

How Does Lending from Commercial Banks Impact Performance of Small Enterprises: A Case Study of District Hafizabad, Pakistan

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Abstract: *This study examines the impact of lending from commercial banks on performance of small enterprises. Financial data of forty business entities of district Hafizabad have been collected from commercial banks, for the period of 2005 to 2013. "Net profit" in the first model and "sales" in the second model are used as dependent variables. Working capital, accumulated profit, net-worth and lending/financing amount are used as independent variables. The study suggests: Firstly, banks' lending positively affects the performance of small enterprises. Secondly, financing amount illustrates positive effect on net profits of the firms. Thirdly, the preferred amount of lending to small enterprises is less than two million PKR.*

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Introduction

Entrepreneurship is the name of changing ideas into reality through creation of economic opportunities. It encourages the ability of innovation, creation and human skills to increase productivity and competitiveness. Across countries, enterprises are classified as micro, small, medium and large, based on different criteria of employment, sales turnover, capital and income (Ayyagari, Beck, and Demirguc-Kunt, 2007; Kroukamp, 2009). For SMEs criteria, variation in types and magnitude of parameters can be observed, among and within countries. In developed countries enterprises with higher level of investment, employment or sales are defined as small or medium compared with developing countries (Kureshi et al., 2009). Unexceptionally, Pakistan is also succeeding hazy directions in describing enterprises (Ardic, Mylenko, and Saltane, 2011; Small and Medium Enterprises Development Authority, 2007) for the targeted development. State Bank of Pakistan (2013) reported that Small and Medium Enterprises (SME) financing in Pakistan inclined towards large and medium enterprises, while the Small Enterprises (SEs) were ignored in banks' lending thus SBP issued new prudential regulations with separate description of SEs. A business entity which has maximum 20 employees with annual sales turnover not more than Pakistani Rupees (PKR) 75 million and party credit limit PKR 15 million from single or all banks is called SE.

It is observed that SEs deal with simple tasks and initially trained their labor force themselves through learning by doing. For year 2014-15, Pakistan having population over 191.7 million with 61.04 million labor force for which 3.6 million labor force is unemployed¹. SEs can utilize inexpensive manpower to enhance its competency role. Large Enterprises (LEs) hire experienced manpower and further train it, to deal with sophisticated technical work and return more benefits to employees (Nasir and Iqbal, 2009) thus SEs could helpful to generate skilled labor for the large scale enterprises with more expected wages for skilled labor. Small and Medium Enterprises Development Authority (2012d) reported that allocation of additional resources for SEs would enhance the production of labor intensive output and will intensify the demand for labor which will reduce the poverty and breed for growth. Figure 1 (in appendix section) shows upward trend of labor force participation of Pakistan, which could help SEs to produce and export labor intensive products for desired economic output.

From total employed persons in the country, 40.51% are self-employed while 46.83% are employees. The least gap is in urban areas, where 18.37% male employed labor is self-employed compared to 18.18% job holders². Evidently, this attitude represents presence of few success stories of self-employment, small monetary returns, less opportunities of training, fewer legal education, pursuance of bribes, lack of proper guidance, inconsistency of government policies, lack of infrastructure and institutional support, political instability and most important, the prevalent of embargos on procuring credit facilities for young educated generation (Berry, Aftab and Qureshi, 1998). Lack of credit facility is ranked a major problem for growth of SEs (Gallup, 2004)³. Important role of financial institutes in developing SEs in Pakistan is imperatively inevitable through overcoming the systematic deficiencies, faced by entrepreneurs. Access to adequate credit facility is limited to most of urban areas of Pakistan; by and large, the entrepreneurs in rural areas are deprived of this facility. Other major hurdles for the growth of entrepreneurship includes but not limited to unavailability of skilled labor, restrictions from modern technologies, electricity shortfall and difficulty in access to market (Hassan, 2008; Aryeetey, 1994). Formal lending policies which unsuited the needs of consumers credit, payment plan, products properties, services offered, security or collateral requirement, terms of payment, repayments, documentations to switch between financial institutions and high costs of borrowing are needed to be readdressed (Yesseleva, 2010; Samue, Ernest and Awuah, 2012). World Bank conducted a survey in 2006-07 which portrayed the meager condition of enterprises of Pakistan in Table 1.

