CHAPTER 2
LITERATURE REVIEW

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Chapter 1 presented the background and justification for the current study. Information presented in that chapter demonstrates significance of small and medium sized enterprises (SMEs) for the developed and as well as transition economies. Further, it discuss details on how small and medium enterprises played important role in India’s manufacturing sector growth and building employment opportunity. With growing internationalization of business the SMEs cannot be stay apart from its affect. As SMEs, to achieve higher growth and expand business presence in competitive era, they have to be more focused on building their competitive advantage.

This chapter provides an overview of the relevant literature and understanding of theoretical background related to this study, with emphasis on various prior studies on SMEs’ at international level and India level. This is followed by a review of prior literature on theory of SMEs growth and competitiveness and SMEs’ firm performance. This literature review also investigates the main theories adopted for SME growth and performance conceptualizations, and measurements. Further chapter discussed on SMEs’ characteristics, and its’ impact on capital structure of SMEs’. The chapter also discusses various variables specific literature, which related to the objectives this study. Finally concluding remarks are made on reviewed theories and literature study.

2.1 Small and Medium Enterprise and Its Characteristics

The successful establishment of small and medium enterprises (SMEs) and their consistent growth and development has long been a source of interest and concern for researchers, government and policy makers because SMEs are increasingly important to the economic growth of the nation’s economy. Their role in economic activity is manifest in both tangible and intangible ways. In response, governments have introduced a variety of policies, including the provision of advice, to facilitate the formation of new firms and to offer support to SMEs to aid their survival and foster improved rates of growth. Small and medium sized
enterprises (SMEs) are the backbone of economy in many countries and very often constitute more than 90% of all the companies or enterprises in some countries (Poon and Swatman 1999, Cull et al. 2006, Ozgulbas et al. 2006). As per the report of International Finance Corporation (IFC) (2015), it is estimated that two third of businesses, all over the world are falls in the category of SMEs. They comprise a widely divergent spectrum of establishments, engaged in economic activities ranging from engaged in economic from micro and rural enterprise to modern industrial units using sophisticated technologies. Such enterprises exist in the form of factories, workshops, trading and service organizations. Ownership patterns range from proprietorship and partnership to companies and co-operatives (Pandey and Shivesh, 2007). While the most nations recognized the fact that SMEs are backbone of the nation’s economy, it is also a fact that SMEs across the world encounter similar problems which prevent them from realizing their fullest potential. Some of the literature suggests that SMEs may be differentiated from larger companies by a number of key characteristics. These are generally described (Addy et al. 1994; Burns and Dewhurst, 1996; Ghobadian and Gallear, 1997; Appiah, Adu and Singh, 1998; Berry, 1998; Marri et al. 1998; O'Regan et al. 2006; Haywood, 1999) as: personalized management, with little devolution of authority, severe resource limitations in terms of management and manpower, as well as finance, reliance on a small number of customers, and operating in limited markets, flat, flexible structures, high innovatory potential, reactive, informal, dynamic strategies.

SMEs are not scaled down versions of large firms (Coad, 2009) and require investigation as unique study objects or a subset of firms within the business landscape. Gyampah and Boye (2001) stated that, the environment factors are different for small firms and large firms in terms of their resource capacity. The SME is insulated from the threat of larger multinational enterprises, because it does not compete for the same customer base, but allows them to access markets opened up to increased competition. SMEs perceive the on-going change as a challenge and are thus subjected to associated competitive pressures (Darcy, 2014; Carson, 1985).
Small and medium sized enterprises (SMEs) are complex, varied, and influenced by a range of factors (Loan et al. 1999) which cannot be depicted by static models (Reid & Adams, 2001). However, these enterprises are often treated as a homogenous group. SMEs differ from larger corporations not only in size but also in aspects of management structure, specialty of knowledge and position on procurement and financial markets. A number of studies have analyzed the relationship between bank size and the credit flow to firms of different sizes. Morris et al., (2001) analyze that there are strong structural underpinnings to the inadequate flow of funds to the SME sector. They argue that the organizational structure of banks in India and processes within them, have taken them far from task orientation, and have created a specific bias against small loan portfolios. A large study observation shows that the Indian financial system has no transparency regarding the financial conditions of SMEs. Therefore, banks hesitate to give loans to small scale units. There is evidence to establish that a fairly significant proportion of loans given to small enterprises in the past have compounded the problem of nonperforming assets of banks. Unless fairly detailed information on small firms is available, banks would hesitate to take the risk and may prefer to lend to relatively larger firms to comply with regulation, thus leaving smaller firms significantly constrained for capital (Rathod et al., 2017)

According to Pandey and Shivesh (2007), small and medium sized enterprises are list out following characteristics: (1) Born out of individual initiatives and skill (2) Greater operational flexibility (3) High employment orientation (4) Low cost of production (5) High capacity to innovate and technology adaptation. SMEs have many points of distinction that separate them from large enterprises. The SMEs follows flat organizational structure and lack of formal organizational setup. SME organizational structure is less bureaucratic than larger firms (Ghobadian and Gallear, 1996). They are also characterized by a lack of formal working relationships and the absence of standardization. Such characteristics make small and medium enterprises more flexible than larger firms (Storey and Cressy, 1995; Levy, 1998). Due to its functionality, SMEs have several advantages over a large
company due to its size and flexibility in adapting to change. It has also been found that market and learning-oriented SMEs, facing strong competition, tend to be more innovative and resilient (Salavou et al. 2004). According to Deeks (1973), the organisational and policy making structure of an SME can be of three types: (1) Monocratic: where most of the decisions are made by the owner or the major shareholder of the enterprise and their presence is absolutely needed in the day to day functioning of the company. (2) Oligarchic, where company policy is decided by two or three company managers or owners with each of them handling one specialized job or the other. (3) Patrician, where the owner or the major stock holder and their family does not get involved with the day to day running of the company and its policy making. Such uniqueness and functionality helps SMEs to survive despite of recent economic meltdown at worldwide level.

Singh et al. (2008), point out the significance of SMEs in selected countries in terms of industrial output, employment, export and GDP. SMEs are regularly facing new challenges with reference to cost, quality, delivery, flexibility and availability of financial resource, human resource development for their survival and growth in the context of a dynamic market scenario. Current literature suggests that SMEs may be differentiated from larger companies by a number of key characteristics. These are generally described (Addy et al. 1994; Burns and Dewhurst, 1996; Ghobadian and Gallear, 1997; Appiah Adu and Singh, 1998; Berry, 1998; Marri et al. 1998; O'Regan et al. 1998; Haywood, 1999) as: (1) Personalised management, with little devolution of authority, (2) Severe resource limitations in terms of management and manpower, as well as finance, (3) Reliance on a small number of customers, and operating in limited markets, (4) Flat, flexible structures (5) High innovatory potential, reactive and informal. Most SME do not have the necessary resources to employ specialists on every position in the company. They focus on their core business and have generalists for the administrative functions (Retzlaff, 2007).

Hermann (1996), states most SME offer a narrow and/or specialized product range in compare to the large scale firms. Due to that, they demand only small amounts of
input factors on procurement markets and cannot benefit from economies of scale. Furthermore, small and medium sized firms are due to their size not in a dominant position on the procurement markets and can only marginally affect the conditions in contracts with their suppliers. In most cases they are dependent on them and receive worse conditions than larger companies (Krey & Rohman, 2008). This dependency is increased by the fact that SMEs use more external sources for their input factors than larger companies (Hermann, 1996). Mistry and Ranpura (2013), in their study discuss that, small firms are biggest supplier to larger enterprises. Through unique buyer-supplier relationship larger firms helps to buildup competitiveness among SMEs. Further, SMEs firms have little existence in formal financial market compare to larger firms. In contrast to larger companies, most SME do not have easy access to equity of capital markets, as they often do not fulfill the required standards and the process for raising fund are costly and time consuming. Furthermore, the amount of money that many of SME need is too small for this type of financing (Borner, 2006).

