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The Influence of Finance on Performance of Small and Medium Enterprises (SMES)

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Abstract*— *The debate, on which finance affect company performance, has been a controversial issue in accounting and finance. This study was undertaken to highlight the issues facing small and medium enterprises (SMEs) in Iraq in their quest to accessing finance to undertake various activities; be it general business operations or carrying out expansion project all in the name of fulfilling the objectives as being job creators and helping to reduce poverty. There are financial institutions that are willing to provide funds to small and medium enterprises (SMEs) but Iraq small and medium enterprises (SMEs) are not able to meet the requirements of these financial institutions. Chief among these requirements is the issue of collateral, which most small and medium enterprises (SMEs) cannot provide. This study contributes to the literature on finance of companies and performance of small and medium enterprises (SMEs) by testing the relationship between the finance and the performance of small and medium enterprises (SMEs), and by providing new insights about the need for promoting a truly cognitive entrepreneur.

Key words: **Finance, Small and medium enterprises (SMEs), Performance.**

I. INTRODUCTION

Small and medium enterprises (SMEs) are very important for employment creation and are important sources of economic growth (Tambunan, 2005). It is therefore not a surprise that small and medium enterprises (SMEs) receive ample attention in Iraq. Early review indicates that Iraq small and medium enterprises (SMEs) account for more than 99 per cent of total companies in the country. The evidence suggests that small and medium enterprises (SMEs) play a vital role in the nation's economy and wellbeing. The largest concentration of small and medium enterprises (SMEs), in terms of numbers, can be found in the textile and apparel sector, followed by food and beverages, metals and metal products, and wood and wood products (Harash et al. 2013; Harash et al. 2014).The promotion of small and medium enterprises (SMEs) is regarded as an important issue in many countries, including Iraq (Harash et al. 2013; Harash et al. 2014), because It plays considerable responsibility in providing further employment and conversion of economy. It is also implicit that sectors conquered by small and medium enterprises (SMEs) are better able to develop dynamic economies of scale (Jasra et al. 2011). The roles of small and medium enterprises (SMEs) in the creation of productive employment are concerned with its position in the center of the range of sizes and resources intensities in a rising economy. Developing economies have started to focus on the crucial role that small and medium enterprises (SMEs) can play in their development (Maad, 2008). Due to the importance of small and medium enterprises (SMEs) in relation to the economic development in a country, studies linked to this field are extremely important to enable researchers and stakeholders to improve their knowledge and expertise in the management of small and medium enterprises (SMEs) (Harash et al. 2013; Harash et al. 2014). In today's increasingly globalized economy, Small and medium enterprises (SMEs) are usually feeder industries for larger industries and they are crucial for economic growth and development (Kongolo, 2010). Small and medium enterprises (SMEs) are now considered to be the major source of dynamism, innovation and flexibility in emerging and developing countries, as well as to the economies of most nations. They contribute substantially to economic development and employment generation (Koh et al., 2007). Small and medium enterprises (SMEs) form as a potential economic back-bone of many regions and make a large contribution to employment than large companies (Chin et al. 2012). But, although they play a crucial role in economic growth and employment the small and medium enterprises (SMEs) in developing countries face a financing gap (Beck & Demirguc-Kunt, 2006; Dube, 2013) related to difficulties in small and medium enterprises (SMEs) access to finance that undermines economic prosperity small and medium enterprises (SMEs) are a fundamental part of the economic fabric in developing countries, and they play a crucial role in furthering growth, innovation and prosperity. Finance is probably among the greatest hindrances to small and medium enterprises (SMEs) in improving financial performance and competitiveness in Iraq. Consequently, improving a business and implementing policy were essential aspects for small and medium enterprises (SMEs) development and finance have been found to be limitation for local and international competitiveness (Beck & Demirguc-Kunt, 2006; Mohd Shariff et al. 2010; Mohd Shariff & Peou, 2008). Unfortunately, they are strongly restricted in accessing the capital that they require to grow and expand, with nearly half of small and medium enterprises (SMEs) in developing countries rating access to finance as a major constraint. It has been reported that the main challenges affecting small and medium enterprises (SMEs) in Iraq include lack of knowledge of small and medium enterprises (SMEs), access to bank credit (the ranking for Iraq in ease of getting credit was 168 out of 181 countries), access to markets, appropriate

