

# **SMEs Development in Developing Countries through Public - Private Partnership**

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## **Abstract**

This study examines the current developments of SMEs in Pakistan and the effectiveness of public-private partnership for SME development. Some important facts are presented. A comprehensive international literature study was undertaken. A questionnaire was developed for small and medium sized enterprises owners and top managers to access the status of their enterprises and also to examine SMEs' developmental strategies adopted by them. Regression was employed for analysis of the data. The study found that SMEs are of overwhelming importance to developing countries because they account for more than 90 percent of all firms outside the agricultural sector. The study also found that main constraints faced by small entrepreneurs are lack of finance, low human resource capabilities, and technological capabilities. Finally, the government has been the most important supporting agency for SMEs in developing economies. However, evidence of the effectiveness of government and private programs to support SME development is mixed and not so encouraging. After analyzing the current SMEs' developmental strategies (adopted by both public and private sectors) the study suggested some future strategies for SMEs' development in developing countries.

Key Words: SME, PPP, developing countries, Pakistan

## **1. Introduction**

Small and medium enterprises (SMEs) are vital to the economies of all countries, specifically developing countries. In present competitive and challenging global environment, an extremely viable and dynamic SME sector is essential for the economic development of developing countries. SMEs are engine of growth in prosperous and growing economy and play an important role in creating economic growth. SMEs contribute to economic development by creating employment for rural and urban population, providing flexibility and innovation through entrepreneurship and increase international trade by diversifying economic activity. Their role in income generation and economic growth for developing countries is critical.

SMEs are strategically important in many developing countries, particularly those located in the Asian region. The SME sector consists of more than 90% of all firms outside the agricultural sector in the region (Wattanaputtipaisan 2003). They are the primary vehicles by which new entrepreneurs provide the economy with a continuous supply of ideas, skills, and innovations (CACCI 2003). All over the world, SMEs are being supported on the grounds that they make substantial contributions to productivity growth and consequently, competitiveness and aggregate economic growth. In addition, SMEs are believed to be especially effective job creators and enjoy the reputation of being sources of income, providing training opportunities as well as important basic services for disadvantaged people (UNIDO 2006).

Small and medium-sized manufacturing sector in Pakistan, even after worst ever global financial crisis maintained its healthy growth at 7.5% in 2008-09 (Economic Survey of Pakistan 2008-09). In Pakistan, SMEs account for more than 95% of the total number of establishments, 80% of employment outside agriculture (SMEDA 2007). Across the South Asia, the contribution of SMEs to the overall economic growth and the GDP is high. It is estimated that SMEs contribute 50% of Bangladesh's industrial GDP and provide employment to 82% of the total industrial sector employment. In Nepal, SMEs constitute more than 98% of all establishments and contribute 63% of the value-added segment. In India, SMEs' contribution to GDP is 30% (Economic Survey of Pakistan 2008-09).

SMEs constitute a very heavy portion of Pakistan's economy as their contribution in GDP is 30%. According to the Federal Bureau of Statistics Pakistan, there are around 3.2 million establishments in Pakistan that fall under the category of SMEs. 90% of the very small establishments accounts for 80% of all non- agricultural sector employment. All these statistics clearly indicates the vital role of SMEs in the economic growth of Pakistan.

However, SMEs due to their size face problems that make them vulnerable and prevent them from attaining growth. These problems are particularly significant in the areas of human resources development, technological capability, and access to financing. In presence of such problems, many SMEs are unable to meet the challenges created due to liberalization and globalization of markets.

In developing countries the full potential of the SME sector has yet to be tapped due to the existence of a number of constraints hampering the development of the sector. SMEs in developing countries primarily face issues relating to business regulations and restrictions,

finance, human resource capabilities and technological capabilities (Asian SME summit 2009). Developing SMEs in developing countries is an important challenge. The main underlying constraints to their growth are lack of finance, lack of human resource capabilities and lack of technological capabilities. There is generally a lack of awareness in developing countries regarding significance of PPPs. The purpose of the study is, twofold: first it investigates into the constraints that SMEs face in developing countries. Second, it suggests how PPP can help to remove the constraints to SMEs development. Therefore, the study investigates the current situation of PPP and forward policies to enhance public-private cooperation in developing countries for SMEs development. The study, therefore, serve to all the stakeholders for improving the various aspects of SME development in Pakistan particularly and in developing countries in general.

The remainder of this paper is structured as follows. Section 2 summarizes recent empirical evidences on SMEs' constraints and patterns. Section 3 discusses PPP, its need and importance and benefits to SMEs. Section 4 presents the research methodology used in the study. Section 5 focuses on the data and the empirical results of the study. Finally, section 6 concludes.