In the study by Longenecker et al. (2006), state that the small and medium sized enterprises are business partner to large scale enterprises and provide products and services that normally cannot be provided by the latter. This they do through special niche markets and the niche might consist of a uniquely specialized service or product, or it may be a focus on serving a particular geographical area. By finding a special niche, SMEs may avoid intense competition from large enterprises. SMEs also give an entrepreneur an opportunity to enter into the business world. Sometimes a small business is the only provider of necessary products and services in thinly populated and small markets. The World Bank proposed pro SME policy based on 3 core arguments: (1) Small and medium enterprises enhance competition and entrepreneurship and hence have external benefits on the economy like efficiency, innovation and productivity growth of nations. (2) SMEs are generally more productive due to their ability to specialize in special niche areas compared to large firms, but financial market and other institutional failures hamper SME
development. Thus, pending financial and institutional improvements, direct government financial support to SMEs can boost economic growth and development. (3) SME expansion boosts employment more than large firm growth because SMEs are more labour intensive. From this perspective, subsidizing SMEs may represent a poverty alleviation tool (Beck et al. 2003). Any nations will also be able to compete globally if it has a vibrant SME sector as it is in a position to offer more standardized and quality and innovative products which comply with international standards. SMEs’ primary competitive advantage is its flexibility; they are often better able to quickly meet customer requests and needs (Temperley, Galloway et al. 2004; Kumar and Russel, 2002; Edwards, Delbridge et al. 2005). The research and development is also vital for the existence and survival of typical SMEs. However, SMEs tend to focus more on incremental innovation, as opposed to radical innovation. SMEs are less vertically integrated than their counterparts, as there are fewer layers of management and bureaucracy. This helps SMEs simplify their management and leads to rapid decision execution to mitigate with external threats and capitalize on opportunity, but it also brings the disadvantages that most SMEs focus on operational matters, rather than planning and strategic issues of future development (Antony et al. 2005; Deros, Yusof et al. 2006; McAdam, Keogh et al. 2007). The personality of an SME’s chief executive officer or managing director is often a key element in the direction, growth, and success of the company; so most of them are very people oriented. This leads working relationship is often loose and informal and the process is often lacks standardization (Temperley et al. 2004). In SMEs, the policy making procedures and resource utilization that are appropriate for large companies are not necessarily appropriate for SMEs (Welsh and White 1981; Deros et al. 2006).

The mortality rates among SMEs firms are high (Timmons, 1999). Actual and potential customers have little justification to trusting newly started or relatively young SMEs that do not have adequate track records owing to their short operating history (Politis, 2005). One major reason for failure can be attributed to inadequate
funding and inefficient marketing (Storey, 1994). O’Gorman (2001), identified that sound financial investments by enterprises in marketing, building of distribution channels, and product research and development are critical factors that contribute to firm growth.

When compared to large firms, SMEs have material disadvantages and are hampered by liabilities of smallness (Freeman and Hannan, 1983) and newness (Stinchcombe, 1965). However, their uniqueness provides them with behavioral advantages in their quest to survive and prosper in primarily targeting niches within the markets they occupy (Nooteboom, 1993). SMEs are therefore not scaled down versions of large firms (Coad, 2009) and require investigation as unique study objects or a subset of firms within the business landscape. Most of the theories of the firm and firm performance do not clearly differentiate between firms of different sizes and therefore do not provide specific guidance for SMEs. Resource-based theory (RBT) postulates that firm performance heterogeneity stems from differences in firms’ ability to obtain, build and use strategic resources and capabilities to create sustainable competitive advantage. Accordingly, the resource endowment of firms comprises unique bundles of both tangible and intangible resources of which intangible resources are deemed strategically more valuable to firms in developing sustainable competitive advantage as they are less imitable (Barney, 1991). The growing body of empirical literature on SME performance, although highly fragmented, provides some evidence on the types of resources and capabilities that holds most potential for SMEs.

2.2 Theory of SMEs’ Growth and Firm Performance

Firm growth and performance are key research topics in the economic, strategy and entrepreneurship literatures. Organizational growth research has attracted considerable attention (Delmar et al. 2003) and can be regarded as a series of lifecycle phases/stages of development through which businesses pass or fail to pass. Small and medium sized enterprise growth and performance studies are available with different theories adopted by scholars in hypothesizing relationships
and developing constructs. The diverse set of perspectives adopted may indicate a lack in commonality in the theories of SME growth and performance. This probably directly results from the multidisciplinary nature of SME growth and performance research. However, the historical trend shows that scholars increasingly adopt multiple theories when designing their studies (Baum, Locke & Smith, 2001; Rhee et al. 2010). It also indicates that new theories are being developed or existing ones are fragmenting, to reflect and/or accommodate the diversity of firm growth and performance. New ideas and insight seem to originate from the overlap of different theories rather than applying singular ones, acknowledging the difficulty in understanding complex relationships through a single theoretical lens (Gray and Wood, 1991). Notwithstanding the economic importance of SMEs and a growing body of empirical evidence, little consensus exists on the main drivers and underlying processes of firm growth and performance (Audretsch, Coad and Segarra, 2014).

Churchill and Lewis (1983), proposed a five stage model of small business growth: existence, survival, success, take off, and resource maturity. Organizational factors (financial, personnel, systems, and business resources) change in importance as businesses grow and develop. According to Greiner (1998), small and medium sized organizations in high growth industries seem to experience higher exponential growth compared to low growth industries. However, enterprises that experience high growth do not develop continuously; undergo uneven growth trajectories, that is, highs and lows, downturns, and recoveries (OECD, 2002).

In case study based research by (Nadvi, 1995), encouraging the growth of small and medium enterprises (SMEs) is widely seen as being an important part of industrial policy in many developing countries. The main aim of supporting SMEs are, it fosters job creations, improving welfare, alleviating poverty, raising incomes, enhancing technical and entrepreneurial capacities as well as the often expedient, political, considerations of fostering key constituencies in civil society. The most of the developed and transition economies emphasis SMEs is also associated with the
failure of the large scale manufacturing sector in meeting many of these objectives and fulfilling the hopes and aspirations of modernization and growth theorists.

According to (Gibb and Davies, 1990), there is no single theory which can adequately explain small business growth and little likelihood of such a theory being developed in the future. Smallbone et al. (1995), studied a number of theories of small business growth although the study not linked to any single theoretical framework. Their study also conclude that, single theoretical framework is partly not possible due to the heterogeneity that exists in the various types of SME but also because of the range of factors that can affect growth, which may interact with each other in different ways in different circumstances. Thus, while it may be possible to identify key success factors that affect the growth of SMEs, it is unlikely that a comprehensive model with predictive capability will emerge. While the diversity in SME growth and performance studies evidently results from the corresponding diversity of theoretical perspectives adopted, this multidisciplinary richness assists SME growth and performance to be explained. It is therefore prudent to explore relevant theories of the firm. The theories adopted by researchers could be classified in one of two groups. The first group includes those theories that may be classified as theories of the firm (e.g., Transaction cost theory), and theories directly related to the dependent variable, including those theories that provide an explanatory framework for firm growth and performance (e.g., Resource based theory). The second group involves those theories explaining phenomena related to the independent variables used in growth and performance studies, which only indirectly relate to SME growth and performance (e.g., social capital theory).

