Methodology

The study is exploratory in nature as it explores the financial sources and obstacles of SMEs. Exploratory research is employed in situations where “little” is known beforehand about that subject (Neuman, 2014). We have cited many papers on this topic related to sample of whole Pakistan, however, there is scarcity of research in this area encompassing the province KP of only. That’s why we categorize this research as ‘exploratory’ based on the sample of KP province. Population of the study is the SMEs sector of whole Pakistan where sample has been taken from Khyber Pakhtunkhwa as this province has very low share of SME portfolio in the country, about 5% (Ul Haq, 2019). Primary data through questionnaire survey is used instead of interview to reach a bigger sample size for analysis (Ali, Imran & Khan, 2021; Burki, Khan, & Saeed, 2020; Waheed & Khan, 2019; Zia, Saeed & Khan, 2018). The final sample consisted of 200 respondents who were owners and managers along with other key employees of manufacturing, trade and services sectors SMEs located in Peshawar, Mardan, Swat and Haripur districts of KP. The number of industrial estates in Peshawar is 7, Mardan has 3, Swat has 2 and Haripur has 1 (Ali et al., 2021). We tried to have a good representative sample from district with highest number of industrial estates (i.e., 7 in Peshawar) to the lowest (i.e., 1 for Haripur). After choosing these districts, we employ Snowball Sampling Method, SSM (Khan, 2011; Khan, Burton & Power, 2013). Many owners and managers of SMEs are not willing to respond and share information, therefore, opting for random sampling of respondents may carry the risk of not getting the required responses. Consequently, SSM was deemed appropriate. Under this method, the researcher requests a participant to refer other participants. Those willing to participate help in further referring other respondents for the study and thus increasing the chances of getting more responses (Johnson, 2014; Parker et al., 2019). For example, we meet Participants 1 and he referred us to three relatives and two friends related with SME businesses. The same approach is also used with other participants. This method is easy and economical to reach a large number of target participants (Khan, Burton & Power, 2011).

Setting for the study is non-contrived as the data has been collected in natural environment. The nature of the data is cross-sectional which is collected at one time. Individual selected as the unit of analysis are owners and/or managers or key employees of SMEs. All participants are assured about the confidentiality of their information (Ullah & Khan, 2018; Khan et al., 2011; Rashid & Khan, 2019). Questionnaire is designed in English but Urdu translation is also provided to those participants who are having difficulty in understanding English.

The semi-structured questionnaire is designed containing 27 questions along with 8 demographics queries (Riaz, Khan & Khan, 2017) – See Appendix 1. The

questions have crafted based on thorough review of relevant literature. We did not follow one ready-made questionnaire. Instead, different questions are extracted from different studies to support our two themes (Khan, 2011; Rashid & Khan, 2019). The questions are designed keeping in mind the two research objectives. The part A has 15 questions about sources of finances and the part B is about the constraints to finances of SMEs having 12 questions. The questionnaires are distributed both online and physical among the respondents (Barghathi, Mirani & Khan, 2021). More than 220 questionnaires were distributed physically of which 191 respondents filled and returned the questionnaire whereas the response of 13 out of 20 online questionnaires were also received digitally. The analysis is done through statistical tests of frequency distribution, reliability and descriptive statistics (Ali et al, 2021; Burki et al., 2020; Waheed & Khan, 2019; Zia et al., 2018; Riaz et al., 2017). The descriptive statistics is a simple and useful way of extracting preliminary information about the data (Sardar, Shah & Khan, 2014; 2018; Khan & Khan, 2015; Saddique & Khan, 2015; Akhtar & Khan, 2016). Descriptive statistics show the overall pattern of data under investigation (Israil & Khan, 2016; Khan et al., 2016; Khan & Khan, 2016; Khan & Khan, 2016; Kiran & Khan, 2016). For this study, we use two descriptive statistics namely, frequency and percentage for extracting the similarity of responses for each question (Khan, Jehan & Shah, 2017; Shah & Khan, 2019; Kiran, Khan & Shah, 2020; Bano & Khan, 2020; Shah, Khan & Ali, 2020; Shah, Khan & Atif, 2021).

4. Data Analysis

4.1 Demographic information

The Table 1 shows the demographic information about the respondents and the SMEs where they are working.