## **2. Literature Review**

SMEs are different from large organizations in several characteristics like resource limitations (financial, human and technological), informal strategies, and flexible structures (Hudson, Smart, and Bourne 2001; Qian and Li 2003). As a consequence, SMEs have higher

failure rate than large enterprises. This also causes slow growth of SMEs. Literature identified three main constraints in SMEs growth in developing countries: (1) lack of finance; (2) low human resource capabilities; (3) technological capabilities.

## ***2.1 Lack of Finance***

SMEs growth and development in developing countries is vital, as they play a key role in creating new jobs and reducing poverty. For various reasons ranging from a lack of collateral to bias against small firms, small firms tend to face greater financial constraints than do larger firms. An IFC study of 10,000 firms across 80 countries found that credit is mentioned more frequently by smaller firms as a constraint on growth (Schiffer and Weder 2001). Adequate financing is necessary to help SMEs set up and expand their operations, develop new products, and invest in new staff or production facilities. However, in developing countries SMEs often run into problems, because they find it much harder to obtain financing from banks, capital markets or other suppliers of credit (OECD 2006).

Several studies recognized lack of finance as major constraint in SMEs development in developing countries (Ayyagari, Demirgüç-Kunt and Maksimovic 2006; Beck et al. 2006; Cook and Nixson 2000; Minton 2006; Tambunan 2008; Zia 2007). Bari, Cheema and Haque (2005) described lack of finance as major constraint in SMEs development in Pakistan. Also SMEs in China are facing greater credit constraints and have limited access to bank loans. Lin (2007) described that over 98% of SMEs have no access to formal financing. Shen et al. (2009) identified that SMEs in China obtain only 12% of their capital from bank loans, while

their peers obtain 21% in Malaysia and 24% in Indonesia. Lacking appropriate financing channels has become the main hurdle for the development of SMEs. Lin (2007) argues that as SMEs are often labor-intensive enterprises, their ability to absorb labor costs are reduced when they face credit constraints. Therefore, the need is to establish small and medium-sized banks through PPP to deal with the difficulty of accessing bank credit for SMEs.

## ***2.2 Low Human Resource Capabilities***

A firm's efficiency is also dependent upon the abilities and how-know of the human capital of its employees. This human capital consists of education and training provided to employees. Educated workers are not only more productive, but they have more learning and innovative abilities (Batra and Tan 2003). Those SMEs which have more capable workers are likely to be more efficient (Hewitt and Wield 1992; Lucas 1993). Several studies recognized low human resource capabilities as major constraint in SMEs development in developing countries (Batra and Tan 2003; Lee 2001; McElwee and Warren 2000).

Human resources in SME generally are weak in terms of their knowledge and skills of market analysis, marketing and product innovation as well as business planning and financial management. Therefore, the need is to develop capacity building programmes to improve the entrepreneurial and business management skills of human resources in SMEs and enhance the effectiveness of SMEs. Entrepreneurial competencies may, therefore, be developed by training and education (Gibb 1986; Romjin 1989). Firms with a literate and well-educated

workforce are thus likely to be more efficient because of their greater capability to absorb and effectively utilize new technology (Hewitt and Wield 1992; Lucas 1993).

### ***2.3 Low Technological Capabilities***

Technology is the key for developing core competency in industry. Technological innovation is regarded as a tool for strengthening the competitiveness of a nation (Sikka 1999). SMEs can largely improve their production abilities and profitability by improving employees' technological capabilities. Employees' technological capabilities can be improved in several ways like R&D initiatives, technology and know-how agreements with foreign and domestic firms, international contacts with foreign firms, and production experience or learning-by-doing (Griliches 1984; Keesing and Lall 1992; Mairesse and Sassenou 1991; Pack 1992; Pitt and Lee 1981; Tan and Batra 1995; Westphal et al. 1979).

New technologies are rapidly emerging, technologies improves efficiency and enables greater production. Technological innovations are a source of profit for enterprises (Dean 1980; Drucker 1985). The potential benefits of modern technology and technological capabilities to SMEs are well known. According to Morse, Fowler and Lawrence (2007) technological capabilities benefit SMEs in several ways. Technologies enhance SME efficiency, reduce costs, and broaden market reach, both locally and globally.

Several studies (Lee 2001; Romijn 2001; Yusuf et al. 2003) recognized Low Technological Capabilities as major constraint in SMEs development in developing countries.

