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SMEs performance and interaction of knowledge management, human capital and finance access

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Abstract

This study presents a conceptual framework that proposes the positive influence of human capital and knowledge management on SMEs performance in the environment of Pakistan via comparative qualitative research methods. As a result, access to finance moderates the relationship between Human Capital and SMEs performance and access to finance moderates the relationship between Knowledge Management and SMEs performance. In conclusion, the role of competition in determining firms' performance demands studies that examine the competition beyond the conventional approach of competition directly affecting the performance.

Keywords: SMEs performance, Pakistan, knowledge management.

Desempeño de las pymes e interacción de la gestión del conocimiento, capital humano y acceso a las finanzas

Resumen

Este estudio presenta un marco conceptual que propone la influencia positiva del capital humano y la gestión del conocimiento en el desempeño de las PYME en el medio ambiente de Pakistán a través de métodos de investigación cualitativa comparativa. Como resultado, el acceso a las finanzas modera la relación entre el capital humano y el desempeño de las PYME, y el acceso a las finanzas modera la relación entre la gestión del conocimiento y el desempeño de las PYME. En conclusión, el papel de la competencia en la determinación del rendimiento de las empresas exige estudios que examinen la competencia más allá del enfoque convencional de la competencia que afecta directamente al rendimiento.

Palabras clave: desempeño de pymes, Pakistán, gestión del conocimiento.

1. INTRODUCTION

SMEs are considered to have special significance for the major part of economic growth all over the world. Their contributory role in developing and developed economies through employment generation, facilitation of innovative products and services and diversified international trade has already been established. At the global level, the strategic role played by SMEs is significant for growth in production, competitive advantage, income generation and aggregate economic development. The significance of SMEs, being the integral part of the economic fabric in developed and developing economies is

considered to have substantially increased over time because they introduce and further economic growth, prosperity and innovation. Additionally, SMEs are deemed to be extremely important as creators of the effective job market and providers of training opportunities and basic services for disadvantaged people.

Therefore, it is an established fact that SMEs' contribution to overall economic development and GDP is fairly high in both emerging and developed countries. SMEs are estimated to represent around 90% of the total firms worldwide besides producing 40% to 80% of the total employment at the global level. According to a report published in 2014, the total number of SMEs, that is accounted for approximately 140 million all over the world, catering for 60% of the total workforces (Abdullahi et al., 2015). For that reason, SMEs are believed to contribute around 46% of global GDP along with the significant contribution to the GDPs of their respective economies. For example, in United Kingdom (UK) the SME sector contributes about 85% of the national economy, whereas, in the USA their share in the national GDP is 51%.

The major focus of this study is the performance of SMEs. The literature provides substantial evidence regarding the significance and contribution of SMEs in the development and growth of the economy. However, sustaining highly competitive long-term performance of SMEs in developing countries is a colossal task (Ates et al., 2013). While SMEs are believed to be fairly strapped because of their size, it is also argued that SMEs are more flexible and versatile and better

structured to deliver higher performance in domestic and international markets when compared with rigid and bureaucratic large corporations. Surprisingly, despite the expected potential to substantially contribute to the economic development of developing countries, SMEs have failed to embrace their true potential and have demonstrated below par performance.

The main causes of dismal performance of SMEs are attributed to resource limitations such as human capital and financial knowledge. Additionally, the lack of capabilities to exploit available resources further complicate the problems of SMEs. Similarly, SMEs in Pakistan experience scarcity of valuable resources and capabilities which has caused sluggish performance of SMEs in recent years. However, the question of the role of human capital, knowledge management and access to finances in relation with the performance of SMEs in emerging economies such as in Pakistan largely remains understudied from theoretical and empirical perspectives. Hence, this study attempts to draw a conceptual framework of SMEs performance and link it with human capital, knowledge management in the presence of the moderating role of access to finance in emerging economies.

1.1. SMEs in Emerging Economies

International organizations have mainly applied quantitative approaches in defining SMEs by determining a criterion; a total number of employees, annual balance sheet, and annual turnover paid-

up capital, sales volume and assets owned etc. For instance, the World Bank definition sets a minimum threshold of 10 employees and annual sales of USD 1 million for a micro business, 50 employees with annual sales of USD 3 million for a small business and having 300 workers with annual sales of USD 10 million for a medium-size business (Beck & Demirgüç, 2006). Similarly, there is no single common definition of SME adopted in Pakistan. The latest SME policy has documented SMEs as ‘an entity with fewer than 250 employees, having a maximum of Rs. 25 million paid-up capital, or worth Rs. 250 million annual sales. Whereas small enterprises refer to SMEs having between 10-50 employees and enterprises holding between 51 and 250 employees, considered as medium-sized enterprises (Akhtar et al., 2015).