Table 1: Demographic Information

Sample Characteristics	Frequency	Percent
Designation		
Accountant	2	1
Advocate	1	0.5
Chief Executive Officer	2	1
Director	8	4
Employee	1	0.5
finance manager	5	2.5
General manager	6	3
HR manager	2	1

Manager	76	38
managing director	1	0.5
Owner	95	47.5
Territory Sale Officer	1	0.5
Total	200	100
Qualification		
SSC	20	10
HSSC	29	14.5
Bachelor	72	36
Master	75	37.5
MPhil	4	2
Total	200	100
Age		
20-25	11	5.5
26-30	69	34.5
31-35	57	28.5
36-40	25	12.5
40 & above	38	19
Total	200	100
Total Assets		
1 Million-5 Million	77	38.5
6 Million-10 Million	77	38.5
11 Million-15 Million	21	10.5
16 Million-20 Million	12	6
20 Million and Above	13	6.5
Total	200	100
Number of Employees		
1-5	50	25
6-10	66	33
11-15	31	15.5
16-20	20	10
21-25	14	7
26 and Above	19	9.5
Total	200	100

Nature of Business		
Manufacturing	62	31
Services	38	19
Retailer/wholesaler	93	46.5
Other	7	3.5
Total	200	100
Time Horizon of Business		
Up to 2 years	23	11.5
Between 2 to 6 years	62	31
More than 6 years	115	57.5
Total	200	100

The statistics in Table 1 show that highest percent (47.5) of the respondents are owners followed by managers who are 76 out of 200. In addition, maximum of them hold master degrees (37.5%) and bachelor degrees (36%). Most of the respondents are young entrepreneurs in the age bracket of 26-35, where 34.5% within range of 26-30 and 28.5% lie in domain of 31-35 years of age. Size of the SMEs, measured with the help of total assets, shows that 38.5% of businesses have investment between 1-5 Million and 38.5% firms have assets between 6-10 Million. Only a small percentage (6.5%) of SMEs have assets more than 20 Million. Number of employees of most of the SMEs (33%) are between 6-10, while 25% businesses are having less than 5 employees. A small percentage (9%) of SMEs have more than 26 employees. With regard to the nature of SME business, about 46.5% of SMEs are related with Retail/wholesale businesses, 31% are involved in manufacturing and 19% are engaged in services sector. The life span of the business of SMEs is satisfactory in the sense that most (57.5%) of them are operating for more than six years.

4.2 Reliability

Questionnaire items are adapted from different sources and for reliability of questionnaire data, Alpha reliability test is used. For instrument reliability, Cronbach's Alpha is used. The dependability indicates the range to which the quantifying tools are error free and without bias (Sekaran, 2003). The procedures recommended by Tabachnick and Fidell (2007) are used to construe alpha values, giving to which $\alpha > 0.9$ is excellent; $\alpha > 0.8$ is very good; $\alpha > 0.7$ is good, $\alpha > 0.6$ is acceptable; $\alpha > 0.5$ questionable $\alpha < 0.5$ is un-acceptable. In this study, dependability score for financial obstacle faced by SMEs is ($\alpha = 0.516$) and sources of finance used by SMEs is ($\alpha = 0.568$) which indicate that the questionnaire is reliable and acceptable.

Table 2: Results of Cronbach's Alpha Reliability

Research Themes	Number of item	Cronbach's Alpha
Sources of finance	12	0.568
Financial obstacle	13	0.516

The Table 2 shows the Cronbach's alpha reliability of 13 items of financial obstacles is found to be 0.516 which is considered acceptable and 12 items of sources of finance is 0.568 which is also in acceptable range.

4.3 Validity

Validity of questionnaire is measured with the help of Confirmatory Factor Analysis (CFA). The concept of CFA is originated from common factor model which indicate that each variable must have an observed measured unique factor (Thurstone, 1947). The CFA is used for correlations among items of the variable (Jöreskog, 1969, 1971). The CFA also used for multiple such as construct validation and evaluation of measurement invariances. When there is two or more than two factors of the latent variable then confirmatory factor analysis is performed (Raykov, 2001). It refers that there should be atleast 2-3 question in each theme to have CFA analysis. In our questionnaire, we have done the analysis (frequency and percentage) of the responses of single question which do not quality for using CFA. Therefore, the research does not have CFA analysis.

4.4 Sources of finances

The Table 3 shows the major source of finance for SMEs in KP province of Pakistan.