Unfortunately, absence of technological capabilities hinders and discourages SMEs from fully grabbing the benefits of new technologies, including, among others, lack of knowledge, resources and training. Public and private sector cooperation can play a critical role in addressing these concerns.

### **3. Public-Private Partnership**

Governments due to the current internationalization of economics and politics are indulged in more interaction with business world (Yanez, Magnier and Ramirez 2008). PPPs are a popular source of developing business sector in developing countries. PPPs have now become a defining characteristic of developmental policies. However, many developing countries governments are currently not committing themselves to this approach. PPPs bring public and private sectors together in long term partnership for mutual benefit. PPPs enable the government to tap into the disciplines, incentives, skills and expertise which private sector SMEs have developed in the course of their normal everyday business. PPPs also help governments to release the full potential of the people, knowledge and assets in the public sector. Further PPPs enables the government to deliver its objectives better and to focus on those activities, fundamental to the role of government, which are best performed by the public sector- procuring services, enforcing standards and protecting the public interest. Though there is no perfect definition of PPP, but in the light of above discussion we proposed following definition for SME sector. PPP—for SMEs is an approach to addressing SMEs

growth problems through the combined efforts of public, private, and development organizations.

In Pakistan and other developing countries, sustainable growth of SMEs can be achieved through PPPs, where the government delivers the minimum standard of quality for products and services; the private sector brings skills and core competencies, while government, donors and businesses jointly bring funding and other resources. Such collaborations can be especially productive in promoting poverty alleviation through micro-finance, enhancing SMEs growth through partnerships as has been the case with polio eradication in Pakistan.

PPP is the most efficient and effective mechanism in number of ways. PPP create a sense of co-responsibility and co-ownership for the promotion of small enterprises. Through PPP, the advantages of the private sector - dynamism, access to finance, knowledge of technologies, managerial efficiency and entrepreneurial spirit – are combined with the social responsibility, network of contacts, environmental awareness, local knowledge, and job generation concerns of the public sector.

PPPs are initiated for the formation of business research centers and industrial parks, or other institutes to provide human, financial and technical help for small enterprises. Such institutions are usually financed and operated by both public and private sector.

### ***3.1 Need and Importance of Public-Private Partnership***

PPP is an approach to cooperation that contributes to the development of SMEs and economic advancement of developing countries through the vitality of the SME sector. Supporting the SME sector of developing countries has the potential to stimulate economic growth, reduce unemployment, accelerate poverty reduction, and improve living standards in developing countries. Unless economic activities in the SME sector advance, employment opportunities and incomes will remain limited, as a result, poverty will persist.

SME contribution in terms of tax revenues is also extremely important in developing countries. These taxes strengthen government's capacity to provide administrative services such as education, health, medical care, and welfare for societal development.

In order to respond to international competitive environment which becomes more severe in today's economic globalization, the competitiveness of local SMEs in developing countries needs to be improved. This improvement is not possible only through private sector's efforts. Governments in the developing countries also need to contribute and help SMEs in private sector to improve their competitiveness. To achieve the objective of improving competitiveness, a public private mixed approach like PPP is needed.

PPP provides support for SMEs capacity development in a developing country and assistance that brings about competitiveness, intending for economic growth that benefits not only the entrepreneurial group but also the entire society of a developing country.

Many of the developing countries have not developed policies and systems to foster the SMEs development. The lack of technical skills and management know-how on a business-level has impeded the birth and growth of businesses. To overcome these obstacles, formulation of SME development policies and capacity development of persons in the public as well as private sector who formulate and implement the policies appropriately are essential.

### ***3.2 Benefits of Public-Private Partnership***

The benefits of PPP to SME sector development are numerous, especially for the developing countries. These include:

- Improves access to finance
- Availability of modern technology
- Sharing of each other's competence
- Cost of product development
- Faster product development
- Facilitation of product acceptability by consumers
- The efficient use of resources
- Better project design and implementation
- Improved operations combine to deliver efficiency and effectiveness
- Increases accountability and incentivizes performance
- Maintenance of required service standards

## ***Hypothesis Development***

In developing countries, PPPs can promote stronger ties between public and private sector, intermediary institutions, and research organizations, and hence they can exert some impact on growth and development of SMEs. Hence, we propose that:

*H1. Levels of partnerships between public and private sector are positively associated with SMEs growth and development (as defined in H1a, H1b and H1c).*

*H1a. Levels of partnerships between public and private sector have positive influences on availability of finance for SMEs.*

*H1b. Levels of partnerships between public and private sector have positive influences on improving technological capabilities for SMEs.*

*H1c. Levels of partnerships between public and private sector have positive influences on improving human resource capabilities of SMEs.*

## **4. Research Methodology**

On the basis of literature review, the tentative model is represented in Fig. 1. The figure indicates the relationships between different SMEs development factors and PPPs. It supposes that there are positive relationships between improving availability of finance, improving technological capabilities, improving human resource capabilities and PPPs.