Gibb and Davies (1990), list out four growth approach; (1) Personality dominated approaches, which focus on the impact of the entrepreneur’s personal characteristics (2) Business management approaches, which emphasize the factors affecting the firm’s performance in the marketplace, particularly its financial performance (3) Sectoral and broader market led approaches, which emphasize the influence of external factors rather than individual firm characteristics (4) Organizational
development approaches, represented by the so called “life-cycle” or “stages of growth” models (e.g. Churchill and Lewis, 1983). Storey (1994), has identified three key components in his analysis of the growth of small firms: The characteristics of the entrepreneur, The characteristics of the organization, and The types of strategy associated with growth. In study Storey’s (1994), define the types of strategy used by SMEs as key component of SMEs growth. SMEs strategies and management actions are considered in relation to products and markets in which SMEs deal, production process followed by SMEs, and lastly organization management specifically to financial management. Hughes (1991), point that though in the early 1980s, the emphasis in public policy was on increasing the rate of new business formation, more recently there has been a growing recognition of the importance of helping expanding firms overcome growth constraints and of encouraging established SMEs to maintain and improve competitiveness. Lewis and Churchill (1983), develops a model relevant to small and growing businesses that delineates five stages of firm development. The study also identifies eight factors prominent in determining firm success or failure. They include: financial, personnel, systems and business resources and the owner's goals for him/herself, operational abilities in doing important jobs, managerial ability and willingness to delegate, and strategic ability for looking to the future. It has also been argued that putting more money into start-ups is less cost effective than helping established SMEs to grow faster (Storey, 1993). Smallbone et al. (1995), identified high growth SMEs on three criteria: (1) Rapid growth: more than doubling sales turnover in real terms (2) Significant size by reaching a minimum sales turnover in a given period of time (3) Financial Stability. According to Egbru et al. (2005), a major factor affecting SMEs growth, especially for family-owned businesses is the succession planning. It is, therefore, necessary for SMEs to identify and train potential successors well in advance. SMEs generally focus their actions on those processes which make them economically viable: typically production and sales, prefer short-term investments which yield a high return, and concentrate most of their efforts on matters of day-to-day survival. Levy et al. (2003) argue that SMEs are good as knowledge creators,
but are poor at knowledge retention. Resilience of SMEs requires knowledge retention through a flexible workforce, strategic managerial thinking, top management support and technology. They need to be proactive in knowledge sharing arrangements to recognize that knowledge has value and the value added is derived from knowledge exchange. In SMEs, personal relationship has traditionally been a major contributor to success. Utilizing these already existing bonds, coupled with a clear understanding of what the company wants to accomplish strategically, can become a sustainable competitive advantage that can lead to growth and increased profitability.

2.2.1. SMEs Firm Performance

Firm size has long been considered as one of the most important contingency variables in firm growth and performance studies. Numerous researchers have argued the benefits and drawbacks of different firm sizes (Audretsch and Thurik, 2001; Bain, 1968; Bracker et al, 1988). The disadvantages associated with small size are referred to as the “liability of smallness” and is primarily associated with resource constraints and problems of legitimacy (Aldrich and Auster, 1986; Freeman and Hannan, 1983). Small firms therefore have financial and human resource disadvantages (Vermeulen, 2005) but behavioural advantages (Nooteboom, 1993). Although growth enhances the survival prospects of small firms (Phillips and Kirchhoff, 1989) and small firms seems to grow faster than large firms on average, it is important to note that over time, the average small firm growth rate variance is higher than that of larger firms (Coad, 2007). Rapid growth is therefore more erratic and less likely to be sustained in small firms (Coad, 2007). On average, small firms experiencing high growth in one year are more likely to experience little growth in the next year when compared to larger firms that exhibit less variance. One explanation for this higher variance directly relates to the previous point on the relationship between growth and survival in that firm age impact the link between size and growth. For example, smaller start-up firms,
younger than five years, experience on average much higher growth than older small firms (Lawless, 2014).

The patterns and determinants of firm growth have recently emerged as an important research topic. In highly competitive global markets, SMEs seek to improve their competitive position to ensure survival by implementing strategies that enhance business performance. Firm strategy therefore concerns itself primarily with the theory of business performance. To excel implies superior performance relative to competitors, and is achieved by mobilizing and adapting resources in a respective competitive arena (Penrose, 1959).

The classical approach to performance measurement given by Sink and Tuttle (1989), claims that the performance of an organizational system is a complex interrelationship between six performance criteria: effectiveness, efficiency, quality, productivity, innovation and profitability. Storey (1994), Study shows that small and medium sized enterprises (SMEs), exhibit distinct characteristics that differentiate them from the majority of their larger counterparts. The concept of strategic performance measurement (PM) was developed in response to the criticisms that traditional PM systems are financially driven and historically focused (Kaplan and Norton, 1993). McAdam and Kelly (2002), there is a general belief that performance evaluation models developed for large organizations can be applied to small and medium enterprises (SMEs) either without modifications or with minute changes. This belief is based on the assumption that large organizations being highly complex, models developed for them will be robust enough to address the complexities of small organization too.

However, while SMEs are similar to large organizations in some ways, they are significantly dissimilar in other ways. Antony and Bhattacharyya (2010), analyze the following variable like, innovativeness, competitiveness, creativeness, effectiveness, productiveness, efficiency and profitability and try to find out the consolidated value of the variables for obtaining organizational performance and excellence. The seven variables were measured for the whole organization and for
work units separately. The model refinement of that approach in that it allows measurement of performance and excellence separately. They used a summated scale average method for organizational performance and total correlation method for organizational excellence. They outline two important points for the seven performance variables: First, the selected variables are related with each other and hence consolidated measures can give information regarding organizational performance and organizational excellence and second; adopting perception based measures for these seven variables provides normalized results for consolidation compared with measures mentioned for each of these variables. Hudson et al. (2001), identified the critical characteristics of performance measures with the help of extensive literature as follows; Clearly defined with an explicit purpose (Globerson, 1985; Neely et al. 1996), Relevant and easy to maintain (Maskell, 1989; Lynch and Cross, 1991), Simple to understand and use (Maskell, 1989; Lynch and Cross, 1991; Neely et al. 1996), Provide fast and accurate feedback (Globerson, 1985; Dixon et al. 1990), Stimulate continuous improvement (Lynch and Cross, 1991; Maskell, 1989).

Moullin (2007), Organizational performance is defined as a measure of how well organizations are managed and the value they deliver to customers and other stakeholders. On the other hand, organizational excellence is defined as outstanding practice in managing organizations and delivering values to customers and other stakeholders. The process of liberalization and globalization, while providing tremendous opportunities, has thrown up new challenges for the Indian SMEs. Hitherto the small and medium scale enterprise, which was maintaining reasonable growth under the umbrella of protective environment, was forced to face challenges of stiff competition both at national as well as international levels. Subrahmanya (1995), Murthy (2004) and Sahoo (2002-04), emphasize the importance of SME in the Indian economy. Having been nurtured in a sort of protective environment for a long time, it finds itself vulnerable to cross border enterprises’ activities in the wake of globalization.
Measuring SME performance is complex and challenging work (Brush and Vanderwerf 1992; Murphy, Trailer et al. 1996; Sapienza and Grimm 1997; Amason, Shrader et al. 2006). The challenges are usually distinct from those of large organizations and, because most existing performance measurement systems were designed for the latter, few tools are available for SMEs.