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technology, low production capacity and lack of interest (Harash et al. 2014; Harash et al. 2013; USAID, 2010). The lack of empirical studies on Iraq finance, particularly on performance of small and medium enterprises (SMEs), has been a major constraint ahead of conducting problem-solving studies. Most of the studies involving small and medium enterprises (SMEs) were merely describing the inadequacies in finance without providing empirical data (Harash et al. 2013; Harash et al. 2014; USAID, 2010). In summary, the problem statement of the research can be stated as follows: The Challenges faced by small and medium enterprises (SMEs) in obtaining finance in Iraq, There are financial institutions that are willing to provide funds to small and medium enterprises (SMEs) but Iraq small and medium enterprises (SMEs) are not able to meet the requirements of these financial institutions. Chief among these requirements is the issue of collateral, which most small and medium enterprises (SMEs) cannot provide. Iraq lacks systematic and empirical researches about the effect of finance on performance of small and medium enterprises (SMEs). The extent that finance has an impact on performance of small and medium enterprises (SMEs) needs to be ascertained to enhance the performance of small and medium enterprises (SMEs). Hence, there is a need to determine the relationship between finance and the performance of small and medium enterprises (SMEs). This study will attempt to examine the influence of finance variable on the performances of small and medium enterprises (SMEs). More specifically, this study aims to shed some light on what finance actually means and investigate the finance affecting the performance of small and medium enterprises (SMEs) in the Iraq. The Contingency Theory developed by Fiedler (1964) was used to support this study.

II. FINANCE

Small and medium enterprises (SMEs) are a policy priority for many countries, given their significance in terms of it play a key role in economic development and make an important contribution to employment (Harash et al. 2013; Harash et al. 2014). Financial access is critical for Small and medium enterprises (SMEs) growth and development, and the availability of external finance is positively associated with productivity and growth. However, access to financial services remains a key constraint to SME growth and development, especially in emerging economies (GFPI, 2011). Finance: Of all the areas in the business environment, improved access to finance has clear benefits to companies of all sizes (Hallward-Driemeier & Aterido, 2007). One of the principal conclusions of modern economics is that finance is good for improving performance (Cecchetti & Kharroubi, 2012) of small and medium enterprises (SMEs) (Beck & Demirguc-Kunt, 2006; Mohd Shariff et al. 2010; Mohd Shariff & Peou, 2008). The idea that an economy needs intermediation to match borrowers and lenders, channeling resources to their most efficient uses, is fundamental to our thinking (Cecchetti & Kharroubi, 2012). Studies have been to point to evidence supporting the view that financial development is good for improving performance of small and medium enterprises (SMEs). More recently, researchers were able to move beyond simple correlations and establish a convincing causal link running from finance to improving performance (Cecchetti & Kharroubi, 2012) of small and medium enterprises (SMEs). While there have been dissenting views, today it is accepted that finance is not simply a by-product of the development process, but an engine propelling improving performance of small and medium enterprises (SMEs)(Mohd Shariff et al. 2010; Mohd Shariff & Peou, 2008). This, in turn, was one of the key elements supporting arguments for financial deregulation. If finance is good for improving performance of small and medium enterprises (SMEs), shouldn't we be working to eliminate barriers to further financial development? Numerous SMEs have limited financial resources (LeCornu et al. 1996). The main sources of financing are the self-financing (internal resources), the debt and finally financial markets. The lack of financial resources can constitute a serious obstacle to SMEs development (Maurel, 2008). The lack of equity capital invested in SMEs makes these businesses more reliant on other sources such as bank lending and other types of financial products (Beck & Demirguc-Kunt, 2006; Mohd Shariff et al. 2010; Mohd Shariff & Peou, 2008). Academic and policy studies of small and medium enterprises (SMEs) resourcing typically focus on finance (LeCornu et al. 1996; Maurel, 2008; Mohd Shariff et al. 2010; Mohd Shariff & Peou, 2008). The Earlier researchers shows Beck & Demirguc-Kunt (2006), Beck et al. (2004) Mohd Shariff et al. 2010; Mohd Shariff & Peou, 2008; and World Bank reports (2010) in a research on the factors that influence the survival and performance of SMEs finds that business performance is strongly influenced by access to finance. Therefore, enterprises that have access to debt finance should perform better than those without access to finance. A researchs by LeCornu et al. (1996), Maurel (2008), Mohd Shariff et al. (2010), Mohd Shariff & Peou (2008) indicated that Finance is defined as a legal contract where one party receives resource or wealth from another party and promises to repay him on a future date along with interest. Previous literatures also finance refers to the situation where by small and medium enterprises (SMEs) owners need financing which may be derived from several sources to support in the maintenance and progress of their businesses. Finance may also come from the total amount of money that owners invested in their businesses in small and medium enterprises (SMEs) (Beck & Demirguc-Kunt, 2006; Beck et al. 2004; Maurel, 2008). Finance was one of the major factors related to the performance of small and medium enterprises (SMEs) (Kristiansen et al. 2003; Mohd Shariff et al. 2010; Mohd Shariff & Peou, 2008 and Swierczek & Ha, 2003). On the whole, based on the findings of earlier research, this study assumes that finance includes the financial resources of small