Moreover, it reveals that partnerships between public and private sectors have positive influences on SMEs growth and development.

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Insert figure 1 here  
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#### ***4.1 Study Design and Data Source***

The above mentioned three important constraints in growth and development of SMEs in Pakistan, viz. lack of access to finance, lack of human resource capabilities and lack of technological capabilities are the main constructs. Each construct was consisted of five corresponding measures. The measures are adjusted and applied to the specific context of Pakistani SMEs. The items of constructs are assessed with a 5-point Likert scale, with “1” being “very low” and “5” being “very high”. The questionnaire was pre-tested for validity to a panel of experts in the related field.

The data were collected via a survey approach by personally managing questionnaires to 400 owners and managers of different SMEs, which were randomly sampled from SMEs located in the upper-Punjab province of Pakistan. The list of firms was obtained from the related chambers of commerce. A follow-up visit was conducted to increase the response rate. After the second survey, 217 questionnaires were received, in which were 216 valid, with a response rate of 54%.

## **4.2 Measurement**

In present study, respondents were asked to indicate the extent of public and private sector partnerships required for growth and development of SMEs (including areas like finance, human resources, and technological resources), and the items of constructs are assessed with a Likert scale ranging from 1 to 5 with the following equivalences, ‘‘1: very low’’; ‘‘2: low’’; ‘‘3: neutral’’; ‘‘4: high’’; ‘‘5: very high’’. The higher the score, the greater degree that the PPPs. The measurement scales used in this study are presented in Table 1.

## **4.3 The Sample**

Sample selected was a mix of micro, small and medium enterprises. Around 87% of respondents were male, with the largest group for genders falling within the 20-30 age range. All respondents were workers in Pakistani SMEs. All respondents were educated to degree level, with 38% having achieved a master degree. In addition, table 1 displays comprehensive profile of the respondents.

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Insert table 1 here  
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## **5. Results and Analysis**

The results in table 2 indicate that if the SMEs are provided with the necessary supporting needs and abilities, like finance, technology and human resources, it would facilitate the SMEs in sustainable growth and development. Means and standard deviations for all the variables were calculated in order to get an idea about the direction of the respondents' perceptions. Table 2 indicates the mean values and standard deviations for the studied variables. A low standard deviation for all the variables indicates reliability of the data and less variation in respondents' perceptions. Also all mean values above three indicates the significance of the variables.

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Inset table 2 here

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Each of the SMEs developmental factor's mean scores was used to produce a correlation and regression analysis corresponding to our hypothesis. The results were used to find that data either support hypothesis or not. A majority of the respondents agree that PPPs have a major impact on every advancement or growth be it technology or otherwise. The SMEs' growth rate is lower, probably due to lack of finance, technological capabilities, human resource capabilities and lack of effective PPPs in these areas as has been evident.

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Insert table 3 here

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Overall, data supports hypothesis H1a, H1b and H1c. The results in table 3 indicates that the relationship between improving availability of finance to SMEs and PPPs is the most significant, with improving technological capabilities of SMEs and PPPs being the next most important relationship. All the SMEs development related variables showed statistically significant correlation with PPP. These results support our research hypothesis H<sub>1</sub>. In other words, existence of such partnerships tended to increase SMEs growth and development. Indeed, it may be more beneficial for managers to learn how to develop PPPs that attempt to overcome obstacles created by lack of resources, such as finance, technology and human capital.

## **6. Conclusion and Recommendations**

On the basis of a sample of 216 owners and managers of SMEs, this paper has empirically explored the relationships between PPPs and growth and development of SMEs in Pakistan. The findings indicate that there are significant positive relationships between PPPs, and growth performance of SMEs, of which financial partnership is the most significant. Despite the progress so far, it is being widely recognized that public and private sectors need to capitalize on mutual strengths to accelerate the process of SMEs development and increase productivity so that the promised benefits reach all the stakeholders. During the past few years, several partnerships have been developed within and between public and private sectors with the objective of achieving these goals. While some of the PPPs have been able to

deliver the anticipated results in the form of improved SMEs performance, others are yet to achieve the desired goals. In fact, successful partnerships in SME sector especially between public and private sectors are still rare because of several constraints. Some important constraints are different objectives of each sector, mutual mistrust, and negative perceptions.