The main challenges to measuring performance in SMEs are as follows:

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<th>Table 2.1: Challenges to Measuring Performance in SMEs</th>
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<td><strong>First</strong> Collecting performance information from privately held SMEs is often difficult due to a lack of historical information and accessibility. The information is often imperfect and the accuracy is hard to be checked. For example, traditional financial measures of performance are often unavailable <em>(Brush and Vanderwerf 1992; Chandler and Hanks 1993; Wang and Ang 2004)</em>.</td>
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<td><strong>Second</strong> Financial data is difficult to interpret <em>(Barnes, Coulton et al. 1998)</em>. This is because SMEs usually have small starting base, enormous and erratic growth rate and uneven record-keeping <em>(Sapienza and Grimm 1997)</em>.</td>
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<td><strong>Third</strong> Many measures, such as future profits and survival, require a longitudinal sample-design. It is inappropriate to use such measures on an SME, due to the group’s typically short operation-history <em>(Brush and Vanderwerf 1992; Chandler and Hanks 1993; Wang and Ang 2004)</em>.</td>
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<td><strong>Forth</strong> Financial data is often influenced by industry-related factors. <em>(Wang and Ang 2004)</em>.</td>
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<td><strong>Fifth</strong> There exists possible source bias, e.g. owner/founder might manipulate the related information in propaganda <em>(Brush and Vanderwerf 1992)</em>.</td>
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<td><strong>Sixth</strong> SMEs’ future and potential performance is more important than lagged</td>
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performance. This requires that performance measurement systems not only measure lagged performance, but also capture future performance. *(Kaplan and Norton 1992).*

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<tr>
<th>Seventh</th>
<th>Most SMEs focus on day-to-day operations. There may not be enough resources to execute comprehensive PM measurement <em>(Stephens 2000)</em>.</th>
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<td>Eighth</td>
<td>The decision-making processes in SMEs are always not formalized and their strategies are often poorly planned, which influences the standard PM system employed in SMEs <em>(Garengo, Biazzo et al. 2005)</em>.</td>
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*(Source: Literature review)*

### 2.2.2 SMEs’ Growth and Financial Performance Measure

As a representative study of firm growth, Evans (1987a, b) examined the effects of firm size and age on growth using data on manufacturing firms in the United States. Although several previous studies had supported Gibrat’s law that hypothesizes that growth is independent of size, Evans found that firm growth decreases with firm size and age. After that, subsequent studies have also found that growth is negatively related to firm size. Evans (1987a, b) proposed a model in which it is assumed that firm growth is a function of firm size and age. However, firm growth is determined not only by firm size and age but also by other firm-specific characteristics. Some empirical studies, therefore, have proposed a model including firm specific characteristics other than firm size and age. For example, Heshmati (2001) found that the degree of indebtedness positively affects sales growth using data on Swedish micro and small firms. Also, Becchetti and Trovato (2002), examined the effect of external finance on firm growth in the Italian manufacturing industry, apart from the traditional regressors of age and size. Moreover, Elston (2002), provided evidence that cash flow has an impact on the growth of firms listed in the Neuer Market of Germany, even when controlling for firm size and age. O’Regan et al. (2006), though considerable attention in the extant literature has been devoted to growth and financial performance of firms, there is a dearth of research...
on high growth firms. Furthermore, the majority of literature in this area focuses on large firms while research on high growth small firms is underdeveloped.

While evaluating enterprise growth, some scholars adopted single evaluation method. Bottazzl et al. (2001), carried out growth evaluation on the world largest 500 new types of pharmaceutical enterprises by application of clustering methodology; Kakati (2003) adopted clustering methodology only too; Wang Juying (2006) et al. went to analytic network process, while evaluating the growth of high-tech SMEs. There also exist scholars, who combined mutli-methods, while evaluating enterprise growth, and compared the empirical results from different methods; Chen Xiaohong et al. (2006), conducted growth evaluation of listed companies in China by GRAM and mutation series method, respectively, and compared and analyzed the accuracy of the two empirical results; Bai Zuwen (2009), chose principal component analysis method, using a panel data set on SMEs in the India’s manufacturing industry, trying to examine whether financial structure affect firm competitiveness and growth.

Slevin and Covin (1990), proved the intimate relationship between enterprise growth and affecting factors of time and external environment, through establishing a model, capable of representing vital influencing factors in growth process of enterprises. Storey and Tether (1998), regarded manager quality, internal factors and business development strategy as important factors in affecting enterprise growth; Canales (2001), put forth two important factors of sustainable and rapid development of enterprises’, one is the growth mode, related resource and capability of enterprise; the other one is the market or customer of enterprise. Wynarezyk and Waston (2005), carried out study and analysis into enterprise growth on 211 British sub-contractors, and empirical result showed positive influence of inter-enterprise cooperation on enterprise growth. Penrose (2009), one of the major scholars focused on driving factor study of enterprise growth, hold the view that the effective utilization of resources plays a vital role in enterprise growth. In addition, Lundvall and Batte (2000), Hitt (2000), Xuqian (2004), Meng Lifeng(2008) et al.
considered employee quality, industry factors, geographical condition and technological innovation capability, which executed significantly impact on enterprise growth, as critical influencing factors as enterprise grew.

McMahon and Holmes (1991), in their study conclude that sound financial management is crucial to the survival and well-being of small enterprises of all types. Studies of reasons for small business failure inevitably show poor or careless financial management being the most important cause (Berryman 1983, Peacock 1985). The SMEs growths are likely to manifest themselves in financial characteristics and performance of these enterprises. The major financial problems likely to arise at this stage are that these resources are insufficient and that the small enterprise is thereby undercapitalized. McMohan, (2001) studied on whether the experience of growth seems to produce discernible and significant financial differences between SMEs over time. Attention was paid to so called "financial profiles" that provide a means for establishing what SMEs look like from an overall financial perspective that is, how they appear to readers of their financial statements or reports. Hutchinson (1989) describes a financial profile as "that set of accounting ratios, available from the firm's profit and loss account and balance sheet, which usefully and efficiently summarises the financial aspects of the firm such as profitability, liquidity and gearing." Study of Boardman et al. (1981) and Hutchinson (1987, 1989) identified that, it is the combined effect of small size and growth that produces distinctive financial profiles for SMEs. It would appear that to ignore enterprise growth is to omit a key shaping influence upon SME financial profiles.

One of the critical functions that adversely affect SMEs is financial management. McMahon (2001), studied the impact of financial management characteristics or practices upon business growth and performance outcome amongst small and medium enterprises engaged in manufacturing. The study extended prior research by attempting to discover whether observed financial management characteristics of manufacturing SMEs appear to have a significant impact on their achieved business
growth and performance, with consideration of key enterprise characteristics. With presenting empirical evidence from prior research provides strong support for the proposition that, as a growing SME progress through various lifecycle stages, the financial dimensions of its operations tend to become more problematic; and that there is consequently a greater need for management if the growing concern is to succeed in survival and performance terms (Hutchison et al. 2005; Vozikis, 1984; Chandler and Hanks, 1994). It is a fact that non availability of critical financial needs is one of the crippling factors for growth of Indian SMEs. However, the major cause for this threat lies in the weak financial competencies of SMEs (Ramarao, 2012). This has led to suboptimal performance of the firms in the sector and resulted in defaults in payments or sometimes even non-payments, depleting the confidence of the financing institutions. This has become a vicious circle driving firms to resort to self-financing or tapping costly sources of capital in turn leading to eroded competitiveness. The capital management and working capital management capabilities of most of the SMEs are questionable. Also in doubt are their credit management competencies. Diversion of capital funds to working capital and vice-versa is a normal phenomenon in Indian SMEs without understanding the consequences. This has aggravated the already existing problems of timely repayments and also inadequacy of funds for the purposes meant when required. A World Bank research group found that banks perceive SME segment to be profitable, but competition in developed countries and macroeconomic instability in developing countries are the main obstacles. Banks in developing nations remain less exposed to SMEs and charge them higher rates and fees due to them having more non-performing loans as compared to the developed nations. Private Banks consider profitability of SMEs as the key driver. Government banks perceive competition among large firms as a driver for SMEs and competition among SMEs as a deterrent. (Beck et al, 2008).