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and medium enterprises (SMEs) owners and the total capital invested into their businesses. In the study the Finance will be measured using a number of dimensions such as Capital sources, Cash in hand, Additional capital, Find loan, financial institution requirements; Banks require collateral & interest, and financial institution. All items will be adopted from the previous studies (Mohd Shariff et al. 2010; Mohd Shariff & Peou, 2008).

III. PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES (SMES)

Much has been written about performance in recent years as the relationship between finance and performance of small and medium enterprises (SMEs) has received considerable attention in finance literature. Researchers have chosen different approaches for the exploration of this issue. In the previous studies, the effects of finance have analyzed on performance of small and medium enterprises (SMEs) by financially and non-financially. The literature on the concept of performance is extensive and the selection of references and the disposition have been made so that the broad spectrum of differences as well as similarities between different meanings will be as clear as possible (Palm, 2008). Early review indicates that defining performance of small and medium enterprises (SMEs) is a challenge across the world. performance of small and medium enterprises (SMEs) have been defined in various ways in the literature, and in any business, the related parties always want to see good performance in their business (Harash et al. 2014; Harash et al. 2013). Researchers in this stream of the performance literature, a wide variety of definitions of company performance have been proposed in literature (Ajanthan et al. 2013; Korir & Imbaya, 2013, Uadiale & Fagbemi, 2012). literatures (Anderson and Reeb, 2003; Ittner & Larcker, 2003; Juhl et al. 2002; Petersen & Schoeman, 2008; Sabancı Özer, 2012; Sacristán-Navarro et al. 2011; Selvarajan et al. 2007; Thrikawala, 2011; Watson, 2007) defines performance as a measure of how well a company can use its assets from its primary mode of business and generate revenues. On the other hand, in the modern literature defines performance as the results of the activities of a company or investment over a given period. Performance can also be defined as the accomplishment of specified business objectives measured against known standards, completeness and cost (Davis & Cobb, 2010; Sabancı Özer, 2012; Sacristán-Navarro et al. 2011; Thrikawala, 2011). According to March & Sutton (1997) Performance is so common in research about small and medium enterprises (SMEs) management that its structure and definition is rarely explicitly justified; instead its appropriateness, in no matter what form, is unquestionably assumed. However, the Performance can also be defined as the accomplishment of specified business objectives measured against known standards, completeness and cost (Davis & Cobb, 2010; Sabancı Özer, 2012; Sacristán-Navarro et al. 2011; Thrikawala, 2011). The performance is the result of strategies the company employs to achieve market-oriented and financial goals (Harash et al. 2014; Harash et al. 2013). The level of success of a company within the small and medium enterprises (SMEs) sector is measured through its performance based on a selected period of time. In business studies, the concept of success is sometimes used to refer to a company's performance (Islam et al. 2011). Given that small and medium enterprises (SMEs) often play a significant role in improving the economy of a country and leads to economy development globally, this puts performance as one of the key issues for small and medium enterprises (SMEs) where management is concerned. Usually a company's performance is seen from the extent it manages to achieve its purposes and goals (Harash et al. 2014; Harash et al. 2013). The performance is the result of strategies the company employs to achieve market-oriented and financial goals (Day, 1994; Harash et al. 2014; Kaplan, 2001; Kaplan & Norton, 1998). The level of success of a company within the small and medium enterprises (SMEs) sector is measured through its performance based on a selected period of time. In business studies, the concept of success is sometimes used to refer to a company's performance (Islam et al. 2011). Given that small and medium enterprises (SMEs) often play a significant role in improving the economy of a country and leads to economy development