¹Pakistan Economic Survey (PES) 2016-17.

²Economic census of Pakistan 2012-13 (Calculated on the basis of age 10 years or more).

³Gallup Cyber letter on SME in Pakistan-2004. It considered that a firm could be a small enterprise if it was not registered with the department of labor. Secondly, if firm employs less than 10 employees classified as SEs.

Table 1: Comparison of Pakistan's Enterprises

Indicator	Firm size/Region	Pakistan	South Asia	All Countries ⁴
Firms percent having bank account	Small (5-19) ⁵	54	72.3	86.6
	Medium (20-99)	88.2	88.5	92.5
	Large (100+)	99.5	94.9	95.2
	Average	64.7	78.9	88.4
Firms percent Loan or credit from bank	Small (5-19)	2.5	31	30.4
	Medium (20-99)	9.2	38.8	45.1
	Large (100+)	62.5	60.3	53.9
	Average	8.6	34.8	36.3
Firms percent loan /credit need	Small (5-19)	59.2	37.3	42.7
	Medium (20-99)	60	47.1	41.9
	Large (100+)	32.6	43.4	42.9
	Average	57.2	40.3	42.1
Firms percentage finance for working capital from banks	Small (5-19)	2.3	26.5	26.7
	Medium (20-99)	8.8	32.4	38.8
	Large (100+)	14.7	43.8	45.4
	Average	4.6	29.6	31.3
Firms percentage female in ownership participation	Small (5-19)	2.6	15.9	39
	Medium (20-99)	12.4	20.9	35.1
	Large (100+)	28.5	40.8	34.5
	Average	6.7	18.9	37.8
Firms percentage minimum one bribe request	Small (5-19)	58.3	20.7	15.9
	Medium (20-99)	64.3	26.1	19.6
	Large (100+)	60.7	36.5	18.3
	Average	60.2	24.5	17.1
Percentage of firms offering formal training	Small (5-19)	2.8	19.6	29.6
	Medium (20-99)	9.9	32.1	45.7
	Large (100+)	33.7	60.3	65.8
	Average	6.7	26	37.7

Source: Enterprise Surveys (<http://www.enterprisesurveys.org>), The World Bank.

However, commercial banks are rational to provide major portion of lending facility to large firms with minimum risk of default thus government intervention for affordable credit access and competitive banking industry for SEs seems plausible. Excess demand of credit facility creates great opportunities for financial organizations to lend with reasonable profit margin. The fact, in case of Pakistan, can be realized in figure 2 (in appendix section) as interest rate on lending of banks for private sector is increasing over time.

High interest rate is the major cause to increase cost of lending which increases the cost of production thus reduces the demand and profits for SEs, especially in rural areas (Hassan, 2008) and reduces the borrowing capacity of SEs. The fact of decreasing trend of SMEs credit and number of borrowers can be observed here, in Table 2.

Table 2: Financing Trends to SME in Pakistan

Year	SME Financing Amount (Billion)	No. of SME Borrowers
2008	383	215,302

⁴ Member countries of world bank

⁵ 5-19, 20-99 and 100+ is the number of employees for small, medium and large firm respectively.

2009	348	212,387
2010	334	211,419
2011	294.3	167,949
2012	266.5	132,167
2013	272.5	136,940

Source: SBP Development Finance Reviews (Various Issues)

Unfortunately, important role of education seems to be ignored in Pakistan. Public spending on education, research and development is comparatively very low in Pakistan, figure 3 (in appendix section).

To date, no known study is conducted to investigate the impact of lending of commercial banks on performances of SEs, using the empirical financial data of SEs. This study is conducted to find the answers, whether financial restraint leads to confine growth of SEs? Is there any evidence of relationship between lending of commercial banks and performance of SEs? How much will be the preferred amount of lending/borrowing facility for SEs? The remaining study is structured as follows: literature review section is presented hereafter then the section consists of methodology and data collection and afterward empirical estimation and results are discussed. Conclusion and policy recommendations are presented before references and appendix is the last section of the study.