The financial strength of an organization determines its strategic capabilities (Johnson and Scholes, 1993). It can be measured through a variety of financial and
non-financial measures. The choice of measures depends on the organization itself as well as its competitive environment. For example, the fixed assets of service organizations are low when compared with heavy industries in which fixed assets play a dominant role. It is therefore not possible to develop a universal framework for measuring financial strength. Grablowsky (1978), analyze that younger small businesses were more likely to prepare cash budgets than longer established businesses. In his research, also comment that the most common planning period for cash budgets was a year ahead, with the frequency of updating distributed widely over weekly, monthly, quarterly, and annual intervals. Growth beyond formation is likely to be financed by retained earnings, trade credit and bank borrowing.

Garg et al. (2003), suggest that as most small firms are privately held, it is unlikely that their CEOs will be willing to provide detailed accounting data on the firms performance. Weston and Brigham (1981), consider the financial implications of five stages of development: formation, rapid growth, growth to maturity, maturity, and decline, and found that major sources of finance at formation are the owners’ personal resources. However, according to McMahon et al. (2001) the major financial problems likely to arise at this stage are that these resources are insufficient and that the small enterprise is thereby under-capitalized. Growth beyond formation is likely to be financed by retained earnings, trade credit and bank borrowing. As a result, growth may have the following effects: Growth may outstrip financial resources, leading to over-trading and liquidity crises. And growth may also cause a financial gap where the small enterprise is forced to rely too much on short-term finance because of a lack of long-term finance. Wang Juying et al. (2006), developed a growth evaluation index for technological SMEs by using the analytic network process (ANP) model based on the balanced score card (BSC) method, in which the financial indicators integrate many measures such as the business’ revenue growth, growth rate of net assets and net profits. Zhang and Hang (2007) developed an evaluation financial system for the sustainable development of SMEs. This system incorporated measures such as profitability,
asset managerial ability, debt servicing, innovation capacity, return on investment, inventory turnover, assets turnover, current ratio, debt to asset ratio, and growth rate of industrial sales.

<table>
<thead>
<tr>
<th>Table: 2.2 Dimensions of Financial Performance Measurement in SMEs</th>
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</thead>
<tbody>
<tr>
<td><strong>Dimension used by various researcher in their study</strong></td>
</tr>
<tr>
<td>Efficiency</td>
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<tr>
<td>Growth</td>
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<tr>
<td>Profit</td>
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Since very little is known about the process of investment decision-making in small firms (Deakins et al. 2000), the gap between theory and practice soon became apparent. Peel and Wilson (1996), argue that there is less theoretical literature on investment decisions in small firms than in large firms. The available theoretical and empirical literature on investment decision making developed for large firms is clearly unsuitable for small firms because the factors affecting small firm investment decisions differ considerably from those addressed by the large firm studies (Keasey and Watson, 1993; Spence and Rutherford, 2001). These factors include high exposure to business and financial risk; separation of financing and investment decisions; and multiple objectives.

Donckels and Mlettinen (1997), built up an indicator system, including market share, enterprise capability, fixed assets condition, sales, numbers of staff and many
other indicators, suitable for evaluating growth of listed SMEs. Sleuwaegen and Goeduy (2002), figured out two measure indicators of enterprise growth, enterprise scale and establishment duration, from a perspective of enterprise scale. Deimar (2003) et al. established enterprise growth models related to established time, industry affiliation and enterprise scale, respectively, and analyzed the reasons for high growth through 19 indicators, such as relative sales growth, absolute sales growth, relative increase in employee, absolute increase in employee, earnings growth, scale, time and average of growth rate and so on.

<table>
<thead>
<tr>
<th>Dimensions</th>
<th>Evaluation Indicator</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Profitability</strong></td>
<td>• Total Assets</td>
</tr>
<tr>
<td></td>
<td>• Profit Margin</td>
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<tr>
<td></td>
<td>• Return on Equity</td>
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<tr>
<td></td>
<td>• Main Operations Margin</td>
</tr>
<tr>
<td><strong>Solvency</strong></td>
<td>• Current Ratio</td>
</tr>
<tr>
<td></td>
<td>• Quick Ratio</td>
</tr>
<tr>
<td></td>
<td>• Assets Liability Ratio</td>
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<tr>
<td></td>
<td>• Equity Ratio</td>
</tr>
<tr>
<td></td>
<td>• Total Assets</td>
</tr>
<tr>
<td><strong>Enterprise Scale</strong></td>
<td>• Operating Income</td>
</tr>
<tr>
<td></td>
<td>• Number of Employees</td>
</tr>
<tr>
<td><strong>Operation Capability</strong></td>
<td>• Total Assets turnover</td>
</tr>
<tr>
<td></td>
<td>• Inventory Turnover</td>
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<tr>
<td></td>
<td>• Account Reevables</td>
</tr>
<tr>
<td></td>
<td>• Growth Rate of Current Assets</td>
</tr>
<tr>
<td></td>
<td>• Fixed Assets Turnover</td>
</tr>
<tr>
<td><strong>Growth Capacity</strong></td>
<td>• Net Profit Growth</td>
</tr>
<tr>
<td></td>
<td>• Total Assets Growth Rate</td>
</tr>
<tr>
<td></td>
<td>• Business Revenue Growth Rate</td>
</tr>
<tr>
<td><strong>Resistance Capability to Risk</strong></td>
<td>• Leverage Integrated</td>
</tr>
</tbody>
</table>
Gupta and Campanha (2003), based on the normal distribution of competiveness, explored the dynamic growth of manufacturing enterprise from various perspectives. Mujing et al. (2005), also established an indicator system for evaluating growth, containing operating capability, profitability and growth speed. They analyzed the growth of high-tech SMEs in China and driving factors of growth environment, growth potential and competiveness of enterprise, based on the establishment of comprehensive evaluation indicator system of enterprise growth, becoming pioneers of this area. Principal component analysis method is effective and relatively advantageous, while applied by multi-indicator comprehensive evaluation Li Lia, Ci Jinfenga, Gao Xuezhua (2012).

McAdam and Kelly (2002), explained that SMEs operate in business contexts that are very different from large business organizations. Given the increasing contribution of SMEs to both developed and developing economies, and the scarcity of studies in this particular sector, there is a need for research studies in this area, which can allow SMEs to develop their own understanding and appreciation of the importance of business excellence and share best practices. Little et al. 1987, in their study that the large scale sector fed the higher end of the market with capital intensive technology and the small scale sector produced inferior goods for the lower end of the domestic market with its lower capital intensity. Indeed, policy measures in India at the time created an environment in which the two sectors often viewed each other as adversaries, which prevented linkages from developing between them.

Fieldsend et al. (1987) report differences in current ratios of large and small British firms and find that significant differences across firms are explained by a size effect. Chen and Balke (1979), in their study reported that the size of enterprises did not seem to have a significant effect on most financial ratios. Only the current ratio was found to have significantly negative effects by different sizes of enterprise. Osteryoung et al. (1992), examined the differences between the financial ratios of large public and small private firms across a large number of narrowly defined
industry groups. They indicate that there are significant differences between the average industry ratios of large public and small private firms for most of the ratios examined. But they found that results associated with the liquidity ratios (current ratios and quick ratio) indicate that there is no difference between the average small firm liquidity and average large firm liquidity across the wide range of industries examined. And the outcome or findings are conflicts with the results reported by both Walker and Petty (1979) and Fieldsend et al. (1987) discussed in the literature. Zhang and Hang (2007) developed an evaluation financial system for the sustainable development of SMEs. This system incorporated measures such as profitability, asset managerial ability, debt servicing, innovation capacity, return on investment, inventory turnover, assets turnover, current ratio, debt to asset ratio, and growth rate of industrial sales. Zhang and Hang used the Analytical Hierarchy Process (AHP) method and grey correlative degree analysis to evaluate the performance of Chinese SMEs.