Table 3: Major Sources of Finance

Statement	Responses by Frequency and Percentage				
	Equity Capital	Family and Friends Loans	Banks Loans	Debt Financing	Govt. Assistance/ Funds
Major Source of Finance	125 (62.5%)	33 (16.5%)	15 (7.5%)	20 (10.0%)	7 (3.5%)

It is evident from the statistics of Table 3 that most (62.5%) SMEs rely on equity capital. In addition, only 16.5% businesses approach family and friends for financing and a meager percentage of 7.5% opt for bank loans. Moreover, 10% SMEs go for debt financing and a lowest 3.5% have assistance/fund from government. When the

respondents are asked about the proportion of bank loan to total capital, maximum (66%) of them consider it 'negligible' (This response is a result of Question No. 11 Part A). Moreover, the propensity of opting for bank loan has been increasing in near past (Question No. 12 part A).

Table 4 shows that major source of financing is Equity Financing. When the respondents are asked about the various forms of Equity Financing, they listed different sources (Table 4). The statistics show that Profit Made by Business (Retain

Table 4: Sources Used for Equity Financing

Statement	Responses by Frequency and Percentage				
	Venture capital	Family and Friends	Business Angles	Profit made by Business	Other
Source for Equity Financing	38 (19.0%)	37 (18.5%)	13 (6.5%)	110 (55.0%)	2 (1.0%)

Earnings) is the major source (55%) of equity financing. Moreover, 19.0% businesses use venture capital for equity finance, and 18.5% opt for Kinship (family and friends). Some other notable sources of equity financing are business angles (6.5%) and other sources (1.0%).

Table 5: Sources Used for Debt Financing

Statement	Responses by Frequency and Percentage			
	Non-financial Institution	Trade Credit	No external Financing Source	Other
Source of Debt Financing	62 (31.0%)	80 (40.0%)	44 (22.0%)	14 (7.0%)

The Table 4 shows that debt financing is not popular source of financing but in case of need, SMEs opt for various sources (Table 4). The most popular way of debts financing (40%) is trade credit, followed by non-financial institutions (22%). In addition, about 22% businesses have 'no external financing sources and 7% go for 'other' sources of debt financing.

The response to Question No. 04 of part A of the survey shows that 32.5% SMEs prefer short-term loan (less than a year) whereas 63.5% prefer long-term loan (more than a year). With respect to process of acquiring loans from financial institutions (Question No. 06, part A), 10.5% respondents are highly dissatisfied while 8.5% are highly satisfied, 28.5% are had mixed opinions (neutral), thus making the overall tally of dissatisfaction as the highest. Similar dissatisfaction is documented about the role of SMEDA in fulfilling the financial needs of SMEs, where 6.5% respondents are highly

satisfied, 18% are highly dissatisfied while 29% of respondents respond as 'neutral'.

Table 6: Major Financial Obstacles

Statement	Responses by Frequency and Percentage					
	Business Location	Complex Documentation	Nature of Business	Collateral Requirement	Interest Rate	Credit Rationing
Major Financial obstacle	50 (25.0%)	17 (8.5%)	28 (14.0%)	16 (8.0%)	61 (30.5%)	28 (14.0%)

4.5 Obstacles/Constraints to finances

The Table 5 shows the major obstacles in raising financing for SMEs. Interest rate is ranked as the highest obstacle (30.5%), while collateral requirement is considered the lowest constraint (8%). Moreover, the second important constraint is business location (25%) followed by credit rationing (14%), nature of business (14%) and complex documentation (8.5%).

In response to Question No. 15 of part B, more than half respondents expressed their concerns about SMEs facing greater difficulties in obtaining loan from financial institutions compared to large enterprises.

Table 7: Other Financial Obstacle from Formal Sector

Statements	Responses by frequency and percentage					
	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Mean
New business can get easy loan from financial institute.	27 (13.5%)	24 (12.0%)	25 (12.5%)	82 (41.0%)	42 (21.0%)	3.44
Effective interest rate is high for SMEs.	42 (21.0%)	76 (38.0%)	47 (23.5%)	25 (12.5%)	10 (5.0%)	2.43
Default Rates by SMEs are higher than large enterprises?	29 (14.5%)	48 (24.0%)	53 (26.5%)	52 (26.0%)	18 (9.0%)	2.91
Collateral is a prerequisite for loans	12 (6.0%)	36 (18.0%)	48 (24.0%)	67 (33.5%)	37 (18.5%)	2.44
SMEs face unfair competition in competing for bank credits	38 (19.0%)	68 (34.0%)	28 (14.0%)	48 (24.0%)	18 (9.0%)	2.70

