

**Access to Finance by Saudi SMEs: Constraints and the
Impact on their Performance**

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ABSTRACT

Access to finance is one of the biggest obstacles facing the development of small and medium enterprises (SMEs) all over the world. The literature shows that growth and development of the SME sector is strongly linked with sustainable access to financial resources. Although a few studies have attempted to examine this relationship in Saudi Arabia, there remain knowledge gaps with respect to the relationship between the development of SME and obtaining funds from financial institutions. In order to fill this gap, this study aims to assess factors that affect access to finance from Saudi banks by SMEs in Saudi Arabia and to identify the obstacles that affect Saudi SME performance.

The first objective of this thesis is to identify the types of finance available to SMEs in Saudi Arabia by identifying internal and external sources of capital. The study tested hypotheses on the relationship between certain characteristics of owners/managers and their businesses, and their need to finance, together with the difficulties they face in accessing finance from Saudi banks. The study also identified current financial products and services provided to SMEs, as well as the loans policies and conditions of Saudi banks and other financial institutions with regard to SMEs.

The primary data in this study were gathered via questionnaire responses from 270 SMEs in Saudi Arabia, and interviews with five Saudi banks and four government and private sector funding agencies. These data were analysed using the following methods: descriptive analyses, chi-square tests, *t*-tests, correlation tests and analysis of variance and then used to address the hypotheses and to meet the objectives of the study.

The research found that there are some significant relationships between owners/managers characteristics (like education & training, and experience) and firms' characteristics (like business size, business ownership type, availability of business plan, and financial ratios), and the difficulties faced in accessing bank credit, as well as the need to obtain funds from Saudi banks. It was found also that the main reasons for most owners/managers failing to obtain finance from Saudi banks were lack of collateral, poor financial performance, infeasible business plans, incomplete information and projects not qualifying for the Kafalah programme. The study found also that difficulties most Saudi entrepreneurs faced when they applied for loans from Saudi banks included high collateral requirements, high interest rates, long time-

lags to receive insufficient finance, and rather challenging loan criteria and application conditions. This indicates the need to improve the availability of credit conditions that offered to SMEs by Saudi banks in order to enhance their access to banks' credit. The findings of the study also demonstrate internal and external obstacles such as availability of capital, competition, customer satisfaction and marketing as the most significant obstacles affecting business performance.

In concluding the thesis, the implications of the findings of this research for entrepreneurs, banks, academics and government are discussed. This study makes some recommendations in order to develop the SME sector in Saudi Arabia, and promote access to finance from banks through establishing a trusting relationship between SMEs and banks. Finally, suggestions are made for future useful research in this area.

DECLARATION OF ORIGINALITY

I certify that this thesis does not incorporate without acknowledgement any material previously submitted for a degree or diploma in any university; and that to the best of my knowledge and belief it does not contain any material previously published or written by another person except where due reference is made in the text.

Signed: _____ On: ____/____/____

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LIST OF ABBREVIATIONS

ADF	Agricultural Development Fund
ANOVA	Analysis of Variance
BRJ	Bab Rizq Jameel
CDR	Corporate Documents Repository
CF	Centennial Fund
CMA	Capital Market Authority
EFA	Exploratory Factor Analysis
EU	European Union
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GSCI	Government Specialized Credit Institutions
HRDF	Human Resources Development Fund
IFC	International Finance Corporation
IMF	International Monetary Fund
MCI	Ministry of Commerce and Industry
ME	Micro-Enterprises
MENA	Middle East and North Africa
MSME	micro, small and medium-sized enterprises
MUIS	Majlis Ugama Islam Singapura
NPA	non-performing assets
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PCA	Principal Components Analysis
PFA	Principal Factor Analysis
PIF	Public Investment Fund
POT	pecking order theory
REDF	Real Estate Development Fund
ROE	return on equity
ROI	return on investment
SAGIA	Saudi Arabian General Investment Authority
SAMA	Saudi Arabian Monetary Agency
SBA	Small Business Administration
SCCI	Saudi Chamber of Commerce and Industry
SCSB	Saudi Credit and Savings Bank
SCTA	Saudi Commission for Tourism and Antiquities
SFD	Saudi Fund for Development
SIDF	Saudi Industrial Development Fund
SMCI	Saudi Ministry of Commerce and Industry
SME	Small and medium enterprise
SPSS	Statistical Package for the Social Sciences
SR	Saudi Riyal
UAE	United Arab Emirates
US	United States
VC	Venture Capital

CHAPTER 1: INTRODUCTION

1.1 INTRODUCTION

The Small and Medium Enterprise (SME) sector has received increased global attention due to its growing importance in terms of income generation, labour absorption, poverty alleviation and contribution to Gross Domestic Product (GDP) (Aremu & Adeyemi 2011; Kayanula & Quartey 2000; Muhammad et al. 2010; Subhan et al. 2013). Consequently, developed economies have begun to direct more attention to SMEs to ensure that they are provided with an appropriate environment for growth (Foreman-Peck et al. 2006; Smallbone et al. 2001). In Saudi Arabia, the SME sector plays an important role in the economy and could potentially enable the Saudi government to reduce its reliance on the oil industry and a depletable source of income that is expected to decline within a few decades (Porter 2008; Sivakumar & Sarkar 2012). It is questionable whether the SME sector could reduce the massive dependence on oil industry in Saudi Arabia, however the research (referred to above) provides a strong argument in support of this claim.

Recognising the importance of the SME sector, the Saudi government has implemented several policies to support SMEs as part of its efforts to diversify its economy and in an attempt to reduce Saudi Arabia's dependence on oil (Jaber 2009). Additionally, the Saudi government has established six institutions to finance SME projects and launched a number of programmes that offer technical and training support aimed at improving the performance of owners and managers in this sector. Further, the Saudi government has established the Kafalah programme to encourage Saudi banks to finance SMEs. Under this scheme, the Saudi government guarantees the repayment of loans made from various financial bodies to certain types of business (Hasbani & Kingsley 2011). This programme effectively removes the risk of default for lenders and was primarily established to promote economic growth by encouraging local banks to finance SMEs (Saudi Industrial Development Fund (SIDF) 2012).

Despite the Saudi government's efforts to enhance and support the bankability of SMEs, these enterprises still struggle to obtain finance in Saudi Arabia and remain un-served or under-served by banks (Rocha et al. 2011a). Given the nature and size of these businesses, banks and other financial institutions are often reluctant to lend them money (Coleman 2004). Indeed, it has been shown that SMEs often have difficulties obtaining finance due to the characteristics of the businesses and the owners or managers (Al-Kharusi 2003; Debo 2006; Sarapaivanich 2006). Research has suggested that the structural characteristics of SMEs, and an inadequate number of financial providers in the capital market, are the primary reasons that SMEs have difficulties accessing capital (Park et al. 2008). According to a study by the International Finance Corporation (IFC), there are 365 to 445 million enterprises in emerging markets and approximately 85 per cent of these enterprises suffer from credit constraints. Further, these enterprises require between US\$ 2.1–2.5 trillion in funding to meet their financial needs (Dwabh 2006). Presently, there are between 9 and 11 million (formal and informal) Micro, Small and Medium-Sized Enterprises (MSMEs) in the Middle East and North Africa region (MENA) countries and almost 1.8 million SMEs in Saudi Arabia alone.

A lack of access to credit can prevent (and in some instances cripple) entrepreneurs from achieving sustainable growth and seizing lucrative opportunities. A number of researchers have contended that if external sources of finance were more readily available and easily accessible, SMEs would increase their success through business development and expansion (Ganbold 2008).

1.2 STATEMENT OF THE PROBLEM

SMEs are considered as a major source of income for the Saudi economy. However, despite the importance of SMEs to the economy and the government's effort to make these SMEs viable, a number of significant obstacles continue to prevent sustainable growth and development in this sector. Many SMEs have limited access to adequate capital and thus may have difficulties meeting financial demands, especially during their development stages and, consequently, perform poorly. This difficulty arises because many SMEs have weak financial bases, no credit ratings and poor business structures. Banks are often reluctant to lend money to SMEs as these enterprises lack the necessary credit information required to measure financial

solvency, default risk and ascertain the nature and size of the business (Coleman 1998; Lund & Wright 1999). Due to the level of risk involved in lending money to SMEs, the interest rates for loans from banks are high (Ramady 2010). Presently, financial institutions in Saudi Arabia are reluctant to offer loans to SME due to the high levels of risk and transaction costs involved (Abalkhail 1999).

An absence of financial programmes and support services for SMEs from banks in Saudi Arabia has shortened the longevity of SMEs. According to the Financial Access and Stability Review (World Bank 2011), the total unmet demand for loans by SMEs in emerging markets ranged from US\$ 2.1–2.5 trillion. Further, in 2010, the proportion of loans from commercial banks to SMEs in the Gulf Cooperation Council (GCC) states did not exceed two per cent and in Saudi Arabia, did not exceed 1.5 per cent (Rocha et al. 2011a). This large credit gap represents both a challenge and opportunity for financial institutions, including banks and governments.

To date, few academic studies have examined the relationship between access to finance and the performance of SMEs in Saudi Arabia. Thus, this study focuses on the problems faced by the SME sector in relation to obtaining finance from Saudi banks. It also examines the internal and external business obstacles affecting the performance of SMEs and seeks to develop appropriate remedies to address these issues.

1.3 OBJECTIVES OF THE STUDY

In light of the problems outlined above, the following aims (relating to the research questions discussed below in Section 1.4) were formulated:

1. Identify the problems faced by SMEs in Saudi Arabia when seeking finance from Saudi banks.

The literature has identified many reasons for SMEs' lack of access to finance in developing countries. However, the present study seeks to identify the specific obstacles faced by Saudi SMEs when seeking finance from Saudi financial institutions.

2. Determine the effect the business environment factors and a lack of access to finance have on the performance of Saudi SMEs.

This objective analyses the impact of difficulties of obtaining finance and the obstacles factors in the business environment that SMEs faced on their businesses performance. Such information will assist in the identification of critical factors and shed light on how any challenges can be addressed and where there is a need for improvement.

3. Identify internal and external sources of finance for Saudi SMEs.

This objective seeks to identify any alternative sources of finance available to SMEs in Saudi Arabia at the different stages of their life cycle, including internal and external sources, in order to identify the optimal capital structure.

4. Identify the current financial products and financial regulations of Saudi banks in relation to financing SMEs and review the requirements and conditions for the provision of loans to SMEs.

This objective seeks to gain insight into the loan conditions and requirements of Saudi banks in relation to SMEs, determine the current funding terms and conditions offered by banks and ascertain if suitable financial products are presently available that meet the business needs of SMEs; as well as, to identify the factors that preventing Saudi SMEs from obtaining finance from Saudi banks.

5. Identify any other appropriate Islamic financial products being offered by Saudi banks to finance SMEs that are currently available in the market and accord with *Sharia* (i.e., Islamic Law).

This objective considers alternative suitable Islamic financial products (not currently offered by Saudi banks) that could meet the financial need of SMEs.

The study contributes to the literature by considering the viable and sustainable forms of finance available to SMEs in Saudi Arabia. The results of the study will increase Saudi entrepreneurs' understanding of the steps they need to undertake to improve their chances of securing and obtaining bank loans to grow and maintain their businesses. Further, the study will enhance entrepreneurs' awareness of the appropriate Islamic financial products available. The study also offers some useful suggestions that SMEs could adopt to improve their chances of obtaining finance from Saudi banks.

1.4 RESEARCH QUESTIONS

To ensure the objectives of the research are achieved, the following questions were formulated to direct the research:

1. Do Saudi SMEs have problems meeting their financial obligations from Saudi banks? (Aim 1).
2. What are the obstacles that SMEs have when obtaining funds from Saudi banks? (Aim 1).
3. How does an inability to obtain financing from Saudi banks affect the performance of SMEs? (Aim 2).
4. What are the current internal and external obstacles affecting the performance of Saudi SMEs? (Aim 2).
5. What factors have a significant effect on Saudi SMEs accessing finance from Saudi banks? (Aim 2).
6. What internal and external sources of finance are presently available for Saudi SMEs? (Aim 3). What products and services do Saudi financial institutions offer to their SME clients? (Aim 4).
7. What are the credit policies, procedures and loan requirements of Saudi banks and other financial institutions in relation to financing SMEs? (Aim 4).
8. Do these products and services meet the requirements of Saudi SMEs? (Aim 4).
9. Have any financial institutions customised their services to meet the special needs of SMEs? (Aim 4).
10. What are the current Islamic financial products provided by Saudi banks? (Aim 5).
11. What other appropriate Islamic financial products could be provided by Saudi banks to finance SMEs? (Aim 5).

1.5 SIGNIFICANCE OF THE STUDY

The proposed research focuses on an important sector of the Saudi economy. Its purpose is to determine the funding needs of SMEs and identify the internal and external obstacles faced by SMEs in relation to financing their operations, with the aim of proposing remedies. Given the

expected decline in the importance of the crude oil industry, Saudi Arabia's economy needs diversify and strengthen its alternative sectors. Thus, this research is particularly significant as it addresses a gap in the literature in relation to a Saudi sector that is becoming increasingly important to the national economy.

1.6 CONTRIBUTION TO KNOWLEDGE

This research addresses gaps in literature in relation to the financing of SMEs in Saudi Arabia and the factors affecting the access of SMEs to institutional credit. Presently, little is known about the financial status of SMEs', including SMEs access to finance in Saudi Arabia. As evidenced by the literature, the Saudi government has expressed concerns about its dependence on the oil industry and, accordingly, begun to pursue strategies and policies to diversify the Saudi economy. Many studies (Sadi 2009, Ramady 2010, Shediak et al. 2008, Ramady 2010, Alghamedi 2014, Shalaby 2004, Alghamedi 2014, Albassam 2015) have shown that SMEs have the potential to form a significant part of the diversification process in Saudi Arabia. It is well established that access to finance is an important dimension of business and is particularly important to SMEs (Grover & Suominen, 2014; Venkatesh & Lavanya Kumari, 2011, Al-Kharusi 2003; Beck & Demirgüç-Kunt 2006; Sarapaivanich 2006). However, as the majority of SMEs do not have access to finance via equity they are completely reliant upon debt. Currently, there is insufficient information on the difficulties faced by Saudi SMEs in the area of finance. This study will contribute to the literature by providing a systematic analysis of SMEs' access to finance and determining the obstacles faced by Saudi SMEs. Further, the results of this research will inform the development of policies aimed at improving the performance of SMEs.

1.7 SCOPE OF THE STUDY

The primary focus of this study is the SME sector of the Saudi economy, as the success of this sector is considered to be of vital importance in the achievement of long-term sustainable economic growth.

In this study, detailed surveys had been sent to 270 Saudi SMEs from three sectors (i.e., the trade, services and manufacturing sectors) located in the three major cities in Saudi Arabia (i.e., Riyadh, Jeddah and Dammam). Then, follow-up face-to-face interviews were conducted with nine financial providers (five Saudi banks and four government or private institutions).

1.8 RESEARCH METHODOLOGY OVERVIEW

Both quantitative and qualitative approaches were used to undertake the research. These approaches were the most appropriate tools to collect and analyse the primary data that was obtained in the study (i.e., the survey and interviews). The framework of this study incorporated theories relevant to the financing of SMEs, including the Pecking Order Theory (POT) and the information asymmetric theory. This study adapted and designed structured interview questions to collect data from five Saudi banks, the Kafalah programme, Saudi Credit and Savings Bank (SCSB) and two other private sector intuitions. These interviews were used to gather basic information on the constraints for financing SMEs in Saudi Arabia. The study used the data collected from the interviews with Saudi banks and other financial institutions to address objectives five to eight.

A survey was conducted with a sample of 270 members of Saudi SMEs from three different economic sectors (i.e., the trade, services and manufacturing sectors) located in three major cities in Saudi Arabia (i.e., Jeddah, Riyadh and Dammam). The Saudi Chamber of Commerce agreed to provide a list of its members. The survey in this research was designed for owners and managers of SMEs. Structurally, the survey consisted of three sections and was deigned to obtain information relevant to objectives one to four.

The collected data was analysed using the Statistical Package for the Social Sciences (SPSS). Descriptive and correlation analyses were undertaken to reduce the raw data into a summary format in the form of simple tabulation of frequency distributions through the calculation of averages, frequencies and percentages. Moreover, the study used chi-square tests to assess the significance of relationships among the difficulty in accessing finance from Saudi banks and the characteristics of entrepreneurs, enterprises and financial institutions. Finally, an Analysis

of Variance (ANOVA) was used to assess the significance of the variation among various internal and external business obstacles and the financial performances of businesses.

1.9 STRUCTURE OF THE THESIS

The thesis consists of eight chapters, whose content is briefly outlined below.

Chapter 1 highlights the objectives and problem of the study, the research questions, and significance of the study and scope, and gives an overview of the research methodology and hypotheses.

Chapter 2 provides an overview of SMEs in Saudi Arabia, their role and importance to the Saudi economy, the operational definition of SMEs, structure of the Saudi financial system, efforts by Saudi government agencies to support SMEs and obstacles faced by SMEs in Saudi Arabia.

Chapter 3 reviews the literature relevant to the objectives of the study, including the internal and external sources of finance for SMEs, SME constraints with respect to access to bank finance, bank policies and regulations, reasons for failure to obtain bank finance and factors influencing SME performance.

Chapter 4 focuses initially on the theoretical framework of the study related to financing SMEs; that is, the POT and the information asymmetry theory. This is followed by an examination of the conceptual framework relevant to the eight objectives of the study, which is designed to identify the finance obstacles that SMEs in Saudi Arabia face when accessing financial services provided by Saudi banks.

Chapter 5 discusses the research approach involving qualitative and quantitative methodology and provides a detailed description of the research design and techniques used.

Chapter 6 presents quantitative findings from preliminary analyses of the data gathered from the owners/managers of SMEs via questionnaires, using descriptive statistics such as

frequencies and percentages, followed by an assessment of the measurement model and the results of hypothesis testing.

Chapter 7 presents the results gathered from face-to-face and telephone interviews with key stakeholders in the Saudi finance sector.

Chapter 8 provides a summary of the study, then draws conclusions and offers recommendations based on the findings, for use by academics, banks and other financial institutions, and entrepreneurs.

CHAPTER 2: SMALL AND MEDIUM SIZED ENTERPRISES IN SAUDI ARABIA

2.1 INTRODUCTION

SMEs dominate the business sector of Saudi Arabia, as is the case with many other countries. However, their contribution to the national economy has remained low so far, despite its potential (Ramady 2010). In the context of continuously declining revenue from its traditional sources such as crude oil, the Saudi Arabian government may find funding even important economic developmental activities, increasingly difficult. Despite best promotional efforts, FDI inflow has been modest (Ramady 2010). Therefore, promotion of local investment is the best solution (Alshahrani & Alsadiq 2014). SMEs offer an attractive opportunity to convert the threat of funds deficiencies affecting economic growth. However, their contribution to the national economy has been quite low, even after implementing several policies and financial interventions to assist them (Alshahrani & Alsadiq 2014; Ramady 2010; Khatib 2012; Binzomah 2009).

As this study is concerned with financial constrains among SMEs in Saudi Arabia, it is essential to introduce the reader to the business environment within which these enterprises function. This chapter undertakes a review of the varied definitions and classifications of SMEs in detail in section 2.2. Discussing their role and importance in the growth and development of national economies follows in section 2.3 and 2.4. It also undertakes a brief review of the business environment in Saudi Arabia in section 2.5. Furthermore, the efforts and contribution of the Saudi government in supporting the sector of SMEs through its financial institution and non-financial support programs are described and discussed follows in section 2.6. The chapter then identifies the problems faced by SMEs in Saudi Arabia through pertinent studies published on the topic so far in section 2.7. From the various points discussed, a research/knowledge gap is identified. The perspectives of undertaking research on the identified gap are briefly mentioned in conclusion, to set the tone for the next chapter.

2.2 DEFINITION OF SMES

Definitions of SMEs vary across countries, depending on the capital invested, the number of employees, annual sales turnover, annual growth rate, the level of technology and the form of the business (Watson, 2010). Previously, researchers have applied two different standards (i.e., quantitative and qualitative criteria) to set appropriate operational definitions and create more contextually appropriate concepts of SMEs. According to the quantitative criteria, the definition of SMEs depends on the number of employees (the most commonly used criterion), the amount of capital investment, production volume, assets value and annual average sales. Conversely, qualitative criteria definitions of SMEs are based on major operating elements such as a business's form, management pattern and annual growth (Abdul Rasoul, 1998; Abu Sayed Ahmad, 2005; Campbell, 1976). Additionally, different countries have their own classifications of SMEs; thus, it is difficult to apply one definition across all countries (De Chiara and Minguzzi, 2002).

Stokes (1992) stated that to be considered a small enterprise, a business must meet three criteria:

1. Have a small market share in a local market;
2. Be managed personally by the owner of the business and not a management structure;
and
3. Be independent and not form part of a larger business.

According to Almahrowg and Mokabalah (2006), there are over 55 definitions for micro-enterprises and 75 definitions for SMEs. The World Bank defines any business with fewer than 50 employees as an SME. Many countries have adopted this standard to define SMEs. Conversely, countries such as the United States (US), France and Italy consider a business with up to 500 employees an SME (OECD 2006). While Sweden considers a business with up to 200 employees an SME and Canada and Australia consider a business with up to 99 employees an SME (Almahrowg & Mokabalah, 2006). In the United Kingdom (UK), business with 50 employees and a turnover less than 3.26 million UK pounds and business with 250 employees and a turnover less than 25.9 million UK pounds are considered small enterprises (SME statistics for the UK and Regions, 2009). Table 2.1 sets out definitions of SMEs for various countries and international organisations. Notably, the number of employees and sales turnover comprise the criteria most frequently used by many countries.

According to Al-Ghamri (1998), a business is usually defined as a small enterprise when it is owned and operated by one sole proprietor; however, the manager or/and owner of the business normally has only a small market share. The definition of SMEs also varies between developing and developed countries; for example, a large number of developing countries (e.g., Saudi Arabia, Egypt, Jordan, Yemen, Oman, Kuwait, Malaysia, Indonesia and Eastern Europe) set the lower limit for the number of employees at SMEs as not exceeding 100 (OECD 2006). Conversely, in relation to developed countries (e.g., the US, Japan and the European Union (EU)), the OECD set the upper limit for the number of employees at SMEs as between 200 and 250 (OECD 2006).

Some countries use a measure of capital or assets to define an SME; for example, in the US, an SME is defined as a business with less than US\$ 9 million in total assets (Hammer et al. 2010). While in the EU, a business is defined as an SME if it has less than USD \$10 million in total assets and in India, a business is defined as an SME if it has less than USD \$100,000 in total assets (Abu Sayed Ahmad 2005; EU 2009). In China, the definition of an SME depends on the major production capability of the industrial enterprise, specifically whether a business has less than 2,000 employees, an annual revenue below RMB 300 million per year and total assets of less than RMB 400 million (IFC 2012).

The World Bank SME Department (Ardic et al. 2011; Gibson & Vaart 2008) defines SMEs using the following indexes:

1. A small enterprise has up to 49 employees, total assets of up to \$3 million and total sales of up to \$3 million;
2. A medium enterprise has up to 300 employees, total assets of up to \$15 million and total annual sales of up to \$15 million (see Table 2.1).

Micro-projects/businesses in different fields of business are defined by a variety of criteria, including the value of assets, capital size, number of employees, sales turnover, and forms of project ownership. In Saudi Arabia, the criterion of number of employees is applied and any firm with up to five employees is defined as a micro-business.

According to the Gulf Organisation for Industrial Consulting (GOIC) (2008), Gulf Cooperation Council (GCC) countries use two main criteria to define a business as an SME: the number of employees and the capital investment. Under this definition, businesses with up to 30 employees and a capital investment of less than US\$2 million are classified as small business.

While businesses with no more than 60 employees and a capital investment of between US\$2 to \$6 million are defined as medium enterprises and businesses with more than 60 employees and a capital investment of more than US\$6 million are classified as large companies (GOIC 2008). In Kuwait, the Chamber of Commerce and Industry (KCCI) defines small enterprises as those up to 20 employees and between KD 150,000 (USD \$0.55 million) and KD 200,000 (USD \$0.73 million) in capital and medium size business as those up to 50 employees and up to KD 500,000 (USD \$1.8 million) in capital of (Koch, 2012). Conversely, the Central Bank of Jordan (CBJ) considers small enterprises as business with up to 30 employees and annual sales turnover less than JD 1 million (USD \$1.4 million) and medium size enterprises as business with up to 100 employees and sales turnover between JD 1 - 3 million (US\$ 1.5 million – 4 million) (Oxford 2016; CBJ 2016).

It is observed that there is a variation in the criteria used for defining SMEs in different countries and also the intercountry criteria. There are no global standards which drive the definition of SMEs. It can be speculated that the definitions of SMEs in different countries may be motivated by self-interests of certain stakeholders, the current and changing nature of the economy and business environment, the demographic profile of the country and the general scale of business undertaken in the country. The definition of the SMEs may be motivated by self-interest of certain stakeholder like the government as government incentives may be associated with how the SMEs are defined. The criteria used to define SMEs will impact the number of SMEs in the country and this may have an influence on the government expenditure and/or taxation. The current and changing nature of the economy and business environment may also have an impact of the criteria used to define SMEs in different countries. The nature of asset ownership and resource employment is constantly changing. In some countries there may be a trend where businesses are owning less assets due to leasing; and maybe choosing contracting out work more often rather than using regular employees (Al-Kharusi 2003; Dabo 2006).

The definition of the SMEs need to change to reflect such dynamic trends. For example, previously, an average SME might have owned \$2 million worth of assets, but currently figure might be lower due to less asset ownership (Clark et al. 2011). The definition of SMEs need to reflect this and evolve accordingly. Furthermore, sometimes the scale of business activity is different for countries based on their demographics and how business is generally done. For example, population-wise, USA is very large (population <300 million) compared to Australia (population > 20 million). This is difference is reflected in the criteria used for defining an SME in the USA and Australia. In USA, a firm with up to 1500 employees is considered an SME

where as in Australia this number is 200 (Hammer et al. 2010; Small Business Administration 2013; Clark et al. 2011). This may be reflecting the differences in the scale of business activity between the countries. Overall, there are numerous definitions of SMEs depending on the country or the institution look at. What is most important is to choose a definition of SME which is most relevant to the central theme of interest. In this research, the central theme is to look at the relationship between access to finance by SMEs and its impact on their performance. Therefore, it was chosen to go for a definition of SMEs which is most commonly used by the relevant stakeholders (i.e. banks, government) in this domain.

The criteria currently employed to define small and medium enterprises does not distinguish between the economic activities Saudi agencies engage in or the legal form business take when incorporating (e.g., partnerships, limited liability companies or proprietorships) (see Table 2.2); rather, it emphasises the number of employees and capital investment. Any SME definition in Saudi Arabia should adopt a common definition across each sector and be used as the standard for data collection, policy analysis and making and for the purposes of financial providers. Further, any definition would also need to be reconsidered from time to time according to economic developments and changes, in particular in relation to prices and productivity.

The current study used two criteria to define SMEs: the number of employees and the capital investment of the firm. Applying such criteria enables accurate comparisons to be made between enterprises that provide similar products and services (NLG, 2004). This study used the definitions of SMEs given by the Ministry of Finance, MCI, Saudi banks and the Kafalah programme (Saleh 2012; Zayani 2010; MCI and Kafalah 2013). Thus, this study only considered SMEs that had between six to 99 employees and adopted the following definitions:

- Small enterprises have between six to 59 employees, up to SR20 million (US\$5 million) capital invested and an annual sales turnover of up to SR5 million (US\$1.3 million);
- Medium enterprises have between 60 to 99 employees, between SR20 and 50 million (US\$5 to \$13 million) capital invested and an annual sales turnover of SR5 to 30 million (USD \$1.3 to \$8 million).

Table 2.1: SME Definitions used by Multilateral Institutions and Countries

Institutions and countries	Small enterprises			Medium enterprises		
	Maximum number of employees	Maximum revenue or turnover (US\$ million)	Maximum assets (US\$ million)	Maximum number of employees	Maximum revenue or turnover (US\$ million)	Maximum assets (US\$ million)
World Bank (Ardic et al. 2011; Gibson & Vaart 2008)	49	3	0.5	300	15	15
IFC (2012)	49	3	3	300	15	15
United States (Hammer et al. 2010; Small Business Administration 2013)	1,500	21	9	1,500	21	9
	*In the US, the size standards of businesses depend on the industry					
European Union (EU) (Abu Sayed Ahmad 2005; EU 2009)	50	10	10	250	50	40
Australia (Clark et al. 2011)	19	5	–	200	> 5	–
United Arab Emirates (UAE) (Kushnir 2010) trade	35	13	–	75	65	–
UAE (Kushnir 2010) services	100	7	–	250	40	–
UAE (Kushnir 2010) manufacturing	100	25	–	250	65	–
GOIC (2008)	30	–	2	60	–	6

Table 2.2: Definitions of SMEs by Different Agencies of the Saudi Arabia Council

Saudi organisations	Small enterprises			Medium enterprises		
	Maximum number of employees	Maximum revenue or turnover (US\$ million)	Maximum assets (US\$ million)	Maximum number of employees	Maximum revenue or turnover (US\$ million)	Maximum assets (US\$ million)
Council of Saudi Chambers	25	–	0.25	100	–	1.3
SAGIA	59	–	–	99	–	–
MCI	50	–	5.3	200	–	13
Saudi banks, Kafalah programme and Ministry of Finance	Any profiting organisation—either small or medium—with annual sales of no more than SR30 million (US\$8 million)					

Source: (Chambers, SAGIA, MCI and Kafalah 2013; Alsulamy 2005; Council of Saudi Chambers 2013; Kushnir 2010; Radwan & Al-Kibbi 2001; Ramady 2010).