globally, this puts performance as one of the key issues for small and medium enterprises (SMEs) where management is concerned. Usually a company's performance is seen from the extent it manages to achieve its purposes and goals (Harash et al. 2014; Harash et al. 2013). Earlier researchers have attempted to provide a clear definition of performance, but they had yet to come to an agreement over a common definition, particularly regarding some aspects of terminology issues, analytical levels, and the conceptual basis for assessment (Harash et al. 2014). Performance of a company can be defined in various ways depending on the questions in mind when we inquire about a company's performance (Daft et al. 1988; Kahn, 1996). The findings of many studies have not managed to provide a common definition to indicate or ascertain performance (Harash et al. 2014). Based on the findings of earlier research, performance encompasses three specific areas of company outcomes: (i) financial performance (profits, return on assets, return on investment, etc.); (ii) market performance (sales, market share, etc.); and (iii) shareholder return (total shareholder return, economic value added, etc.) (Griffin & Mahon, 1997; Richard et al. 2009). Small and medium enterprises (SMEs) performance may be measured using objective, subjective, or operational measures. According to Previous studies Ittner & Larcker (2003), Juhl et al. (2002), Petersen & Schoeman, (2008) and Selvarajan et al. (2007), the study suggest the goal approach as a composite measure of SME performance. The goal approach measures performance using financial (objective) and non-financial measures (subjective) measures (Dowling & Helm, 2006; Thrikawala, 2011; Watson, 2007). According to these literatures financial measures of performance can be referred to as the results of a company's operations in monetary terms. Financial measures of performance are derived from the accounts of a company or can be found in the company's profit and loss statement or the balance sheet. In addition, financial measures are also referred to as objective measures because they can be individually measured and verified. However, it is essential to introduce non-financial measures of performance in conjunction with financial measures in order to fully measure performance (Ittner & Larcker, 2003; Juhl et al. 2002; Petersen & Schoeman, 2008; Selvarajan et al. 2007). The non-financial measures are also known as the subjective performance measures of performance (Petersen & Schoeman, 2008). Non-financial measures are measures not found in charts of accounts of a company (Ittner & Larcker, 2003; Selvarajan et al. 2007). The use of non-financial measures of performance supplements accounting measures and gives data on progress relative to customer requirements or competitors and other non-financial objectives that may be important in achieving profitability (Henri, 2004; Ittner & Larcker, 2003; Juhl et al. 2002; Kaplan, 2001; Selvarajan et al. 2007). In the modern literature, the level of success of a company within the SMEs sector is measured through its financial performance based on a selected period of time (Harash et al. 2014). In business studies, the concept of success is sometimes used to refer to a company's financial performance (Islam et al. 2011). Researchers have utilized measures financial and non-financial, as the most important this measures in the measurement of small and medium enterprises (SMEs) performance (Chong, 2008). The study suggests that no one measure of performance should be taken on its own and to obtain a true measure of how a company is performing, different measures (financial and non-financial) should be used together on the basis of previous studies (Anderson & Reeb, 2003; Bhagat & Bolton, 2008; Davis & Cobb, 2010; Dowling & Helm, 2006; Ittner & Larcker, 2003; Juhl et al. 2002; Petersen & Schoeman, 2008; Sacristán-Navarro et al. 2011; Selvarajan et al. 2007; Thrikawala, 2011; Watson, 2007). Therefore, in this study Performance measuring small and medium enterprises (SMEs) is measured by financial measures (Return on Assets (ROA), Return on Equity (ROE), Sales growth, and Profitability growth) and non-financial measures (Employee growth, Customer satisfaction, Satisfaction with performance compared to competitors, and Overall satisfaction) items as profitably applied to area of major concern to the measuring small and medium enterprises (SMEs), is widely used by one or more users, and improves the quality of their performance.