Venkataramna and Ramanujam (1986), integrated three dimensions in a multiple hierarchical construct using financial performance and organizational effectiveness (constituency performance level) as dimensions of the organizational performance domain. The research outcome presents that, business performance is “a subset of the overall concept of organizational effectiveness” and at the center of organizational effectiveness is financial performance. Murphy et al. (1996), include 51 literature survey in their research and all the articles were empirical, composed of small businesses and included performance as a dependent variable. The three most frequently reported performance dimensions were efficiency, growth and profit. The efficiency dimensions included return on investment, return on equity, return on assets, return on net worth and gross revenues per employee. Return on assets or return on Investment, was utilized in 22 out of 40 articles reportig this variable. They noted it as return on assets is the best measure for small organizations since it is easy to understand and calculate. Voulgaris et al. (2000), discuss the evaluation of SMEs performance on the basis of a financial ratio
analysis, for a sample of Greek SMEs during the period 1988–1996. The evaluation framework is based on a multiple criteria decision aid (MCDA) method, namely the UTADIS (UTilités Additives DIScriminantes) method (Jacquet-Lagrèze, 1995; Doumpos and Zopounidis, 1998). The UTADIS method enables the development of an evaluation model that can be used to classify the SMEs into appropriate homogenous classes according to their financial performance. This evaluation model aggregates all pertinent evaluation criteria (financial ratios) into a single evaluation index that represents the performance of the SMEs. In the case study presented in this article, the UTADIS method is used to identify the major aspects that influenced the performance of Greek SMEs over the past decade. The financial performance is an indicator of business success or failures which can be seen from ROI, ROE, cash flow liquidity and others. It is the important end result of the organization performance as it exhibited the sustainability of the business (Green et al. 2008; Wallenburg and Weber, 2009). The financial performance is related with every performance of the organization and is being affected by performances of marketing, investment and logistics, including the information technology’s effect and the internal and external organization’s cooperation (Lee and Hsiao, 2014). As such, It has the ability to measure the financial performance from various indicators, for example, profitability, market shares, return on sales (Hassan and Agus, 2005), return on investment, average profit and the increase of profit (Chien and Shih, 2007), increase on sales (Lee and Hsiao, 2014), increase on return of investment and increase on net profits (Riedel et al. 2007).

Majumdar and Chhibber (1999), found in their Indian study that leverage has a negative effect on performance. Joshua Abor (2007), his study indicate that capital structure influences financial performance, although not exclusively. By and large, the results indicate that capital structure, especially long-term and total debt ratios, negatively affect performance of SMEs. This suggests that agency issues may lead to SMEs pursuing very high debt policy, thus resulting in lower performance. Michaelas et al. (1999), examined 3,500 UK small firms randomly selected from
and representing ten industries. Profit and loss accounts and balance sheets for a ten-year period (1986-1995) were examined in order to ascertain the influence of operating risk, age, profitability, size and industry on financial structures. Lopez-Garcia and Aybar-Arias (2000), examined 1,000 Spanish SMEs in the years 1994-1995. Their results suggest that a significant influence of industry on short-term debt, but indicate little support for a significant effect on long-term debt. Their findings also suggest that enterprise size is an important influence on financial behaviour, and that medium sized concerns act in a significantly different way from micro-businesses. Johnsen and McMahon (2005), reported that cross industry differences in financing behaviour do exist even after controlling for other relevant influences on SME financing choices such as enterprise size, business age, profitability, growth, asset structure and risk.

<table>
<thead>
<tr>
<th>Researcher(s) and year</th>
<th>Financial Measurement characteristic</th>
<th>Variables</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burns (1985)</td>
<td>Liquidity</td>
<td>Current Ratio and Quick Ratio</td>
</tr>
<tr>
<td></td>
<td>Profitability</td>
<td>Return on Total Assets, Return on Net Assets and Return on Equity</td>
</tr>
<tr>
<td></td>
<td>Leverage</td>
<td>Gearing ratio and Long term Debt Ratio</td>
</tr>
<tr>
<td></td>
<td>Liquidity ratios</td>
<td>Current assets/Current liabilities</td>
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<tr>
<td></td>
<td></td>
<td>Current assets/Total assets</td>
</tr>
<tr>
<td>Hutchinson (1989)</td>
<td>Leverage Ratios</td>
<td>Owners’ equity/Total assets</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Current liabilities/Total asset</td>
</tr>
</tbody>
</table>

A theoretical explanation of capital structure that has gained greater support in the small business literature is pecking-order theory (Myers, 1984). Pecking-order theory takes into account the asymmetric information that exists between the management of a firm and its investors to explain the capital structure adopted by firms. This theory sees financing organized in a hierarchical pecking order, internal sources first, external debt financing second, with external equity financing a last
resort. Under pecking-order theory we would expect leverage to be negatively related to the profitability of the firm (profitable firms have more internal finance available resulting in less of a need for external financing), and positively related to the size and the asset structure of the firm (firms with a greater percentage of fixed assets would be more able to access collateralized debt).

Paul et al. (2007) argue that two main factors provide a rationale for the applicability of pecking-order theory to SMEs. First, SMEs exhibit significantly higher levels of asymmetric information than larger firms, especially those with a relatively short history. This is due to a lack of historical performance data on which financiers can make investment decisions (Binks and Ennew, 1996; Cressy, 1996; Reid, 1996; Hall et al. 2000). Second, owner-managers of SMEs tend to exhibit strong aversion to losing control over their business activities that the introduction of new financiers might entail (Berggren et al. 2000; Paul et al. 2007). This leads to a strong preference for financing options that minimize intrusion into their business activities. More and more writers have begun to question the received logic of pecking-order theory, at least as it applies to SMEs, in particular start ups (Howorth, 2001; Paul et al. 2007; Atherton, 2009). This work accepts the idea that pecking-order theory provides a better explanation than competing theories for the capital structures of SMEs, but challenges the ‘order’ the original theory presumes.

Some researchers argue that SMEs are subject to a more extreme version of pecking-order theory (Ang, 1991; Holmes and Kent, 1991; Howorth, 2001) than that proposed by Myers (1984). This is labelled by Holmes and Kent (1991) as a ‘constrained’ pecking order or by Ang (1991) as a ‘modified’ pecking order. These versions of the theory result from the fact that SMEs tend to rely overwhelmingly on internal sources of finance in the start-up and development phases and have limited access to capital markets and other large-scale equity investment. Evidence is beginning to emerge of considerable variety in observable pecking orders given the often very different evolutionary experiences of firms (Atherton, 2009). History it seems matters and this explains why earlier studies (Chittenden et al. 1996) found
no evidence of a specific pecking order in the financing preferences of firms. As of present, there has been limited research examining the applicability of pecking-order theory to the developing economy context. Recent work on SMEs in Poland and Ghana (Klapper et al. 2006; Abor and Biekpe, 2007) and on larger Chinese firms (Tong and Green, 2005; Huang and Song, 2006) indicates that pecking-order theory might hold valid outside the context of mature economies.