2.3 ROLE AND IMPORTANCE OF SMES IN NATIONAL ECONOMIES

SMEs contribute significantly and have a major role in the growth of most national economies around the world; for example, SMEs in the United States (US) comprise 99 per cent of all firms, employ over 50 per cent of private sector employees, account for approximately 39 per cent of the US GDP and represent 98 per cent of all US exporters and 34 per cent of US export revenue (Ngek & Van Aardt Smit 2013). In the last seven years, the credit conditions of SMEs in the US have improved. In June 2013, Commercial and Industrial (C&I) loans of \$1 million or less amounted to \$288.7 billion (a \$47 billion increase from 2008). Similarly, other industrialised countries have high proportions of SMEs; for example, SMEs in Japan account for more than 99 per cent of the total enterprises in the country and account for 55.3 per cent of the GDP (EIU 2010). SMEs have also been shown to promote and create employment in countries; for example, in Germany, SMEs contribute 87.7 per cent to the GDP and 75 per cent of employees work at SMEs. Furthermore, the contribution of SMEs to the GDP was 64.3 per cent in Spain and 44 per cent in Austria (Savlovski & Robu 2011),

Conversely, the contribution of SMEs to the GDP in the Middle East and North Africa (MENA) region is low compared to developed countries; for example, SMEs account for 99 per cent of the GDP in Lebanon. 70 per cent of the GDP in the United Arab Emirates (UAE) and accounted about 95 per cent of the economic projects in the country, and employs more than 60 per cent of the workforce. In addition, in Egypt the sector of SMEs present about 99 per cent of the private enterprises in Egypt and generate for nearly three-quarters of new employment generation. While, in Kuwait, SMEs constitutes approximately 90 per cent of the private enterprises, and provide 45 per cent of the total labour force; however, the national workforce rates in this sector of less than 1 per cent. Further, SMEs in MENA countries provide approximately 82 per cent of employment in Lebanon, 69 per cent in Tunisia, 50 per cent in Morocco and Jordan, and 30 per cent in UAE (Al-Yahya & Airey, 2014). Moreover, The sector of SMEs in Yemen account for 96 per cent of the GDP in 2010, and about 77 per cent in Algeria, 60 per cent Palestine during the same year. Also, 99 per cent of the firms in Turkey are SMEs; they contributed around 38 per cent of the GDP and employed about 80 per cent of the work force in Turkey (Emine 2012).

Although, SMEs in Arab countries not only play important roles in job creation of employment and dominate their national economy in terms of number of firms making up more than 90 per

cent of all enterprises, but also create a competitive environment and supplied larger enterprises with essential raw materials. However, the economies of the Arab countries lack diversity since they are still heavy reliance on oil revenues. Consequently, SMEs in those countries contribute little to their nation economy since they turn into import oriented and service based economies especially for the non-oil producing Arab countries such as Jordan, Egypt, Lebanon and Morocco. This leads to lock Arab countries into inferior positions in global markets (World Bank 2012, Emine 2012)

The contribution of these SMEs to the GDP remained low in GCC countries compared to that in other strong economies. As shown in Figure 2.1, the SME contribution to Saudi GDP was only 33 per cent, whereas SMEs in other developed countries contributed 50 per cent or more to their GDP (Skoko 2012; Akheris 2012; Edinburgh Group 2012; Rashid & Rachid 2013). The low contribution from SMEs to the Saudi GDP can be attributed to a number of factors. These factors include: lack of access to finances, lack of marketing strategies, lack of management, and strict government regulations (Akheris, 2012; GOIC, 2013; Nasser, 2011).

Certainly SMEs have a significant role to play in a national economy so much that it would be negligent for any country to ignore. Rather it would be sound governance for Saudi government seeking development and support to SME sector as one of its major growth goals.

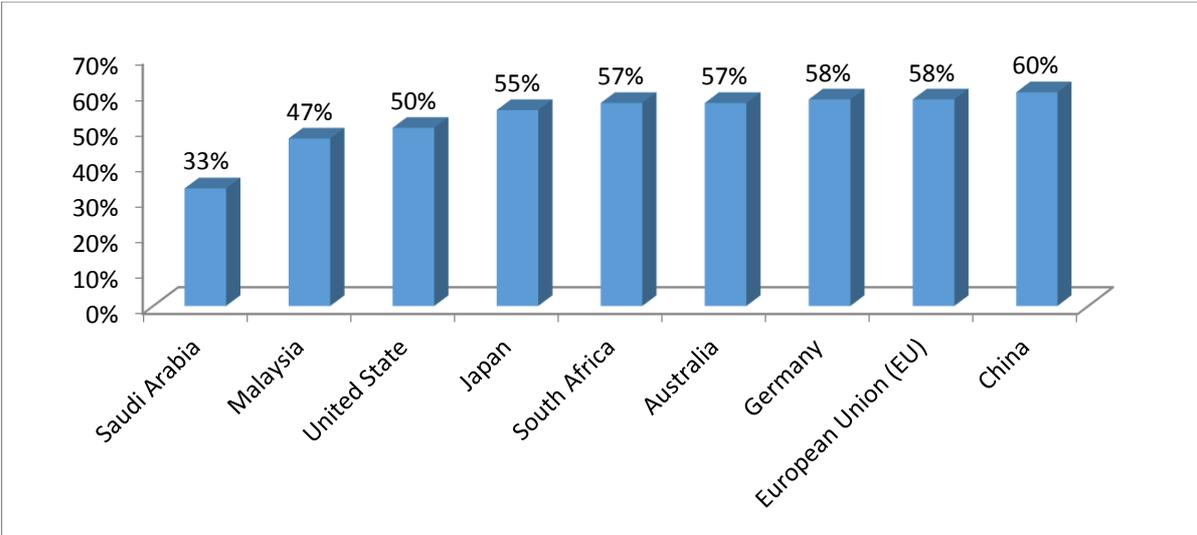


Figure 2.1: Contribution of SMEs to GDP in Different Countries (Akheris, 2012; Edinburgh Group, 2012).

2.4 THE IMPORTANCE OF SMES TO SAUDI ARABIA ECONOMY

SMEs act as important strategies to create jobs, diversify the economy, enhance the living standards, increase production capacity, and add value to the economy (Subhan et al. 2013; Sadi 2009). Therefore, most countries promote SMEs by providing a favourable growth environment through delivering necessary infrastructure and other factors. These factors include favourable social and economic conditions, human resource development centres, diversification into non-oil sectors (such as industry, mining, and agriculture), and reforming towards pro-growth policies and procedures in order to ensure sustainable development and growth strengthening (Aigboduwa & Oisamoje, 2013). Influencing factors are the globalisation of economic activities, opening up of new markets, and promoting competition. This is certainly the case in Saudi Arabia, where SMEs not only play an important role in the aforementioned areas, but are also considered as an alternative to the oil industry, which is expected to decline within a few decades (Radwan & Speechley, 2011; Ramady, 2010; Shalaby, 2004). Oxford Business Group (2016), cited Ibrahim Al Hunaishel, director-general of Saudi Credit and Savings Bank as saying that as oil prices are declining, the contribution of private sector to GDP is evident, and the best way to achieve this is to promote SMEs.

The importance of having diverse income sources has long been recognised by most countries as an important element of national economic stability (Alghamedi, 2014; Ramady, 2010; Shediak et al., 2008). Dependence on a single source of income, such as oil, can result in a nation being susceptible to great risk, especially when that source experiences volatility in price. Thus, if oil prices suddenly fall, this can negatively affect a country's budget and GDP. Therefore, as a result of price fluctuations in oil revenues, the government of Saudi Arabia's five-year development plan focuses on diversifying the productive base of the economy (Kayed & Hassan, 2011). Saudi Arabia's development process has promoted a productive entrepreneurship sector in the business environment to positively contribute to the challenges facing the national economy.

According to the CDSI (2010), SMEs are considered the backbone of the Saudi national economy. Some further points about the importance of SMEs to the Saudi economy are described below through a range of statistics (CDSI, 2010):

- The number of SMEs licensed by the Ministry of Commerce and Industry (MCI) by the end of 2014 was more than 946,000, of which, approximately 85 per cent were of sole proprietorship. These SMEs employ more than 5.6million workers, with an estimated financial investment of about US\$65 billion (SR250 billion). SMEs encompass 82 per cent of the total workforce in Saudi Arabia (CDSI 2014).
- The number of SMEs with 6 to 19 employees licensed by the MCI by the end of 2014 was about 128,193, which is an increase of 15 per cent from 2003 and about 13.4 per cent of the total business enterprises in the Saudi market (CDSI 2014).
- The number of micro-sized enterprises with one to five employees licensed by the MCI by the end of 2014 was about 791,938. This represents an increase of 36 per cent from 2003, and accounts for 84 per cent of the total businesses in the Saudi market (CDSI 2014).
- The number of large enterprises with 20 or more employees licensed by the MCI by the end of 2014 was about 26,740. This is an increase of 24 per cent from 2003, and represents 2.6 per cent of the total business enterprises in the Saudi market (CDSI 2014).
- As shown in Figure 2.2, SMEs are distributed in different sectors: trade, manufacturing, agriculture, construction and real estate, and services. The commercial and services sectors dominate SME activities. Together, they account for about two-thirds of all sectors. In contrast, health, education, and mining and quarrying have a minor presence of less than one per cent each (CDSI 2014; Hertog 2010).
- Total employment in Saudi Arabia is about 5,625,540 workers, engaged in all economic activities. The above number of workforce in Saudi Arabia is experiencing a citizenship employment problem. Despite the fact that 98 per cent of SMEs are owned by Saudis, only about nine per cent of the total workforce comprises Saudis, and the sector is dominated by a large majority of non-Saudi workers (CDSI, 2014). Relatively, those workers are distributed in terms of economic activity as follow, 84 per cent of the employees work in one-to-four workers' enterprises, 13 per cent have five-to-nineteen workers, and the remaining of 3 per cent work in firms that have more than 20 workers.

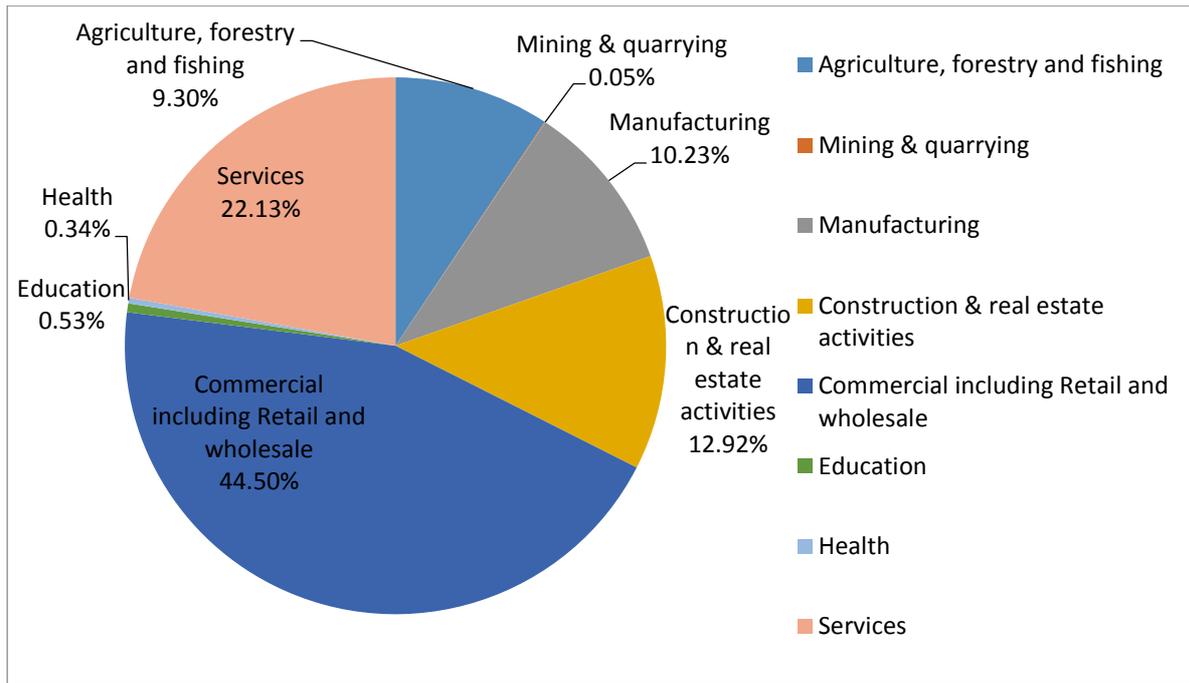


Figure 2.2: Sectoral breakdown of Saudi SMEs (CDSI, 2010).

A report of A T Kearney (2014) compared the potential role and status of SMEs in the economic development of GCC countries. The need for dedicated institutional support by the government was stressed. Promoting highly innovative SMEs with highest growth potential is recommended. Previous studies by Abalkhail (1999), Alfaadhel (2010), Hajjar (1989), Otsuki (2002), and Shalaby (2004), noted that the SME sector is capable of converting the Saudi economy from an oil-based economy to a more diversified and sustainable economy. There is scope to use this sector to expand the economic base, diversify sources of income, and provide job opportunities. The Saudi government has realised the need to overcome the main obstacles that face the majority of SMEs in terms of obtaining concessional finance for their projects. Hence, as aforementioned, the Saudi Ministry of Finance has undertaken a number of initiatives to provide funds through government lending banks to support SMEs with specific packages for each sector, as well as adopting ambitious development policies for the national economy (Albatel, 2003).

2.5 THE BUSINESS ENVIRONMENT IN SAUDI ARABIA

In Saudi Arabia today, and throughout the Middle East region, there is a new generation of talented entrepreneurs who are gradually reshaping the economic environment. Saudi Arabia is undergoing promising economic growth and offers favourable corporate tax rates that make Saudi Arabia an appealing business venue to many foreign investors (Alshahrani & Alsadiq 2014; Ramady 2010; Khatib 2012; Binzomah 2009). The objective of this section is to present the development and business environment in Saudi Arabia by identifying the opportunities and the threats that are challenging the Saudi economy.

The Kingdom of Saudi Arabia has introduced many economic reforms in response to rapid changes in the global economy, with the aim of building a solid economic base capable of achieving economic stability in the face of intense global competition. As a result, the Kingdom has gradually opened the local economy to compete in global markets. One reason for this shift in emphasis (diversifying into the non-oil sector with an active role for the private sector) was due to the sharp decline in oil prices from the mid-1980s to the 1990s, which resulted in the Saudi GDP declining by 40 per cent (Ramady 2010). Other economic reforms undertaken to diversify sources of income were increased employment opportunities for Saudi citizens; liberalised trade; safeguarded intellectual property rights; expanded investment and international trade; and support for SMEs (Sohail 2012, SAMA 2012; Alshahrani & Alsadiq 2014; Ramady 2010; Khatib 2012).

According to the Saudi Arabian General Investment Authority (SAGIA, 2014), the economy in Saudi Arabia offers opportunity in many areas, including industry, trade, services, agriculture, and tourism. All these sectors have the ability to accommodate many new investment opportunities for SMEs, which represent an important job source for Saudi job seekers (Alghamedi, 2014; Sadi, 2009). However, to ensure sustainable development, Saudi Arabia requires adequate investment of the national income for productive contribution to a sustainable economic base by enhancing the capabilities of SMEs.

The economic structure of Saudi Arabia consists of two main sectors: the oil sector, represented by the government sector; and non-oil sector, represented by the private sector. The oil sector led the economic development during the early stages of the five-year strategic plan for Saudi Arabia due to the significant revenues derived from high oil prices. The dramatic growth in GDP in the 1960s reflected the influence of government spending to establish a strong infrastructure, invest in the development of national human resources and encourage the growth of non-oil sectors. However, this development initiative diminished due to the sharp decline in oil revenue (Al-Sayari 2007, Cappelen & Choudhury 2000, Matabadal 2012).

During 1970–2009, Saudi Arabia implemented eight development plans and is currently into its ninth plan. These plans were aimed at developing infrastructure development projects, and building a strong diversified economy to assure a bright future for the people of Saudi Arabia through improved income and a better standard of living. The eight development plans had different core objectives depending on the stage of development (Alshahrani & Alsadiq 2014; Ramady 2010; Khatib 2012). The (current) Ninth Five Year Plan (2010–14) continues the development process to consolidate the Kingdom's sustainability based on five major themes: (a) enhancing the standard of living of citizens and improving the quality of their lives, (b) reducing unemployment by raising national human power participation rates, (c) creating balanced development among all regions of the Kingdom, (d) upgrading national human resources skills and capabilities, and (e) enhancing the contribution of the private sector in the process of development. In the case of SMEs, the current plan aims to develop frameworks for sponsoring and organising SMEs in order to drive their economic growth to contribute more to GDP (MEP 2010).

A good business environment of a country is reflected in its economic performance indices. Historically, good steady economic growth is both the cause and the effect of a good business environment. It continues to attract more business and investments for the economy to grow.

The business environment in Saudi Arabia had many ups and downs during the last two decades. A MEED report of 2013 (James 2013), presents data to show that its GDP steadily increased during the period 2002-2011, except in 2009, when the oil prices were hit and the entire world suffered an economic crisis. The latest trend is that fast declining oil prices and the continuing economic stress around the world are, in turn, affecting the economic growth of the

country. The outlook for business growth was excellent as per the report. The GDP tripled to \$580 billion during this decade, averaging over 15 per cent annual growth after adjusting for inflation. The government went ahead with increasing budgetary support for human resources development, social welfare and health and the development of economic resources and infrastructure. These steps can support the flow of investments in business and its growth (James 2013).

According to the World Bank report for 2015 (World Bank, 2016), Saudi Arabia ranks 82nd among the countries in ease of doing business. It fares well in investor protection, taxation, getting credit, getting power, and property registration. But it fares badly in enforcement of contract and resolving insolvency. According to Transparency International report (Transparency International, 2015), the corruption perception index increased from 44 in 2012 to 52 in 2015, indicating tremendous improvement in reducing corruption. This is an encouraging sign and should encourage greater inflow of foreign capital. However, many reports predict a major slump in the economy of Saudi Arabia in 2016, if the current trend of falling oil prices continues. According to IMF, the GDP of Saudi Arabia will grow by only about 2.2 per cent in 2016. By the end of 2016, the budget deficit of Saudi Arabia will rise to 20 per cent. If the current policies continue, Saudi Arabia may exhaust all its oil reserves within five years, according to an IMF estimate (Alshahrani & Alsadiq, 2014). The Saudi Arabia government has started severe austerity measures in order to counteract some of the negative economic outcomes. “With lower oil prices, the importance of growing the private sector’s contribution to GDP has become clear. The best way to do this is by boosting the SME segment,” Ibrahim Al Hunaishel, director-general of Saudi Credit and Savings Bank, told OBG (Oxford, 2016).

2.6 EFFORTS AND CONTRIBUTION OF SAUDI ARABIA TO SUPPORT SME SECTOR

Recognising the importance of SMEs, the government of Saudi Arabia has implemented strategic plans to encourage young people to invest in these enterprises, with the aim of diversifying sources of income and reducing dependence on oil. Economic reforms undertaken to diversify sources of income included, increased employment opportunities for Saudi citizens, trade liberalisation and safeguard to intellectual property rights, expansion of investment and

international trade, and general support for SMEs (Agil, 2013; Albassam, 2015; Alghamedi, 2014; SAMA, 2012; Sohail, 2012).

To build a diversified economy and reduce the dependence on oil, the government of Saudi Arabia provided different types of support and facilities, such as granting long-term, interest-free loans, leasing industrial land for factories, housing for workers in industrial areas equipped with full facilities and services at nominal prices, and providing customs duty exemptions for imported tools and equipment used in manufacturing (Sadi, 2009). By the end of 2012, factories in the industry sector numbered more than 6,500, with a total investment of US\$224 billion. The industry also employs more than 600,000 of which 75 per cent are in SMEs (Saleh, 2012; SMCI, 2013). The SME factories (4935) recorded 33 per cent growth during the five years ending 2012, as a result of the government’s promotional policies. Correspondingly, investment funding in these factories gradually rose by about 30 per cent from US\$6.5 billion in 2004 to US\$8.5 billion in 2012 (SMCI, 2013). The Saudi industry fund has supported numerous factories in areas such as food products, beverages, textiles, wood products, furniture, cement, petroleum products, and plastics. These industries contributed US\$44 billion to the national economy, which is equivalent to about 10 per cent of the GDP, according to the Saudi Arabian Monetary Agency (SAMA, 2012). In addition, the number of workers in SME industries grew from 180,000 in 2008 to around 277,000 in 2012, which represented almost five per cent of the total labour force, according to the Ministry of Commerce and Industry (MCI, 2013; Sadi, 2009; SMCI, 2013). Table 2.3 illustrates the growth in the number of SMEs and their funding by the SIDF.

Table 2.3: Number, Funding and Employment Patterns of SMEs in Saudi Arabia by SIDF (SMCI, 2013)

Year	Number of SMEs	Growth (%)	Total funding (US\$ million)	Growth (%)	Number of workers	Growth (%)
2008	3,694		6,625		179,867	
2009	3,903	5.35	6,916	4.20	193,724	7.15
2010	4,078	4.29	7,141	3.15	210,251	7.86
2011	4,439	8.13	7,660	6.77	239,072	12.05
2012	4,935	10.05	8,426	9.09	277,807	13.90

As shown in above (Table 2.3), the increase in the number of workers was much greater than the increase in the number of SMEs, which demonstrates the high employment potential of SMEs. Interestingly, during the same period, funding did not keep up with the pace of growth in the number of SMEs, which suggests that there is inadequate funding for SMEs. According to the Financial Access and Stability Review (World Bank, 2011), the total unmet demand for loans by SMEs in emerging markets was US\$2.1–\$2.5 trillion. The report further states that the proportion of loans from commercial banks that benefited SMEs in GCC countries did not exceed 2 per cent in 2010, and in Saudi banks, it did not exceed 1.5 per cent (Rocha et al., 2011a).

The financial institutions bear the largest burden to fulfil the financing needs of this sector (Jaber, 2009). The Saudi financial system as shown in (Figure 2.3) consists of the SAMA (the central bank of Saudi Arabia, established in 1952), 12 commercial banks, and five specialised government lending institutions. The five lending institutions are: SIDF, the Public Investment Fund, the Real Estate Development Fund, the Saudi Arabian Agricultural Bank, and SCSB (Samargandi et al., 2014). In addition, a number of exchange companies manage the purchase and sale of foreign currencies. There are also a large number of insurance companies and agents dealing with various types of insurance, such as medical, commercial, and a variety of other linked insurance schemes for consumers. Finally, the capital market consists of the government securities market, as well as the stock market. Financial services specific to SMEs are provided by some of these financial institutions (Abalkhail 1999).

2.6.1 The Scope of Government Financial Institutions Funding SMEs

Although the various financial institutions of Saudi Arabia provide various services to the government, the public programmes specific to SMEs are only a few. Some of these are discussed below:

2.6.1.1 Saudi Arabian Monetary Agency (SAMA)

The SAMA is the top agency of the Saudi financial system and is the central bank of the Kingdom. Since its establishment in 1952, it has played a vital role in the development of the

Saudi economy by advancing the country's monetary system, promoting the growth of the financial system, and maintaining the stability of domestic prices and exchange rates (SAMA 2012). Specifically, the main functions of SAMA are: issuing the national currency (i.e., Saudi Riyal), acting as a banker for the government, supervising commercial banks, managing the Kingdom's foreign exchange reserves, promoting growth, and ensuring the soundness of financial systems (SAMA, 2013, Samargandi et al., 2014). In addition, SAMA has given more attention to encouraging growth of the banking system and banks, especially after the significant expansion in the national economic activity. SAMA has created a distinct investment and business environment by maintaining the stability of domestic prices and exchange rates of the Saudi Riyal (SAMA, 2013, Samargandi et al., 2014). Since SAMA is a controlling bank, it can give guidelines to commercial banks and other financial institutions on lending to SMEs.

2.6.1.2 Commercial Banks

The Saudi banking system has developed to become one of the safest and efficient monetary systems in the world (Almazari & Almunani, 2012; Samargandi et al., 2014). Today, 12 Saudi banks and numerous international banks work under the supervision and control of SAMA (Abalkhail, 1999; SAMA, 2015; SCSB, 2015; SIDF, 2015). The Saudi banks provide a wide range of products and services, including banking services to individuals and companies, as well as; provide Islamic banking business, where each bank has its own unit for offering Islamic banking services.

The Saudi government has made significant investments in training Saudi nationals via a special training programme developed in collaboration with the Banking Institute of the SAMA. As a result, the number of Saudi workers in the banking sector has increased by more than 90 per cent of the total number of employees in Saudi banks (SAMA, 2013). These facilitates easier and direct interaction with SMEs, giving communication access to SME owners and local managers.

2.6.1.3 Government Lending Institutions

A number of Government Specialised Credit Institutions (GSCIs) are significant players in the Saudi financial system.

First, the Agricultural Development Fund (ADF) provides funding and credit facilities to support agricultural development and its sustainability. This may perhaps include small farm projects in SME format (ADF 2013).

Second, the Public Investment Fund (PIF) provides large amounts of capital to facilitate and establish major industrial projects that are viewed as producing significant value in the development of the national economy (Samargandi, et al. 2014; Abalkhail 1999; SAMA 2015; SCSB 2015; SIDF 2015). As only big projects are funded by PIF, SMEs are unlikely to get help from PIF.

Third, the Saudi Credit and Savings Bank (SCSB) supports social development by funding SMEs, productive family (micro-home) businesses, and social programmes. This agency can significantly help SMEs by funding them (SCSB 2014).

Fourth, The Saudi Industrial Development Fund (SIDF) aims to support industrial development of either small or large factories through the provision of interest-free, medium-, and long-term loans. SIDF can get part of the financial assistance, as both small and large factories are financially helped (SIDF 2015).

Fifth, the Real Estate Development Fund (REDF) supports urban development by providing medium- and long-term loans for individuals and institutions to build residences (Samargandi et al., 2014).

At the end of 2012, the total loans disbursed since the inception of these institutions has exceeded US\$ 100 billion (Samargandi et al., 2014). It is not clear whether any funds were given to SMEs by any of these institutions, and, if so, the amount. From the description of activities and coverage of sectors, it seems, out of the five government funding institutions, only one SCSB can significantly assist SMEs. There is no indication of any of the other three financial institutions providing any help to the SMEs. The Saudi financial system gradually developed with the structure that appear in (Figure 2.3).

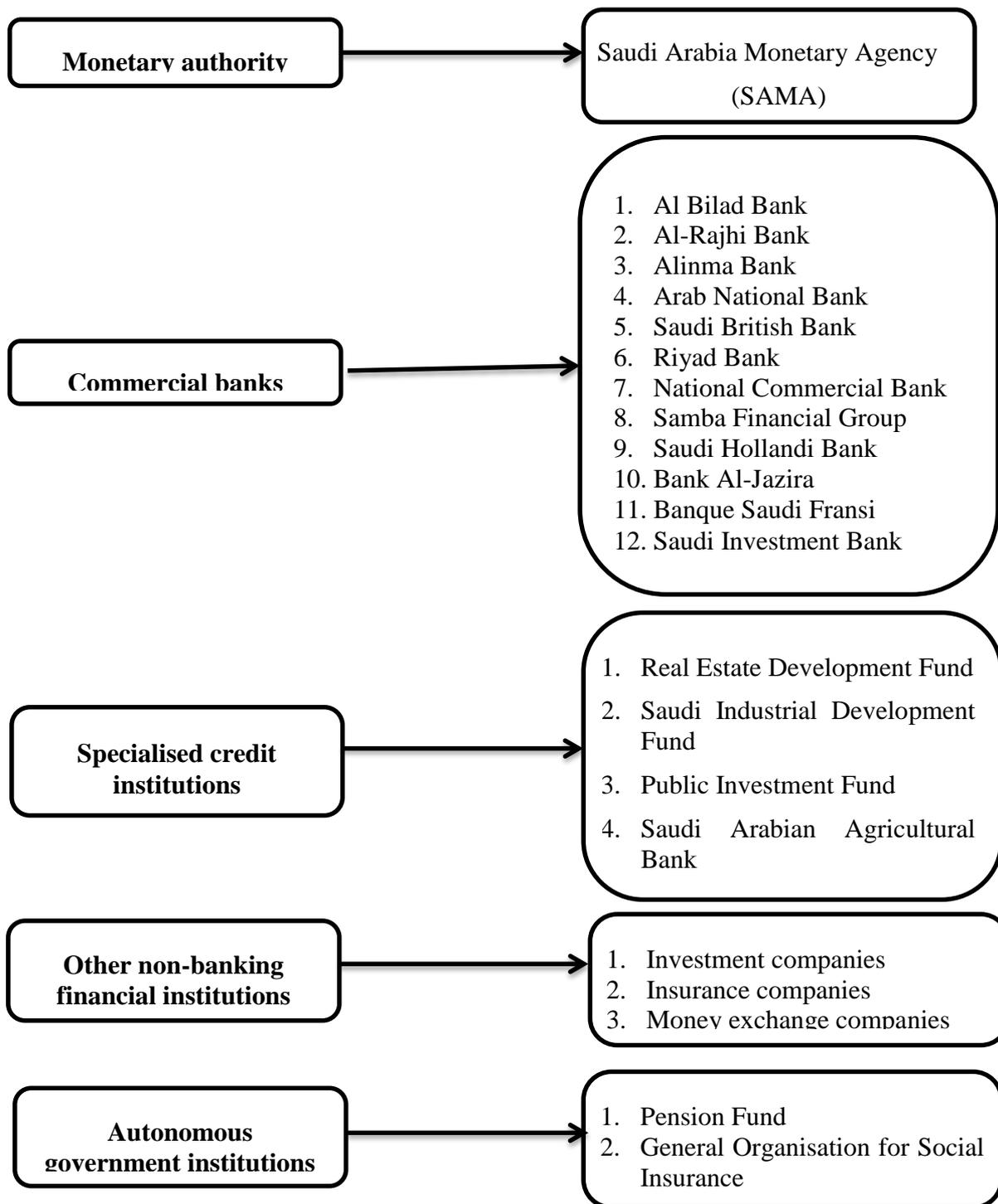


Figure 2.3: Saudi Arabian Financial Structure. Source: (Abalkhail, 1999; SAMA, 2015; SCSB, 2015; SIDF 2016)

2.6.1 Source of Debt Funding and Efforts by Saudi Government Agencies to Support SMEs

According to the steps taken by the Saudi government, the structure of SME financing can be diagrammatically represented as shown in Figure 2.4.