Literature Review

A handsome quantity of literature is available which discussed the characteristics and problems of SEs, mostly used survey data. SMEs are heterogeneous in nature; same policy package would not be an optimal option for all (Berry et al., 1998). Dasanayaka (2008) pointed out the absence of single acceptable definition of SME, updated database and coordination mechanism for SMEs. Storey (2004) explained the unawareness of SEs from payback of training and the enterprises which have higher failure rate tend to expense out less for formal training of employees and encourage learning by doing. Coad and Tamvada (2008) suggested technical knowledge as a source of growth for small firms and lack of demand is ranked the first reason of decline of an enterprise. Khawaja (2006) considered SMEs development in Pakistan is a hazy target due to absence of clear policy and regulatory framework, uniform definition, size disadvantages, funding arrangements and policy review systems, altogether.

Das (2007) pointed out the average size of firms in term of employment declined to 4.6 employees from 6.3 employees, a rise in SEs. Persistent constraints for SEs include insufficient financing facilities, technological backwardness, inadequate infrastructure and lack of policy for product reservation. Cull et al. (2006) discussed insignificant contribution of governments for better development of capital markets where private sector boosted its profits by partially fulfilling the credit needs of enterprises in general and SEs particularly. Datta (2010) suggested the adoption of liberalized financing policy where informal sector will encourage the formal sector to expedite the process for sanction of loan that will enhance the quality in credit market. Small banks are almost completely devoted to encouraging financing to small business (Weston and Strahan, 1996).

Hassan (2008) discussed the high cost of credit facilities availed by SEs especially in rural areas of Pakistan and partnership modes of financing are suggested to counter the problem of financing facility. Coad and Tamvada (2008) pointed out sole proprietorships firms showed faster rate of growth and declining as well, compared to their counterparts while females owned enterprises failed rapidly than male's ownership. Afaqi and Nadia (2009) pointed out the failure of Pakistan in its SMEs growth than potential of generating employment opportunities regarding population size and poverty reduction targets. Demographical changes are estimated as significant factors for financial institutes and firms owners to utilize credit (Samue et al., 2012; Aysan, Disli and Schoors, 2013). Small and Medium Enterprises Development Authority (2012d) reported that trade openness showed positive impact on SEs development by generating more profits, employment opportunities and poverty

reduction. High interest rate with macroeconomic instability in developing countries and low profit margin in presence of competition in developed economies, are estimated the biggest hurdle for SMEs financing (Beck, Peria and Kunt, 2008). Ardic et al. (2011) pointed out the SMEs loans to GDP ratio is 13% in developed countries and 3% in developing countries where absence of unique SEs definition is a major issue. This study suggested directions for improvements of gathering data from formal and informal sources.

Small and Medium Enterprises Development Authority (2010-11)⁶ report emphasizes to create an investment friendly environment to enhance innovation for economic development and growth. Small and Medium Enterprises Development Authority (2012b) reported that governments in newly industrialized economies allocate resources to promote the culture for the development of SEs, attraction of incentives and reducing the hurdles to start SEs. Competitive banking industry is helpful for expansion of enterprises (Samue et al., 2012). It is necessary to promote, relationship banking environment, for maximum usage of financial services (Aysan et al., 2013). Beck (2010) explains that growth of SEs creates business environment that leads to growth rather driver of growth. Unavailability of financing facility significantly hampers the growth of SEs and is not true for LEs. Beck and Demircuc-Kunt (2006) studied a number of growth obstacles faced by SMEs compare to LEs and limited access to finance is considered most significant growth constraint. Yesseleva (2010) pointed out the owners of SEs appeared to have low level of satisfaction for their present financial institutions and the survey indicated credit facility remains the first order concern for the SEs working in Australia. Lack of financial access to SMEs is a major problem for the growth of this sector in Pakistan (SBP, 2010; Alam, et al., 2016; Sbia, Shahbaz and Ozturk, 2017). The aforementioned literature suggests the positive role of SEs for poverty reduction and growth objective. It also points out the lack of financing facilities, absence of unanimous definition of SEs and the need for integrated system of growth environment. Studies used the questionnaires to point out SEs financing needs without estimating the impact of financing, as it bears cost. Thus, the current study is pioneer study in its nature and helpful for researchers in quantifying the impact of lending and preferable amount of lending to SEs.