According to Pakistan Tanners Association (PTA), Pakistan is one of the few countries in the where negative growth of exports occurred compared to the regional competitors, namely India, China and Bangladesh that have had reported consistent growth in exports. Citing the underlying reasons for the negative growth, the experts of the industry view that the absence of export-focused policies in Pakistan has held the SMEs from reaching their optimum performance. Nonetheless, in the last few years, the government of Pakistan appears to have taken some measures to support the sagging figures for exports in Pakistan. For instance, the leather industry in the country was given exemption from sales in the year of 2016-17.

In addition, the rate to refinance was also reduced to 3 % from 3 ½ percent applicable earlier. Despite these measures, the government apathy towards the leather and other SMEs remains a challenge, as lamented by PTA Chairman, Gulzar Firoz. He expressed the disquieting statistics of decline in exports of leather goods such as jackets by 19 percent, gloves by 16.5 % and footwear by 31% during the first five months of 2015-16. Comparatively, the leather exports of Bangladesh grew by 100%, of China 20% and of India by 63% during the same time. This explains why Pakistan's share of leather export in the world is only 0.5% compared to India's share, 2.5%, China's share, 19%, Vietnam's share, 4% and Italy's share 9%.

Among the major obstacles in the success of SMEs in Pakistan is SMEs' inability to attract and retain skilled human capital. Superior human capital is highly instrumental in leverage the firm's performance. However, SMEs in Pakistan currently faces an acute paucity of skilled human capital which may play a significant role in introducing novel ideas, enhancing quality standards and providing value addition in SMEs in general. For instance, the scarcity of skilled human capital has hampered the growth of the SMEs in the leather industry of Pakistan as past researches indicated that human capital directly affects the quality of products and productivity and profitability of the firms.

In addition to the shortage of the required level of expertise (i.e. skilled human capital), the leather industry of Pakistan also faces the challenge of managing knowledge related to the internal and external

business environment. In today's business environment, it is essential for the firms to acquire, assimilate and disseminate relevant explicit and tacit knowledge to boost their performance. In the contemporary business world, only knowledge-intensive firms are able to sustain a competitive advantage. SMEs in Pakistan generally fail to equip themselves with updated knowledge pertaining to their businesses which is one of their critical factors that cause dismal performance of SMEs in Pakistan (Afraz et al., 2013).

Additionally, the problems related to human capital, knowledge management are the other major factors that may substantially affect SMEs performance. Another notable factor in the environment of Pakistan is access to finance. As reported by the World Bank, SMEs have lower changes in securing loans for business than larger firms. Instead, SMEs largely depend on personal and internal resources to funds to start and operate their enterprises. Fifty percent of formal SMEs do not have access to formal credit. The gap to access finance is even wider for informal and micro enterprises. It is estimated that around 70% of small and medium-sized enterprises in emerging economies face the paucity of finances. Even though the gap between demand and supply of finance varies amongst regions, it is notably wide in Asia and Africa.

The current credit gap for formal SMEs is estimated to be around USD 1.2 trillion; and the total credit gap for both formal and informal SMEs is estimated to be around US\$2.6 trillion (Alibhai et al., 2017). Likewise, SMEs in Pakistan remain stranded and ineffective

due to a shortage of finance to meet their strategic objectives. It is evident in the literature that access to finance is among the few major constraints that hinder growth and development in case of small and medium-sized firms. Moreover, access to finance serves as a prerequisite to acquire and optimally utilize the required human capital; besides, the availability of finance is crucial to managing the financial cost of knowledge management.

2. CONCEPTUAL FRAMEWORK

Extant studies illustrate a positive relationship between human capital and firm performance as demonstrated by Sharabati. In comparison, few studies in the literature reveal the insignificant relationship between human capital and firm performance. Similarly, there are contradictory findings that do not validate the relationship between knowledge management and SMEs performance. Conversely, some studies have found a positive relationship between knowledge management and firm performance such as (Aslam et al., 2013).

2.1. Human Capital

Several researchers have defined human capital as the degree of creativity, idea and knowledge development skills possessed and employed by individuals in their organizations. Various researchers have identified knowledge as one of the basic determinants for the

continuation and survival of a firm. Recognizing the significance of knowledge, many scholars have focused their interest to explore the relationship between human capital and firm performance (Bramhandkar et al., 2007). This relationship has been empirically established by various researchers such as Sharabati verified that the existence of a positive link between human capital and the firm performance. However, with respect to empirical research, some studies demonstrate conflicting results concerning the association between human capital and firm performance. In this regard, Chan revealed that human capital is negatively related to certain performance indicators. Similarly, Wah Chu, Chan and Wu in their study found that human capital had no impact on certain performance measures such as productivity. On the contrary, the positive relationship between human capital and firm performance has been established by Kamukama.