The structure of SME financing, which consists of two main finance providers: the government and the private sector. The government sector provides loans and credit guarantees through the SCSB, and the SIDF to commercial banks as third-party guarantees for financial assistance to SMEs. The private sector consists of commercial banks and non-profit funds such as the Centennial Fund (CF) and the Abdullatif Jamel Fund for small businesses (Alfaadhel, 2010).

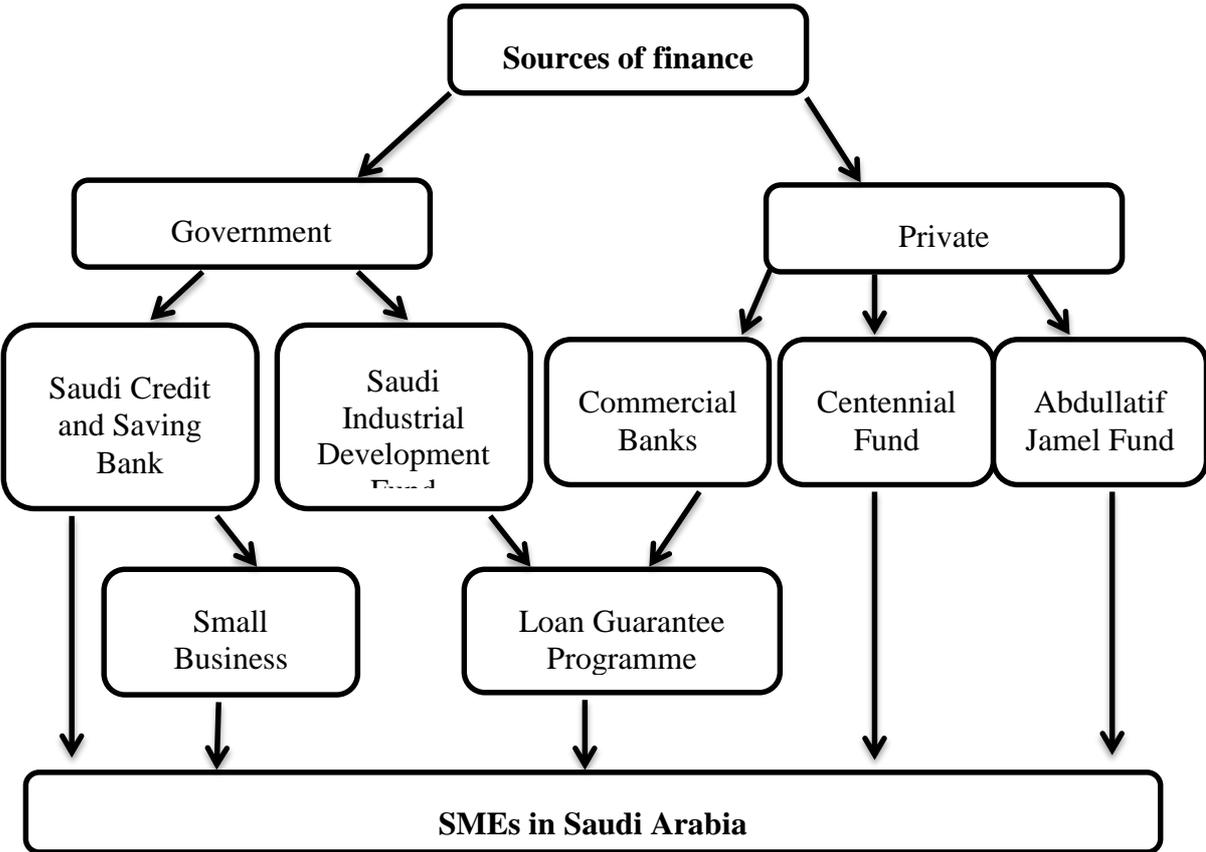


Figure 2.4: Structure of SME Financing in Saudi Arabia (Alfaadhel, 2010).

2.6.1.1 The Role of Saudi Credit and Savings Bank (SCSB)

The SCSB is an important government entity that provides development loans to Saudi citizens to enable them to actively contribute to the progress of their country's economic construction. The SCSB's objectives are as follows (SCSB 2014):

- a. Provide interest-free loans for small and medium businesses, citizen handymen and professionals to encourage them to start their own businesses
- b. Provide interest-free social loans to people with limited income so that they can overcome their financial difficulties.

The funds available to the SCSB have increased to around 36 billion SR (US\$9.6 billion). Further, the SCSB has 26 branches spread over different regions of the Kingdom to facilitate direct delivery to the point of need. The number of loan beneficiaries exceeds 21,000 with a total funding amount of 4 billion SR (US\$1 billion). The SCSB's target plan for 2014–2015 is to fund at least 6,000 projects and disburse loans totalling 2 billion SR (US\$500 million). The SCSB also provides technical and training support, and helps SMEs to explore business opportunities and prepare feasibility studies. All these services are provided either directly or through collaboration with sponsors (SCSB 2014).

The SCSB has cooperated with other related authorities, such as the 'Riyadah', to provide the best support and care for SMEs. The Riyadah is an independent, non-profit national organisation founded by the National Entrepreneurship Institute, a joint initiative of the Ministry of Petroleum and Mineral Resources, and the General Organization for Technical and Vocational Training (SCSB 2014). The aims of Riyadah are to (Riyadah 2014):

- Promote a culture of having your own business among members of the Saudi community and build positive attitude towards it;
- Develop a national programme for entrepreneurship;
- Develop cadres of professionals specialised in the field of entrepreneurship and development of SMEs; and,
- Provide training, consultancy and guidance, and embrace and facilitate access to finance.

2.6.1.2 Kafalah Programme as a Finance Guarantee Body

As the SMEs are expected to play an important role in the national economy, the problem of funding has become a national concern. The main route adopted by the Saudi Arabia government is to initiate an SME Loan Guarantee Programme, known as the Kafala programme, introduced in 2006. This was established by the Ministry of Finance in collaboration with local banks. The government has also encouraged Saudi banks to finance SMEs by establishing a Kafala programme to provide the guarantees required by banks for SMEs to receive their financial support (Hasbani & Kingsley, 2011). Kafala is a sponsorship programme supported by the SAMA to promote economic growth by encouraging local banks to finance SMEs (SIDF, 2012). The funding range of the programme is between SR80,000 and 1.6 million (US\$20,000 to 450,000), for terms of up to seven years, and it guarantees up to 80 per cent of the total loan (Aljazira, 2012). However, despite government efforts to encourage Saudi banks to support SMEs, some banks remain reluctant to finance SME projects due to risk considerations, which could lead to the failure of some of these enterprises (Viñals & Ahmed, 2012).

The aim of the Kafala programme is to encourage financing bodies to finance Saudi SMEs that cannot provide the necessary guarantee or financial records to prove their eligibility for funding. The programme provides a financial guarantee for establishing, developing, or enhancing productive SMEs. Although the programme does not provide funds directly, it does provide a guarantee of 80 per cent repayment of funds to Saudi financial institutions should the SME go bankrupt (SIDF, 2013). Essentially, it is a third-party risk coverage mechanism which to achieve the following (Kafala, 2013):

1. Help SMEs obtain the necessary Islamic funds to develop and expand their activities
2. Encourage financial institutions to improve their business relations with the SME sector
3. Attract new SMEs that are not used to dealing with financial institutions
4. Develop the Saudi SME sector, as it plays an important role in the national economy.

There are 12 local lenders, out of whom 10 have opted for the Kafala programme. The major Kafala-backed lenders are National Commercial Bank, Riyadh Bank, Arab National Bank, and Al Rajhi Bank. These four banks together, have accounted for around 80 per cent of the total SME lending so far.

The Kafala programme can be used for any project for which the total value of the guarantee does not exceed SR 1.6 million. The programme defines an SME in Saudi Arabia as ‘any profitable activity, whether small or medium, that is established under the applicable regulations of Saudi Arabia (Kingdom of Saudi Arabia), with a yearly sale value that does not exceed SR30,000,000’ (Kafala, 2013).

The Kafala programme has been highly successful since its inception (see Table 2.4), providing more than 4,200 guarantees for more than 2,600 SMEs valued at SR2.02 billion (US\$540 million); whereas banks and other financing institutions provided funding of SR4.34 billion (US\$1.1 billion) (Kafalah, 2013; SIDF, 2013).

Although the Kafala programme had been highly successful, in the long term, a more pro-active approach by the banks is necessary for commercial viability. The success of the Kafala programme has created a positive attitude among the commercial banks towards SMEs. It is now being considered as a financially attractive segment and banks have started to compete for business in this sector. The setbacks of the banking sector during the recent global economic crisis have also forced them to look for alternate financial markets and SMEs have emerged as a promising sector. Commercial banks now have SME departments dedicated to SME financial servicing. Some banks have separate SME units, while others have SME divisions in their corporate offices. Instead of downscaling corporate lending instruments for SMEs, separate financial products, specific to SMEs, are being developed by the banks. Although problems still remain, sub-contractors of big corporates are being funded on cash-flow basis (SIDF, 2013).

Table 2.4: Number of Approved Guarantees and of Enterprises Benefiting from Kafala (Kafala, 2013; SIDF, 2013)

Year	Loan amount (million SR)	Guarantee amount (million SR)	Number of guarantees	Number of beneficiaries
2006	49	22.1	51	36
2007	278	127.9	263	211
2008	279	117.6	292	207
2009	464	180.8	504	315
2010	716	271.4	777	480
2011	1,283.6	635.6	1,208	742
2012	1,266.2	666.9	1,191	646
Total	4,334	2,022	4,286	2,637

For total loan amounts of SR4.334 billion, only SR2.022 billion were guaranteed between 2006 and 2012. This represents approximately 46 per cent of the loan amount, which is significantly less than its benchmark of providing up to 80 per cent guarantees. During the entire period of 2006–12, there was no year in which the percentage exceeded 50 per cent. In a further report, till the third quarter of 2014, 10,118 loan guarantees, for a total value of SR4.9 billion (\$1.3 billion) have been provided. The number of SMEs assisted, also increased, from 36 in 2006 to more than 10000 per annum since 2013 (Kafala, 2013; SIDF, 2013).

2.6.1.3 Centennial Fund

The Centennial Fund (CF) is an independent, non-profit organisation concerned with financing youth projects. The fund aims to enable the younger generation to become successful business owners. The CF also provides counselling for current business owners (Al Munajjed, 2010; CF, 2011). It has financed around 3,400 Saudi youths with a total value of more than SR 730 million (US\$200 million). It has also trained about 2,200 youths in a range of management skills such as accounting, marketing, and how to prepare feasibility studies (CF, 2011).

2.6.1.4 Bab Rizq Jameel

Bab Rizq Jameel (BRJ) is a social programme initiated by the Abdullatif Jameel Corporation to help Saudi youth find opportunities to work and start their own businesses (BRJ, 2013). The main goals of the BRJ are to (BRJ, 2013):

- Provide job opportunities for young men and women.
- Support small entrepreneurs with interest-free loans.
- Provide a unique and motivating environment for small entrepreneurs.
- Provide financial support to productive families in small handicraft or industrial projects.
- Provide interest-free loans for those who wish to start their own businesses through franchise arrangements (BRJ 2013).

In addition to financing, the government has launched a number of programmes to offer technical and training support in order to improve the SMEs' competitive capabilities.

2.7 OVERVIEW OF OBSTACLES FACED BY SMES IN SAUDI ARABIA

Despite the importance of SMEs to the Saudi economy, the sector faces a number of significant obstacles to its sustainable growth and development (Alfaadhel, 2010; Alsamari et al., 2013; Binzomah, 2008). The most notable challenges confronting Saudi SMEs are as follows.

2.7.1 Absence of a Regulatory Framework and Co-ordinated Policy Approach

Otsuki (2002) and Shalaby (2004), highlighted the main difficulties affecting SMEs in Saudi Arabia as being a lack of funds, skilled human resources, management skills, marketing skills, modern technology, information, policy structure, regulations, and incentives. Further, they cited cost problems and raw material purchases, weak bonds between SMEs and large enterprises, and other pertinent issues. They concluded that the Saudi government needs to adopt clear policies to support SMEs, reduce bureaucracy, and establish an independent organisation to embrace this sector. They also suggested that the government encourage commercial banks to more liberally provide loans to SMEs. These initiatives could reduce the high risk of failure and bankruptcy during the first year of SME establishment, which arises

from issues such as lack of finances and scarcity of technical support and advice, particularly in the area of business incubators (Alshaibe, 2000).

According to Alfaadhel (2010), the major weaknesses for Saudi SMEs are the lack of skilled Saudi human resources, absence of small business incubators, difficulties accessing financial resources, lack of awareness of entrepreneurship among the Saudi youth, lack of policy structure, labour regulations, and high interest rates for commercial loans. There is an absence of regulatory bodies specifically acting as independent institutions to regulate, support, and develop the SME sector in Saudi Arabia. These institutions could coordinate with government bodies to formulate and develop regulatory frameworks to restructure the SME sector in Saudi Arabia, in order to create a more favourable environment to ensure the sustainable growth of SMEs (Alfaadhel, 2010).

2.7.2 Inefficient Bureaucracy

Inefficient bureaucracy of government agencies is a persistent problem in developing countries, especially with respect to the rules and regulations surrounding SMEs. As stated by Ramady (2010) and Radwan and Speechley (2011), SMEs in Saudi Arabia face bureaucratic obstacles in the form of complex procedures that impede easy establishment. According to Hani (2012), Saudi economists estimated that, in 2011, around 30 per cent of the Saudi SMEs exited the market. They suggested that this was due to recent government regulations and bureaucracy, labour law, financial constraints, and poor management performance (Hani, 2012). A study conducted by the SME Centre at the Riyadh Chamber of Commerce and Industry showed that 44 per cent of SME managers consider the labour regulations issued by the Ministry of Labour to be the main obstacle to their development. Further, Hertog (2012) stated that around 65 per cent of SME managers across the GCC, viewed bureaucracy to be the most significant obstacle faced by SMEs (see Figure 2.5).

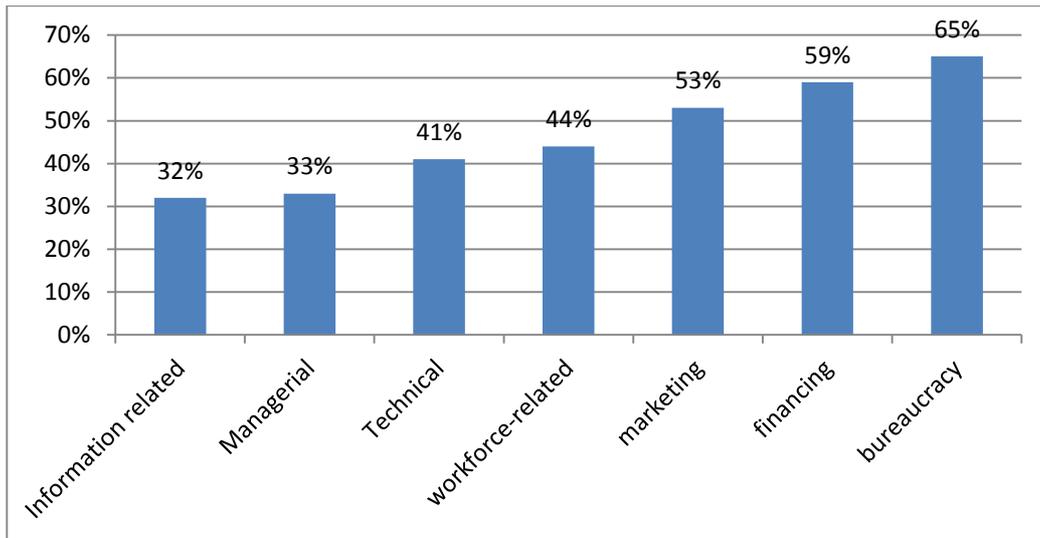


Figure 2.5: Business Obstacles Indicated by SME Managers in GCC Countries (Hertog, 2010).

2.7.3 Lack of Management and Human Resources Skills

Another major cause of business failure is poor managerial experience and worker skills. Many studies have found that some SMEs that exited the market had weak management and unqualified workers (Alfaadhel, 2010; Ghosh et al., 2001; Lin, 1998). The poor management in most Saudi SMEs is due to firms ignoring or failing to invest in enhancing their human resources skills. This is attributed to a low awareness of the importance of training and improving workers' skills (Binzomah, 2008).

2.7.4 Marketing Problems

One of the main obstacles faced by Saudi SMEs is marketing, which includes distribution, promotion, and sales (Aleqtisadiah, 2012; Alfaadhel, 2010). Given that Saudi SMEs need to compete with low-price local and international products, the traditional high cost of production and marketing in Saudi Arabia places them at a disadvantage. Awareness of the importance of marketing and sales for generating business among Saudi SMEs is low, compared to large companies. To increase their sales, SMEs must pay attention to marketing tools and techniques, such as packaging, advertising, and after-sales service (Binzomah, 2008). Aleqtisadiah (2012), investigated the marketing impediments faced by SMEs in Saudi Arabia. He concluded that most SMEs lack adequate marketing and sales strategies, lack support from marketing research,

and adopt a random pricing policy that does not consider competitors' prices or production costs. Aleqtisadiah (2012), suggested that SME owners and managers need to enhance their sales skills through appropriate training courses, and collaborate with marketing consultants in order to improve their marketing and sales performance.

2.7.5 Limited Access to Finance by SMEs

The absence of ongoing financing programmes and support services for SMEs from banks in Saudi Arabia reduces the life of projects. According to the Financial Access and Stability Review (World Bank 2011), the total unmet demand for loans by SMEs in emerging markets was US\$2.1 to \$2.5 trillion. The report further stated that the proportion of loans from commercial banks that benefited SMEs in the GCC did not exceed two per cent in 2012, and did not exceed 1.5 per cent for Saudi banks (Rocha et al., 2011a). These findings were corroborated by Al-Yahiya and Airey (2012), who found that 89 per cent of Saudi SME owners faced difficulties when obtaining loans from Saudi banks. This problem was directly related to the rejection of more than 80 per cent of SME loan applications by Saudi banks (Taha, 2012). Figure 2.6 demonstrates that Saudi banks are ranked among the lowest in the Middle East region in terms of the percentage of bank loans directed to SMEs.

As Figure 2.6 indicates, Saudi banks generally avoid lending to SMEs. This is due to:

- The high transaction costs associated with the high risk of SME projects (Allen & Udell, 2007; Casey & O'Toole, 2014).
- The inability of projects to provide the adequate collateral needed for loans (Brussels, 2007).
- The risk of bank profits being reduced by the high administrative costs of lending to SMEs (Wehinger, 2014).
- The failure of SMEs to meet credit application conditions (Hallberg, 2000).

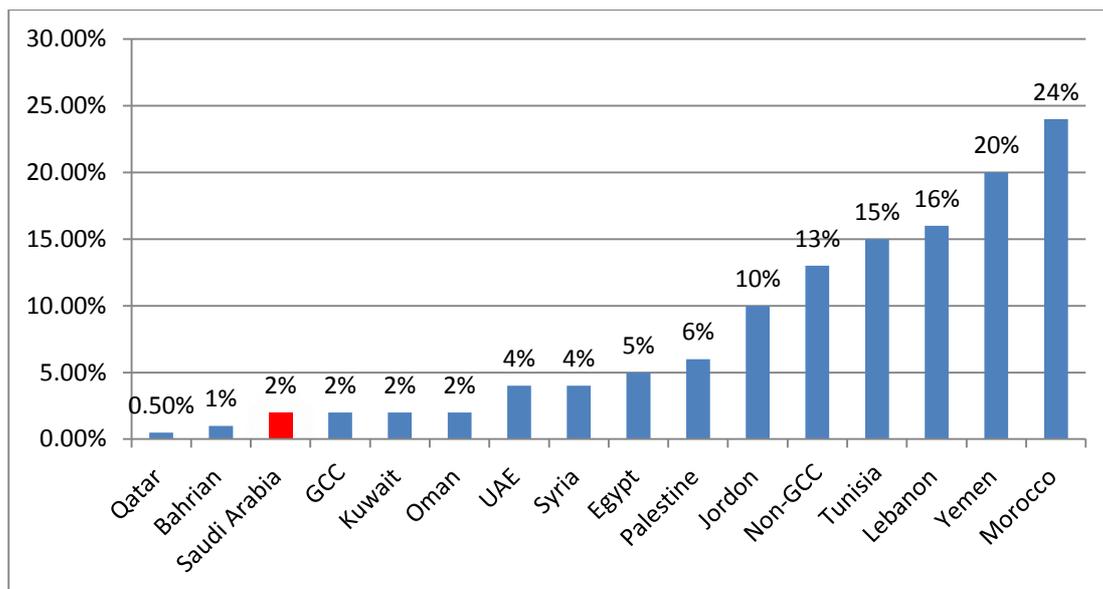


Figure 2.6: Loan Disburseals by Commercial Banks in GCC countries (Percentage of Total Applications) (Al-Yahya & Airey, 2012).

A large risk factor is also associated with the non-return of loan amounts by many SMEs due to the failure of their business. If many such non-returned loan losses are carried by banks, this increases their non-performing assets, and damages their business reputation and profitability, which are essential to attract investments (Nagaraju & Kavitha Vani, 2013). Another reason for the lack of finance is that SMEs may not have appropriately audited balance sheets for their business (Qureshi & Herani, 2011). This is because the owners of these companies do not separate their personal accounts from company accounts. This leads to inaccurate financial statements and a disorganised financial position, which impedes the approval of funding applications (Ong, cited in Chay, 2014).

Commercial banks prefer to advance short- and long-term credit to large companies that are capable of meeting all the obligations required for loan approvals, including providing the required guarantees or collateral to mitigate risk. To cover high risks, commercial banks charge high interest rates that make projects financially unviable. This obstacle results in the reluctance of a number of SMEs to seek loans from commercial banks. This was supported by Hajjar (1993), whose study of 200 small Saudi factories found that:

- 68 per cent of respondents relied on personal savings to finance their investment;
- 17 per cent of respondents had received funding from relatives and friends;
- 5 per cent of respondents had received funding from commercial banks; and,

- 23 per cent of applicants to commercial banks had succeeded in obtaining the required financing, yet 78 per cent of these were approved because of their personal connection with the directors of the banks, while only 20 per cent were able to provide the required guarantees.

Due to these financing problems for SMEs, most governments have established specialised lending institutions to support and provide loans specifically to SMEs, in order to fill the financing gap between SMEs and banks, or credit providers, as a way to enhance the credit market. However, some credit providers believe that the government may give loans to unviable enterprises, which would encourage entrepreneurs to use these loans for purposes other than business, and subsequently increase repayment non-compliance (National Commercial Bank Market Review, 2003). Binzomah (2008) stated that the main obstacle encountered by government specialised lending institutions is a lack of commitment; as most Saudi entrepreneurs consider loans to be charity donations that do not need to be repaid. As a result, financial institutions impose strict conditions to grant loans in order to avoid the risks associated with lending to SMEs on a large scale.

There is little doubt about the significance of SMEs to the national economy. However, these enterprises are experiencing major constraints that affect their growth. Among the major difficulties faced by SMEs are: access to finance, marketing, government regulations, operations, and management problems (e.g., Abalkhail, 1999; Ibrahim, 2006; IFC, 2012; Kola, 2001; Kushnir, 2010; Sajini, 1997; Sarkar, 2000; Sejjine, 2000; Storey, 1994). Among these, access to finance is considered as the most important constraint. Hence, the government has adopted a number of finance and non-finance programs to reduce the impact of this constraint on the development of this sector (Trulsson, 2002; Van Stel et al., 2007; Kushnir, 2010). Some of the more recent reports point out to the many inadequacies that still persist, in spite of the various policies and schemes implemented by Saudi Arabia government, as discussed above.

In the Oxford Business Group report (OxfordBusinessGroup 2016), it was pointed out that in Saudi Arabia, already 90 per cent of the registered business and 60 per cent of the total employment are contributed by SMEs. Out of about 11 million micro-, small-, and medium-sized enterprises in the Middle East and North Africa (MENA) region, around 1.8 million are

in Saudi Arabia. The credit gap in these SMEs is estimated as \$300 billion for their optimal operation. This credit gap is a challenge as well as an opportunity. Increase in credit to this segment seems attractive as the banks have adequate capital and strong liquidity ratios, placing them in a good position to lend money across the private sector, without worrying about their balance sheets. However, the extent of lending to this segment is very low. SMEs accounted for only about 2 per cent of the total lending by all Saudi lenders in 2011. In comparison, the share of SMEs in total lending is 20 per cent in leading developing countries, and 25 per cent in developed countries (OxfordBusinessGroup 2016).

Based on the literature review of the previous studies, it appears that no academic study has examined the direct and indirect relationships among the performance of the SMEs and access to finance in Saudi Arabia. It is important to note that few studies from different countries with respect to their level of economic development, social, and cultural factors had dealt with the problem of the impact of difficulties in accessing finance with the business performance. However, their findings are generally not applicable in other economic environments, especially in the Saudi economy. In spite of the contribution made by the SMEs to the country's economy, there is limited study done regarding these relationships in Saudi Arabia. Therefore, this study examines these relationships in an attempt to provide empirical evidence that might fill the gap in this area, and to recommend policies relevant to addressing these issues.

2.8 SUMMARY

This chapter began by providing various SME definitions that inform different countries, which demonstrated that there exists no universally accepted definition of an SME. In Saudi Arabia, the relevant authorities—such as the Council of Saudi Chambers, SIDF and Saudi banks—have each developed their own definitions. This study chose to use the definition given by the finance, commerce and industry ministries, as adopted by Saudi banks and the Kafalah programme.

The second section provided an overview of the role of SMEs in the national economy and the current situation for Saudi SMEs, which indicated that they continue to face many obstacles in accessing financial support at sufficient levels to ensure financial sustainability. This was followed by a discussion of Saudi economy and the efforts of Saudi government agencies to

support SMEs. Even with all the efforts, the contribution of SMEs to the economic growth of Saudi Arabia has remained low. Although some reasons and solutions have been given in various isolated reports, most of them derived their conclusions based on comparisons with other countries. A comprehensive and systematic study to enquire into the reasons for the poor contribution of SMEs, and methods to remove the constraints on performance within the Saudi Arabia context, is urgently required. This study aims to fulfil this research/knowledge gap. The solutions developed may be offered to the government for suitable actions.

More specifically, this study undertakes a detailed investigation of the financial constraints faced by Saudi SMEs in terms of obtaining bank loans. It aims to determine the reasons behind the reluctance of the commercial banks and other financial institutions to finance SMEs, given that the majority of SME loan applications are rejected. It also aims to determine how this difficulty in accessing bank credit affects SMEs' business performance. The next chapter reviews the most significant and relevant studies associated with sources of finance, and access to finance of the SMEs, from banks.

CHAPTER 3: LITERATURE REVIEW

3.1 INTRODUCTION

Access to finance is the backbone for developing SMEs in any national economy. Increasing access to capital for SMEs is necessary to ensure the sustainability and growth of the sector, and improve firm performance. Financial constraints are one of the largest obstacles and most common problems faced by SMEs worldwide. The main reasons for these constraints are weaknesses in the financial base, lack of creditworthiness, lack of collateral and poor business structures (Al-Kharusi 2003; Beck & Demirgüç-Kunt 2006; Dabo 2006; Ibrahim 2006). Currently, banks in Saudi Arabia are reluctant to provide credit facilities to SMEs due to their perceived high level of risk and associated transaction costs (Abalkhail 1999; Hajjar 1989).

The SMEs in most Arab countries have a low level of access to finance and have a lower reliance on bank loans compared to other countries in the region (World Bank 2011a). Only 20 per cent of SMEs in Arab countries have access to bank credit, which is considered as the lowest ratio among all regions (World Bank 2011a).

McKinsey has estimated that the financing gap for SME in MENA region is about US\$ 2.26 billion that includes US\$1.05 billion in Egypt, US\$ 547 million in Jordan, US\$ 497 million in Morocco, US\$ 247 million in Tunisia, and US\$ 26 million in Lebanon. McKinsey also, estimated that the demand for SME lending will increase by 125 to 150 per cent in the next five years in MENA countries (Stein, Goland, and Schiff 2010, World Bank 2012).

In Saudi Arabia, SME financing is one of the lowest in the world (Al-Yahya & Airey, 2014). According to Al-Yahya and Airey (2014) only two per cent of Saudi banks' total lending is directed towards SMEs. This low percentage appears to be mostly attributable to SMEs' lack of appropriate collateral and adequate financial infrastructure.

Recently, the importance of financing SMEs has attracted the attention of many researchers who have focused on formulating strategies to achieve a higher level of economic efficiency and performance by the SME sector in national economies. Grover and Suominen (2014) and Venkatesh and Lavanya Kumari (2011) investigated 10,000 SMEs' access to finance in 80 different countries and found that the key factors driving SMEs' success and sustainable growth were easy access to finance. Additionally, these studies showed that 39 per cent of small firms listed obtaining financing as a major obstacle. Similarly, a survey by the Federal Reserve Board of New York showed that 49 per cent of 670 SMEs had difficulties obtaining finance.

A lack of finance can affect SMEs at two business phases: the start-up phase and the expansion phase (Klonowski 2012). According to Rocha et al. (2011), only 20 per cent of SMEs in the MENA region have the opportunity to access bank credit and only eight per cent of the total amount of bank loans in the MENA region is to SMEs. Further, of the total bank loans applied for by SMEs in the MENA region, only two per cent were approved in Gulf Cooperation Council (GCC) countries and 13 per cent in non-Gulf Cooperation Council (non-GCC) countries.