Nature of business is hurdle in obtaining loans.	12 (6.0%)	36 (18.0%)	48 (24.0%)	67 (33.5%)	37 (18.5%)	3.41
Government's policies are in favor of large enterprises	39 (19.5%)	58 (29.0%)	21 (10.5%)	55 (27.5%)	27 (13.5%)	2.87
Banks are responsive to SMEs	17 (8.5%)	56 (28.0%)	69 (34.5%)	39 (19.5%)	19 (9.5%)	2.94
The government has clear vision to promoting SMEs.	13 (6.5%)	43 (21.5%)	28 (14.0%)	67 (33.5%)	49 (24.5%)	3.48
The response of the govt. to the needs of business is high	22 (11.0%)	26 (13.0%)	55 (27.5%)	47 (23.5%)	50 (25.0%)	3.39
Access to long-term credits is more important for SMEs	72 (36.0%)	72 (36.0%)	16 (8.0%)	29 (14.5%)	11 (5.5%)	2.18
Getting loan from banks is quite easier	5 (2.5%)	33 (16.5%)	56 (28.0%)	63 (31.5%)	43 (21.5%)	3.53
Loans from family and friends is quiet easier	33 (16.5%)	87 (43.5%)	30 (15.0%)	42 (21.0%)	8 (4.2%)	3.53
In general the condition of SME in KP is quite better	33 (16.5%)	59 (29.5%)	36 (18.0%)	43 (21.5%)	29 (14.5%)	2.88

The results of Table 7 show that the major problems faced by SMEs are lack of access to finances from formal financial sectors in Khyber Pakhtunkhwa which is in line with the literature (Wasiuzzaman, Nurdin, Abdullah & Vinayan, 2020; Motta, 2020; Ali et al., 2021; Rao et al, 2021; Baker et al., 2021). One of the major reasons in difficulty to get loans from banks and other financial institutions is the unfavorable repayment criteria, while lack of repayment history and loan defaults on the part of SMEs are also amongst the reason to get inadequate support from formal financial sectors and this finding is also supported by literature (Motta, 2020; Cumming et al., 2020). According to our questionnaire survey, high interest rate on loans from formal financial sector is the major obstacle to SMEs. The documentation process for obtaining loans for SMEs is also much difficult when compared to large businesses. New businesses cannot get loans easily from financial institutions. A large number of respondents agreed that the effective interest rate, which banks charge on SMEs, is higher than large businesses. According to the managers of small businesses, collateral is important for getting loans but this should be in consonance with the financial health of SMEs. Another ambiguous factor is that SMEs are facing an unjust competition from large businesses in obtaining bank loans on the one hand while skewed government policies toward large businesses on the other hand.

According to the survey of this study, SMEs are avoiding loans from formal financial institutions due to collateral requirements, long documentation process,

red-tapism amongst the others in Khyber Pakhtunkhwa, but when it becomes necessary to get loans, they prefer non-financial institutes (friends & family, informal financial sector) and trade credit. SMEDA and other financial institutions also lack competence in attracting SMEs to avail loans and other facilities.

5. Conclusion and Way Forward

The main conclusion is that equity capital is the major source of financing for SMEs in Khyber Pakhtunkhwa along with the use of retained earnings. In KP, majority of SMEs prefer to use own equity and retained earnings in the startups and growth phases. In addition, the major problems faced by SME sector of KP are financial obstacles, especially financing from banks and other formal financial institution. Other findings of the study reveal that there are complex procedures for getting loans from formal financial institutions, higher interest rates, higher collateral requirements, non-friendly policies of SMEDA and government toward SMEs. This spurs the small and medium businesses to trust informal sources for getting finances such as getting loan from friends and family, rely on trade credit, and use personal equity.

The results of this study suggest SMEDA to review their policies about the small businesses by making it transparent and friendly. The findings document that the procedure for getting bank loans is more complex as compared to large businesses. Banks should also tailor their financial products and services according to the needs of SMEs and make it transparent and SME's friendly. Formal financial institutions should arrange seminars for the financial awareness about their products and services for SMEs sector because most of the managers or owners of the small enterprises are unaware about the financial product.

The study is based on cross-sectional data due to time and resources constraints and limited to Khyber Pakhtunkhwa province while future studies can compare it with other provinces by using longitudinal data. Other studies can also focus on the role of political and cultural factors in SMEs financing for more robust results. The impact of various allied institutions on SMEs can also help to explore new research avenues.