Methodological Framework and Description of Variables

Framework of Panel Data

Panel data is the combination of cross section and time series data. Using this data to estimate relationships among variables allow differences of, cross sections in one time and same cross section in different time periods. In panel data, number of observations increase considerably which provide more accurate estimated results. Repeating cross sections urge for better study for the dynamics of change. Greater degree of variability reduces the multicollinearity and ultimately improves the estimated results. We will determine whether Fixed Effect Model (FEM) or Random Effect Model (REM) also called Error Components Model (ECM) best suits our data.

In FEM intercepts in the model are assumed to be different among parties/entities mean it realizes that each entity has some specific characteristic. We used Hausman test to determine either FEM or REM best suits to the data. Fixed Effect (FE) regressions are used, significantly, because data frequently fall into groups such as parties, industries, states, etc. and features of these groups might disturb dependent variable which is being controlled with FEM, omitted factors bias would be the result if simple OLS technique is applied. General to specific approach is adopted for factors determining financial return of SEs, however the objective is to observe the behavior of dummy variable of financing. Software package Stata-11 is used for estimation.

Collection and Sources of Data

This study is using data of customer financials, obtained from lending commercial banks. The data of same SEs has been used before and after receiving financing facility from scheduled banks and financial

⁶ SME development report (2010-11) by SMEDA, Pakistan.

returns/statements are comparatively analyzed. Banks maintain financial record of active client firms only. The performance of same SE before and after receiving financing shows a valid argument for estimating the impact of financing facility for SEs. Data collection is done according to definition of SBP for SEs. Analysis of empirical data suggests a quantitative direction for the policy makers and researchers about performance of SEs. It will be helpful for SBP and organizations which estimates the impact of lending from commercial banks on performance of SEs. It will provide directions for SEs whether to borrow from banks or not, if yes than how much to borrow. This study is helpful in policy directions for banks, to which they should lend and how much is the preferred amount to lend SEs. Data of forty small firms from 2005 to 2013 obtained from commercial banks. The said financial data is required by banks for used in lending process to evaluate the customer worth. Hafizabad is selected for convenient sampling. During collection of data from banks authorities, it came to our knowledge that large number of SEs with good financial summaries applied to avail credit facility and due to lack of financing ability of banks, shortage of staff in banks, lengthy procedures, cost of documentation and other exogenous factors SEs remained unable to utilize credit facility. Keeping in view, the prevailing circumstances dummy variable for financing facility is treated as exogenous variable.

General model of panel data for estimation can be written as;

$$Y_{it} = \beta_{1i} + \sum_{k=1}^{N,T} \beta_{kit} X_{kit} + \varepsilon_{kit} \quad (1)$$

where $i=1,2,3,\dots,N$ cross sectional unit, $t=1,2,3,\dots,T$ refers to time periods. Y_{it} is the dependent variable for “i” cross section at time period “t” and X_{kit} is the “k” independent variable for “i” cross section at time period “t”. The linear representation of the net-profit equation can be as follow:

$$\text{npft}_{it} = \beta_{1it} + \beta_2 \text{sles}_{it} + \beta_3 \text{tlbt}_{it} + \beta_4 \text{tast}_{it} + \beta_5 \text{wcpt}_{it} + \beta_6 \text{crto}_{it} + \beta_7 \text{pcpt}_{it} + \beta_8 \text{apft}_{it} + \beta_9 \text{nwrt}_{it} + \beta_{10} \text{deqr}_{it} + \beta_{11} \text{roeq}_{it} + \beta_{12} \text{drcv}_{it} + \beta_{13} \text{dpyb}_{it} + \beta_{14} \text{dinv}_{it} + \beta_{15} \text{fam}_{it} + \beta_{16} \text{dfiy}_{it} + \beta_{17} \text{d1}_{it} + \varepsilon_{it} \dots \dots \dots \quad (2)$$

- | | |
|--|---------------------------------|
| npft = Net Profit | sles = Sales |
| tlbt = Total Liabilities | tast = Total Assets |
| wcpt = Working Capital | crto = Current Ratio |
| pcpt = Paid up Capital | apft = Accumulated Profit |
| nwrt = Net Worth | deqr = Debt Equity Ratio |
| roeq = Return on Equity | drcv = Days Receivables |
| dpyb = Days Payable | dinv = Days Inventory |
| famt = Financing Amount | dfiy = Dummy for Financing Year |
| d1 = Dummy for Financing Amount less than two million Pakistani rupees | |

Estimated Results

Hausman test⁷ suggests fixed effect model is best option for our data set.