Venkatesh and Lavanya Kumari (2011) found that the following five options for financing SMEs are widely available worldwide: equity, hybrid capital, venture capital, angel funds and debt. This chapter reviews some of the most significant and relevant studies that in this area and identifies the gaps in the literature. This chapter also reviews the literature on SME sources of finance, the financial capital structure of SMEs, access to finance (including constraints), performances of SMEs and Islamic finance. Finally, this chapter provides a summary of the studies reviewed and makes some concluding comments.

3.2 SOURCE OF FINANCE

It must be noted here that SMEs need finance at different stages of their life cycle from establishment, launching of the company and through the phases of development and growth. There are two main types of financing: equity and debt. Equity can be from internal sources, such as personal savings, family and friends, and retained earnings; or from external sources such as 'angel finance', VC and public offers. Debt can be sourced from banks, private funds or government institutions.

3.2.1 Equity Finance

Firms of any size, including start-ups and existing businesses, need finance at some point in their life cycle. At the critical business establishment or start-up stage, some investors depend on their personal savings or on those of their friends and relatives, whereas others need access to external finance from third parties (English 2003; Holmes et al. 2003). These potential sources of equity finance are discussed below.

3.2.1.1 Internal Equity Finance

a. Personal Savings or Family and Friends Financing

One of the main and most popular ways of financing new and start-up businesses is through owner savings, and sometimes from friends and relatives. This way of funding is characterised as having no cost and low risk (Holmes et al. 2003, Indarti & Langenberg 2004; Levy 1993; Liaw 1999). Bates and Hally (1982) identify four main reasons for using this approach to financing: (1) for start-ups and early stages of projects; (2) for expansion or renovation, such as purchase of new equipment, machinery, or finance of working capital; (3) for financing of new products or innovation through VC; and (4) for rearranging the current financial structure of the company. Some studies show that most new SMEs consider personal savings or loans from family and friends as the main source of equity finance (Ganbold 2008; Porter 2008).

According to Abalkhail (1999), approximately 68 per cent of SMEs in Saudi Arabia depend on their personal savings to finance their business, and around 17 per cent obtain funds from the personal capital of family and friends. However, this type of financing fails to meet the financing needs of SMEs, especially during the growth stage. As firms grow and develop, most need to gain access to external finance in order to expand and stay in the market, forcing them to seek alternative sources.

b. Retained Earnings

Retained earnings are the most frequent funding source used by established profitable firms to finance their needs. Retained earnings are the profits generated from sales that remain after allowing for operational and interest costs, and tax expenses (Al-Kharusi 2003; Corporate Document Repository (CDR) 1997; Chiu 1998). The remaining profit is invested back into the business to meet its requirements including future expansion. The major advantages of using this type of finance are that it is low-cost capital and is easily available to management (as it is an internal source and a long-term fund with no obligations (CDR 1997; Shenoy 2013)). However, complete reliance on personal savings and retained earnings tends to decline as the business grows and develops.

SMEs generally rely more on internal finance because they face restrictions from external financing institutions. The study by Baldwin et al. (2002) found that more than 50 per cent of firms rely on internal sources of finance. Of these, 39 per cent obtained their capital from retained earnings and 12 per cent used funds from owners and managers. The other firms were financed through banks and other financial institutions.

3.2.1.2 External Equity Finance

a. 'Angel' Finance Investors

Angel investors have the desire to contribute and participate in the development of business by providing capital to existing or nascent enterprises that have the potential to grow, through debt or through convertible loans or an ownership share in the project (Prowse 1998). In fact, angel finance fills the gap left after obtaining finance from other sources such as personal, family and

friends, and VC investors (Aacs & Audretsch 2003). The main advantages of business angel finance are associated benefits such as access to administrative and operational consulting, adding of investment value to the business through their network of business contacts and extensive relationships, and directing the business owner to operate in a professional manner. Kerr et al. (2010) demonstrate that existing projects funded by angel investors are less likely to fail than those relying on internal funding. Angel investors usually provide funds of between US\$50,000 and US\$10 million, outside the range that is evaluated by VCs (Aacs & Audretsch 2003, Wetzel 1994b). In the US, a total of 66,230 entrepreneurial ventures received an amount of US\$22.5 billion in angel funding investments up to 2011; and the number of active angel investors in the US reached 318,480 individuals in 2011, an increase of 20 per cent from 2010 (Sohl 2012). Other studies have found that business angels invested around £650 million annually in the EU, serving around 1.3 million enterprises; and the number continues to grow (Commission 2000; Dabo 2006). In Arab countries, the Arab Business Angel Network matches investors with small enterprises in the Arab region that require US\$100–500 thousand to fund their businesses (Writer 2008). In Saudi Arabia, according to the Badir Programme for Technology Incubators, almost 290,000 angel business investors are willing to direct their investments towards potential growth projects in the field of information and communication technology (Badir 2013).

Some studies point out that with this type of financing, entrepreneurs take time to find a suitable investor with the right expertise and interest, because inappropriate angel investors can be disadvantageous for the business. Angel investors typically have a share of the ownership and take a certain portion of the profit. They also have the decision-making authority in some cases, which business owners and managers may find disadvantageous (Iqbal & Llewellyn 2002; Wilson 2002).

b. Venture Capital

VC is a form of finance that provides funds to promising business ventures that have the potential of growth with a high return, from the early stages of the business until the exit phase of their association. In fact, VC is considered one of the most significant means of external funding, adding value to the economy of developing and developed countries alike (Kaplan & Stromberg 2002). Such investors provide not only cash, as is the case of most bank finance, but also management experience and business connections.

The idea of VC began in the US in the 1950s in response to the finance needs of SMEs at various stages of their business cycle, especially in the technological fields (e.g. computers, telecommunications electronics and information technology) (Baleadi 2008). According to a study commissioned by the National Venture Capital Association (NVCA), between 1970 and 2000, VC investment companies in the US created jobs for more than 7.6 million employees by providing SMEs with more than US\$273 billion. The same firms produced goods and services worth around US\$1.1 trillion in 2000 (DRI-WEFA 2001). Many countries have realised the significance of VC in financing high-risk SME projects and have made it a priority within various programmes and strategies for the development of this sector. Consequently, the UK government in collaboration with the EU have established a special fund called the *Small and medium enterprise venture capital and loan fund*, which aims to support UK SMEs. Additionally, the Indian government has founded a special VC fund to support small and medium-sized electronic industries. Venture capitalists usually control boards and are involved directly in the management of the company, in order to ensure the success of the business venture (Rosly & Abu Bakar 2003).

The future of VC in GCC countries is promising, since SME banks in the GCC provide less than 2 per cent of the required funds. According to a VC report by MENA, private equity association in the number of VC and SME deals increased by 28 per cent in 2011 compared with 2010 (MENA Private Equity Association (MENAPEA) 2012). In Saudi Arabia, VC funding is still at an early stage of development and growth, but the Saudi government has recently pushed and encouraged for more VC equity financing for SMEs (MENAPEA 2012). A study conducted by Hajjar (1989) concluded that VC investors are a major provider of external financing for SMEs in Saudi Arabia. By 2006, the SAGIA and the American Venture Capital Firm had established a US\$100 million Saudi VC fund to provide growth capital and late-stage venture capital to Saudi SMEs (OECD 2006c).

c. Public Share

In contrast to the volume of investments in large companies, SMEs do not have the option of issuing shares or bonds as they are not able to meet the conditions and requirements of stock markets. Therefore, internal equity is their main source of finance (Carpentier & Suret 2006; Sarapaivanich 2006).

3.2.2 Debt Financing

Debt financing is a form of borrowing that must be repaid within a limited period of time, usually with an interest payment. This type of finance is accessed in the form of a loan or bonds in contrast to equity finance, which can be accessed in the form of a partnership or stocks. The main sources of debt financing are banks, private funds and GSCIs. When considering the difference between debt and equity financing in term of ownership, debt financing does not maintain ownership in the business, as equity finance does, by distributing the ownership among stockholders (English 2003).

a. Banks

Bank loans are a significant source for finance for most firms' business activities. Many SMEs prefer to take loans from external sources like banks and other financial institutions (Black & Gilson 1998; Keasy & Watson 1993). One of the major functions of banks is to provide short- and long-term loans to various economic sectors. At the establishment stages of the life cycle of SMEs, short-term loans are financial products extended to firms for a short period of time, which often does not exceed 12 months. Such products are aimed to meet financial needs for ongoing day-to-day operations, such as rent, salaries, inventories and accounts receivable (English 2003). Short-term loans offered by banks include trade credit, overdraft, account receivable financing and credit cards (English 2003; Holmes et al. 2003). Most banks resort to the use of short- rather than long-term loans to finance SMEs, especially at start-up stages. This is because of the lack of financial guarantees from SMEs and their high-risk nature (Al-Kharusi 2003; Beck & Demirgüç-Kunt 2006; Sarapaivanich 2006).

In the UK, banks play a significant role in financing the expansion of SMEs and provide 90 per cent of all small firm lending (Batechelor 1989). A vast majority (75 per cent) of UK small firms have obtained short-term loans from banks at some point (Lund & Wright 1999). Although short- and medium-term loans are very expensive, SMEs are still heavily dependent upon them, as long-term loans by banks are difficult to obtain (Austin et al. 1993; Keasy & Watson 1993; Lund & Wright 1999). A study conducted by Cánovas and Kant (2011) found

that SMEs can easily access long-term loans in countries such as Austria, Denmark, Iceland and Norway, as these countries protect the rights of their creditors by enforcing existing laws. However, some European banks, particularly those in Italy and Spain, charge a high interest rate for short-term loans granted to small industrial companies (Bryant 2013). A study by Ozer and Yamak (2000) investigated the preferential source of finance for small businesses in Turkey by examining 101 hotels through a structured survey, finding that most hotels preferred bank finance over other external finance. According to a study conducted by the OECD (2006a), the majority (over 79 per cent) of SMEs in various European countries rely on bank financing (see Figure 3.1).

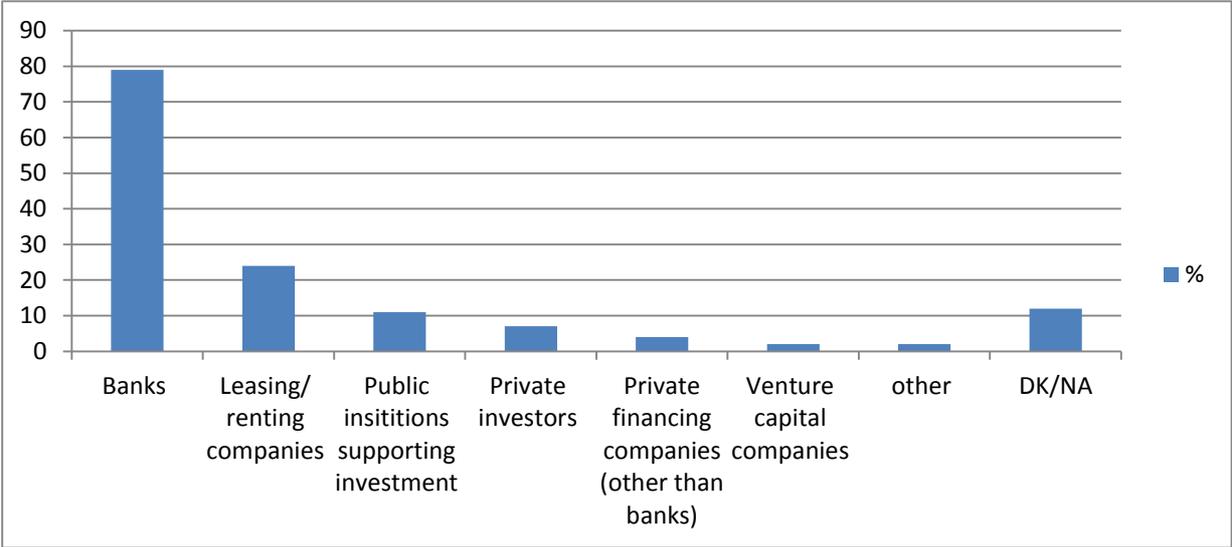


Figure 3.1: Sources of Financing for EU-based SMEs (OECD 2006a)

With respect to the relationship between banks and SMEs, several studies have found that unlike large firms, which have relationships with multiple banks, most SMEs have a relationship with only one bank (Awad 1994, p. 3; Iqbal & Molyneux 2005). However, they are more likely to develop relationships with multiple banks as the business expands and the size of the firm increases (Samad et al. 2005).

A study by Sejjine (2000) investigated the financial constraints faced by small industry firms in Saudi Arabia. The author used data from a survey developed by the SIDF (which provides information on financing small projects in the Saudi industrial sector) using a sample of 200 industry firms. The study found that 68 per cent of respondents relied on their own personal

resources to finance their investment at start-up stages, 17 per cent received funding from relatives and friends, and only 5 per cent received funding from banks. The study concluded that over 93 per cent of the capital investment for SMEs in Saudi Arabia is from owner equity, and only 4 per cent is from bank loans and other supplier facilities.

The absence of ongoing financing programmes and support services for SMEs in Saudi Arabia is responsible for the shortened lives of SMEs. According to the Financial Access and Stability Review (World Bank 2011), the total unmet demand for loans by SMEs in emerging markets was US\$2.1–2.5 trillion. The report further states that the proportion of loans from commercial banks that benefited SMEs in GCC countries did not exceed 2 per cent in 2010, and in Saudi banks, it did not exceed 1.5 per cent (Rocha et al. 2011a). Similarly, a study by (Otsuki 2002) has highlighted that the main difficulties affecting SMEs in Saudi Arabia is shortage of capital and credit providers: more than 70 per cent of the SMEs did not receive any loans.

The wide variation in the market structure and competition in the banking sector has an adverse effect on access to finance by SMEs. Low competition in the lending market will increase the number of obstacles to credit and external finance for SMEs (Beck et al. 2004; Carbo-Valverde et al. 2009). According to Kerr and Nanda (2009), higher competition among financial providers led to deregulation in the US. This in turn led to higher volumes of entry and ease of access to finance among entrepreneurs. Similarly, Boot and Thakor (2000) argue that stronger competition among banks and financial institutions for financing SMEs will reduce profit margins at the transaction level. This will push banks and other financial providers towards relationship lending. In the case of Saudi Arabia, besides the GSCIs there are only 12 large banks that provide loans for individuals and businesses, indicating a low competitive lending market. This leads to limited access to bank credit by entrepreneurs (IMF 2013). This was validated by IMF (2013) and Rocha et al. (2011a), who find that SME loans accounted for just 2 per cent of lending by Saudi banks.

b. Government Specialized Credit Institutions

The establishment of specialised lending institutions in most countries of the world came as a reaction to the avoidance of banks in providing long-term loans for SMEs. Governments have realised that the SME sector is facing difficulties in obtaining finance from banks and private financial institutions, especially if simply left to market forces. Therefore, it was necessary to

create specialised institutions to provide medium- and long-term credit facilities to SMEs, especially for the purposes of investment and working capital. Most of these institutions are either governmental or quasi-governmental that create specialised funding channels to finance SMEs. The source of capital of these financial institutions consists of the government, and contributions from major companies and business people (Al-Kharusi 2003).

Given the importance of this sector to the national economy, many countries have adopted ambitious plans in order to finance SME projects. They have also launched a number of supporting programmes to offer technical and training support to increase the supply of funds to SMEs, subsidise loans and loan guarantees, and improve their performance (Al-Yahya & Airey 2012; Cressy 1996; Hasbani & Kingsley 2011; Mason & Harrison 2001).

The EU has implemented a number of schemes and programmes to support SMEs through direct contribution in order to finance their projects. These programmes also consist of entrepreneurship training, support services, business incubators and technology transfer mechanisms, as a direct aid to individual SMEs (European Commission (EC) 2013; European 2012). Further, the government of Australia has launched a number of initiatives to grant financial assistance and business advisory services for Australian SMEs (Australiasme 2013). Most European countries have interest rate-supported programmes to enable SMEs access to funds in order to benefit from bank credits at favourable conditions and to encourage banks to lend to SMEs (KOSGEB 2012; OECD 2013).

In Saudi Arabia, the government has acknowledged the significant role played by SMEs in diversifying the economy and creating jobs (Ramady 2010). As a result, the government has established six financing institutions in order to finance SME projects, and reduce alleged debt gaps, particularly for growing small firms and start-ups. The Saudi government has also launched a number of programmes that aim to offer technical and training support in order to improve the performance of owners and managers in this sector (Albatel 2003). Finally, the government has encouraged Saudi banks to finance SMEs by establishing a Kafalah programme. This programme provides the required guarantees for financing bodies on behalf of SMEs (Hasbani & Kingsley 2011). The programme is intended to encourage local banks to finance SME programmes (SIDF 2012). The funding range of the programme is between

80,000 and 1.6 million SR (US\$20 thousand to US\$400 thousand) for up to seven years and guarantees up to 80 per cent of the total loan (SIDF 2012). From the start of the programme in 2006 up to the end of 2012, Kafalah issued around 4,765 guarantees in relation to 2,909 SMEs, with guarantees amounting to 2,304 million SR (i.e. approximately U.S \$614.4 million) vs. approved funding of 4,836 million SR (i.e. around U.S \$1290 million) (SIDF 2012).

Despite the government's efforts to overcome obstacles to obtaining finance for SMEs, loans offered by Saudi banks and other financial providers such as VC and angel funds still the expectancy-level, which poses a major hindrance to development of this sector (Abalkhail 1999; Hajjar 1989; Sajini 1997). The proportion of loans to SMEs by banks in Saudi Arabia is considerably lower than those of other countries in the region, supplying only 2 per cent of total loans demanded by SMEs (Rocha et al. 2011a).

Some studies argue that government intervention in the case of capital market imperfection may create imbalances in the economy and increase the cost of capital (Foster & Kaplan 2001; Fritsch & Mueller 2004; Her Majesty's Treasury (HMT) 2003a). Government intervention will increase the supply of funds to SMEs at lower cost, but this action could cause economic distortions and allow inefficient businesses to persist (Lattimore et al. 1998). According to Sarapaivanich and Kotey (2006), and Sevilla and Soonthornthada (2000), government interference to increase fund supply to SMEs will not solve difficulties associated with the existing financial gap.

3.3 FINANCIAL CAPITAL STRUCTURE OF SMES

Capital structure of firms determines how projects and assets are financed. The rate of capital structure varies for each firm. In fact, capital structure proportion determines how assets are divided into equity and debt, and the profit divided between creditors and owner equity. The financial structure of a business is a combination of equity and debt finance in order to fund its assets and business activities. Each type of finance source has a different cost associated with it. The cost of capital for each available source will influence future investment decisions by the business (Peirson et al. 2002). The cost of equity is the rate of return that the business is expected to earn for equity investors (shareholders). This is meant to compensate for risk

tolerance associated with their investment and the amount of change in the value of shares over time. Conversely, the cost of debt refers to the interest rate that the firm has to pay for the loan over a specific period of time. The interest rate of the debt consists of the risk-free rate of return and the premium expected for the extra risk. As there is a difference between the equity and debt finance in terms of cost, business owners consider this cost involvement when evaluating and choosing a suitable source of funds for their firms' financial structure (Abor & Biekpe 2005; Peirson et al. 2002).

Several studies have shown that most SMEs rely on internal equity as the main source of finance. Indarti and Langenberg (2004) found that in Indonesia, more than 79 per cent of SMEs rely on both personal savings and family loans as a source of funding. Additionally, most SMEs in Oman (Al-Kharusi 2003), Ghana (Quartey 2003), Nigeria (Dabo 2006) and Saudi Arabia (Hajjar 1989) rely on internal equity as their main source of finance. However, several studies have shown that SMEs in more developed countries such as Korea and the US are heavily dependent on debt finance for funds (Carter & Auken 1990). According to some studies, the proportion of debt finance in several SMEs tends to increase after the initial year of business operation, because at the start-up stage it is difficult to access external sources of finance (Berger & Udell 1998; Hamilton & Fox 1998). The financial structure of small firms in other developed countries such as Australia depends heavily on personal funds and on the passing of time; particularly in the growth phase, borrowing from banks increases significantly (Karim & Archer 2013).

A study by Hans (2004) aimed to compare among countries the determinants or factors in financial structure optimisation. The author compared the results of previous studies conducted in the US (483 companies from 1989 to 1998), UK (122 companies from 1990 to 1996) and Sweden (17 companies from 1991 to 1996). The study focused on clarifying and comparing among the financial systems the importance of capital, and reported differences between companies in terms of the cost of capital. Further, there is a link between capital structure optimisation and investment decisions. Hans (2004) also noted that most companies that relied on equity finance more than on debt have an optimal capital structure compared to those that heavily depend on debt financing.

Hajjar (1989) found that 68 per cent of Saudi SMEs rely on personal savings and 17 per cent seek finance for their business activities from informal sources. Only 3 per cent of entrepreneurs gained capital from Saudi specialised lending institutions, and 5 per cent from banks.

3.4 ACCESS TO FINANCE

Access to finance is the backbone of the development of SMEs in any national economy. Increasing access to capital for SMEs is necessary to ensure the growth and sustainability of the sector, improve firm performance, allow economic growth through the provision of liquidity, and make money available to both individuals and businesses. As the liquidity of banks increases, firms can secure their financial needs to fund their operations and working capital, ensuring the survival of the business and helping them achieve greater success.

However, financial constraints on obtaining long-term finance from commercial banks and other credit providers are one of the biggest obstacles facing the growth of SMEs in both developed and developing countries (Beck & Demirgüç-Kunt 2006). High-risk investments, inadequate business plans, lack of collateral and incomplete information make potential financial providers and investors reluctant to fund SMEs. There is no doubt that finance availability for SMEs will allow their operations expand, and help them take advantage of new investments, ensure effective performance, and develop their products and services (Leeds 2003).

Bukvic and Bartlett (2003), using data from 200 SMEs between 2000 and 2001, assert that access to finance is the main constraint encountered by SMEs. Three major factors determined access to bank loans by SMEs: high interest rates, high collateral requirements and high service fees. Pissarides (1999) and Ahmed (2004) added other factors to this list: high cost of finance, limited external equity and VC, and lack of a relationship with bankers. Difficulties with access to credit financing by SMEs affects the economy in the long run as these enterprises employ a large number of people from the labour force and contribute to a national income GDP (OECD 2006b).

3.4.1.1 Definition of Access to Finance

Access to finance services ‘implies an absence of obstacles to the use of these services, whether the obstacles are price or non-price barriers to finance’ (Demirgüç-Kunt et al. 2008). In other words, individuals or businesses have access to financial services (e.g. loans, trade credit, deposit, payment and insurance) without any obstacles. Therefore, it is important to distinguish between the actual users of a bank’s financial services and non-users that may have access to the financial services but do not use them, either because they do not need them or decide not to use them due to cultural or religious obligations. In contrast, some non-user enterprises do have the desire to use the financial services of banks, but do not have commercial access to bank services. This is attributed to many causes including low income, high fees and cost of services, excessive requirements to open an account or lack of information, resulting in failure of these non-user enterprises, which end up leaving the market (Demirgüç-Kunt et al. 2008).

The constraints of access to credit occur when the internal financial resources of the business are insufficient to cover the financial needs of their project. Meanwhile, business owners do not have enough access to external funds or debt finance. This occurs because there is a wide gap between the rate of return from the project and the rate of return desired by the external finance providers (Demirgüç-Kunt et al. 2008). This gap exists because financial providers (especially banks) refuse to lend to SMEs under conditions of asymmetric information (Dembe & Boden 2000; Demirgüç-Kunt et al. 2008), which occur when one party in a transaction has more, or superior information to the other (Lean & Tucker 2001b).

3.4.2 Measuring Access to Finance

Measuring financial access is not easy, due to lack of data. Studies have used access to the financial market or to long-term debt, and collateral, as measures of access to finance by SMEs. The majority of SMEs lack collateral and are unable to access the financial market, and as a consequence they encounter obstacles in accessing finance (Chittenden et al. 1996). Bukvic and Bartlett (2003) and Coleman (2004) show that the high cost of capital, high collateral requirements and banks’ bureaucratic approach are all factors that affect access to finance by

SMEs. Other studies conclude that high interest rates and administration costs are limiting the ability of SMEs to access capital (Holmes et al. 1994; Levy 1993; Pissarides 1999), and can negatively affect SME growth and financial performance (Oniovosa 2013). In addition, Kariuki (1995) evaluated procedures for accessing finance and observed that the time taken by SMEs to obtain funds is considered as a constraint to their accessing finance.

To test the theory of information asymmetry mentioned in Section 4.2.2, it is important to measure financial access to bank services using empirical data. Demirgüç-Kunt et al. (2008) used a survey to measure access to banking finance by firms. They tested several factors through the following indicators: the number of bank accounts per 1,000 adults, number of bank branches per 100,000 adults, the loan income ratio and the percentage of firms with lines of credit (Ganbold 2008). Although these indicators may not be precise measures of access to finance, they do provide a reasonable indication (Ganbold 2008). Relevant research has concluded that impediments to obtaining funds by SMEs are high collateral requirements, the high cost of loans, inability to access easy external finance and complicated loan accessing procedures.

In the current study, the following indicators to measure access to finance are used:

- 1) Reason for not applying for banking funds
- 2) Cost of credit; that is, the interest rate charged for the loan
- 3) Access to outside capital
- 4) Loan requirement collateral, procedures, services fees, loan duration, required paperwork, sufficiency of loan amount, and time to obtain finance
- 5) Reason for the bank refusing the loan application
- 6) Relationship between characteristics of the business and owners/managers of SMEs and difficulty in accessing finance
- 7) Availability of Islamic financial products and degree of acceptance of existing Islamic financial products
- 8) Government funds—eligibility for applying to the fund, and requirements
- 9) Kafalah programme—knowledge and requirements.

Indicator (1) identifies the factors preventing owners/managers of SMEs from applying for a bank loan, whereas indicators (2)–(5) investigate the requirements and conditions imposed by

banks to finance SMEs and indicator (6) investigates factors that influence the ease of access to current financial services provided by Saudi banks. The last two indicators define the requirements of both government specialised funds and the Kafalah programme (guarantee schemes).

3.4.3 Gaps in Access to Finance

The financing gap is defined as ‘the difference between the demand for funds by SMEs and the supply of funds’ (Mazanai & Fatoki 2012, p. 59). Park et al. (2008) argue that the main reasons for SMEs suffering from finance gaps can be found in their business, and owner/manager characteristics, and market imperfections on the supply side. Some studies argue that the main reasons behind the lack of access to capital by SMEs are the structural characteristics of SMEs and the imperfection of financial providers in the capital market (Park et al. 2008). Additionally, Holmes et al. (1994) found that small firms may experience a financing gap due to lack of collateral and insufficient financial information. Thus, the financing gap may arise due to uncertainties associated with asymmetric information and agency problems, which increase the risks of lending. On this basis, banks operate under a moral hazard and adverse selection risk and may charge a high interest rate, driving out high-risk borrowers without credit (Mazanai & Fatoki 2012). Overall, the bank may engage in credit rationing and not address the credit demand hence a large number of loan applicants may be left without access to finance, even if they were willing to pay high interest rates (Alfo & Trovato 2006). Credit rationing is focused on the financing gap in SMEs and banks argue that the existing information asymmetries and agency problems may lead to credit rationing conditions (Stiglitz & Weiss 1981b). These information asymmetries can cause two major problems: the limitation of information provided to financial lenders about the firm’s financial conditions and the real status of the investment project (adverse selection). The second problem would make the bank operate under a moral hazard. Alfo and Trovato (2006) identified that these factors would lead banks and other lenders in the capital market to hesitate to finance such projects, which would produce divergence between demand and supply of funds.

According to a study by the IFC, there are between 365 million and 445 million enterprises in emerging markets, and around 85 per cent suffer from credit constraints. These enterprises require around US\$2.1 trillion to 2.5 trillion in funds to fulfil their financing needs (Dwabh 2006). Also, there are between 9 and 11 million (formal and informal) micro, small and medium-sized enterprises (MSME) in the MENA countries, where nearly 1.8 million SMEs are in Saudi Arabia alone. In addition, the IFC report estimates that the credit gap among MSMEs in the MENA and Middle East region for financing the operational needs of SMEs is upwards of US\$300 billion (Mohsin 2009).

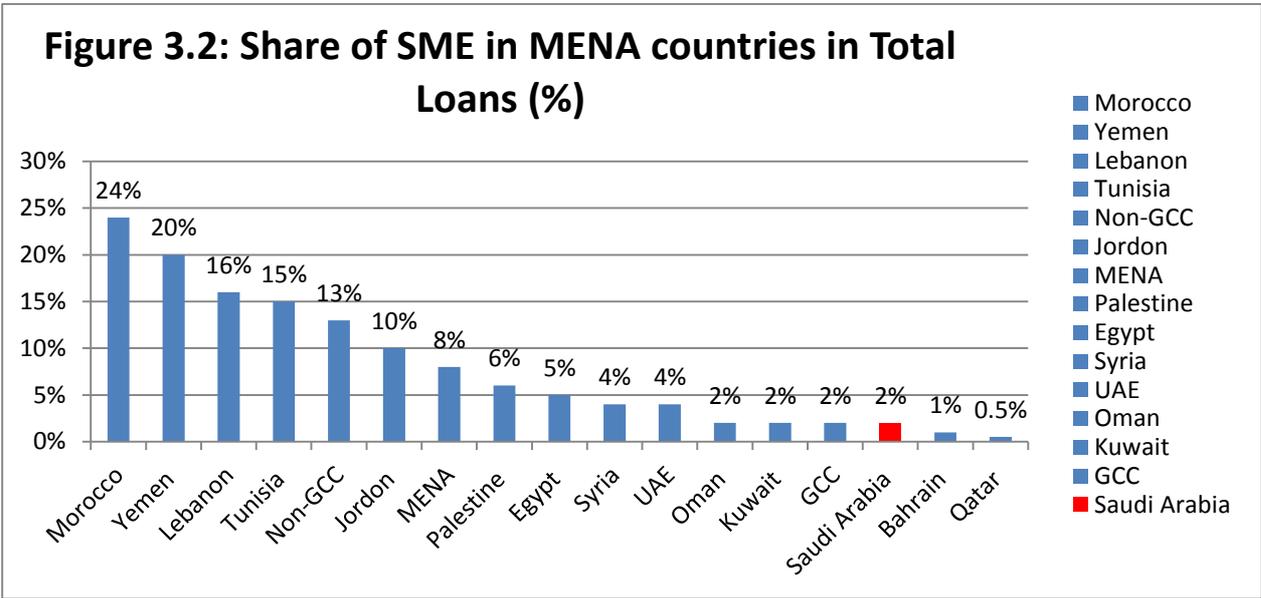


Figure 3.2: Share of SME loans. Source: Adam and Lahsasna 2013; Majlis Ugama Islam Singapura (MUIS) 2014; Rocha et al. 2011a

According to the Financial Access and Stability Review by the World Bank in 2011, the total unmet demand for loans by SMEs in emerging markets was between US\$2.1 trillion and 2.5 trillion. The report further states that the proportion of loans from commercial banks that benefited SMEs in the GCC did not exceed 2 per cent in 2011. Comparable figures in Saudi banks also did not exceed 2 per cent (Figure 3.2) (Adam & Lahsasna 2013; MUIS 2014; Rocha et al. 2011a). This large credit gap is a challenge as well as an opportunity for financial providers including banks and governments alike.