Empirical studies on SMEs in developed countries generally provide support for a positive relationship between asset structure and long-term leverage and a negative relationship between asset structure and short-term leverage (Chittenden et al. 1996; Hall et al. 2000; Cassar and Holmes, 2003; Sorgorb-Mira, 2005; Ortqvist et al. 2006). This results from the fact that, in the short term, enterprises use sources of financing which do not require fixed assets as collateral, such as trade credit and bank overdrafts, whereas in the long term financing is secured against fixed assets. In developing economies Nguyen and Ramachandran (2006) find evidence of a negative relationship between asset structure and leverage for Vietnamese SMEs, the overwhelming proportion of which was short term. Klapper et al. (2006) find evidence of a positive relationship between asset structure and long-term leverage, and a negative relationship between asset structure and short term leverage. The table 2.5 explains some of the financial variables studied by researchers for measuring financial performance of small and medium enterprises.

<table>
<thead>
<tr>
<th>Table 2.5 Ratios considered for Financial Performance Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Authors</strong></td>
</tr>
</tbody>
</table>
| Altman et al. (1968, 1979, 1981, 1994) | • EBIT / Assets  
• Current Assets / Current Liabilities  
• Total Debt / Total Assets  
• Ability to bear cost of debt  
• Retained earnings / Assets  
• Working capital / Assets  
• Sales / Total Assets  
• Profitability (ROI, ROA) |
<table>
<thead>
<tr>
<th>Source/Year</th>
<th>Ratios</th>
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</thead>
</table>
| Earl and Marais (1982); Marais (1979) | - Current assets / Gross Total Assets  
- Interest / Gross Total Assets  
- Cash flow / Current liabilities |
| Izan (1984)                        | - EBIT / Interest   
- MV equity/ Liability  
- EBIT/ Total Assets  
- Funded debt / shareholder funds  
- Current assets/Current liabilities. |
| Bhatia (1988)                      | - Cash flow/ Total Debt  
- Current ratio  
- Profit After Tax /Net worth  
- Sales/ Total Assets  
- Working capital management ratio |
| Greece et al. (1998)               | - Gross Income / Current liabilities  
- Total Debt / Total Assets  
- Net working capital/ Total Assets  
- Gross Income/ Total Assets  
- Current Assets / Current liabilities. |
| Sogorb and Mira (2005)             | - Total Debt / Total Assets  
- Tax Paid / Profit After Tax  
- Intangible Assets / Total Assets  
- EBIT / Total Assets |
| Ebaid (2009)                       | - Return on Equity  
- Return on Assets  
- Gross Profit Margin  
- Short Term Debt / Total Assets  
- Long Term Debt / Total Assets |
| Mateev and Anastasov (2010)        | - Total Assets  
- Intangible Assets / Total Assets  
- Current Assets / Current Liabilities  
- Total Debt / Total Assets  
- Operating Revenue / Total Assets  
- (Profit Before tax + Depreciation)/ Total Assets |
| Terdpaopong and Mihret (2011)      | - Current Assets / Total Assets  
- Working capital / Total Assets  
- Total Debt / Owners’ Equity  
- Total Income / Total Assets |
2.3. SMEs’ Financial Competitiveness

Competencies lead to competitiveness (Ramarao, 2012). Competitiveness has been described many by researchers as a multidimensional and relative concept. The significance of different criteria of competitiveness changes with time and context. Theories and frameworks must be flexible enough to integrate the change with key strategic management processes if their utility is sustained in practice. While there are many theories about competitiveness and related inter-disciplinary fields of strategy, operations, resource-based view (Barney, 2001), and economics, they are not used widely by practitioners in their decisions for enhancing or sustaining competitiveness. Competitiveness can be treated as a dependent or independent variable, depending on the perspectives from which one approaches the issue. Berkely et al. (1988), has suggested a framework that has three folds: (1) The competitiveness performance, (2) Competitiveness potential, and (3) The management processes. A similar framework can be found in the World Competitive Year book (WCY, 2002). In the WCY formula, “world competitiveness” is a combination of assets that are inherent and created as well as processes that transfer assets into economic results (Man, 1998). Competitiveness involves “a combination of assets and processes, where assets are inherited (considered as natural resources) or created (infrastructure) and processes transform assets to achieve economic gains from sales to customers” (DC, 2001). According to Dunning (1995), competitiveness is about benchmarking economic performance. It can be looked at from three different levels: country, industry, and firm level. Competitiveness originated from the Latin word, “competer”, which means involvement in a business rivalry for markets. It has become common to describe

<table>
<thead>
<tr>
<th>Source: Literature Review</th>
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</thead>
<tbody>
<tr>
<td>Batrancea et al. (2017)</td>
</tr>
<tr>
<td>- EBIT / Total Assets</td>
</tr>
<tr>
<td>- Current Assets / Total Assets</td>
</tr>
<tr>
<td>- Total Debt / Total Assets</td>
</tr>
<tr>
<td>- Net Profit / Total Assets</td>
</tr>
<tr>
<td>- Total Debt / Total Equity</td>
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<tr>
<td>- Net Profit / Total Sales</td>
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| (Source: Literature Review) |

2.3. SMEs’ Financial Competitiveness

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economic strength of an entity with respect to its competitors in the global market economy in which goods, services, people, skills, and ideas move freely across geographical borders (Murths, 1998).

Dangayach and Deshmukh, (2001), state that creating new forms of competitive advantage has become major area of concern for management in such an uncertain and competitive environment. These uncertainties due to globalization of the Indian market after economic reforms have led to drastic changes in the approach of Indian small to medium sized enterprises (SMEs) and large organizations for developing various competencies to get competitive advantage. The new competition is in terms of reduced cost, improved quality, products with higher performance, a wider range of products with better service, and all delivered simultaneously. In such a challenging, volatile, and hyper competitive environment, any manufacturing firm, which is able to compete on all dimensions of competitive priorities such as fast delivery, high quality, low price, volume, and product flexibility, can be considered a competitive firm (Singh et al. 2008).

Gunasekaran et al. (2011), states that the key factors that influence resilience and competitiveness of SMEs are grouped as internal, external and enabling factors. Strength in the internal factors contributes significantly to the resilience and competitiveness of SMEs. Any weakness in the internal factors would result in ineffective and non-optimal utilization of the enabling factors. The resilience and competitiveness of a small enterprise is also depending on the generating capital for the business (Beck and Demirguc-Kunt 2006).

From the perspective of the business enterprise, performance is usually taken to mean its productivity, profitability, market share, or rate of growth of sales; its benchmark of comparison is the performance of its major competitors and, more particularly, those perceived to utilize "best practice" techniques and strategies. Competency is the combination of knowledge, skills, behaviours, and attitudes that contributes to one’s effectiveness (Hellriegelet al. 2005). A business entity in order to achieve its goal, requires the competencies as physical qualification in the form
of resources and intellectual qualification in terms of innovation and knowledge. Competitiveness is a comparative concept of ability and performance of a firm, sub-sector or country to sell and supply goods and/or services in a given market. It is the ability of a firm or a nation to offer products and services that meet the quality standards of the local and world markets at prices that are competitive and provide adequate returns on resources employed or consumed in producing them (Business Dictionary, 2009). Competitiveness should not be regarded as an end in itself.