Table 3: Hausman Test

Test: Ho: difference in coefficients not systematic.
$\chi^2(12) = 48.14$
Prob.> $\chi^2 = 0.0000$

As the chi- square value is 48.14 and probability value is “0” percent. In addition, it was considered good to use the robust option to obtain reliable results. Seven estimated equations are mentioned in Table 4, using robust standard errors to estimate the impact of banks’ lending on net-profit of the small firms and five estimated

⁷ Various models are estimated and they suggest FE and Hausman test of model 4 is presented in Table 3.

equations are mentioned in Table 5, using robust standard errors to estimate the impact of credit amount on sales of the small firms. It is worth to mention here that we are unable to find direct significant relationship of financing amount and net-profit of the firms but there exists an indirect relationship through sales. To check the impact of financing amount on the performance of firms' net-profit for the years when firms used credit facility in comparison with years when firms did not use financing facility, we used dummy variable to distinguish years when firm was using financing facility.

Table 4: Net Profit as Dependent Variable

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Sales	0.0473***	0.0492***	0.0552***	0.0539***	0.0541***	0.0452***	0.0447***
	(0.00482)	(0.00281)	(0.00296)	(0.00538)	(0.00549)	(0.00308)	(0.00347)
Total Liabilities	0.0885***	0.0960***	-0.0554***			-0.0852	
	(0.0124)	(0.0133)	(0.0163)			(0.0647)	
Total Assets	0.00599	0.00700				0.00835	
	(0.00589)	(0.00469)				(0.00803)	
Working Capital	0.00410	0.00687		0.0594*	0.0794*	0.0318*	0.0300*
	(0.00836)	(0.00631)		(0.0298)	(0.0430)	(0.0167)	(0.0163)
Current Ratio	-3.261						
	(4.212)						
Paid up Capital	0.00873						
	(0.0423)						
Accumulated Profit	0.131**	0.113*		0.481*	0.529**	0.478**	0.472**
	(0.0504)	(0.0597)		(0.243)	(0.261)	(0.217)	(0.222)
Net Worth	0.0894**	0.102***				0.176***	0.175***
	(0.0367)	(0.0121)				(0.0373)	(0.0332)
Debt Equity Ratio	6.140**	5.533***					
	(2.963)	(1.514)					
Return on Equity Ratio	2.923						
	(5.703)						
Days Receivables	1.903***	1.921**	4.532**				
	(0.593)	(0.776)	(2.077)				
Days Payables	1.870						
	(3.110)						
Days Inventory	-1.686*						
	(0.855)						
Dummy Variable for Financing Year	-132.0	-93.48	393.5***	175.1**			
	(302.2)	(82.01)	(124.8)	(85.62)			
Financing Amount	0.0144						
	(0.104)						
Dummy Variable Financing Amount Less Than Two Million					477.5***	474.1***	464.0***
					(123.4)	(80.67)	(75.54)
Constant	-592.6*	-792.0***	286.2*	-330.0	-615.5	-1,867***	-1,903***
	(312.0)	(159.1)	(158.8)	(405.8)	(587.5)	(653.9)	(700.3)
Observations	173	178	213	278	201	201	201
R-square	0.947	0.944	0.875	0.784	0.795	0.850	0.842

Number of Parties	33	33	34	40	40	40	40
F-Statistic	166.8	176.3	98.00	40.11	.	.	.

Robust standard errors in parentheses: All models are estimated by using fixed effect.