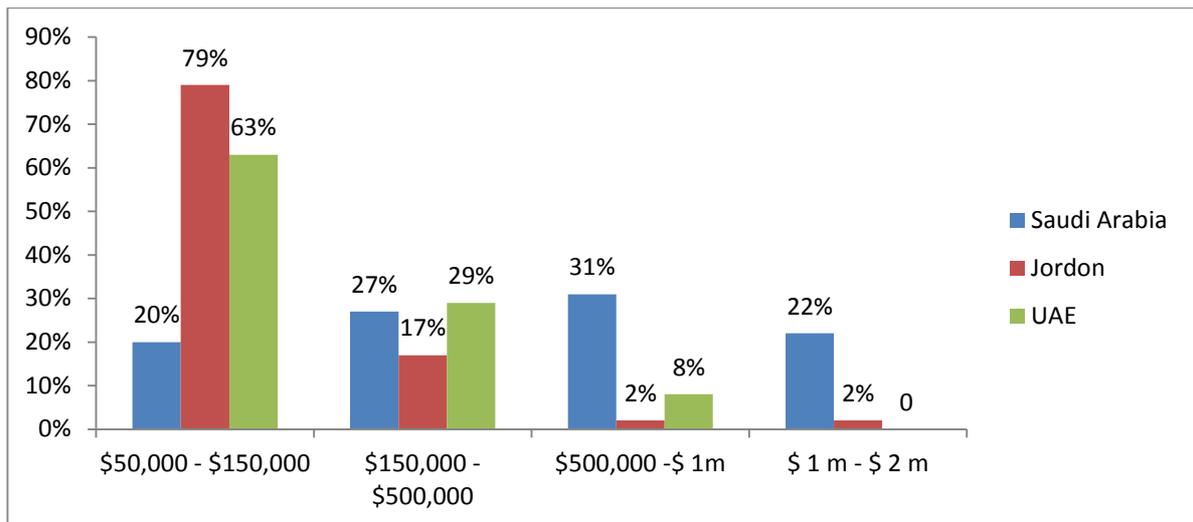


Figure 3.3: Desired Financing Amounts for SMEs in Saudi Arabia, Jordan, and UAE.
Source: Hasan 2008

Hasan (2008) studied the SME market in Jordan, Saudi Arabia and the United Arab Emirates, in order to better understand their needs and the challenges that SMEs face. The study used questionnaires with 150 local SME owners across the three countries, and interviewed 50 expert intermediaries from governments, banks, academia and international donors operating locally. The result showed that around 20 per cent of SME owners in Saudi Arabia require between US\$50,000 and \$150,000, and around 27 per cent, between US\$150,000 and \$500,000 (Figure 3.3). More than half reported financing requirements of \$500,000 or more (Hasan 2008).

3.4.4 SME Constraints on Access to Bank Finance

The problem of lack of access to financing is significant: most SMEs face credit challenges to finance their business activities in several ways. Although there is no difference between small and large firms in terms of financing sources, the difference lies in the ease of access to those sources. Therefore, finance choices for SME entrepreneurs are influenced by the available internal and external sources of funds. Even though internal sources of finance are considered to be the basis for start-up stages for most SMEs, these entities need external or debt finance at the early growth phases in their life cycle when cash flow is irregular. However, creditors and financial providers need guarantees from SMEs to ensure repayment in view of information

asymmetrics. Thus, lenders decide to finance businesses based on the owners' creditworthiness and the expected cash flow of the project. As a result of the high risk inherent in financing SMEs, lenders may resort to charging high interest rates with short-term loans in order to avoid any financial risk (Berger & Udell 1998; Fraser 2004; He & Baker 2006).

Many studies have emphasised that the major obstacle to SME growth is access to finance (Beck & Demirgüç-Kunt 2006). According to a study conducted by the OECD (2000) in various European and Asian countries, access to finance is at the top of the list of obstacles facing SMEs in these countries. Hussain et al. (2006) investigated SME access to finance in the UK and China. The authors selected 32 owners and managers of SMEs in each country in order to discover their source of funding and other financial supporting provisions. SMEs in both countries similarly utilise internal sources of financing, such as personal savings and family support during their start-up stages. However, in the advanced stages of the business life cycle, the UK firms relied on financial institutions whereas those in China relied on family support to obtain credit. Further, the lending policies of UK banks are more controlled and centralised when financing SMEs, and they only provide short-term loans to reduce their financial risks. This approach tends to impose constraints on the growth of SMEs by limiting their strategic planning.

OECD surveys on access to finance (debt and equity finance) for 20 OECD member countries and 12 non-member countries in 2004 revealed a significant problem of obtaining funds, especially in developing countries. The study also stated that 'due to the problems of dealing with uncertainties such as agency problems, asymmetric information, adverse credit selection and monitoring problems', banks and other financial providers offer high interest rates and ration credit, making it difficult for most potential borrowers to access funding and credit (OECD 2006b). As shown in Figure 3.4, around 80 per cent of SMEs in OECD countries have a financial gap, compared with around 90 per cent in non-OECD countries (OECD 2006b). Further, equity finance in OECD countries indicated significant gaps except for debt.

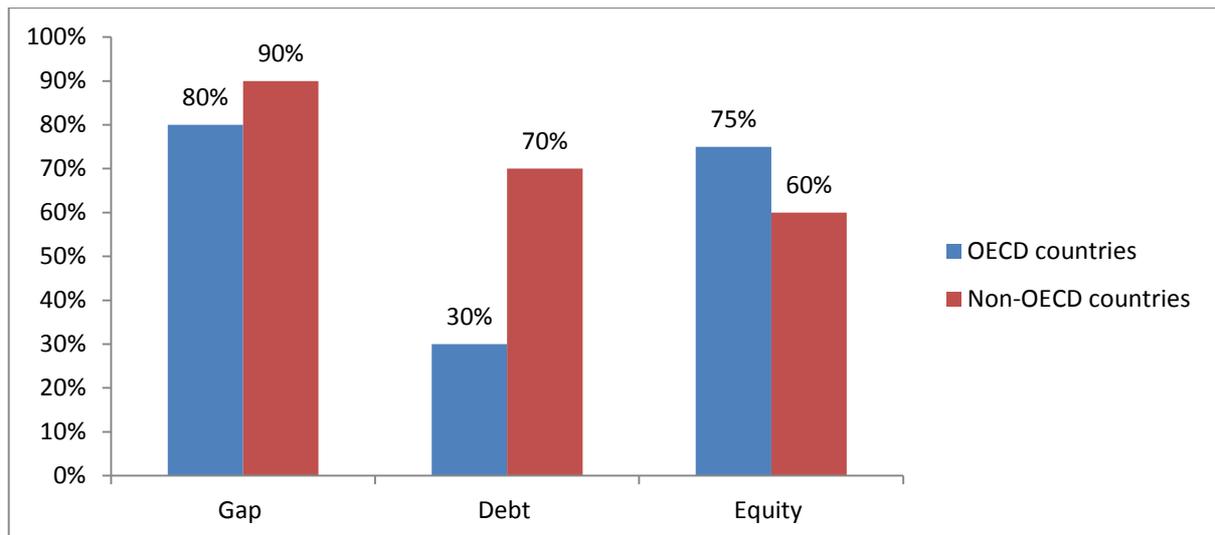


Figure 3.4: The SME Financing Gap: Theory and Evidence (OECD 2006b)

One of the main prerequisites for a firm's growth and development is having adequate funds and ease of access to finance (Black & Gilson 1998; Wilson 1994). However, SMEs are struggling to access finance and raise funds from banks and other external finance sources (Smorfitt 2009; Storey 1983), which causes most to fail due to lack of capital (Hall & Young 1991; Smallbone & Rogut 2001).

Al-Kharusi (2003) investigated financial constraints and obstacles to accessing capital faced by Omani SMEs in the manufacturing, trade and services sectors. The study analysed two main dependent variables in order to determine the need for finance and difficulties in raising finance in Oman. Three independent variables included were company characteristics, owner and manager characteristics, and Islamic financial methods. The study framework considered three main theories: agency, capital structure and information asymmetry theory. Agency theory was used to characterise the relationship between SMEs and their financing partners with the aim of separating ownership from management, and defining the relationship between the manager/owner and the investor/lender (Berger & Udell 1998; Coleman 1998; You 1995). The study used structured questionnaires and interviews and data were analysed using ANOVA as well as chi-square tests to determine if there was a need for external finance (Oakey 1984). The study found that the three sectors are in need of financing and there is a financing gap primarily because the government can only provide limited support. Further, the study found that most Omani banks were reluctant to lend to SMEs and turned down most of their loan applications because most firms provided incomplete business plans and lacked sufficient collateral. In

addition, Al-Kharusi (2003) suggested that the commercial banks would be better off using Islamic financial products for financing SMEs, as most Omani entrepreneurs prefer the Islamic financial system.

Dabo (2006) examined the availability of finance to SMEs in Nigeria in the manufacturing, trade and services sectors. The study used agency and information asymmetry theories to assess factors that affect the relationship between the provider or principle (banks) and the agent (small firm) (Binks & Ennew 1996; Broecker 1990; Lean & Tucker 2001). In addition to the agency theory, the study used the moral hazard theory, as owners are expected to assume the risks associated with the loans (Binks & Ennew 1996; Taylor 1998). Dabo (2006) used five main dependent variables including whether or not SMEs applied for debt finance; whether or not they applied for equity finance; difficulties in raising external finance; acceptability of external finance offered; and use of Islamic equity finance. The independent variables used were SME characteristics, owner/manager characteristics, whether they had a business strategy, the financial institutions approached, and whether they used Small and Medium Industries Equity Investment Scheme funding or Islamic finance. Meanwhile, the study adopted a mixed method approach, using questionnaires, interviews and case studies to collect the primary data for the research. The study found that the characteristics of lenders affected the decision to apply to banks as external sources of finance. The study also found there is a gap in Nigeria in terms of financing SMEs, and that Nigerian banks charge high interest rates for a short period to fund these entities.

According to Fatoki & Smit (2011) and Trust (2006), 75 per cent of new SMEs established in South Africa fail within the first two years of the business life cycle. The report stated that SMEs in South Africa faced many challenges that lead to a high failure rate. One of the major impediments is the cash flow problem. Most SMEs in South Africa struggle to access finance and raise funds from banks, which affects their capital structure and performance (Smorfitt 2009).

The issue of access to finance in the SME sector has received little attention in Saudi Arabian literature. However, the focus of the current study is more on access to bank finance for Saudi SMEs. Among the oldest and most significant research on financing constraints of SMEs in

Saudi Arabia was conducted by Hajjar (1989), who investigated small and medium-sized businesses in the Saudi economy in order to find ways to improve this sector's contributions to the country. The study further focused on the importance of capital provision to small firms in order to encourage their growth rates. To achieve the objective of the study, the author identifies the main difficulties that small businesses face in accessing internal or external sources of finance. In addition, the study identifies the constraints on commercial banks and government funds in terms of providing appropriate financing to small businesses. A case study approach was used as a way of identifying financing problems encountered by small businesses. The findings provide further evidence on the inadequacy of access to financial resources for small businesses in Saudi Arabia. Hajjar's (1989) study added that most SMEs in Saudi Arabia are facing difficulties in obtaining loans from external finance sources.

In another study on financing issues for Saudi SMEs, Kola (2001) found that one challenge is the high cost of finance charged by financial providers due to information asymmetry, and insufficient collateral provided by small firms. The study concludes that most Saudi entrepreneurs are dissatisfied with the existing finance providers as they face a complicated loan procedure, high requirements and lack of flexibility in the terms and conditions, which are too cumbersome to meet (Kola 2001; Looney 2004).

Beck et al. (2005) investigated how access to finance constraints affect SME growth. An analysis of survey data revealed that lack of access to finance may slow growth rates of the most promising firms. Other finance-related factors that pose barriers to firm performance are high interest rates, bank paperwork and bureaucracy, and collateral requirements. Further, when a country has a greater financial inclusion system, it can play a part in improving access to capital, promoting start-up firms and enterprise development, and sustaining growth for SMEs, which would have a positive effect on the national economy.

Although the SME sector plays an important role in developing the national economy, the difficulties that this sector encounters in accessing external and debt finance remain a global problem (Wu et al. 2008). In fact, access to finance for SMEs in both developed and developing countries has been considered in many studies (Rogerson 2008; Torre et al. 2008), and many

studies have suggested further research into the obstacles that SMEs encounter with respect to access to finance (Maas & Herrington 2006).

3.4.5 Factors Influencing Access to Finance

Several studies have concentrated on the definition of the financial gap in the context of access to finance by SMEs (Bhaird & Lucey 2006; Carter et al. 2003; Watson et al. 2006). Some factors influencing access to finance are discussed in the following sections.

3.4.5.1 Supply-side Factors

The financial gap for SMEs has long been a topic of debate in most advanced developed countries such as the UK, US and Canada, and in the EU. There is agreement that the reasons for the poor access to finance by SMEs relate to either unavailability of funds or the cost of funds being high compared to that experienced by large firms (Holmes et al. 2003).

Unlike large firms, SMEs have limited access to finance from financial providers because of their lack of skilled management and of reliable financial information. Because of the high risk of failure and high operational costs associated with SMEs, banks often charge higher interest rates and transaction fees to SMEs than they do to larger businesses. This is done to account for the higher risk involved (Coleman & Cohn 2000). Holmes et al. (1994) investigated 425 firms including SMEs and large businesses, finding that the cost of funds and loan application fees is greater for SMEs than for large businesses, so that banks can reduce the high default risks involved in funding SMEs. It is known that the cost of loan applications for SMEs is always higher than it is in large firms. There is a negative relationship between the cost of loan applications and loan amounts; that is, for a large loan amount the application costs are low. As SMEs always apply for small loans, the cost of the application is most often high (Gibson 2002). As a result, SMEs are often forced to resort to other informal sources of funding where interest rates are higher. Hence, SMEs avoid borrowing amounts more than they are able to repay, to reduce their solvency risk (Office of SMEs 2001).

3.4.5.2 Demand-side Factors

Although government intervention is aimed to increase the fund supply for SMEs, most banks and financial providers are still are not interested in providing capital at the start-up stages of the SME business life cycle. Therefore, SMEs have to be investment ready in order to obtain easy access to debt and equity credit (Harding & Cowling 2006; Harrison & Mason 1996). Mill Consultancy (2013) defines investment readiness as having ‘sufficient information, credibility and trust to an investor, to motivate him to invest in a proposition’ and being attractive to financial providers. The main reason for constraints on most SMEs with respect to accessing finance is that they usually are not investment ready (Harding & Cowling 2006). To assess whether a firm is investment ready, three dimensions can be explored: owner/manager readiness (Harding & Cowling 2006; HMT 2003a; Kotey & Meredith 1997), business readiness (Bhaird & Lucey 2006; Esperanca et al. 2003) and information readiness (HMT 2003a; Mason & Harrison 1996).

1. Characteristics of the Owner/Manager

Owner/manager readiness is the attractive characteristic of the owner/manager that is provided to capital providers, to motivate them to invest in such firms. There are four main characteristics of owners/managers of the business that influence its access to finance: work experience, level of education, age and gender (Cooper 1998; Crook 1997).

a) Experience

According to Bukvic and Bartlett (2003), the work experience of the firm’s owner/manager is one of the most significant factors that financial providers consider when they make a financing and investment decision. Bukvic and Bartlett (2003) argue that when the owner/manager has prior experience in business, funding providers will be more confident to lend to them, since they have more knowledge and skills in managing the business, which ensures greater control over potential risks. The work experience of the owner/manager of an SME has a positive effect on access to finance in Saudi Arabia (Hajjar 1989).

Greater managerial experience leads to improved business performance (Pelts et al. 1998). In fact, Storey (1994) argues that the entrepreneur with adequate prior experience can more easily play a significant role in managing and organising the work, which can promote the growth of the new firm. Conversely, Kvale (1996) found that a lack of prior experience for many SME owners and managers creates higher risk, which affects a firm's ability to access external finance.

b) Education and Training

A number of studies have reported that the level of an owner/manager's education influences their knowledge of running and managing financial planning for their business. This increases ability to obtain funds (Coleman 2004). An empirical study by Storey (1994) identified that entrepreneurial characteristics such as educational level, management skills, training and previous experience all have a significant influence on the success of firms.

A number of studies have reported that education and skill level, as well as the business experience of the SME owner or manager are the main factors considered by financial providers and banks when making financing decisions (Bukvic & Bartlett 2003). In fact, these characteristics may have a significant effect on the performance of managers of the business and thereby influence the growth and development of a firm (Pelts et al. 1998). Bukvic and Bartlett's (2003) contention is that when the owner or manager has more prior experience in business, fund providers will be more confident in lending them money because they have more knowledge and skills in managing the business and controlling for potential risks. Coleman (2004) and Merritt (1998) report that the level of an owner's or manager's education positively influences their knowledge of running and planning the business, which increases their ability to obtain funds when required (Coleman 2004).

To ensure improved performance, SME managers need to keep up to date with new knowledge and skills in different fields of business and management through training and workshop programmes (Pinson 2004). At the same time, organisations have to provide regular formal

training courses for their employees to enhance skills in performing their jobs (Fisher & Schoenfeldt 1999). Most companies provide training to their employees for many reasons. When the firm hires new employees, they need orientation and teaching for better understanding of their initial role. Through training, the organisation aims to enhance worker level skills and increase their commitment to their work. Also, training increases job satisfaction (Khan & Bhatti 2008; Rashid et al. 2012).

Akram et al. (2011) measured the performance of 215 small enterprises in Jamaica by examining the influence of owners' human, social and financial capital on their business profitability. The study found that vocational training and owner experience were positively associated with increasing profits of the business.

c) Gender

There is some evidence that female owners/managers are less successful at accessing equity and debt finance (Saffu & Manu 2004, Shaw et al. 2006). A 2003 study shows only 4.2 per cent of US\$19 billion in VC went to female-owned enterprises in the US (Foreign Investment Analysis Service (FIAS) 2008). However, other studies (e.g. Coleman 2002; Fabowale et al. 1995), show that men and women have an equal ability to access financing. According to Nicola (2011), female entrepreneurs in MENA countries have limited access to finance due to a lack of collateral, training, experience and business knowledge—especially in the fields of marketing and finance—which makes it difficult for women to appropriately present their investment projects to financial providers or investors. Another report Global Partnership for Financial Inclusion (GPMI 2011), shows that around 40 per cent of female-owned SMEs in the Middle East are unserved by bank credit services such as overdrafts, financing, leasing and trade finance. The reasons typically given for this are female characteristics higher business risk and cultural bias (GPMI 2011). Although bank credit and equity fund availability has increased in the US, female entrepreneurs still encounter difficulties in obtaining finance because of their lack of education and business experience (Carter et al. 2003). However, in an investigation of barriers to raising bank finance faced by SMEs in the UK (specifically the influence of personal characteristics such as ethnicity, gender and education), Irwin and Scott (2009) found that gender has no significant effect on access to bank credit.

In Saudi Arabia, female entrepreneurs face many challenges when attempting to start a business, such as barriers to accessing bank finance, the need for male permission due to religious tradition, and lack of business experience (Minkus-McKenna 2009). Sadi and Al-Ghazali (2010) investigated 350 female-owned businesses in Saudi Arabia and found that Saudi women confront a variety of challenges that prevent development and growth of their businesses. These challenges include obtaining capital, overcoming traditional restrictions, and facing a lack of market studies, community support and coordination between various government departments. Further, Danish and Smith (2011) analysed data from 33 Saudi women entrepreneurs in commercial sectors, including those that exited businesses and those in the process of establishing one, to determine the challenges and constraints faced by SMEs owned by Saudi women. They found that less than 3 per cent finance their businesses through commercial banks; the main funding source was personal finance (personal savings, family or friends' resources). In order to improve access for Saudi females, the need for more training and mentoring and the removal of some government and administrative procedures were stressed.

2. Business Characteristics

Business readiness refers to characteristics of firms that encourage debt and equity financial providers to invest in such business (Bhaird & Lucey 2006; Esperanca et al. 2003). To encourage financial providers to provide funds to SMEs, the owner/manager of the business has to prove the ability of the firm to repay loans through its financial leverage ratio and the size of the business (Berger & Udell 1998; Esperanca et al. 2003). There is a relationship between the financial leverage (the amount of debt that a firm uses to finance its assets) and access to finance. In other words, the higher the financial leverage (debt more than equity) of the firm, the higher the bankruptcy risk and the less attractive the firm is as an investment for finance providers (Beal & Goyen 2005; Cassar & Holmes 2003). Other studies consider business characteristics that influence ease of access to the current financial services provided by banks, such as availability of a business plan, business size, business growth and profit, and business type (Abalkhail 1999; IFC 2012; Kushnir 2010; Sejjine 2000).

a) Business Size

Several studies on SMEs show that the size of the firm determines its ability to obtain funds. Most SMEs are unable to access finance as they lack financial information and tangible assets as collateral (Abor & Biekpe 2005; Berger & Udell 1998; Coleman 2004; Coleman & Cohn 2000).

Several studies indicate that the source and amount of external finance for SMEs vary according to the stage of a firm's life cycle (Hartley 2004; Kohlbacher 2006; Smallbone & Rogut 2001; Stake 2000). Sahliman (1990) and Wetzel (1994a) argue that start-up firms might encounter more difficulty in obtaining external finance due to the opaqueness of their business. Therefore, most SME owners depend heavily on personal savings and loans from family and friends for financing their new start-up. SMEs typically rely on the firm's retained earnings during the early growth stages. However, Al-Kharusi (2003) failed to find any association of the employment size of small businesses and the need for external finance, with difficulties in the process of obtaining external finance in SMEs in Oman. In Australia, any businesses with turnover less than AU\$50,000 have no lending products and face difficulties accessing finance (ABA 2013).

SMEs face constraints in access to credit because they have fewer tangible assets such as an inventory and equipment to serve as collateral, which reduces the probability of obtaining a loan (Berger & Udell 1998; Keasey & Watson 1993). Lenders and investors prefer not to risk their investments by lending to small businesses due to a lack of collateral. Abor and Biekpe (2005) and Baxter and Jack (2008) report that banks are more comfortable financing firms that have adequate tangible assets in order to mitigate risks associated with information asymmetry and moral hazards. One of the main reasons behind the reluctance of investors and financial providers to provide funds to SMEs is the size of such businesses (IFC 2012; Kushnir 2010). Based on the adopted definition of SMEs, as discussed in Section 2.1.2, the current study will use the number of employees and sales turnover as a measure of the size of a firm.

b) Business Plan

Information readiness is the ability of SMEs to provide adequate information to attract credit providers. Most SMEs face obstacles in obtaining external equity and debt due to inaccurate, incomplete or unavailable recording of financial and non-financial information about the business. Thus, the provision of financial information and a business plans for an SME has a positive effect on its access to finance (HMT 2003a; Holmes et al. 2003; Mason & Harrison 1996).

A business plan is a written document setting out the business goals, describing the nature of the business and its strategies including the marketing and financial strategy, and containing information about the organisation's team, customers and competition (Pinson 2004). It is an important document needing to be prepared at the start-up stage of a business. It provides directions and guidelines to the owner/manager of the business and contains five sections: executive summary, description of the business, description of the product or service, market analysis and financial forecasting (Pinson 2004). Typically, a business plan is prepared by the owner/manager of the firm, who spends substantial time collecting accurate data to develop realistic and practical expectations for the firm's future. The business plan should be regularly updated.

Bank and loan providers consider a business plan as the main document required for determining the potential success of the applied project by assessing the repayment ability of the owner/manager. Therefore, the availability of a feasible business plan favourably influences SME access to finance, as banks and lenders prefer to offer loans based on the reliability of the business plan (Barrow 1993; Berry et al. 1993a; Reid 1998). In the GCC region, most start-up businesses fail to obtain funding through banks and investors because of a poor business plan (Abalkhail 1999; IFC 2012; Kushnir 2010; Sejjine 2000).

c) Business Growth and Profit

Numerous studies have discussed the constraints of SMEs in accessing external finance (e.g. Abalkhail 1999; Ibrahim 2006; IFC 2012; Kola 2001; Kushnir 2010; Sajini 1997; Sarkar 2000;

Sejjine 2000; Storey 1994). This difficulty in obtaining funds affects business performance (Zikmund & Babin 2010) and growth during both the early years and over the life of the firm (Everitt 2002; Malhotra 2009). Doumato (2010) examined the positive relationship between access to credit and the performance of garment producers. Performance was measured by current profitability percentages and employment growth rate percentages for the period 1995–2003. The authors found that different factors affect credit access on the one hand and growth and profitability on the other. They suggested that further research in the field, especially from a developing economy perspective, was required. In addition, Aremu and Adeyemi (2011) observed a positive relationship between access to credit and total factor productivity in Bulgarian firms.

From a developed economy perspective, the United Nations Development Programme (UNDP 2011) measured the relationship between access to finance and productivity in the US using a triple testing approach. The authors found that the productivity of the firm increases with strong access to finance. Generally, a high growth rate may have an effect on a firm's ability to access finance from banks and other financial institutions: banks and other financial providers are probably more willing to fund SMEs that have high potential growth in the market with a good cash flow position (Ahmed & Hamid 2011). Other studies (e.g. Ayyagari et al. 2008; Beck et al. 2005) showed that enterprises with greater access to finance are also more likely to have strong growth rates.

d) Business Ownership Type

The legal structure of a business can affect its ability to access external sources of finance (Barlow & Robson 1999; Binks & Ennew 1997; Merritt 1998). Deakins and Freel (2003) observed that incorporated firms have more credibility with financial institutions and are more likely to have easy access to external finance than are unincorporated (small business) firms. Owners/managers of SMEs therefore will face greater difficulties when attempting to raise capital due to the lower preference for funding unincorporated firms. In sum, the small size of firms, their lack of collateral and the higher risks associated with SMEs can impede their access to finance (Freedman & Godwin 1992).

3.4.6 Banks and Small Firms

Banks have evolved and become one of the fundamental pillars in the economic development of most countries worldwide, through their main functions (Abu Hamad 2002). Saridakis et al. (2011) have found that there is a positive relation between bank finance and SME survival. Banks support businesses that are focused on maximising their value and at the same time controlling risks. Therefore, when a bank takes a decision regarding a loan application from a small firm, it focuses mainly on the risks involved, and finding a way to mitigate those risks.

Hall and Hutchinson (1995) investigated the relationship between SMEs and their banks, finding that although the relationship between firms and banks is ambiguous and has been scrutinised, the SME sector represents a significant market for most commercial banks (Hall & Hutchinson 1995; Henderson & Harvey 1995). Financial services provided by banks to SMEs take several forms, including short-term loans, trade credit, credit cards and overdrafts. These suit the financing needs of SMEs for their day-to-day activities (Hutchison & McKillop 1992). Berry et al. (1993a) argue that there are three main reasons for the importance of the SME sector for banks: (1) most small firms depend on banks as their main financing source ahead of any other external source of capital; (2) there is less competition among commercial banks for financing small firms; and (3) the SME sector has high potential growth in the national economy. In fact, banks in most developed countries have ambitious strategies for supporting SMEs in their countries, including providing funds and engaging in consultations to develop this sector. According to OECD (2006a), most OECD countries are able to access bank finance and obtain sufficient credit.

In contrast, in many emerging markets SMEs do not have access to bank financing as banks in these countries inhibit SME lending (OECD 2006a). Like other requirements, such as the legal framework, marketing and sales, access to bank finance is one of the most important requirements for the development of SMEs. Therefore, the lack of access to bank credit is the main obstacle facing these projects that bars their growth (Hutchison & McKillop 1992). Most SME owners start their businesses with their own savings or with the financial help of friends and family, but when their businesses begin to develop, grow, expand and diversify, external equity and debt is needed in order to finance their investment needs (Berger & Udell 1998; Storey 1994). According to Beck et al. (2009) and International Trade (2009), the cost of

finance and access to finance are ranked as the top seven important challenging factors that face SMEs and that have an effect on the growth and performance.