Proposition 1: Human capital positively influences SMEs performance in Pakistan.

2.2. Knowledge Management

Bali (2005) defined knowledge management in terms of the systematic arrangement, planning, scrutinizing and deploying the technological, environmental and operational knowledge and expertise to achieve targeted objectives. Nonaka & Takeuchi significantly contributed to conceptualize and exploit theoretical perspectives of

knowledge by establishing employee's experience and creative skills as essential prerequisites to gain competitive advantage. They defined knowledge in terms of two basic types, tacit and explicit knowledge. Explicit knowledge is available in words, numbers and codes that are easily communicated, stored and shared with others. Whereas, tacit knowledge, as it is embedded in an individual's minds and experiences, can only be achieved through personal practice. The interaction between these two types of knowledge evolved in the form of a model known as Nonaka Model, which incorporates four modes of knowledge conversion.

Effective knowledge management potentially equips an organization with higher customer service, loyalty and satisfaction, efficient and practical approach for decision making, problem-solving, exchange of best experiences and overall improved organizational performance improvement (Alavi et al., 2005). Ahmadi and Ahmadi (2011) highlighted that organizational success is greatly reliant on its capabilities in terms of creating knowledge, organized and utilized. Wang emphasized that knowledge management primarily deals with organizational information that is embedded into various units, processes, branches and employees, thus playing a powerful role in overall organizational performance.

Proposition 2: Knowledge management positively influences SMEs performance

2.3. Access to Finance as a Moderator

Wiklund and Shepherd have also emphasized the fundamental role played by access to finance in superior SME performance. Likewise, the study conducted by Mazanai and Fatoki revealed the existence of a positive linkage between SMEs performance and access to finance. Nevertheless, the absence of financial availability can ultimately create hindrance in exhibiting the maximum potential of SMEs as the contributor to economic development. The same has been validated by Jabeen, Shehu, Mahmood and Kofarmata that due to the insufficient accessibility to financial resources and services, an insignificant relationship emerges between entrepreneurial orientation and performance of SMEs in Pakistan. Additionally, the studies conducted by Kira revealed that certain attributes/ factors of SMEs such as firm's location, size, and the age of industry, incorporation, business information, and firm's collateral security tend to influence SMEs' access to debt financing. Therefore, based on the above-mentioned literature, access to finance is introduced as a moderating variable in this study.

Proposition 3: Access to finance moderates the relationship between Human Capital and SMEs performance.

Proposition 4: Access to finance moderates the relationship between Knowledge Management and SMEs performance.

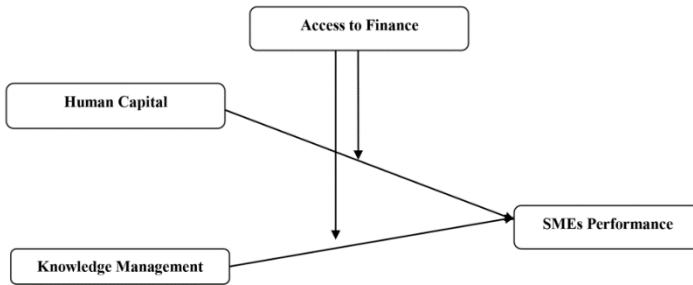


Figure 1: Proposed Framework

3. DISCUSSION AND FUTURE RESEARCH

Despite growing research on SMEs performance and the contributing factors, the studies on SMEs in the emerging economies like in Pakistan remain scarce. Especially, evaluating the factors that carry major weight in the present intense competitive environment in the developing countries are seldom found in the literature despite the fact that developing countries more rely on SMEs than the developed countries. While some studies in the past have been keen on exploring the factors specific to less developed economies, others have reported contradicting results on the factors earlier identified.

Hence, the conceptual framework proposed by this study is one of the early attempts to conceptualize the role of knowledge management, human capital and access to finances in the context of emerging economies. The proposed framework holds substantial importance as SMEs in Pakistan suffer a major challenge of competing with the neighboring economies like China and India that have secured remarkable success in injecting the right resources and competencies

and contribute to the rapid growth of their economies. In contrast, SMEs in Pakistan have a long journey ahead to reach where its neighboring countries have already reached; and the proposed framework is one of the early attempts in this cause (DALIR et al, 2014).

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