*** p<0.01, ** p<0.05, * p<0.1

In model 1 (Table 4), we found insignificant “dfiy” along with six other insignificant independent variables. To find for the best relationship between variables, we dropped some insignificant variables here and estimated the model 2 and here again we found insignificant “dfiy” along with other variables. Similarly, we proceeded to estimate the data set and found that model 4 where “npft” is dependent variable seems to best fit which shows that the firms using credit facility for the years earn more net-profit to PKR: 175,100/- in comparison with years when financing facility was not offered by the banks. That shows the positive contribution of financing facility in enhancing net-profit for the small firms. Other three independent variables included in the model 4 are statistically significant. “sles” shows a positive significant relationship with “npft” which shows if sales increases by one unit (one thousand PKR) net-profit increases by 0.0539 units (PKR: 53.9/-). Working capital is significant having positive relation with net-profit and shows that if it is increased by one unit (one thousand PKR) net-profit will increase by 0.0594 units (PKR:59.4/-). Accumulated profit in this model also has statistically significant positive relation with net-profit which shows that if one unit increases in accumulated profit, it will enhance net-profit by 0.481 units (PKR: 481/-).

We further estimated models to answer whether financing amount (instead of financing facility) contributes in enhancing performance of SEs and the current study was unable to find statistically significant direct relationship of financing amount to net-profit. Theoretically, SEs earn profit by using credit amount as their working capital to enhance productivity capacity by selling larger quantity of output in the market. To explore the relationship further, we estimated the data set by taking sales as dependent variable to answer the question whether financing amount contribute in enhancing SEs net-profit. In this regard, we estimated five models and it seems that model 4 (Table 5, below) explains the answer of the question.

Model 4 of Table 5, where “sles” is taken as dependent variable explains that if firms use one unit i.e financing amount, it enhances sales by PKR: 2,246/- annually. Firms’ net-profit enhances indirectly through increasing sales (model 4 shows). Other variables included in this model are working capital and net-worth; both variables are statistically significant and positively related with dependent variable. Working capital shows, one unit (one thousand PKR) rise in credit disbursement increases sales by 0.669 units (PKR: 669/-) and if net-worth increased by one unit then sales increases by 2.739 units (PKR 2739/-).

Till now we have found the answers of two questions and the question of how much might be the preferred amount to disburse to SEs, remains unaddressed. We estimated model 7 (Table 4) to answer this question. We used dummy variable to distinguish financing amount. Dummy variable is used for firms having financing amount less than two million PKR. In this model “npft” is dependent variable which explains that the firms using financing less than two million earn PKR: 464,000/- more net-profit relative to firms utilizing credit amount more than two million. Other variables in this model are “sles”, “wcpt”, “apft” and “nwr”. All these variables are positively related to “npft” and are statistically significant. If there is one unit (one thousand PKR) increase in sales, net-profit will increase by 0.0447 units (PKR: 44.7/-). If working capital increases by one unit, net-profit will increase by 0.030 units (PKR: 30/-). If accumulated profit increases by one unit, net-profit will increase by 0.472 units (PKR: 472/-) and one unit increased in net worth will lead to increase net-profit by 0.175 units (PKR: 175/-). Thus, three models explained our three questions posted in the start of the study.

Table 5: Sales as Dependent Variable

VARIABLES	(1)	(2)	(3)	(4)	(5)
Net Profit	16.94***	16.93***	16.73***		
	(1.281)	(1.255)	(1.315)		

Total Liabilities	1.846*** (0.377)	1.843*** (0.369)	1.750*** (0.316)		0.369 (0.747)
Total Assets	-0.0728 (0.0897)	-0.0860 (0.0643)			
Working Capital	-0.00767 (0.136)			0.669* (0.340)	0.654* (0.345)
Current Ratio	57.68 (74.73)	60.49 (68.97)			
Paid up Capital	-0.188 (0.874)				
Accumulated Profit	-1.471 (0.903)	-1.349 (1.034)	-1.180 (1.032)		
Net Worth	-1.085 (0.741)	-1.246*** (0.288)	-1.321*** (0.310)	2.739*** (0.691)	2.700*** (0.719)
Debt Equity Ratio	-129.5** (49.02)	-128.3** (48.25)	-120.0*** (32.32)		
Return on Equity	92.74* (50.63)	93.16* (50.87)	95.92* (49.06)		
Days Receivables	-57.69*** (15.47)	-58.62*** (14.27)	-55.17*** (13.26)		
Days Payables	-128.0* (66.49)	-129.4* (64.07)	-126.1** (60.79)		
Days Inventory	11.59 (16.86)	12.44 (16.47)			
Financing Amount	0.254 (0.514)	0.249 (0.510)	0.237 (0.485)	2.246** (0.875)	2.149** (0.835)
Constant	9,838*** (3,318)	9,635*** (3,245)	10,973*** (3,180)	-7,171 (7,450)	-7,335 (7,332)
Observations	173	173	177	287	287
R-square	0.932	0.932	0.931	0.403	0.404
Number of Parties	33	33	33	40	40
F-Statistic	86.96	76.80	73.29	11.91	9.654