Access to bank credit by SMEs, according to many studies (e.g. Binks et al. 1992; Mannan 2007; Oakey 1990) is subject to severe restrictions such as strict lending conditions, high interest rates, high administrative fees and short loan durations. All of these requirements imposed by banks are difficult for most SMEs to meet. In many cases, banks in most emerging markets are subjected to high interest rates that make it complicated to price credit to SMEs in a way that mitigates the lending risk. Therefore, the absence of track record, existence of information asymmetries, high risks involved with such businesses, and lack of collateral are all factors that would leave a large number of potential entrepreneurs without access to bank credit (Mannan 2007). As a result, banks are less willing to fund individuals who cannot commit to repay the loan, and most impose conditions to ensure that borrowers will fulfil their obligations (Abor & Biekpe 2005). Nonetheless, if the banking system is willing to earn reasonable returns and shows little intention to lend to SMEs, this will be a real incentive for firms to provide credible and transparent accounts (OECD 2006a).

Banks, in many cases, enforce several lending conditions in a loan contract before granting the loan to SMEs. Such conditions include obtaining personal commitments and adequate tangible assets as collateral. Typically, the value of the collateral is higher than the value of the granted loan, and can be taken over by the bank in case of payment default (Kayanula & Quartey 2000; Muhammad et al. 2010; Subhan et al. 2013). Further, Smallbone et al. (2001) found that most loan providers required collateral as security. Given the prevalence of this practice, the value of collateral can constrain the growth and success of SMEs (Foreman-Peck et al. 2006).

Generally, the main difficulties faced by newly established SMEs when applying for a bank loan is the uncertainty associated with their lack of track record and credit history. This uncertainty makes the banks reluctant and uncomfortable to approve and grant funds to an SME, as this is associated with high credit risk. Therefore, banks resort to requesting high guarantees to secure the loans.

In fact, the constraints and difficulties that limit most enterprises in obtaining bank credit have created a big gap in lending relationships between banks and SMEs. As information about

SMEs is difficult and costly to obtain, the lending relationship is considered as an appropriate way to cope with the lack of transparency between the two parties. Relationship lending is 'based significantly on "soft" qualitative information, gathered through contact, over a period of time with the SME and often with its owner and members of the local community' (Subhan et al. 2013). Such soft information collected from suppliers, customers and competitors can be used to assess the future prospects of SMEs (Ibrahim et al. 2013; Lahsasna 2010). A long-term relationship between the bank and a firm may enhance access to credit for the firm (Ahmed 2007). As a result, loan interest rates decline over time, and long-term loans are provided to SMEs (Lahsasna 2010). Bass and Schrooten (2004) assert that information asymmetry will lead to high interest rates, even if there is a long-term relationship between borrower and bank. Other empirical studies discovered that there is a positive relationship between banks and borrowers, and access to finance and credit conditions and requirements, such as loan interest rates and collateral requests (Ibrahim et al. 2013; Lahsasna 2010).

As observed by Youssef (2012), the interaction over prospective business loans between banker and borrower are unfavourable for the owners/managers of SMEs. The banks claim that financing SMEs is not problematic; instead the real problem lies in the scarcity of economically and financially viable commercial projects and entrepreneurs (Pretorius & Shaw 2004). The characteristics of entrepreneurs, such as management skills, business experience and project attributes can be a hindrance to successfully accessing finance (OECD 2006a).

Banks and other financial institutions finance SMEs by (i) employing assets-based lending, in which assets are pledged as collateral; (ii) financial statements lending, which relies primarily on a strong financial condition of the firm; and (iii) business credit scoring, which is based on the personal credit history of the owner and the firm obtained from consumer credit bureaus (Subhan et al. 2013). In advanced countries, the banking systems are adopting the credit scoring model to distinguish between high and low risks. This approach assesses the riskiness of loan applicants with a view to overcoming information asymmetry problems. The credit scoring technique can be used to predict the performance of an existing business based on its previous experience, determine loan approvals based on credit scoring techniques, and also verify client information. This enables the bank to reduce the cost and time of processing loan applications. After the SME submits an application with all required documents, the credit scoring software

assigns a score based on data provided by the borrower (Moullin 2003, p. 3). The decision to grant the loan depends on the result of the credit scoring assessment. IMF (2013) investigated the credit scoring situation for SMEs in Kenya, finding that most lenders are not using credit scoring for assessing the credit risk of Kenyan SMEs, with the exception of two large banks that have developed their own internal models to assess SME loan applications. The study concludes that by adopting the credit scoring approach, Kenyan credit bureaus will enhance the lending process and reduce the borrower's risk, reduce the interest rate and have fewer collateral requirements (IMF 2013).

Several studies have shown that sharing credit information has a positive effect on credit access to SMEs and is associated with higher lending (e.g. Braun and Clarke 2006; Guest et al. 2012). In the case of the US, the credit scoring and proprietary information of owners of SMEs has been obtained from credit bureaus to assess creditworthiness and reduce transaction costs of loan processing. Hence, the lending to small firms by banks has increased over recent years (Howitt & Cramer 2008).

Mutezo (2005) and Van Eeden et al. (2004) argue that banks often impose a number of stringent lending criteria and conditions that must be met by applicants to receive credit, but most SMEs do not meet them. Therefore, banks refrain from financing their needs. For the most part, the lending policy and criteria of the bank for financing SMEs is established by authorities and senior management of the bank, who determine the rules and requirements. Despite differences in these policies from one bank to another, there are often similarities in terms of the general framework of the component and contents (Abu Hamad 2002). Components of bank lending policies with respect to financing SMEs include: (1) legal liability legislation in terms of interest rates, minimum funding and economic activities to be funded; (2) the acceptable collateral by the bank, where the client specifies the type of collateral to be accepted to mitigate the risks inherent in lending operations, and (3) determination of the loan term. In most cases, banks provide only short-term loans for SMEs in order to reduce the risks associated with granting loans (Abu Hamad 2002). Nakamura (1993) and Lewis et al. (2011) point out that when the economy is down and affected by recession or financial crisis, most banks take a more hard line approach to lending by raising their financing conditions and requirements for security and loan guarantees.

3.4.6.1 Reasons for Failure to Obtain Bank Finance

Commercial banks create value through applied loans by mitigating and controlling the risks involved. Based on the abovementioned literature, there are several reasons behind the reluctance of banks to lend to SMEs:

1. The principal–agent problem consists of adverse selection and moral hazard.
 - 1.1 The adverse selection problem arises due to the high risk of borrowers, who are unable or unwilling to repay their debt. Therefore, the finance provider (principal) would provide loans to the agent (borrower) with a high-risk premium to minimise potential bad debts and monitoring costs (Demirgüç-Kunt et al. 2008).
 - 1.2 The moral hazard reflects the risks arising from one party of the lending transaction (agent or principal) in good faith. Moral hazard exists when one party bears the risks over the other party, due to information advantages. In order to overcome these risks, the principal (bank) requires a high collateral requirement to ensure the commitment of the firm’s owners (Braun & Clarke 2006; Deakins & Hussain 1993; Dembe & Boden 2000; Storey 1994).
2. Transaction cost problems arise from information asymmetries, resulting in the high cost of loans. There are always transaction costs associated with small loans, which could diminish investment returns of small enterprises (Demirgüç-Kunt et al. 2008; Ganbold 2008). Thus, banks are reluctant to offer loans to SMEs, to avoid high transaction costs that affect bank profits: ‘the larger the loan, the smaller the unit transaction cost’ (Duan et al. 2009).
3. Information asymmetry is insufficient or absent information available to financial providers relating to the owners/managers of the business or the business itself, due to a lack of accounting records and audited financial statements. Also, the hindrance of access to SME information from credit and financial providers makes SMEs suffer from credit rationing and causes serious problems in accessing finance (Abereijo & Fayomi 2005; Duan et al. 2009; Ganbold 2008; Mutezo 2005; Van Eeden et al. 2004). Additional literature on SME access to finance (Abereijo & Fayomi 2005; Demirgüç-Kunt et al. 2008; Torre et al. 2006; Turner et al. 2008) indicates that a well-established credit and financing information-sharing infrastructure with respect to firms, and well-developed auditing financial statement reporting greatly improves access to finance for SMEs.

4. Limited collateral is a problem for SMEs: banks mitigate the risks associated with lending to SMEs by demanding high collateral. This constitutes an obstacle to accessing credit and obtaining the necessary funds from banks. Most finance providers make financing decisions based on criteria such as ‘credit history, past bank account management, entrepreneurial track record, willingness to invest own money and evidence of repayment capability, based on the merits of the business or investment proposition’ (Bakhas 2009; HMT 2003b). Thus, sharing the risk of loss with the lender through provision of adequate collateral provides an alternative source of repayment in case of borrower insolvency. Studies conducted by Abereijo and Fayomi (2005), Tagoe et al. (2005), Beck and Demirgüç-Kunt (2006) and OECD (2006a) found that a lack of collateral restricts access to finance for entrepreneurs, and also that the lack of suitable assets or collateral is a global phenomenon constraining SME access to finance.
5. Lack of financial information and poor business plans of SMEs are a problem because banks make lending decisions based both on the strength of financial statement records, and a clear and feasible business plan of applicant firms. SMEs typically are not very good at bookkeeping because of a low volume of business activities and lack of knowledge about accounting. When a business applies for a loan, the bank scrutinises the financial condition of the firm through their financial statements in order to judge the ability of the firm to meet its short- and long-term repayment obligations (Matthew 2011). According to Al-Kharusi (2003), one of the main reasons for the failure of entrepreneurs in obtaining finance by banks in Oman is their inability to provide banks with financial statements and relevant accounting indicators. The banks use this accounting information to analyse the firm’s financial performance and its level of profitability, liquidity, cash flow and stability, before funding business applicants (Business Finance Market 2008).
6. Finally, the business plan of a firm is considered as the most significant written document required by the bank as a condition for applying to finance. Business plans prepared by the entrepreneur describe their business goals, and contain overall marketing, financial and operational information to enable owners, managers and financial providers to have a clear vision of the firm’s potential costs, profit and risks (Pretorius & Shaw 2004; Timmons & Spinelli 2007). Aryeetey (1995) highlights that poor financial recording and lack of a business plan always disqualify a firm from obtaining funds. Abereijo and Fayomi (2005), Beck and Demirgüç-Kunt (2006) and OECD (2006a) point out that SMEs have a great opportunity for easy access to bank credit simply by presenting a qualified business plan.

Mutezo (2005), Torre et al. (2006) and Van Eeden et al. (2004) have identified a number of other factors that influence access to finance by SMEs: lack of entrepreneurial and microfinance skills within financial institutions, discrimination, lack of management and business skills, lack of investment readiness and poorly developed business plans, lack of access to and awareness of business information, lack of mentoring and assistance, and lack of government support. In addition, Abalkhail (1999, p. 44) found that most of the reason behind reluctance of banks to finance SME is because these entrepreneurial firms often have 'short performance histories, small scale operations, weak access to supply and distribution markets, ill-liquidity, long development time, uncertain growth rates, no collateral, relatively high transaction costs for the size of the investment, potentially high information asymmetries between entrepreneurs and potential investors, and low survival rates'.

3.5 PERFORMANCE OF SMES

Measuring business performance is an essential element of assessing the ability of a firm's continuation and growth, and identifying its strengths and weakness. Preferred performance measurement models vary between researchers, depending on the objectives and questions of the research (Boyatzis 1998; Saleh 2012).

Smith and Reece (1999, p. 153) define business performance as 'the operational ability to satisfy the desires of the company's major shareholders'. Ordinarily, business performance is a measure of how well the firm achieves stockholder/investor interests. Another definition of organisation performance by Moullin (2003, p. 3) is that 'performance measurement is evaluating how well organisations are managed and the value they deliver for customers and other stakeholders'. Through his definition, Moullin (2003) aims to show the significance of the assessment to ensure the way the firm is managed, and how it progresses towards its goals and objectives. Generally, performance measurement is a process where information about business activities is gathered, monitored and assessed in order to achieve the determined goals. The current study focuses on the SME sector in the Saudi Arabian economy and carries out a detailed investigation of obstacles that affect its performance. The eventual aim is to propose remedies for these issues.

3.5.1 Factors Influencing SME Performance

There is no doubt that to enhance the contribution and performance of SMEs in the economy, decision and policy makers need to study the factors that affect the stability and sustainable growth of this sector (Gaskill et al. 1993). Despite the significant contribution of SMEs to the economy, they still encounter internal and external constraints that influence their sustainability and growth. This diminishes their ability to contribute effectively in the business world. According to Flahvin (1985), around 70 per cent of new start-up businesses fail within their first two years. Elasmag (2009) has concluded a number of problems facing SMEs in Arab countries, such as lack of IT support, management skills, and financial and human resources. He suggested that to overcome these difficulties and build a strong SME sector, the government has to support these entities. This can be done through laws and regulations that make it easy for such companies to do business, and provide financial and tax incentives.

Fouad (2013) investigated factors that affect the performance of SMEs in the manufacturing sector in Egypt, including management skill factors, in order to explore the obstacles facing Egyptian SMEs. Management factors like human resources, and financial, general, production and marketing management were identified and analysed. Fouad (2013) collected data through questionnaires completed by the owners/managers of 50 SMEs. The study found that most owners/managers of Egyptian manufacturing SMEs suffer from lack of management skills and lack of skilled human resources. This has a direct influence on their performance in the manufacturing sector. The study also found that the most important factors affecting the performance of SMEs were a lack of finance due to stringent requirements and high cost.

Similarly, Lussier (1995) interviewed 160 owners/managers of SMEs in Australia in order to find the most significant factors that influence their performance. The study found that lack of access to sufficient capital was among the top 15 factors leading to poor performance of SMEs. Other factors were record keeping and financial control, industry experience, management experience, planning, professional advisors, education, staffing, product/service timing, economic timing, age, partners, parents, minority and marketing. Further, Kihlstrom and Laffont (1979), Lean and Tucker (2001b), Luigi and Sorin (2009) and Tudose (2012) found that entrepreneurial factors related to the owners/managers of SMEs that influence business

performance include age, gender, work experience, management skills and availability of capital.

Similarly, Moorthy et al. (2012), attempted to identify the factors affecting the performance of SMEs in the manufacturing sector in Malaysia. The study investigated 300 SMEs in the Malaysian manufacturing sector using contingency theory. The study measured four main variables: effective entrepreneurship, appropriate human resource management, use of marketing information and application of information technology. In addition, the study employed other data analysis techniques, such as descriptive statistics, Pearson's product moment correlation coefficient and multiple linear regression analysis. The researchers report a negative relationship between ineffective entrepreneurship, as well as inappropriate human resource management and the performance of SMEs. Further, there is a significant positive relationship between use of marketing information and increased performance of SMEs in Malaysia.

Soini and Veseli (2011) identified external and internal factors affecting the growth of SMEs in Kosovo. Using qualitative and quantitative methods, the researchers collected primary data by interviewing managers of three Kosovar SMEs. Secondary data were compiled by reviewing the data relating to the current status of SMEs in Kosovo. The study compared multiple case studies and found several external and internal obstacles influencing the growth of SMEs. External factors included access to finance, competition, corruption and other barriers to trade. Internal factors included lack of skilled labour, marketing strategies, innovation level and investments in technology.

Alfaadhel (2010) identified the main obstacles facing SMEs in Saudi Arabia by presenting critical success factors on the demand side (owner/manager) and the supply side (provider). The study used a mixed methods approach to better understand the subject matter. Statistical analysis methods, descriptive statistics, frequency statistics and Analytical Hierarchy Process AHP test methods were applied to analyse the quantitative and qualitative data collected through questionnaires and interviews. Moreover, the author used SPSS software to analyse the data. The study measured 20 factors and structured them into three groups: entrepreneurial, enterprise and environmental factors. Further, it identified three factors—quality of the product and service, customer satisfaction and business planning—as the most significant ones for

owners/managers and support providers. The study further reported gaps in the level of support provided to SMEs to address their constraints.

With respect to Saudi Arabia, studies by Abalkhail (1999), IFC (2012), Kushnir (2010), Otsuki (2002), Sejjine (2000) and Shalaby (2004) have highlighted the main difficulties affecting SMEs, which are ‘the lack of funds, lack of skilled human resources, lack of management skills, lack of marketing skills, lack of modern technology, cost problems and raw material purchases, lack of information, lack of policy structure, regulation and lack of incentives, and weak bonds between SMEs and large enterprises’.

Based on previous studies, it is noted that among several factors influencing SME performance, access to sufficient finance was most frequently mentioned. A number of studies emphasised the importance of finance to business activities such as the development of products and services, business expansion, ensuring sustainability of the business and better performance (Leeds 2003). Therefore, the current study will examine the effect of access to bank finance on SME performance in Saudi Arabia.

3.5.2 Performance Measurement

Measurement systems for the performance of enterprises rely on available information about the environment and the current operational and financial performance of the enterprise. Firm performance refers to the firm’s ability to succeed in the market and achieve appropriate outcomes. The study of SME performance has attracted many researchers (e.g. Alasadi & Abdelrahim 2008; Cron et al. 2006; Jarvis et al. 2000; Thomas et al. 2008). There are many models and techniques for measuring the performance of organisations. These have been developed and integrated with the theories of management and business. The most popular models for assessing a firm’s performance relate to financial measures such as profit return on investment (ROI), sales turnover (Cron et al. 2006; Siegel & Castellan 1988; Wood 2006), and design quality and product improvement (Laura et al. 1996). Other studies have suggested measuring business performance using a balanced scorecard approach. This is based on evaluation of all business activities and performance in accordance with a strategic planning and management system (Kaplan & Norton 1996). Balanced scorecard forces are focused on

four important perspectives: learning and growth, internal business processes, customer and financial perspectives. This approach can be used for a variety of organisations including profit or non-profit, small or large, service or industrial, and government or non-government. However, the balanced scorecard technique does not provide a complete performance measurement system; it only provides executive managers with an instrument to monitor performance against strategic and operational objectives (Brignall 1991). It is more a strategic management tool than a performance measurement tool (Kaplan & Norton 1996). In addition, the balanced scorecard does not properly address the dimensions of performance addressed by the SMART pyramid and the determinants model (Neely 2002). Therefore, this model is difficult to use for many enterprises (Ittner & Larcker 2003).

Other scholars have examined business performance through financial evaluation based on analysis of records, financial statements and financial ratios. These indicators are typically linked to the goals of most owners/managers of enterprises (Palepu et al. 2000; Schutjens & Wever 2000; Siegel & Castellan 1988). Palepu et al. (2000) reported that return on equity (ROE) is one of the most significant indicators of the financial performance of a firm. They argue that return on assets is as important as ROE since it measures the ability of the firm to generate profit from its assets.

A number of researchers has emphasised use of both objective and subjective measures, as most owners/managers of SMEs are reluctant to cooperate and share their business information. This typically has a negative effect on the results of a performance measurement (Lumpkin & Dess 1996). The data required for the objective model must be collected over at least five years to provide a reliable and accurate snapshot of a firm. Further, subjective or non-financial measures determined by personal information are difficult to quantify. McMullan et al. (2001) show that subjective measures could lead to skewed results. They argue that when it comes to a firm's performance assessment, most owners/managers of businesses avoid providing any related information. Therefore, a number of studies found that both subjective and objective measures have a positive relationship with business performance, and combining the two methods increases the chances of a firm obtaining finance (McMullan et al. 2001).

The current study will measure the financial performance of SMEs using financial ratios and indicators such as profit margin, growth rate, sales annual turnover and ROI.

3.6 ISLAMIC FINANCE

Despite the importance of the banks to SMEs growth, it is unfortunate that SMEs face a number of obstacles in obtaining finance within the limited sources of finance (Black & Gilson 1998; Keasy & Watson 1993). In this section, the study will discuss other sources of finance that are available to the SMEs. One source of finance that has gained a vast degree of importance in the recent past is Islamic financial products.

In the recent years, Islamic finance and banking services have penetrated the market and have competed against conventional financial product and have gained widespread acceptance. This road, however, has faced many challenges mainly because of the apparent constraints (Heffernan 1996). Continued education of the general population and the specialist practitioners has helped to dispel the myths about Islamic finance and be accepted as part of the financial system in general. In the area of SME funding, however, the financial system, in general, have not made any strong contributions, despite the strong potential of the SME sector. This is especially true of the MENA region. A study by the International Finance Corporation found that the SMEs in nine countries, Iraq, Pakistan, Yemen, Saudi Arabia, Jordan, Tunisia, Morocco, Lebanon and Egypt will not consider conventional banking alternatives and are in need of up to \$13.2 billion in Islamic finance. For example, up to 90 per cent of SMEs in Saudi Arabia are in need of Shariah-compliant banking services, and around 35 per cent of them are refraining from utilising funds from non-Islamic banking sources (Ernst & Young 2014, IFSB 2014).

Islamic financing is flourishing around the world, particularly in Islamic countries; however, the size of businesses continues to restrict access to *Sharia* compliant financing. The IFC report surveyed 160 banks and found a potential gap between \$8.63 billion and \$13.20 billion in Islamic SME financing across nine countries (i.e., Iraq, Pakistan, Yemen, the Kingdom of Saudi Arabia, Egypt, Lebanon, Morocco, Tunisia and Jordan). Further, the IFC report noted that only 36 per cent of the 160 banks surveyed had SME offerings (Zeidane 2015). However, the IFC report noted that ‘Islamic Finance’s emphasis on asset-backed financing and risk-sharing

feature means that it could provide support for small and medium-sized enterprises' (Alam 2015).

Customer demand has created significant growth in the area of Islamic banking in Saudi Arabia. In 2013, 54 per cent of overall financing in Saudi Arabia was *Sharia* compliant (Gazette 2015). Given the desire and strong demand from customers (both personal and corporate) for external sources of Islamic financing, it appears likely that the Saudi banking market will convert to full-fledged Islamic banks. Thus, this study sought to investigate the relationship between the availability of Islamic financing and the desire of SMEs' owner/managers to apply for bank credit in Saudi Arabia. Further, this study identified the current Islamic financial products offered by Saudi banks and suggested other Islamic products that could be provided to meet the financial need of SMEs.

Presently, Islamic financing is undergoing significant growth and, for the last decade, has gained significant attention in the international finance sector. Islamic banking is a sector within the general Islamic finance industry and includes asset management and financial investment products that are becoming increasingly sophisticated (Khan & Bhatti 2008). According to the Arab Monetary Fund (AMF) (2011), Islamic banks have grown approximately 20 per cent annually over the previous decade compared to conventional banks that have grown only four per cent annually. Further, in 2011, the number of Islamic financial institutions reached approximately 300, operating in 51 countries around the world with assets estimated at US\$1.5 trillion (AMF 2011). Since 2008, increased demand for various types of Islamic finance in the public and private sectors resulted in the growth of Islamic banking in Saudi Arabia exceeding 14 per cent. Additionally, by the end of 2011, Saudi Islamic banks increased their share of total deposits to more than 20 per cent of all deposits. This increase was due to a steady growth in customer deposits at rates that exceeded the average growth rates of conventional banks (Argaam 2012).

One objective of this study was to identify the *Sharia* compliant financial products currently offered by Saudi banks to finance SMEs and, of these, the most appropriate financial products for SMEs. The Islamic banking system and Islamic forms of financing are based on principles of Islamic law. Under Islamic banking, all transactions must follow two basic principles: (1) the sharing of profit and loss; and (2) a prohibition on the collection and payment of interest (Akram et al. 2011; Rashid et al. 2012). Additionally, the Islamic financial system is based on Islamic law provisions and principles that aim to serve all members of society and achieve

Islamic economic growth and development (Iqbal & Mirakhor 1999, 2007). The main principles of Islamic financing include:

1. *Riba*—a prohibition on accepting and receiving interest under Islamic law. However, Islamic economics does not prevent the receipt of a rate of ROI as pre-agreed by all contacting parties. The *Qur'an* (Islam's the holy book) refers to *Riba* in a number of different verses and states:

O you who believe! Devour not usury, doubled and multiplied; but fear Allah that you may prosper [3:130] (*Qur'an* 2013).

Those who devour *Riba* will not stand except as stands one the Satan has driven to madness by his touch. That is because they have said: “Trade is but like *Riba*” but Allah has permitted trade and forbidden *Riba* [2:275–276] (*Qur'an* 2013).

The prohibition of *Riba* is also mentioned in the *Hadith* (the record of the sayings of the Prophet Muhammad, peace be upon him). Jabir Abdullah reported that the Prophet cursed the receiver of interest and the payer thereof, the one who records it and the two witnesses thereof. He said ‘They are all alike [in guilt]’ [Muslim, Tirmidhi, Ahmad] (*Razi* 2008).

2. The sharing of the risk of business return (i.e., profit/loss) by the two contractors or parties (Islamic Finance Education Council (IFEC) 2013).

Despite the prohibitions and the absence of interest, some forms of trade and commerce are permitted in Islamic banking. Thus, Islamic finance can be applied to the many types of financing contracts that are permissible under *Sharia*.

The Islamic financial system participates in financial markets through two major categories of banking activities: fixed return or mark-up schemes and profit–loss sharing schemes. The majority of Islamic banks prefer fixed return schemes to profit–loss sharing schemes, as the former are less risky and involve short-term monitoring contracts (Iqbal & Llewellyn 2002; Wilson 2002). According to Rosly and Abu Bakar (2003), contracts in *Murabaha* and *Ijara* (the two core Islamic finance models) are the most common fixed return Islamic banking transactions across several Islamic countries and represent 90 per cent of Islamic banking

activities in Malaysia. Currently, *Murabaha* and *Ijara* constitute the majority of banking transactions and represent the highest percentage of Islamic banking activities in Bahrain (i.e., 93 per cent) and Dubai (i.e., 88 per cent) (Iqbal & Molyneux 2005). These two Islamic finance models are also the core methods of financing used by the Saudi bank (Binzomah 2008). These two types of contract are currently used to finance business purposes (e.g., for the purchase of raw materials, equipment, vehicles, importing and exporting) and for private purposes (e.g. for the purchase of cars and houses) (Wilson 2002).

Islamic financial principles are based on profit-loss sharing agreements; thus, ‘any collateral demanded by the Islamic bank secures against possible fraud or repayment-evasion, but not against the risk of losses (Awad 1994, p. 3). Islamic finance products have been shown to be preferable products for meeting the needs of SMEs (Ibrahim 2003). Accordingly, Islamic banks and other financial institutions have a competitive advantage in relation to the strategic innovation of new Islamic products. However, appropriate Islamic financial engineering techniques need to be developed (Alsualm 2007). Guendouz (2007) defined Islamic financial engineering as ‘the set of activities that include the design, development, and implementation of both tools and processes of financial innovation, in addition to formulating innovative solutions to the problems of funding, all under the guidance of Islamic law’.

According to IFC, approximately 35 per cent of SMEs in the MENA countries are excluded from accessing bank credit, as most SME owners seek Islamic financial products that are not readily available on the market (IFC 2014). The IFC report examined Islamic financing across the nine MENA countries and found a potential market gap for SMEs of US\$13.2 billion (with a corresponding depository potential of US\$9.71–15.05 billion in Saudi Arabia).

Some of the more widely used Islamic financial products that are available from Islamic financial institutions for financing SMEs are detailed future below (Abalkhail 1999; IFC 2012; Kushnir 2010; Omar & Iqbal 2000; Sejjine 2000).

3.6.1 Murabaha (Cost-Plus Sale)

The Murabaha is a short-term Islamic financing instrument based on undertaking a trade with a mark-up. In this form of Islamic finance, for example, the entrepreneur agrees with a bank or a financial provider, to purchase a certain tangible product from a supplier and then re-sell it to

the buyer, who knows and agrees on the prices of commodity based on the sale price of the goods to be sold and an agreed fixed profit (similar to cost-plus) (Abdalla 1997; Omar & Iqbal 2000). The payment under a Murabaha transaction will be made either at the time of sale or as a lump sum at a specific time (Said et al. 2009). Murabaha is one of the most popular Islamic financial instruments provided by banks to finance SMEs in Islamic countries such as Oman and Saudi Arabia (Abalkhail 1999; Al-Kharusi 2003; IFC 2012; Kushnir 2010; Quartey 2003; Sejjine 2000). According to Siddiqui (2010) and Islam (2012), the Murabaha is the most appropriate Islamic financial model to cover SMEs' short-term needs such as working capital, purchasing of raw materials and export credit financing.

3.6.2 Mudaraba (Partnership Financing)

The second Islamic financial model suitable for financing SMEs by banks and other financial providers is the Mudaraba contract (Abalkhail 1999; Dabo 2006; Hajjar 1989; Sejjine 2000). This model is based on a partnership where one partner is the financial provider (banks and investors) and the other partner is called the Mudaraba, trustee or agent. In the case of a profit, the two partners share the net profit according to agreed ratios in advance. If there is a loss, both parties bear it: the investor loses their capital and the Mudaraba loses their effort. However, if the loss occurred due to negligence in running the business or breaches of the conditions of the Mudaraba contract by the entrepreneur (Mudaraba) then they alone will be liable to return funds and cover the loss (Iqbal & Mirakhor 1999; Sarker 1999). To mitigate risks involved with Mudaraba contracts, the investor (bank or other financial provider) must be careful with the entrepreneur partner, who is a professional with a trusted record, as most SME owners/managers cannot provide collateral (Kazarian 1993). Ibrahim (2003) argued that the Mudaraba contract application is like other Islamic financial products with high risk and constraints, and poses a real problem when used to finance SMEs, due to the high costs of following up and monitoring projects. Samad et al. (2005) argues that Mudaraba and Musharaka (see below) contracts are distinct from other financing modes.

3.6.3 Musharaka (Constant or Diminishing Partnership)

The Arabic Musharaka means ‘sharing or being a partner’. It refers to a form of partnership or joint venture in which all partners share the profit or loss. This outcome is distributed according to an agreed ratio and on the basis of their equity participation (Usmani 1998). The bank, or venture financial investors, will finance the project entrepreneur in agreed proportions for a limited period during which the bank provides the funds and the entrepreneur manages the project. Both parties are allowed to charge a fee or wage for any management or labour put into the project (Usmani 1998). Musharaka can take two different forms. The first, the diminishing partnership, is a type of partnership where the two parties (bank and entrepreneur) enter into a partnership agreement to buy and own assets. Based on the agreement, a bank will gradually sell its share of the purchasing assets to the entrepreneur until complete ownership occurs at an agreed price within a specific period of time (Abdalla 1997; Omar & Iqbal 2000). The second form is constant partnership, which refers to a long- or short-term agreement throughout the contract period between financial provider and entrepreneur (Sarker 1999). Unlike Mudaraba contracts, under the Musharaka financial instrument, the financier is allowed to participate in the management of the project in which they invest (AL-Fadhily 1998).