The study highlighted some of the policy areas relevant for the success of SMEs where public-private cooperation appears to be the most suitable mechanism for support. It is generally accepted that technology provides growth in output and tangible improvements in efficiency and productivity. For this reason, access to appropriate technology, together with an effective technical and HR assistance programme, is vital for the development of small enterprises. But, as without financial resources, it has proven difficult to develop such programmes. The inability of SMEs themselves to access adequate technological and managerial resources, together with the modest efforts of governments, indicate the need for PPPs. Based on the above analysis, some policy recommendations and implications are given as follows: (1) Both public and private sector should try to develop an overall conducive environment to entrepreneurship, innovation and SMEs growth. Promoting access to finance through developing cooperation between public-private sectors financial institutions and introducing innovative financial instruments to reduce the risks and transaction costs of lending to SMEs. (2) Government measures to promote SMEs should be carefully focused, aimed at making markets work efficiently and at providing incentives for the private sector to assume an active role in SME finance. Where necessary, banking systems should be reformed in line with market-based principles. (3) Governments should also act to improve awareness

among entrepreneurs of the range of financing options available to them from officials, private investors and banks. (4) Micro-credit and micro-finance schemes play an important role in developing countries and efforts should be made to boost their effectiveness and diffusion. (5) Developing PPPs in education sector to increase the availability of skillful human capital, which is essential for SMEs growth and prosperity. Further enhancing cooperation between public and private sector educational and research institutions will also help improving technological capabilities of SMEs. (6) Develop an environment that supports the growth and dissemination of innovative technologies for and by SMEs to take advantage of the knowledge-based economy.

If public- and private-sector actors are willing and able to take these steps, both may realize the potentially significant benefits of PPPs, including improved access to technological, human and financial resources. This will further improve the capacity of SMEs to solve problems that cannot be addressed by a single actor. Most important, greater public-private partnership may contribute to the improvement of livelihoods for a major portion of small entrepreneurs, and other vulnerable individuals and households in developing countries. Future research can be conducted to identify solutions to these problems, and more in-depth studies are needed to better understand the ground realities associated with PPPs and their implementation in SME sector.

**Table 1: Respondents' Profile**

| <b>Characteristics</b> | <b>N</b> | <b>Percentage</b> |
|------------------------|----------|-------------------|
|------------------------|----------|-------------------|

|                             |     |      |
|-----------------------------|-----|------|
| <b>Age (years)</b>          |     |      |
| 20 -30                      | 27  | 12.5 |
| 30-40                       | 66  | 30.6 |
| 40-55                       | 123 | 56.9 |
| <b>Gender</b>               |     |      |
| Male                        | 186 | 86.1 |
| Female                      | 30  | 13.9 |
| <b>Education</b>            |     |      |
| Masters or above            | 78  | 36.1 |
| Graduation                  | 138 | 63.9 |
| <b>Type of organization</b> |     |      |
| SMEs                        | 216 | 100  |

**Table 2: PPPs assessments, Mean and Standard Deviations**

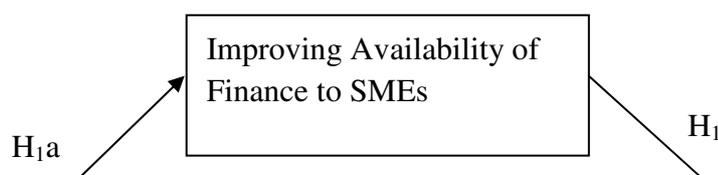
|  | <b>N</b> | <b>Mean</b> | <b>Standard deviations</b> |
|--|----------|-------------|----------------------------|
| Improving Availability of finance to SMEs and PPPs     | 216      | 3.97        | .786                       |
| Improving technological capabilities of SMEs and PPPs  | 216      | 3.87        | .710                       |
| Improving human resource capabilities of SMEs and PPPs | 216      | 3.68        | .784                       |

**Table 3: PPP and SMEs growth and Development: Summary of Regression Analysis**

**Predicting SMEs' Growth and Development**

| <b>Variables</b>                                       | <b>Adj. R<sup>2</sup></b> | <b>B</b> |
|--|---------------------------|----------|
| Improving Availability of finance to SMEs and PPPs     | .91                       | .923     |
| Improving technological capabilities of SMEs and PPPs  | .73                       | .841     |
| Improving human resource capabilities of SMEs and PPPs | .64                       | .826     |

**Figure 1: Conceptual Model**



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