Robust standard errors in parentheses: All models are estimated by using fixed effect.

*** p<0.01, ** p<0.05, * p<0.1

Conclusion

This study is conducted to answer the three questions about performance of small enterprises when lending is from commercial banks. First, whether financing facility contributes to enhance SEs performance. Second, whether financing amount does matters in performance of SEs and third, how much is the preferred amount of lending to SEs. Working on empirical data suggests a quantitative direction for the policy makers and researchers about performance of SEs. It would be helpful for SBP and organizations to estimate the impact of banks' lending on SEs. It might provide directions for SEs by addressing their question of borrowing from commercial banks or not and how much to borrow. It might be helpful in policy directions for banks by suggesting how much the preferred amount to lend is.

Our estimated results are drawn on the basis of data collection of SEs, as per definition provided by (State Bank of Pakistan, 2013). The study is more fruitful as it based on empirical data of customer financials provided to

the lending banks by the customers. Based on our estimated results, we found that the same firms earn more net-profit of PKR: 175,100/- in years when they were using credit facility in comparison with years when financing facility was not offered by the banks. It shows the positive contribution of financing facility in enhancing net-profit of the small firms. We further estimated to answer whether financing amount (not financing facility) contribute in enhancing performance of SEs. This study remains unable to find statistically significant direct relationship between financing amount and net-profit. Secondly, we found that financing amount has indirect positive effect which enhanced performance of firms through increasing sales. If firms use one thousand financing amounts, it enhances sales by PKR: 2,246/- annually. Financing amount increases sales that lead to enhance firms' profit. Third, we estimated that firms used financing amount less than two million revealed better positive impact of financing on their net-profit as compared to firms using financing amount greater than two million. The firms using financing amount less than two million earn PKR: 464,000/- more net-profit relative to firms utilizing credit amount more than two million.

Policy Recommendation

This study recommends central banks to assign targets to commercial banks to enhance credit to SEs. Access of financing facility from commercial banks should be made easy for small enterprises as utilizing credit will enhance the performance of small enterprises which will reduce the pressure from government to generate employment opportunities and motivate the masses to opt self-employment. An active government intervention is suggested to promote SEs for steady growth of LEs. Secondly, this study suggests that policy makers should target the number of firms to be lent rather than only targeting the amount to be disbursed, as small firms using less than rupees two million generate relatively more profit than the firms using greater financing amount. On the basis of literature review study suggests to uniquely define the small enterprises with the consent of all concerned organizations and establish a taskforce with participation of concerned public and private organizations to work as an integrated system to enhance the culture of establishing small enterprises in the country.

Limitations of the Study

The empirical case study deals with Small Enterprises (SEs) rather generalization to SMEs, however, the availability of limited financial data of SEs bounds for global or other regional generalization.