Ibrahim (2003) has identified the following advantages in financing SMEs by Musharaka contracts:

- Easy to apply and understandable by both parties
- Meets the capital needs of management
- Does not have high collateral requirements
- Suitable for current and fixed capital
- Does not require cash input to obtain finance
- In case of a total failure, the entrepreneur has no need to repay the debt.

According to Ibrahim (2003), partnerships with SMEs provide a better rate of return on capital investment than does interest-based financing, and Hajjar (1989) states that 80 per cent of the 560 Saudi SMEs respondents to his survey prefer to obtain finance through the Mudaraba contract, as Saudi owners/managers refuse to share business ownership with finance providers.

3.6.4 Ijara (Islamic Leasing)

Ijara is an Islamic form of leasing based on a fixed-rate structure similar to conventional lease instruments. Generally, the bank buys the asset from a supplier then leases it to the client (entrepreneur) (International Trade Centre (ITC) 2009). The Ijara concept refers to selling the needed benefit for lessee over a specified period of time at fixed price that should be agreed in advance, while ownership of the assets remains with the seller (bank) until the buyer (entrepreneur) has repaid the full amount of payment. An agreed amount is paid monthly towards the bank (ownership), until the entrepreneur owns the asset. In Ijara contracts, when leasing the asset the lessor bears all liabilities, such as insurance premium costs, management and maintenance, and any late payment will terminate the contract immediately (Binzomah 2008). There are two types of Ijara (leasing), classified as operating Ijara and financial Ijara (Karim & Archer 2013). In operating Ijara, the financial provider (owner) of the asset signs an agreement with a lessee for a specified period and against payment of pre-determined rentals. Under this type of arrangement, ownership of the leased assets remains with the owner at the end of the lease contract. A financial Ijara (Muntahia Bitamleek) is the same as an operation Ijara contract except that it gives the lessor the option to sell the asset to the lessee at the end of the contract period (Karim & Archer 2013).

3.6.5 Bay' Al-salam (Deferred Delivery) and Istesnae

Bay' al-salam is a forward contract (Karim & Archer 2013) that is 'a sale of an object, which is not available at the time of the conclusion of the sale, but will be delivered in the future on a fixed future date' (Muhammad & Chonga 2007, p. 22). In other words, bay' al-salam transactions are based on the buyer paying the seller the full agreed price in advance of a specific (quality and quantity) commodity that the seller promises to deliver at a specific future date. In contrast, Istesnae is a forward contract where payments are made in advance in order to produce certain specified products. These types of contracts can be utilised for several financing purposes; for example, an Islamic bank can finance farmers for agricultural operations by providing them funds to buy or sell their produce in the forward market. In the case of SMEs, a bank can use bay' al-salam to provide the necessary funds for purchasing input

or raw materials for the production process. The bank has the option, after receiving the product, to sell it through a ‘promise to purchase’ agreement from the third party for cash or deferred payment (Iqbal & Mirakhor 2011).

3.6.6 Waqf

A *waqf* is a voluntary charitable endowment in the form of cash or property for charity purposes and community development. The contribution of *waqf* in Islamic societies has been significant over recent decades (Ahmed 2004). For centuries, *waqf* has played an essential role in the Islamic economic system serving education, health services, water, clinics and hospitals, environmental protection, mosques, universities and several other public utilities (MUIS 2014). According to Majlis Ugama Islam Singapura (MUIS), *waqf* is ‘the permanent dedication of both movable and immovable properties by a Muslim for the aims of pious, religious and charitable activities recognised by Islamic law’ (MUIS 2014). The main source of *waqf* is voluntary donations made by well-intentioned founders, and is considered an ongoing charity. Two types can be issued from the main *waqf*: a charitable *waqf* and an investment cash *waqf* (Dwabh 2006; MUIS 2014). A charitable *waqf* is allocated for social welfare and philanthropic purposes recognised by *sharia* as supporting a poor segment of society and all activities that satisfy the needs of people, such as providing food, clothes and shelter (Hasan 2008). On the other hand, a cash *waqf* investment fund is based on Islamic law and aims to participate and be invested in businesses that serve community development and prosperity. Cash *waqf* can be defined as ‘charitable endowments established with cash capital’ (Aziz et al. 2012, p. 3).

The cash *waqf* fund generates its capital from rental properties and donations from people as cash by purchasing cash *waqf* certificates issued by Islamic banks (cash *waqf* trustees). The funds will then be invested in Islamic-based investment portfolios such as Islamic mutual funds, or Islamic bond (Sukuk) funds (Masyita & Febrian 2004). One of these investments is lending cash to SMEs through one of the Islamic financial products (Murabaha, Musharaka, Ijara, Salam etc.) to promote entrepreneurship, with limited availability of funds to increase production, export capabilities and growth potential. The revenue generated from such

investment can be redirected for charity or social services (Adam & Lahsasna 2013; Mohsin 2009).

The four Islamic schools of thought—Imams Shafie, Hanafi, Hambali and Maliki—have agreed to allow cash *waqf* for the sake of the development of general public purposes (Adam & Lahsasna 2013). Mannan (2007) and Ahmed (2007) suggest that cash *waqf* financing serves social objectives in society and would also lead to productive SMEs. Dr Ahcene Lahsasna (2010) developed a simple flexible cash *waqf* model enabling SMEs to apply to Islamic financial institutions. He suggests establishing management of a cash *waqf* department unit and appointing a trustee in the financial institution to manage the invested capital of the cash *waqf* fund.

The proposed cash *waqf*-based model has been considered in several financial institutions in different countries, such as microfinance institutions in Indonesia (Ahmed 2007), MUIS (Islamic Religious Council of Singapore) in Singapore (Hasan 2008), and Waqaf An-Nur Corporation Berhad (WANcorp), Johor Corporation Berhad (Jcorp) and Pengurusan Klinik Waqaf An-Nur Berhad in Malaysia (Dahlia & Haslindar 2013). An-Nur Corporation applied a corporate cash *waqf* model in other countries including Turkey, Pakistan and South Africa (Dahlia & Haslindar 2013). In Bangladesh, the cash *waqf* was promoted through the Social Investment Bank Limited (Ibrahim et al. 2013).

More recently, the Saudi elite has escalated calls in recent years to revive the role of investment *waqf* capital in the social and economic development of Saudi Arabia. In 2010, the Saudi government established a general authority for endowments under which the authority registers all *waqf* in the Kingdom of Saudi Arabia, and maintains a database of all movable and immovable endowments. The authority also develops plans, policies and regulations relating to endowments. Further, the Saudi *waqf* authority manages the investment of both movable and immovable properties estimated at around 500 billion SR (US\$130 billion) according to John Sandwick, an expert from Islamic Wealth Management Switzerland (cited by Youssef 2012).

3.7 SUMMARY

This chapter discussed the sources of financing that SMEs need at different stages of their project life cycle. These are classified into two major sources: equity and debt finance. The equity finance is divided into internal funds, such as personal savings, family and friends support, and retained earnings; and external finance, which include angel finance, VC and public shares. Debt finance is the second form of finance, which is loans that must be repaid within a limited period of time, usually with interest, and this can be done through loans or bonds; in contrast to equity finance, which can be done through partnerships or stock. The main source of debt financing is usually banks, private funds and GSCIs.

Most small firms use external sources of finance for debt financing. This is because debt financing does not maintain ownership in the business (as equity finance does); rather it distributes the ownership among shareholders. Therefore, banks are considered to be the main financing sources for SMEs, yet most firms face a number of constraints in accessing bank credit. These include high collateral requirements, complicated loan procedures, and high loan costs and interest rates. These financing constraints arise from the nature and size of these businesses. Most of these types of businesses face a financing gap, and have a lack of management and financial skills, lack of business experience, and are information asymmetric.

There is no doubt that access to credit is a significant factor affecting business performance. Some studies suggested that to ensure a better contribution and performance of SMEs in the economy, decisions and policy makers need to study factors affecting the stability and sustainable growth of this sector. The review of research on factors that hinder performance of SMEs identified lack of finance, lack of financial control and accounting information, lack of management skill and experience, and inability to respond and adapt to change, as the main factors. Both internal and external factors that influence business performance have been measured via a range of techniques. Such measurement models for assessing a firm's performance include traditional indicators that measure the firm's financial conditions and abilities, including financial ratios, profit margin, ROI and annual sales turnover (Cron et al. 2006; Laura et al. 1996; Siegel & Castellan 1988; Wood 2006).

The current study investigates the influence of access to finance on the performance of SMEs, using traditional financial measures such as ROI, annual sales turnover, growth rate and profit margin. The study will also identify problems faced by the Saudi SME sector in obtaining finance.

The chapter continued with a thorough review of Islamic financial products commonly used by banks for financing SMEs (e.g. Murabaha, Ijara and Mudaraba) and other products less commonly used, such as Musharaka and Bay' Al-Salam. The chapter also discussed another potential Islamic source of finance that could be used to finance SMEs—cash *Waqf* investment funds.

The next chapter will present the theoretical framework related to financing SMEs, examine the conceptual framework underlying the study, identify the dependant and independent variables, and discuss the established relationships between them.

CHAPTER 4: RESEARCH FRAMEWORK

4.1 INTRODUCTION

The literature review revealed a paucity of research on financing the SME sector by Saudi Arabian banks. The literature review identified that to ensure that SMEs contribute significantly towards growth and economic diversification in Saudi Arabia, Saudi banks needed to better identify ways to help SMEs overcome the financial constraints they face in financing their projects. Thus, the current study attempts to identify and analyse the problems faced by SMEs in Saudi Arabia in obtaining financial assistance from Saudi banks. This chapter presents a conceptual research framework for testing and analysing the financial constraints that face SMEs to better understand the dynamics of banks' importance in ensuring easier access to finance for SMEs, which could improve their business performance.

To achieve this, the present chapter initially focuses on the theoretical framework of the study related to financing SMEs. This is followed by an examination of the conceptual framework upon which this study is based. The chapter concludes by identifying the dependent and independent variables and reviewing the established relationships between them.

4.2 THEORETICAL FRAMEWORK

The theoretical framework employed in the study assists in explaining the financial structure of SMEs and their financing practices and obstacles. In this section, two main theories on financing and financial structure of SMEs are explained: the POT and the information asymmetry theory. It should be noted that most capital structure theories have been developed to explain the capital structure of large firms, whereas this study will apply them to SMEs.

4.2.1 Pecking Order Theory of Financial Structure

The POT was proposed by Myers (1984). The theory assumes that there is a preferential financing hierarchy order when a firm chooses a funding source. According to Myers' theory, firms always prefer to finance their investments through internal sources of finance represented by retained earnings as the first option, as this is less costly than external funding. When internal funding sources are insufficient, outside funding is sought through borrowing, as lower information costs are associated with this activity. Another option is to issue equity finance as a source of capital (Myers 1984).

Modigliani and Miller (1963) were the first to introduce a financing order within a firm when choosing funding sources. The POT theory of financial structure showed that when the firm issues new shares to finance specific projects, the value of the shares may decline because new shareholders are unable to estimate the actual cost of the project effectively due to information asymmetry. Two explanations linked to the POT framework in the selection of capital structure of the firm are information asymmetries and transaction costs.

Information asymmetry occurs when one party in a transaction has more or superior information than the other(s). This often happens in transactions when the seller knows more than the buyer (Lean & Tucker 2001b); for instance, where the seller is the firm's owner or manager and the buyer is the investor. Typically, management should disclose this information to potential funding providers, but they may fear that the declared information could serve the new equity holders' interest and diminish their own power within the firm. This deters management from revealing some information (Baskin 1989). Essentially, information asymmetry results in one party having greater, and more relevant, information than the other party. The greater the information asymmetry from different external sources of funding, the higher the ROI from each type of source (Sarapaivanich 2006).

Harrison and Mason (1986) find that both banks and small businesses operate without access to full and accurate information and information is asymmetrical between two parties when the required information is available only to one party and not to both. As a result of information

asymmetry, banks or other lenders will demand high interest rates from SMEs and compensate for the risk via a provision for wealth confiscation in the case of repayment default (Pettit & Singer 1985). Normally, insufficient information about the SME's investment opportunities and their managerial capability will increase the probability of credit risk. This results in SMEs facing credit rationing due to difficulties in identifying the quality of risk associated with the borrower (Al-Kharusi 2003; Peterson & G 1992).

The POT suggests that the optimal capital structure of a firm is achieved when it (a) resorts to external sources of finance; and (b) favours borrowing through debt sources, as the option associated with the lowest level of information asymmetry (Modigliani & Miller 1963).

The second explanation linked to the POT framework in the selection of capital structure of firms is related to transaction costs. Transaction costs are incurred as a result of the financing decision of firms when they obtain necessary funding. For instance, a firm will select funds from the cheapest and easiest source and gradually move to the next least expensive. Internal sources of funding such as returned earning; personal savings and family assistance are considered to be the cheapest, followed by debt and then external equity (Chittenden et al. 1996; Frank & Goyal 2005).

Many studies of SMEs show the importance of POT and information asymmetry as significant factors affecting their financial structure (Berggren et al. 2000; Berger & Udell 1998; Cassar & Holmes 2003; Chirinko & Singha 2000).

Fama and French (2002) analysed data from 3,000 dividend- and non-dividend-paying US firms over the period 1965–99. They found that the majority of firms always preferred internal sources of finance over outside equity, thus supporting the POT. However, the authors also identified that the POT assumption that firms obtain funds from issue debt before external equity was not valid. In the case of non-dividend-paying firms with low levels of leverage, equity issuance stock was their major source of financing.

Miguel and Pindado (2001) examined the financial structure of 133 non-financial Spanish SMEs over the 1990–97 period, finding that most firms bore transaction costs when they adjusted their current debt level over the previous period. The Spanish SME firms usually preferred to finance their investment needs with internal cash flow, supporting the POT. Further, SMEs will face financial difficulties when asymmetric information exists.

De Haan and Hinlopen (2003) investigated the financing decisions of 150 Dutch SMEs over the 1984–97 period. Like previous studies, they distinguished between internal and external finance. By using a multinomial logit model and an ordered probit model, the study found that Dutch companies preferred an internal source of finance over bank loans, followed by share issues and, finally, bond issues. This further supports the POT.

Producing results consistent with these findings, Benito (2003) investigated the financial structure decisions of Spanish and UK SMEs using a sample of 6,417 Spanish firms for the period 1985–2000, and 1,784 UK firms during 1973–2000. The study examined the implementation of two theories in both countries: tradeoff and POT. The results showed a positive relationship between debt and investment, and as a negative relationship between cash flow and debt. These findings support a preference for POT in both countries.

Following Benito (2003), Hogan and Hutson (2005) examined the financial structure of 117 new Irish software product firms. Based on questionnaire responses from the businesses founders, the study found that financing in most firms was split between internal and external sources, with preferred sources of finance being those associated with the least information asymmetry—consistent with POT. To overcome many of the information asymmetry problems associated with obtaining external sources of finance such as VC, Hogan and Hutson (2005) advocate that SMEs consider relinquishing control over their businesses. In another study, Watson and Wilson (2002) investigated a sample of 629 UK SMEs and observed results consistent with POT in which internal equity such as retained earnings was preferred over debt.

As one might expect, financing patterns vary between SMEs and large firms. Unlike large enterprises, SMEs are run by owner/managers that exercise a great degree of control over the financial structure of the firms due to their high degree of autonomy. According to several studies, the pecking order approach determines the behaviour whereby most owner/managers

SMEs prefer debt over external equity. This is mainly due to their reluctance to relinquish control and independence of the firm. Further, debtors are not able to interfere in managing the business and the resulting debt is less costly than issuing outside equity (Berger & Udell 1998; Hommel & Schneider 2003; Jordan et al. 1998; Michaelas et al. 1999). As the above studies show, the POT predicts a hierarchical order in the financing policy of a company and most SMEs prefer internal sources of finance, followed by debt and then outside external financing (Hamilton & Fox 1998).

However, the POT does not explain the influence of taxes, financial distress, security issuance costs, agency costs or the set of investment opportunities available to a firm upon that firm's actual capital structure. Another limitation of POT is overlooking the problems associated with financial decisions of management when financial slack occurs, and focusing on the effect of availability of positive Net Present Value NPVs of projects (Butt et al. 2013; Jahanzeb et al. 2014)

Some studies related to financing SMEs (e.g. Quartey 2003; Sarapaivanich 2006) incorporated the POT as it is useful for explaining capital structure changes in firms (Tudose 2012). The theory also will help to better understand the preferred hierarchy for financing decisions made by Saudi SME managers and owners.

4.2.2 Information Asymmetry Theory

As mentioned earlier, information asymmetry is when owners and managers of SMEs have more, and better, information about their business than do lenders, in terms of both the financial state and risks facing their business. Thus, complete and accurate information about the firm is not available to the lender and bank. This makes lending decisions difficult and affects optimal loan contracts (Broecker 1990; Lean & Tucker 2001a). Several studies show that one of the most significant factors affecting SME access to finance is the existence of information asymmetry (Berger & Udell 1998; Coleman 1998). This is because investors and lenders always require information about the firm's financial conditions and performance to properly evaluate the probability of success and growth potential of the project before providing finance.

However, this information is limited and not always available. The consequence of such a lack of information is that creditors will charge higher rates to mitigate the risk involved in financing SMEs and to compensate for the possibilities of failure (Keasy & Watson 1993; Pettit & Singer 1985). Peterson and Rajan (1994) stated that when information asymmetry exists, most banks and lenders are likely to reduce the extent of lending or resort to credit rationing, even when SMEs are willing to pay a fairly high risk-adjusted interest rate.

Lehmann and Neuberger (2001) posit that the more complete and accurate the information provided to the banks and institutional investors by SMEs, the more favourable the loan contract terms in terms of interest rates and collateral requirements. However, the costs of gathering and analysing such information are high and hence to avoid the cost, banks and lenders limit their focus to the desired and relevant information. Thus, when information asymmetry exists, one of three scenarios with respect to banks evaluating loan applications from SMEs tend to occur: the bank (i) accepts the loan application but with a high risk-adjusted interest rate; (ii) accepts the application with imposition of high collateral requirements; or (iii) rejects the loan application.

Generally, SME managers lack the required skills to manage the financial affairs of the firm and hence tend to provide low-quality information. As banks and other institutional investors rely on past financial information as an indicator of the current performance and future profitability of an SME, it needs to reduce the information asymmetry by building a close relationship with the bank (Watson 1986). Hoshi et al. (1991) observed that firms that have established a good relationship with banks have easier access to bank credit and appear to be less sensitive to liquidity considerations than firms without such a relationship. Most studies related to financing SMEs (e.g. Al-Kharusi 2003; IFC 2012; Quartey 2003; Qureshi & Herani 2011; Sarapaivanich 2006) report that asymmetric information affects SME access to bank credit and is therefore one of the main obstacles to obtaining external finance.

The consequence of information asymmetry between credit providers and SME owners/managers result is a reduction of the supply of finance to firms. This can lead to two main problems: (i) adverse selection; and (ii) moral hazard (Berger & Udell 1998; Lean & Tucker 2001b; Peterson & Rajan 1994; Stiglitz & Weiss 1986), as discussed below.

4.2.2.1 Adverse Selection

Adverse selection arises when banks have insufficient information regarding both the expected quality of SME management and their projects. This problem occurs when the entrepreneurs possess greater and better information about their risky business projects than do their potential lenders. In such cases, lenders would either charge the borrower higher interest rates or require higher levels of collateral to reduce the negative effect of the information asymmetry and to cover the high risk of bad debts (Broecker 1990; Lean & Tucker 2001a; Stiglitz & Weiss 1986). To avoid high interest rates and high collateral requirements, SMEs must provide sufficient and complete information to financial providers (Craig et al. 2004, Friedman & Hahn 1990).

4.2.2.2 Moral Hazard

The second consequence of information asymmetry is moral hazard. This is a situation when business owners have a tendency to take a greater risk to protect against the cost that could be incurred by the other party. As a result of the moral hazard problem, the bank can accept the loan application of an SME upon the provision of appropriate collateral, compounded by the trend towards longer-term debt. Alternatively, the bank can reject a loan application from a small firm due to moral hazard, market concentration, centralisation of lending decisions, and the increasing use of computer credit scoring (Lean & Tucker 2001a). Therefore, imposing high collateral on lenders can resolve incomplete information and reduce moral hazard concerns (Chan & Thakor 1987). In addition, the willingness to provide collateral represents a ‘signal to the bank that the entrepreneur believes the project is likely to succeed—otherwise he or she would not commit their personal resources to it’ (Storey 1994, p. 210). However, as not all SMEs can provide appropriate collateral, many small businesses fail to expand (Binks & Ennew 1987; Lean & Tucker 2001b).

Willingness of financial providers to provide funds to SMEs is reduced as a result of information asymmetry (Berger & Udell 1998; Peterson & Rajan 1994). However, Meza and Webb (1987) demonstrate that as the inability of financial providers to find out all of the relevant characteristics of borrowers, the information asymmetry can lead to an oversupply of finance rather than an undersupply. However, some researchers suggest that the availability of

financial information will decrease the extent of the moral hazard and adverse selection problems, and eventually facilitate easy access to finance for SMEs (Binks et al. 1992).

This study will consider information asymmetry theory in order to discern how the availability of financial information could influence access to bank finance by SMEs in Saudi Arabia (Al-Kharusi 2003; Quartey 2003; Sarapaivanich 2006).

4.3 CONCEPTUAL FRAMEWORK

As Lean and Tucker (2001b) point out, business and entrepreneur characteristics determine the level of difficulty (or ease of access) to obtaining funds from financial providers or investors. Figure 4.1 presents the conceptual framework that will be used in this study. This framework was constructed to incorporate relevant theories and results from empirical studies such as those of Johnson et al. (2002), Lean and Tucker (2001b) and Storey (1994). It was designed to identify the internal and external sources of finance available to SMEs, and the factors that influence ease of access to the current financial services provided by Saudi banks and other GSCIs that affect Saudi SME performance by impeding their access to finance. This can be done through investigation of the relationship between the difficulty in accessing Saudi banks for finance and factors influencing this access. These factors can be categorised into three main areas: (i) characteristics of SME owners/managers (experience, gender and education of the entrepreneur) (Abalkhail 1999; Ibrahim 2006; IFC 2012; Kushnir 2010; Sarapaivanich 2006; Sejjine 2000); (ii) business characteristics (availability of business plan, business size, business growth and profit, and business type); and (iii) characteristics of the financial institutions (availability of Islamic finance products and services, and requirements and conditions of obtaining funding) (Abalkhail 1999; IFC 2012; Kushnir 2010; Sejjine 2000). Lean and Tucker (2001) argue that a firm's ease of access to finance is influenced by the characteristics of the firm itself and the attitude and objectives of the business owners/managers.

Further, the study will investigate finance structure decisions of Saudi SMEs with respect to obtaining funds, and some relevant Islamic banking and finance methods used to finance SMEs by Saudi banks. The framework also incorporates the pertinent theories of financing relevant to SMEs, such as information asymmetric theory (Abalkhail 1999; Al-Kharusi 2003; Binks &

Ennew 1996; Dabo 2006; Quartey 2003; Taylor 1998). In addition, the study will include the POT, proposed by Myers (1984), which predicts the firm's desire to rely first on internal sources of funds, as well as low external financing, and finally, matters concerning public or private equity (Abalkhail 1999; Chittenden et al. 1996; Dabo 2006; Hall et al. 2000; Quartey 2003).

The study will also identify different types of business obstacles that affect Saudi SME performance (Alshaibe 2000). All business obstacles facing SMEs to be measured will be classified into two main categories: internal and external. Internal obstacle variables to be included relate to both the entrepreneur (Lean & Tucker 2001b; Luigi & Sorin 2009; Kihlstrom & Laffont 1979; Tudose 2012) and the enterprise (Jahanzeb et al. 2014; Meza & Webb. 1987; Tudose 2012). External obstacle variables to be included relate to the business environment (Butt et al. 2013; Meza & Webb 1987; Sibilkov 2009; Tudose 2012). The study will also identify the current available *sharia*-compliant financial products on the Saudi Arabian market, and investigate some other appropriate Islamic financial products for financing SMEs. The identification and justification of the selection of the variables representing these concepts are discussed in the following section.

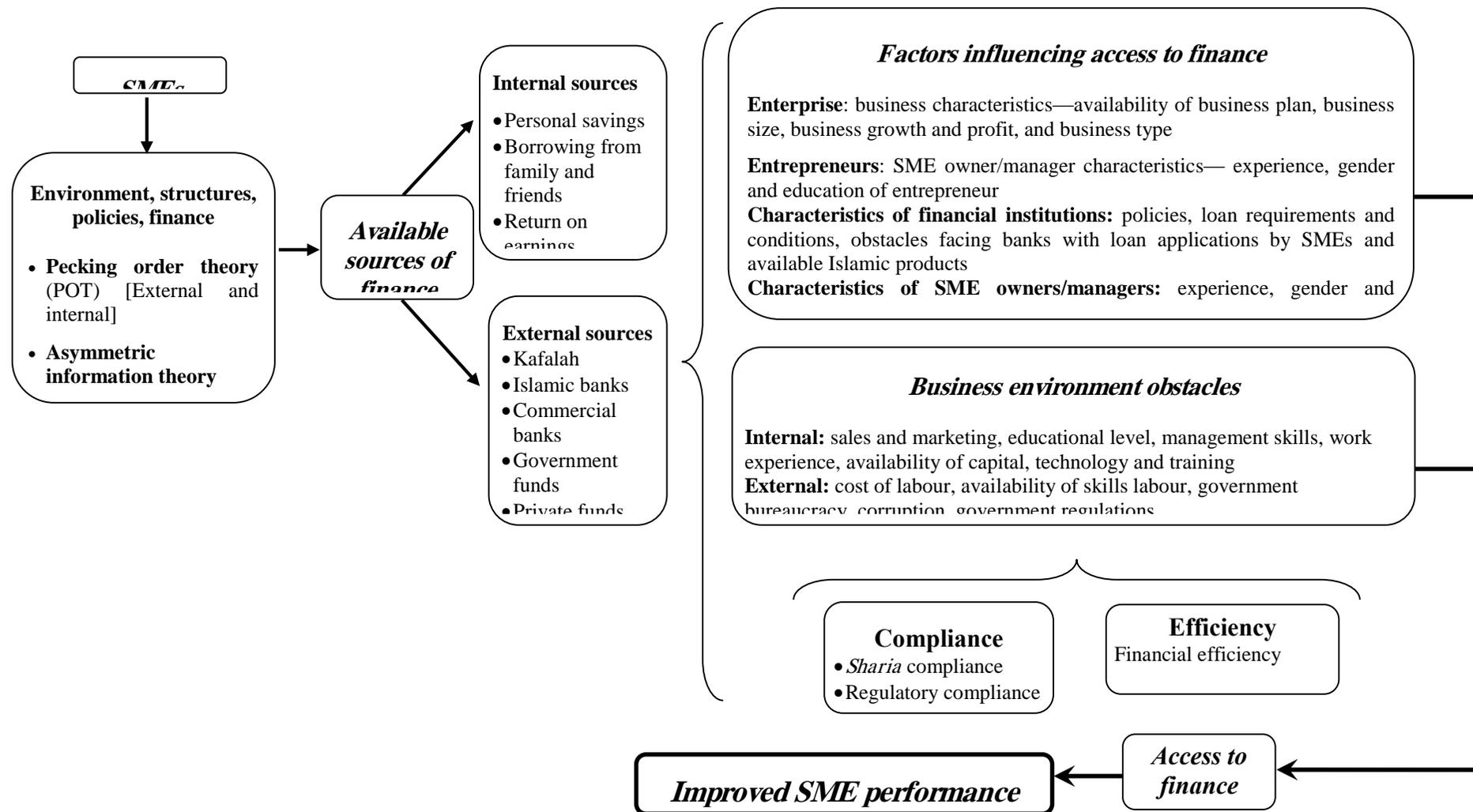


Figure 4.1: Conceptual Framework (Constructed by the Author)

4.4 STUDY VARIABLES

4.4.1 Dependent Variables

The main objective of this study is to measure the influence of the difficulties of access to finance from banks on business performance of SMEs. The study also measures the influence of internal and external business obstacles on firm performance. In order to realise the study objectives, the researcher will analyse and investigate relationships among a number of dependent and independent variables, and the difficulty in accessing to banks finance.

The literature review identified some factors that influence the ease of access to finance by SMEs, thus affecting business performance. These factors can be categorised into three main areas:

1. the characteristics of owners/managers of the business
2. the characteristics of the firm
3. the characteristics of the financial institution.

The three main dependent variables in the study are as follows.

4.4.1.1 Access to Finance

The difficulty in accessing bank finance by owners/managers of SMEs is considered a major obstacle hindering the sustainable growth of this sector in many developing and developed countries (Abereijo & Fayomi 2005; Beck et al. 2005; Berger & Udell 1998; Dabo 2006; Demirgüç-Kunt et al. 2008; Fraser 2004; He & Baker 2006; Ibrahim 2006; Kola 2001; Looney 2004; OECD 2006a).

Despite the strength of the banking sector in Saudi Arabia and the encouragement of the Saudi government in the form of support and lending to SMEs, Saudi banks are not responding

effectively to the capital needs of SMEs, particularly at the early stage of their business (Kola 2001). Other studies (e.g. Bukvic & Bartlett 2003; Indarti & Langenberg 2004; Leeds 2003; Pissarides 1999) found that when SMEs experience difficulties in accessing finance, their potential growth and market expansion is threatened. Typically, most SMEs encounter their highest level of financial constraint during the start-up or early growth stages (Abalkhail 1999; Ibrahim 2006; IFC 2012; Kushnir 2010, Sejjine 2000; Storey 1994). Hence, the main reason behind the majority of SME failures and effects on their performance is the lack of access to capital, due to limited feasible finance sourcing options (Abalkhail 1999; Hall et al. 2000; IFC 2012; Kushnir 2010; Sejjine 2000; Smallbone & Rogut 2001; Storey 1994).