IV. CONTINGENCY FRAMEWORK

This study attempts to shed light on the issues of small and medium enterprises (SMEs) in the Iraq. The conceptual framework of this study below shows the relationship between the variables under study. The independent variable is the finance and the dependent variable is the performance small and medium enterprises (SMEs). The model describes the effective mechanism of finance on performance small and medium enterprises (SMEs). It shows how the dimensions of finance impact the aspects of performance small and medium enterprises (SMEs). The following sections present the detailed proposition related to these relationships. Many researches stress the importance of the finance to improve performance small and medium enterprises (SMEs) and sustainable competitive advantage for small and medium enterprises (SMEs) (Beck & Demirguc-Kunt, 2006; Beck et al. 2004; LeCornu et al. 1996; Maurel, 2008; Mohd Shariff et al. 2010; Mohd Shariff & Peou, 2008; World Bank reports, 2010). In Figure 1, the conceptual model proposes how finance impacts on performance small and medium enterprises (SMEs). In order to exam the proposed relationships between finance and performance small and medium enterprises (SMEs), a number of testable hypotheses will be highlighted in this stage of the study. These include:

The performance small and medium enterprises (SMEs) will vary with the choices of finance adopted.

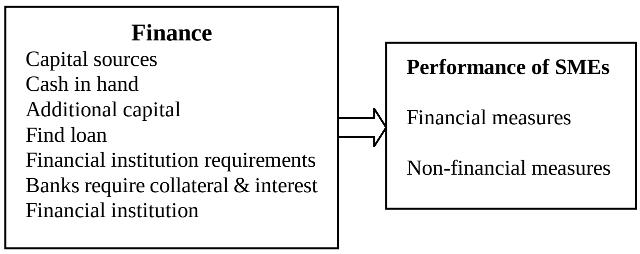

Fig 1. Proposed theoretical framework

V. CONCLUSION

The study tries to deal with issues of performance pertaining to small and medium enterprises (SMEs). Based on the review of this study, the performance of these firms lead to some critical issues and many studies dealt with the subject matter from many different angles. The current research discusses one of the important issues: the status and conditions of financial performance of small and medium enterprises (SMEs) in Iraq. Also, the study specifically refers to the finance that affects the financial performance of SMEs in Iraq. Based on studies access to finance is a particular problem for small and medium enterprises (SMEs), Small companies tend to have much higher rates of job growth but also are more likely to go out of business or remain stunted due to institutional and financial constraints. The value of the SMEs sector is recognized in economies world-wide, irrespective of the economy's developmental stage. The contribution towards growth, job creation and social progress

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is valued highly and SMEs is regarded as an essential element in a successful formula for achieving economic growth.

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