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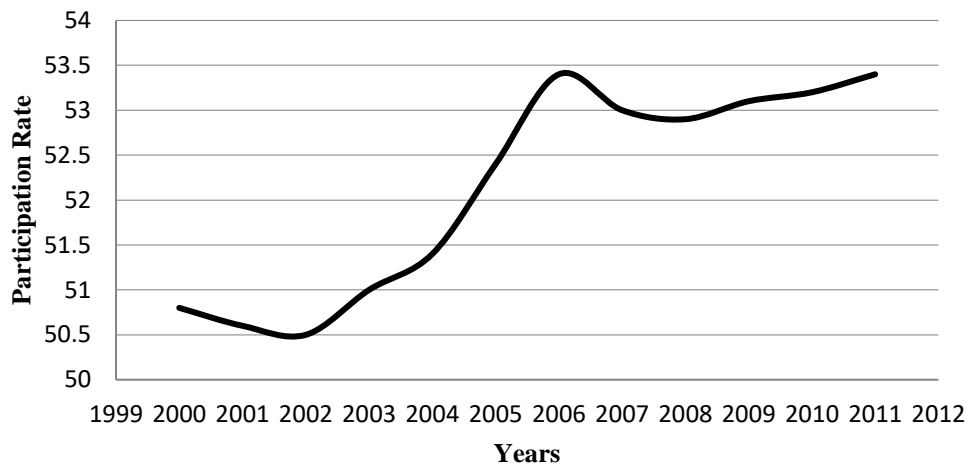
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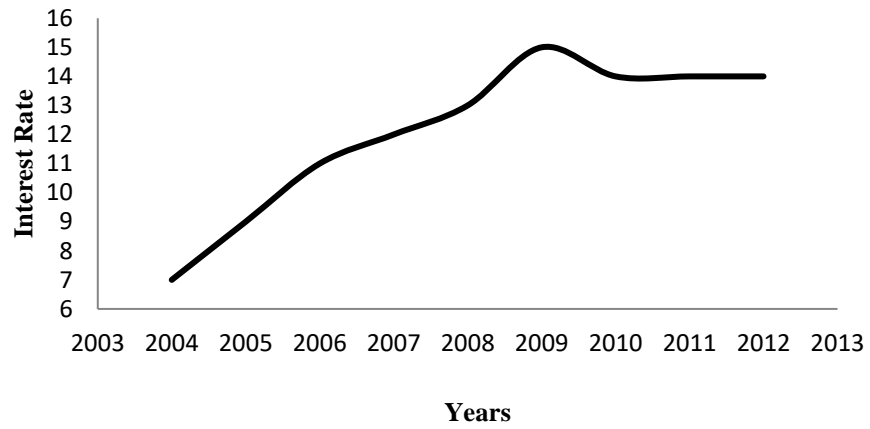
Appendix

Figure 1: Labor Force Participation Rate



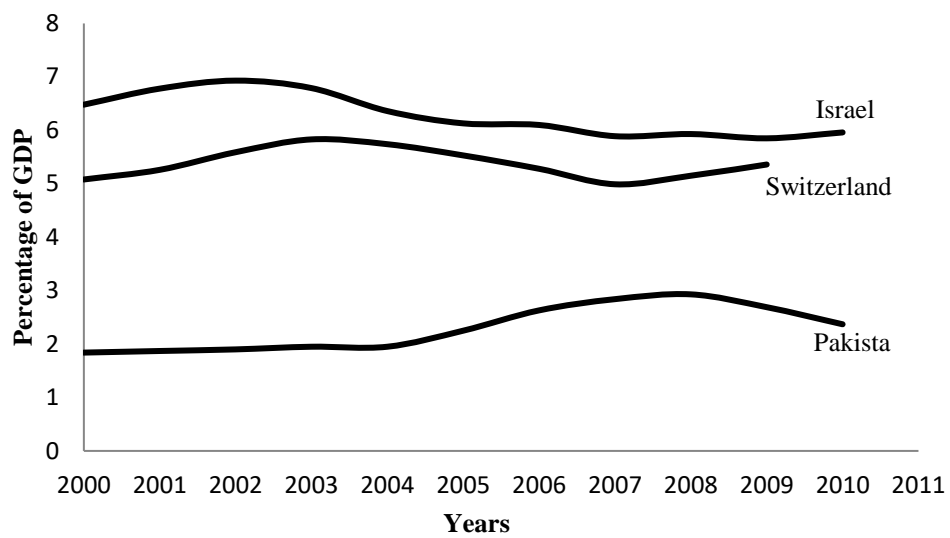
Source: TheGlobalEconomy.com, The World Bank

Figure 2: Interest Rate on Banks' Credit to Private Sector



Source: TheGlobalEconomy.com, The World Bank

Figure: 3 Public Spending on Education as Percentage of GDP



Source: TheGlobalEconomy.com, The World Bank