Momaya et al. (2001), define competitiveness is the ability to design, produce and market products or service superior to those offered by competitors in view of the price and non-price factors. Nambirajan T. and Prabhu M. (2010), Competitiveness is a multidimensional concept. Competitiveness means firms' ability to match the standards of the leaders in its industry on various benchmarks and critical success factors. Competitiveness describes the capability of SMEs to produce income/output and to maintain employment levels in domestic and international competition. Consequently, in the absence of competitiveness, SMEs may face the crisis of sickness or closure. The study focused on factors that determine the competitiveness of small and medium scale industries in Union Territory of Pondicherry. Factors such as production volume, market size and finance availed through loans from banks and financial institutions, infrastructures which include roads and telecommunication facility and liberal trade regime are considered. Porter (1985), a sustainable competitive advantage creates barriers for competitors and makes imitation difficult. Errin (2004), in order to compete with their competitors, firms have to develop competitive competencies. Core competencies enable the organization to envision the markets that do not yet exist. The two most important ingredients to enhance the competitiveness of SMEs are access to finance and to the new technologies. Without access to new technologies, SMEs in developing countries will continue to use outdated modes of production and will not be able to meet international quality requirements. (UNCTAD, 2005). Competitiveness can be studied at three levels: country, industry/sector and firm although all the three levels of competitiveness are interlinked with each other.
Ajitabh, Momaya, (2004), points that the firm level competitiveness defines as ability to design, produce and market products or services superior to those offered by competitors. According to Man et al. (2002), Competitiveness of small and medium enterprises (SMEs) should comprise the four major constructs relating to the firm’s internal factors, external environment, influences of the entrepreneur and the firm’s long-term performance. Singh et al. (2005), specified these four factors for the purpose of measuring competitiveness index of an organization as assets, pressures, constraints, strategy development, competitive priorities, processes and performance in their framework. O’Farell et al (1992, 1989, 1988), have conducted a number of studies on the relationship between sources of competitiveness and firm performance, with focus on price, quality, design, marketing, flexibility, and management. The importance of firm level competitiveness is confirmed by a large number of studies discussed above. Recognizing the dynamic role processes play in enhancing competitiveness, the role of processes in firm level competitiveness need to be examined. In manufacturing sector, SMEs act as specialist suppliers of components, parts, and sub assemblies to larger companies because the items can be produced at a cheaper price than the large companies could achieve in-house. Lack of product quality supplied by them could adversely affect the competitive ability of the larger organizations.

Majority of SMEs have simple systems and procedures, which allows flexibility, immediate feedback, short decision-making chain, better understanding and quicker response to customer needs than larger organizations. In spite of these supporting characteristics of SMEs, they are on tremendous pressure to sustain their competitiveness in domestic as well as global markets. Owing to global competition, technological advances and changing needs of consumers, competitive paradigms are continuously changing. These changes are driving firms to compete, simultaneously along different dimensions such as design and development of product, manufacturing, distribution, communication and marketing (Singh et al. 2008). Fleisher and Bensoussan (2003), indicate that ‘the source of competitive advantage within a firm is often multifactorial in that it usually cannot be attributed
to only one type of resource’. They suggest that it is the interaction between the different types of resources that drive a firm’s competitive advantage. Competitiveness has been described many by researchers as a multidimensional and relative concept. The significance of different criteria of competitiveness changes with time and context. Theories and frameworks must be flexible enough to integrate the change with key strategic management processes if their utility is sustained in practice.

The concept of core financial competence is extended from core competitiveness. The core competitiveness refers to the ability of an enterprise to develop unique products, technologies and unique marketing methods. It’s a collection of techniques, experience and knowledge which can help maintain a company’s competitiveness under certain circumstances in the long run, and it is integration of core technology with managerial capabilities. Core competitiveness is a theory of enterprise development strategy, proposed by American scholar Pula Harrar, Germany and British scholar Hammer in the early 1990s. It concentrates on the intangible and dynamic ability resources based on market competition, and refers to the combination of technological and managerial systems which can bring competitive advantages to an enterprise. In essence, core competitiveness is a managerial concept that is characteristic of the future knowledge economy. As its subsystem, core financial competence has the similar nature. There isn’t an acknowledged definition as to core financial competence at present. But there are many related studies. Core financial competence refers to a series of exclusive, outstanding, and dynamic financial management competitiveness with knowledge and innovation as its nucleus, and it is rooted in the financial management system project.

Zhenmin Liu and Shunze Wei (2006), core financial competitiveness is a sort of integrated competitiveness based on core competitiveness and crystallized by effective financial capabilities. Penetrating through the business finance ability, it is the comprehensive financial capability that enhances a company’s core competitiveness, maintains its competitive advantage and achieves stable
development in the long term. Zhenyu Jin (2008), core financial competence is a combination of knowledge and skills of the financial department. It enables a business to work financially better than others and ensures a normal and effective operation and it is an indispensable force that maintains a company’s competitive advantage. Huimin Liu and Songke Guo (2011) summarized that although there isn’t a clear definition of core financial competence, at last all researches hold that core financial competence is a kind of strategic financial competitiveness aimed to add value to the company. That is to say, core financial competence is unique, implicit comprehensive, and holistic, and dynamic in development and grows by knowledge accumulation. In their research they studied the present situation of core financial Competence of SMEs in guangdong province of china and the result of the research on core financial competence of SMEs shows following factors i.e. Non existence of implicit financial strategy, Lack of Financial Resources and unreasonable financial structure.

2.4 Research Gap

This systematic literature review carried out to identify and interpret emergent concepts, trends and gaps in a large sample of small and medium enterprise growth, their performance measurement, financial management practices and SME’s financial competitiveness literature. The review draws conclusions that, there is the diversity in theories associated with SME growth and its performance measurement. The main theories found in the literature could be broadly classified as either theories of firm or resource based theory. Literature finding shows that none of the theories individually explains the complexities of SME growth and performance adequately (Smallbone et al, 1995). Most of the studies uses combine these theories in designing their research models, rather than relying on a single one. Large studies considered the growth and profitability of SMEs’ as a dependent variables and measure with multiple dimensions. But few studies found on how financial management practices and financial measures effect the firm’s growth and financial competitiveness. Literature review also found that that there is little research
devoted to competitiveness issues in SMEs especially in the context of financial competitiveness, which is true in India also. Most studies are limited to large organizations in financial aspects e.g. Benchmarking and Business Plan, Balance Score Card (Gregory 1993, Neely et al. 1994; Kaplan et al. 1996). SME measurements based on project models: Resource Based View (RBV), Cluster, Total Quality Management (TQM), (Biazzo et al. 2012, Hudson, 2001, Darcy et al. 2014). But very little empirical evidence is available that studies the small and medium enterprises with context of financial performance measurement and its impact on the SMEs’ financial competitiveness. SMEs have less market power and limited resources to develop competitive advantage (Connor, 2002). According to RBT, the resources required for the development of competitive advantage comprise bundles of both physical and intangible resources, of which the latter has the greatest strategic potential (Ray et al. 2004; Barney, 1991). Empirical research confirms that SMEs could develop competitive advantage and enhance their survival by relying heavily on leveraging superior financial practices and resources (Coleman et al. 2013).

Most previous studies largely have concentrated on examining, investigating and describing the behavior of SMEs in practicing financial management. Five specific areas of financial management practices including accounting information systems, financial reporting and analysis, working capital management (including cash management, receivables management, inventory management and payables management), fixed asset management and capital structure management have long attracted the attention of researchers (McMahon et al. 1993). But it appears that there still are some gaps in the literature in the context of SMEs financial competitiveness and its impact on overall performance of SMEs, which need to be addressed. Firstly, most previous researchers focus on investigating and describing financial management practices whereas there has been little research examining the impact of financial management practices on SME competitiveness and its profitability. Secondly, there is very little literature evidence on, which examines
the relationship or the impact of three variables: liquidity, financial leverage, and activity on competitiveness variable. Therefore, this study will extend previous studies by focusing on examining the simultaneous impacts of financial management practices and financial characteristics on SME competitiveness and performance using the empirical evidence. Last, this study also contributes more broadly to the SME growth and financial performance of SMEs specifically acting in the manufacturing sector.
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