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Appendix 1: Questionnaire

Financial Pattern of Small and Medium Enterprises (SMEs) in Pakistan

This study requires some data from the owners and/or managers and other employees of SMEs in order to explore the sources and the major obstacles in obtaining finances. The data and other information obtained through this questionnaire will be kept confidential and will not be used for other purposes except this research study. The questionnaire is divided into two parts. The first part is concerned with the sources of finance and the second part is concerned with financial obstacles faced by SMEs.

We will remain Thankful for your valuable time and participation.

Demographics

1. Name: (Optional) _____
2. Designation: _____
3. Qualification: _____
4. Age: (Optional) _____
5. Total assets of your enterprise: _____
6. Number of employees in your enterprise: _____
7. What is the nature of your business?
 - i. Manufacturing
 - ii. Services
 - iii. Retail/whole Sale
 - iv. Other. Please specify _____
8. No. of years of operation of your business?
 - i. Up to 2 year
 - ii. Between 2 to 6 years
 - iii. More than 6 years

Part A: Sources of Finance

1. What is your major source of finance?
 - i. Equity Capital
 - ii. Friends and family loans
 - iii. Bank loans
 - iv. Debt Financing

v. Govt. Assistance funds vi. Other. Please specify_____

2. Which of the followings source you have used for equity financing?

- i. Venture capital ii. Family and friends
 iii. Business Angles iv. Profit made by the business
 v. Other. Please specify_____

3. Which of the followings source have you used for Debt financing?

- i. Non financial institution ii. Trade credit
 iii. No external equity financing source iv. Other. Please specify_____

4.

5. What kind of loan maturity you prefer?

- i. Short term (for 1 year or less) ii. long term (for more than 1 years)

S. No	Indicate how much you agree or disagree to the following statements	Strongly agree	Agree	Neither disagree nor agree	Disagree	Strongly disagree
5	Access to long-term credits (over 2 years) is more important for SMEs than short-term credit?					
6	Getting loan from banks and other institutions is quite easier?					
7	Getting loans from family and friends is quite easier?					
8	In general, the condition of SME in KP is quite better?					

S. No	Rate overall satisfaction	Highly Satisfied	Satisfied	Neu-tral	Dissatisfied	Highly Dis-satisfied
9	The process of acquiring loan from financial institutions?					
10	The role of SMEDA in fulfilling your financing needs either from banks or other sources?					

11. The proportion of bank loans to your total capital is

Non or negligible	10% to 20%	20% to 30%	30% to 40%	40% to 50%

12. In response to question 11, how do you see that in recent period (2010-2016), the trend in bank loans is

Firmly increasing	Increasing	Unchanged	Decreasing	Sharply decreasing

Part B: Financial Obstacles

13. Rank according to importance the major financial obstacles in running an SME in KP?

	Very important	Important	Neutral	Less important	Least important
Location of your business					
Complex documentation procedures					
Nature of business					
High collateral requirements					
High interest rate					
Credit rationing (you get less than what you demand)					

14. Which of the following obstacle(s) you think is (are) most important and if tackled, will enable you get loan easily?

- i. Location of your business ii. Complex documentation procedures
- iii. nature of business iv. High Collateral requirements
- v. High interest rate vi. Credit rationing (you get less than what you demand)

vii. Other. Please specify _____

Tick Mark level of difficulty or easiness in the following Table

S. No.		Very difficult	Difficult	Neutral	Easy	Very easy
15	Rank the documentation process for obtaining a loan on comparative basis between SME and large enterprises of KP?					
	SME					
	Large enterprises					

S. No	Indicate how much you agree or disagree to the following statements	Strongly agree	Agree	Neither disagree nor agree	Disagree	Strongly disagree
16	New business can get easy loan from financial institutions?					
17	The effective interest rate that bank charges on SMEs are higher than effective rate charges on large enterprises.					
18	Default Rates on loans made by SMEs are higher than those made to large enterprises?					
19	Collateral is a prerequisite for getting loans?					
20	SMEs face unfair competition from large enterprises in competing for bank credits?					

21	Your nature of business is a hurdle in obtaining loans from formal financial institutions?					
22	In general, government's policies are in favor of large enterprises?					
23	Banks are responsive to SMEs' financing requirements?					
24	The government has clear vision, strategy and policies to promote SMEs?					
25	The responsiveness of the government to the needs of business is high?					

Tick Mark in the relevant column of the Table

26. How Small Medium Enterprises Development Authority (SMEDA) can help to reduce the gaps between your financial needs and financing products of banks.

27. Apart from above obstacles and sources of financing which financial obstacle is more challenging and which source of financing results in maximum probability?

Thank you very much for your Time and Input!