The current study identifies the problems faced by the Saudi SME sector in obtaining finance from Saudi banks. In order to measure access to finance by SMEs, the study considers three main factors (characteristics of owner/managers of SMEs, characteristics of business, and characteristics of banks and other financial institutions) that influence ease of access to the current financial services provided by Saudi banks.

4.4.1.2 Obstacles Facing SMEs in Saudi Arabia

This section identifies the different types of internal and external business obstacles that determine growth of SMEs and affect their performance and access to finance (Ajilouni 2006; CPA Australia 2009). Over their business life cycle, most SMEs are exposed to obstacles that could directly affect their operations and profitability, and increase their probability of failure (Abalkhail 1999; Ibrahim 2006; IFC 2012; Kola 2001; Kushnir 2010; Sajini 1997; Sarkar 2000 p. 1; Sejjine 2000; Storey 1994). There is a need to better identify and manage the obstacles associated with SME borrowers in order to mitigate present difficulties. This study determines the internal and external business obstacles related to entrepreneur, enterprise, and external business environment factors that affect the business performance of SMEs in Saudi Arabia.

4.4.1.3 Availability of Islamic Financial Products

This refers to the availability of Islamic financial products provided by commercial and Islamic banks in Saudi Arabia to help finance the future needs of SMEs (Hajjar 1989). According to Ajlouni (2006) and Sajini (1997), the limitations of current Islamic financial products provided by banks and other financial providers may affect decisions by business owners to apply for loans and access to banks' financial services. The present study identifies

the current Islamic financial products and services provided by Saudi banks, and suggests alternative Islamic finance products that may overcome the limitations of current financing products offered by Saudi banks.

4.4.2 Independent Variables

4.4.2.1 Owner/Manager Characteristics

Viñals and Ahmed (2012) discussed the relationship between the characteristics of firms and owners/managers of SMEs, and the level of difficulty in accessing external financing from lenders and investors. Several studies have found that characteristics of the SME owner/manager, such as gender, level of education and training, and business experience, have an effect on access to finance from banks (Dabo 2006; Sarapaivanich 2006). Therefore, an SME's ability to obtain funds partially depends on its owner/manager's characteristics. This variable will be measured by investigating the relationship between the difficulty in accessing Saudi bank credit and characteristics of SME owners/managers (experience, gender and education of the entrepreneur) (Abalkhail 1999; Ibrahim 2006; IFC 2012; Kushnir 2010; Sarapaivanich 2006; Sejjine 2000).

4.4.2.1.1 Gender

The gender of the business owner/manager can, according to some studies, influence access to capital (Saffu & Manu, 2004; Shaw et al. 2006). Additional studies by Belcourt et al. (1991) and Saffu and Manu (2004) indicate that female SME owners/managers are less likely to be able to access bank credit as most collateral is controlled by male business owners/managers. This study measures the influence of gender of business owner on access to bank credit using

quantitative methods of testing the relationship between the genders of owners/managers of SMEs and their difficulty in accessing finance. The study also investigates the relationship between access to finance and gender of SME owners by interviewing banks and other financial institutions to ask if they consider applicant gender when they assess loan applications.

Training and Education

A number of studies have reported that education and skill level are major factors considered by financial providers and banks when making financing decisions (Bukvic & Bartlett 2003). This study identifies the influence of level of training and education of SME owners/managers on access to finance through use of quantitative methods to test the relationship between the level of training and education of SME owners/managers and their access to bank credit. The study also measures the relationship between access to finance and level of education and training of SME owners by interviewing banks and other financial institutions to determine whether they consider applicant level of education and training when they assess loan applications.

4.4.2.1.2 Experience

Adequate business experience and sufficient management knowledge of SME owners/managers has a positive effect on access to bank finance in many countries (Cron et al. 2006). This study investigates the number of years of experience that SME owners/managers have and how this affects access to finance. Owners/managers of SMEs are asked about the number of years of experience they had when they started their businesses. Further, the study tests the relationship between the number of years of experience of owners/managers and their access to finance. Finally, the study asked representatives of Saudi banks if they consider the experience of owners/managers of SMEs when they evaluate their loan applications.

4.4.2.2 Business Characteristics

Due to the high risks associated with funding SME projects, the characteristics of a firm are very important factors examined by financial providers and investors to assess the ability of an applicant firm to repay the funds. Three main factors affect SME access to bank credit: size of firm, business plan and ownership type (Berger & Udell 1998; Bhaird & Lucey 2006; Burns & Grey 1998; Esperanca et al. 2003; Miles & Huberman 1994; Reid 1998; Storey 1994)

Size of Business

Several studies show that the size and age of a firm can influence the financing decision of financial providers (Abor & Biekpe 2005; Berger & Udell 1998; Coleman 2004; Coleman & Cohn 2000). The size of a firm can be measured by total assets and capital investment of the business, total revenue, net profit or number of employees. As discussed in Section 2.1.2, and according to a number of definitions of SMEs, the size of firms in Saudi Arabia is measured by the number of employees and sales turnover (Abalkhail 1999; Alfaadhel 2010; Alsulamy 2005; Kushnir 2010; Radwan & Al-Kibbi 2001). This convention is followed in the current study (Bennett & Donnelly 1993; Johnsen & McMahon 2005; Jordan et al. 1998; Romano et al. 2001; Tigges & Green 1994), by requesting information from participant of owners/managers of SMEs about the number of employees and the annual sales turnover of their firms. In addition, the study tested the association between the size of the firm and the difficulty in accessing finance from Saudi banks. Finally, the research involved asking Saudi bank representatives through interviews if they consider the size of business when they evaluate loan applications.

4.4.2.2.1 Business Plan

Bank and loan providers consider a business plan as the main document required for determining the potential success of the applicant's project by assessing the repayment ability of the owner/manager. Therefore, the availability of a feasible business plan favourably influences SME access to finance, as banks and lenders prefer to offer loans based on the reliability of the business plan (Barrow 1993; Berry et al. 1993a; Reid 1998). The participating

owners/managers of Saudi SMEs in this study were asked via the survey if they had a business plan when they started their business. Further, the study tested the association between the existence of a written business plan for the firm and its difficulty in accessing finance from Saudi banks. Finally, participating Saudi banks were asked through the interviews if they consider business plans when they evaluate loan applications.

4.4.2.2.2 Business Ownership Type

The legal structure of a business can affect its ability to access external sources of finance (Barlow & Robson 1999; Binks & Ennew 1997; Merritt 1998). The participating owners/managers of Saudi SMEs were asked about the type of business they have, and the association between ownership type and difficulty in accessing finance from Saudi banks was assessed. Participating Saudi banks were asked if they consider the type of business when they evaluate loan applications.

4.4.2.2.3 Growth and Profitability

This study identifies the effect of accessing external finance on SME performance by measuring firms' profitability, ROI, leverage ratios, sales annual turnover and annual growth rate (Sarapaivanich 2006).

4.4.2.3 Characteristics of Financial Institutions

Financial intermediaries may impose financial restrictions and conditions on owners/managers of SMEs stemming from asymmetric information, limited collateral, poor financial conditions, lack of a business plan and high business risk. Such financial constraints will prevent funding to potentially promising and valuable SME projects (Lean & Tucker 2001a).

4.4.2.3.1 Loan Conditions and Requirements

Banks and financial providers in both developing and developed countries are facing difficulties due to problems associated with the effects of asymmetric information, adverse selection and moral hazard. As a result, banks are less willing to fund individuals who cannot commit to repay loans, and most impose conditions to ensure that borrowers will fulfil their obligations (Abor & Biekpe 2005). The Saudi SMEs participating in this study were asked through the survey about the loan conditions and requirements that banks require from them when they apply for loans. Also, Saudi banks were asked through interviews about their loan policies, and conditions and requirements for lending to SMEs.

4.4.2.3.2 Islamic Finance

This study is concerned with identifying currently available *sharia*-compliant financial products provided by Saudi banks to finance SMEs. The owners/managers of SMEs were asked about the current Islamic financial products and services provided by Saudi banks. Also, the banks were asked what products and services they offer to borrowers.

4.4.2.3.3 Obstacles Facing SMEs in Saudi Arabia

SMEs, like large corporations, face many different types of obstacles to their business activities.

In this study, variables that represent obstacles to Saudi SME owners/managers will be identified and classified into two main categories: internal, which includes entrepreneur and enterprise factors; and external obstacles, which include the business environment. Entrepreneurial factors related to the owners/managers of SMEs comprise age, gender, work experience, management skills and availability of capital (Kihlstrom & Laffont 1979; Lean & Tucker 2001b; Luigi & Sorin 2009; Tudose 2012). Enterprise factors include variables that affect the business, such as availability of skilled employees, cost of labour, training, customer satisfaction, competitors, marketing and sales (Jahanzeb et al. 2014; Meza & Webb 1987; Tudose 2012). Environmental factors include government bureaucracy, corruption, legal issues,

government support, advisory services, and government regulations, especially on labour (Butt et al. 2013; Meza & Webb 1987; Sibilkov 2009; Tudose 2012).

The participant owners/managers of SMEs in this study were asked about the obstacles that most affect their business performance.

4.5 SUMMARY

In summary, the first part of this chapter provided a brief examination of the theories related to the financing and capital structure of SMEs. These theories were incorporated to explain some of the conflicts between SMEs and Saudi banks. An assessment showed that appropriate and complete information about SMEs might not be available to lenders, and this persistent information asymmetry has led to the reluctance of the financial institutions to provide financing to SMEs. The majority of SMEs appear to avoid publishing their vital financial information required by the banks to assess their applications, which makes the banks often reluctant to lend to SMEs and this affects optimal loan contracts from being obtained. The present study examined the consequences of information asymmetries and considered how they affect the ability of SMEs to access bank credit. POT, an alternative theory, may also apply to capital structure decisions of SMEs, as it was shown that firms primarily prefer obtaining internal finance (rather than external finance) and, if necessary, obtain external finance through debt financing (rather than equity financing).

This chapter also outlined the conceptual framework that was designed to identify the internal and external sources of finance available to SMEs, and the factors that influence ease of access to the current financial services provided by Saudi banks and other GSCIs that affect Saudi SME performance by impeding their access to finance. The conceptual framework constructed for the study was employed to examine the relationship between the characteristics of entrepreneurs, enterprises, financial institutions and the related difficulties SMEs have in obtaining financing from Saudi banks. Each of the abovementioned characteristics affects the performance of SMEs.

The chapter further provided a comprehensive review of dependent variables that will be used in this study, including difficulties in accessing finance, obstacles facing SMEs in Saudi Arabia

and the availability of Islamic financial products. The dependent variables were then linked to the independent variables that broadly comprised the characteristics of the main decision makers, enterprises, financial institutions and how the obstacles to financial access affect the performance of SMEs in Saudi Arabia. The following chapter identifies the research methods used in this study and provides a justification for the data collection method.

CHAPTER 5: RESEARCH METHODS

5.1 INTRODUCTION

This chapter will describe and discuss the research methods used in this study and provide a justification for their selection. The previous chapters contained a detailed literature overview of SMEs, including definitions, characteristics and barriers to them accessing external finance. A framework to identify such issues was established based on the review.

In order to select a valid and justifiable research methodology, it is important to be aware of the research process and elements of the theoretical and philosophical issues (Sadler-Smith et al. 2000). Hence, the present chapter will discuss mixed research methods involving qualitative and quantitative methodologies. This will be followed by the rationale for the data collection method employed in the study, which consisted of a questionnaire survey with a sample of SME owners/managers, as well as interviews with key people in public and private financial institutions. This is followed by an outline of the analyses applied to the data. Finally, the chapter describes the development of the survey instrument and tests of its validity.

5.2 OVERVIEW OF THE RESEARCH METHODOLOGY

In the social sciences, there are two principal paradigms of empirical research: quantitative and qualitative (Bryman 2004). Quantitative research applies a systematic approach to analysing quantitative data relating to social phenomena using statistical and mathematical methods. This research philosophy is based on logical positivism. Quantitative research aims to develop and employ mathematical models, theories and assumptions related to the studied phenomena (Given 2008). The measurement process is the major focus of quantitative research because it provides an effective link between empirical observation and mathematical expression of quantitative relationships (Given 2008). In contrast, qualitative research is an attempt to understand social phenomena by focusing on human behaviour, and phenomenological and hermeneutic research (Denzin & Lincoln 2005). While the quantitative approach emphasises

testing causal relationships via a suitable set of hypotheses, attempting to answer questions such as ‘How much?’, ‘How many?’, ‘How often?’ and ‘To what extent?’ (Bryman 2004), the qualitative approach attempts to answer questions such as ‘Why?’, ‘How?’ and ‘In what way?’ Data are collected in quantitative research by drawing directly on techniques with individuals and groups, experiments, surveys, histories and analysis. However, the qualitative method employs techniques such as case studies, participant observation and interviews (Wagner 1997). Generally, the qualitative approach offers a more detailed focus on a narrower range, and the quantitative approach provides a wider but less detailed focus (Babbie 1973).

Both the qualitative and quantitative approaches have advantages and disadvantages. Some researchers (e.g. Ospina 2004; Huberman & Miles 2002; March 1988) have asserted that qualitative methods are concerned with providing complete and accurate analysis, as well as more facts with detailed descriptions of events. However, these approaches also require more time to complete the research, and are generally more expensive, more complicated and are always subject to human judgement. In contrast, methods using the quantitative approach are cheaper, simpler and provide wide-ranging overviews. However, both approaches involve a ‘trade-off’ in relation to their external validity, reliability and precision (Wagar 1998). For example, the quantitative approach has a high level of internal validity and reliability, but its structure is weak, and the qualitative approach has greater external validity because the research approach is highly structured, and the context and the subject of the study are not artificially separated (Gill & Johnson 1993).

Hoepfl (1997, p. 14) explains the basic differences between the two forms of research by stating that ‘phenomenological inquiry, or qualitative research, uses a naturalistic approach that seeks to understand phenomena in context-specific settings. Logical positivism, or quantitative research, uses experimental methods and quantitative measures to test hypothetical generalizations’. Similarly, Liebscher (1998) argues that a quantitative approach is suitable when the variables of interest (typically, numerical data) are measureable, and research hypotheses can be formulated and tested. In contrast, qualitative research works with non-numerical data.

In sum, quantitative research tends to be deductive, involving a move from the general to the specific (Gay & Airasian 1999), and the qualitative research tends to be inductive, relying on in-depth analysis of a researched topic (Wagner 1997).

5.3 METHODOLOGIES USED IN PREVIOUS STUDIES

This section reviews the main methods adopted in past studies on SMEs, particularly methods that have been used to measure SMEs' access to finance. A number of SME studies have been exploratory in nature (e.g. Gibson & Vaart 2008; Oakey 1984; Pell & Wilson 1996; Van Auken & Carter 1989). Oakey (1984) investigated the effect of different types of VC funding on innovation by SMEs by applying chi-square tests and measures of correlation to analyse the collected data. Typically, the initial analysis is performed using descriptive statistics. Hypotheses are then tested using a range of parametric or non-parametric methods depending on the shape of the data distribution (e.g. chi-square, *t*-tests, Mann–Whitney U test).

Al-Kharusi (2003) investigated the financial constraints faced by Omani SMEs in accessing capital in three different sectors (i.e. manufacturing, trade and services). Data were collected using structured questionnaires and interviews. The survey questions were analysed using ANOVA and chi-square tests to examine the need for external finance. The data collected from the structured interviews in this study were analysed as cross-case studies to supplement the results from the questionnaire survey.

A study by IFC (2012) examined access to finance for SMEs in Nigeria in the sectors of manufacturing, trade and services. The study adopted a mixed-methods approach and used questionnaires and interviews to collect data. Kushnir (2010) examined SME participants in the Saudi economy using a case-study approach to analyse interview responses.

Other studies on SMEs have focused on the examination of the relationships between SMEs, and the availability of capital investment funds and their business innovation by utilising chi-square testing and measures of correlation to analyse the results obtained (e.g. Bracker &

Pearson 1986; Ahmed 1987; Bracker et al. 1988; Carter & Van Auken 1990; Keasey & McGuinness 1990; Hassan 1990). Some of these studies used a field-study approach (Osaze 1981; Oakey 1984), while others (Binks et al. 1986; Ahmed 1987; Austin et al. 1993) used case studies and adopted an in-depth examination of a small number of SMEs operating in their own context. Conversely, Stockport and Kakabadse (1992) and Holiday (1995) used questionnaires and interviews to collect the data for their studies. However, there are other methods that rely on participant observation or ethnography that few studies have adopted in examining the life of SMEs, but are considered the most effective in such research.

Previous studies of SMEs have primarily used quantitative techniques. The most common methods for collect primary data are questionnaires and interviews that focus on examining the relationship between SMEs and other factors. In such studies, data are analysed using chi-square tests and correlations (e.g. Ahmed 1987; Holliday 1995; McKillop & Hutchinson 1994; Pell & Wilson 1996).

After reviewing a number of studies on SMEs (e.g. Abalkhail 1999; Ibrahim 2006; IFC 2012; Kushnir 2010; Sejjine 2000), this research selected mixed-method approach (which uses a combination of the quantitative and qualitative methods) as the most appropriate for analysing the primary data collected for this study (i.e. questionnaire surveys and interviews). Descriptive analyses, chi-square tests, *t*-tests, correlation tests and ANOVA were used to address the hypotheses and meet the objectives of the study.

To measure SMEs' access to finance, this study applied subjective criteria to measure access to finance from Saudi banks by examining the perception of owners/managers of SMEs of their ability to obtain finance. This study also applied subjective criteria to measure access to finance. For example, unsuccessful access to finance may be due to SMEs being unwilling to provide collateral or pay a high interest rate of a loan.

Several studies have used factors that indicate difficulty in accessing finance to measure the funds obtained by SMEs (Rasheed 2004; Van Auken 1999). For example, Chittenden, Hall and Hutchinson (1996) examined access to finance by small firms by measuring two main factors:

access to financial markets and access to long-term debt. They found that small firms were not able to access the capital market or long-term debt because they do not have sufficient collateral. Other studies focus on access to debt finance given that SMEs rely on loans as their main source of finance due to their inability to access the capital market (Binks, Ennew & Reed 1992; Coleman 2004; Pissarides 1999). Such studies use several factors to measure the barriers of access to finance, for example, the high cost of debt, high collateral requirements and the bureaucratic procedures of banks (e.g. Bukvic & Bartlett 2003; Coleman 2004; Kariuki 1995). It has been found that the cost of credit impedes SMEs from accessing finance (Carter & Van Auken 1990, Levy 1993).

However, Kariuki (1995) examined the procedures of obtaining credit to SME measure access to finance, finding that the time spent on applying for a loan and making financing decisions is expensive for firms, and also represents an impediment to the use of formal sources of finance by SMEs. Similarly, Haron and Shanmugam (1994) employed cost-of-timing to obtain finance as a main factor for measuring access to finance by SMEs given that the availability of financing assists the firm in covering their needs at any time. In contrast, Rasheed (2004) examined ability to raise financial capital by using a five-point Likert scale ranging from 'never' to 'often' to measure the frequency with which owners/managers experience obstacles in accessing finance. To overcome the different limitations relating to the validity of results inherent to quantitative and qualitative research methods and to employ the measures of access to finance for SMEs, this study combined the two research methods in a mixed-methods approach. The constraints for SMEs obtaining funds are generally classified into five criteria:

1. High cost of credit
2. High collateral requirements
3. Time required to obtain loan is too long
4. Complexity of loan-application procedures
5. Lack of outside equity capital.

This study focuses on the perceptions of owners/managers of their experiences and ability to access external finance focusing on these five factors with consideration of other factors (Coleman 2004; Hamilton & Fox 1998; Holmes et al. 2003).

5.4 RESEARCH DESIGN

A research design provides a framework on how data are to be collected and which priority instruments should be used for analysing them (Bryman 2004). The literature review showed that data were gathered from different types of sources: (i) interviews; and (ii) questionnaires (surveys).

5.4.1 Interviews

Interviews are considered as an essential research method to collect data (Cooper & Schindler 2001). Kvale (1996) defined interviews as ‘an interchange of views between two or more people on a topic of mutual interest, sees the centrality of human interaction for knowledge production, and emphasises the social stuntedness of research data’. Other researchers define interviews as a conversation or direct verbal contact between the researcher (interviewer) and a sampling participant (interviewee) in order to gather the necessary and relevant information for a study through asking questions based on the topic (Cohen et al. 2000; Hoyle et al. 2002; O’Leary 2004). The interview can be classified according to the structure of the questions used to collect the primary data. Thus there are structured interviews, semi-structured interviews and unstructured interviews. The decision to choose any one of these types depends on the nature of the research problem and variables to be addressed (Saunders et al. 1997).

According to Al-Assaf (2003), Gray (2004) and Kerlinger (1973), the main reasons for employing interviews as a tool to collect data relate to: (i) sample size, which plays an important role in the selection of interview as a tool for data collection. A number of study populations imposes on the researcher limitations in gathering objective data through interview as this requires time and effort by the researcher; (ii) sample participant type, which refers to the type of study sample, in terms of variation in age or cultural level, for example. It may be difficult to use an adequate research technique such as a questionnaire with children or illiterate people, so the interview becomes an appropriate tool; (iii) information type required: if the information to be obtained is confidential and sensitive, or if there is a need to obtain highly personalised

data, then interviews are preferable to surveys for collecting the data (Al-Assaf 2003; Gray 2004; Kerlinger 1973).

Each of the three different types of interviews (structured, semi-structured and unstructured) have their own strengths and weaknesses. Unstructured interviews are used to develop questions during the interview, whereby interviewees are encouraged to express their opinions, speak openly, give as much detail as possible and share their experience with the topic. Although this type of interview allows the interviewer to discover important information about the interviewee, the researcher may not obtain objective data relevant to the topic and may talk or ask inappropriate and irrelevant questions. Thus, it could be difficult for the researcher to code and analyse the data (Alshaibe 2000; Kajornboon 2005). In semi-structured interviews, the interviewer has the right to ask selected questions of the respondent, and may also change or adjust the interview questions from time to time depending on the direction of the interview with respect to the required focus (David & Sutton 2004; Gray 2004). However, this type of interview is quite time consuming to conduct and the responses are difficult to analyse (Alshaibe 2000).

This study will adopt structured interviews to collect data from Saudi banks and other government and private specialised credit institutions. In structured, or standardised, interviews the same questions are asked to all respondents, which results in answers that contain the same context. Corbetta (2003) defines 'structured interviews' as 'interviews in which all respondents are asked the same questions with the same wording and in the same sequence'. According to Bryman (2004) and Corbetta (2003), the advantage of this type of interview is that the researcher has control over the format and the dialogue of interview and can make sure that the questions are presented in the same order each time. Also, the structured interview maintains a focus on the relevant study. Hence, it will be easier for the researcher to analyse, code and compare the data. Many SME studies (e.g. Al-Kharusi 2003; Sajini 1997; Sarapaivanich 2006) have used this technique.

Consequently, face-to-face interviews were designed and conducted for this study. This is a valid and appropriate technique due to its use in previous studies as well as its efficiency and ease of creating codes to interpret, its ease of comparison, convenience and advantage in

overcoming time and resource limitations. In some instances, questions dealt with complex issues that required explanation by the interviewer (e.g. financial and economic information) (Badr 1982; Bryman 2001; Lang & Heiss 1984; Rubin & Babbie 1989; Shaughnessy & Zechmeister 1994). The interviews for this study were conducted with representatives of nine financial institutions: five Saudi banks, two GSCIs and two Saudi private sector funds. The objective of these interviews was to gather basic understanding of the constraints of financing SMEs in Saudi Arabia, and to identify the factors that influence ease of access of SMEs to the current financial services provided by Saudi banks and other GSCIs, which therefore affect their performance. These interviews are exploratory in nature and provide an opportunity to clarify issues relevant to the study problem. Data from these interviews were employed in a triangulation exercise to validate and expand on the results of the survey data. The nine structured interviews constituting the qualitative approach adopted a cross-case studies strategy as the research design and were analysed in the form of thematic analysis to give a detailed description of both implicit and explicit ideas within the data analysis (Braun & Clarke 2006; Guest et al. 2012; Saleh 2012).

The content of the interview questions of this study was primarily based on the literature and the research objectives. The questions were reviewed by a group with expertise in the area and were translated into Arabic by a certified translation office. The translations were checked for accuracy by the researcher's academic supervisor at the Institute of Public Administration in Saudi Arabia. The response format of the interview questions was open-ended, where respondents were allowed to give more information and answer freely in their own words (Cooper & Schindler 2001). The interview was divided into three main sections—with 28 open-ended questions—to identify loan policies and requirements in financing SMEs, obstacles facing banks with loan applications by SMEs, the availability of Islamic financial products and services, the relationship between banks and SMEs, and financing for SMEs. The interview began with general questions about SMEs in Saudi Arabia; the kind of services banks offer to them and how banks view the future of this sector. The interview then gradually moved to more detailed questions about the constraints of financing SMEs in Saudi Arabia, policies and regulations adopted by the bank in financing SMEs, available Islamic finance products and how the bank manages the risks of financing such businesses. Permission was granted by all nine interviewees to audio record the interview. The study followed a logical order of questions in order to foster and build the trust and interest of the respondent so they could answer the

questions with more confidence (Binzomah 2008). In addition, an information cover letter and consent form were provided to participants involved in the study outlining the significance of the research and the value of their participation (see Appendix 1).

5.4.2 Questionnaires (Surveys)

The second most popular and widespread data collection method used in social research is the questionnaire. The questionnaire is a list of written questions designed to elicit information from selected respondents. Questionnaires can be conducted by mail, online survey, telephone, face-to-face interviews, handouts or electronically (Gillham 2008; Shaughnessy 1994). Questionnaires or surveys have advantages over some other data collection techniques. They can cover a large geographical area at low cost and provide time for participants to consider their answers carefully. They also provide a greater uniformity of responses as respondents receive the same questions. This assists in the analysis and interpretation of a large numbers of responses (May 1993; Remenyi & Williams 1995).

The questionnaire survey used in this study was designed for owners and managers of SMEs and their businesses. The questionnaire survey was conducted on a sample of 270 members of the Saudi SME sector. The Saudi Chamber of Commerce and Industry (SCCI) provided a list of its members that was used as a sampling frame to select the respondents for the survey. The list also provided the names of the businesses, the responsible officers and their contact details. The surveys were distributed in two ways: first, the businesses were initially asked by telephone to provide detailed information about the survey and to make appointments for interviews with willing respondents, and then participants were asked to sign a consent form prior to the commencement of the face-to-face interviews. Second, the survey was distributed via a web-link using 'Survey Monkey'. This was sent to the email list of SME owners provided by the SCCI. The questionnaire was translated into Arabic by certified translation services and the interviews conducted in Arabic. The translations were checked for accuracy by the researcher's academic supervisor at the Institute of Public Administration in Saudi Arabia.

Structurally, the questionnaire consisted of three sections. The first had 17 questions that collected background information about the firm and its owner. Section 2 had 33 questions aiming to identify internal and external obstacles that the firm faced (entrepreneurs, enterprises and business environment factors). The last section comprised 23 questions focused on identifying the financial access constraints faced by SME owners/managers in Saudi Arabia.

The sample of 270 was deemed sufficient to test hypotheses about the population given the statistical methods that were adopted, which were mainly contingency table analysis, correlation and regression tests. Similar studies had used samples of equal size or smaller than 250 (Clark 2011; Hajjar 1989).

5.5 DATA COLLECTION

This study used interviews and questionnaires as the primary instrument for data collection. To achieve effective data collection through interviews and questionnaires, the study followed four stages, further discussed below: instrument development, pre-testing, sampling and instrument distribution.

5.5.1 Instrument Development

The questionnaire instrument adopted in this research consisted mostly of closed-ended questions in a multiple choice format. In essence, some of the questions of the questionnaire were designed using the Likert scale, which offers the advantage of a standard format providing answers that can be coded quickly, easily and without error (Albaum 1997).

In view of the objectives of this research, as well as the dispersed locations of potential respondents, the personal structured interview approach with financial institutions along with face-to-face and online questionnaires with SME owners/managers were selected as the most

appropriate methods for data collection. Abalkhail (1999), Kushnir (2010) and Sajini (1997) point out that survey formats must be carefully designed, attractive, well organised and appear simple, to ensure a high response rate (Mayer & Piper 1982). In order to make the questionnaire simple and understandable by interviewees, this study paid attention to the layout of research questionnaires, to ensure they followed proper sequence and logic (Binzomah 2008).

The purpose of interviews in this study was to obtain two different types of information from finance organisations: first, their lending relationships with owners and managers of Saudi SMEs; and second, the reasons behind their reticence in financing the SME sector, and risks associated with lending to this sector. The interview questions covered three main areas related to Saudi SMEs: access to external sources of finance, by investigating loan policies and requirements for financing SMEs, and the process of evaluating loan applications; obstacles facing banks with loan applications, by determining the causes and factors that lead to the rejection of SME lending requests; and Islamic financial products and financial services available to SMEs by these financial institutions. The duration of each interview ranged from 60 to 90 minutes.

The questionnaire for this study consisted of three sections: background information about the firm and the owner; internal and external obstacles faced by the firm (entrepreneurs, enterprises and business environment factors); and financial access constraints faced by SMEs.

To develop the questionnaire for this study, the researcher examined several surveys used previously in SME studies to understand the correlation between the objectives of their studies and the data they had collected (Abalkhail 1999; Al-Kharusi 2003; IFC 2012; Kushnir 2010; Sajini 1997; Sarapaivanich 2006). In accordance with Mayer and Piper (1982), and Qureshi and Herani (2011), the questionnaire design of the study adopted the following principles: simplicity, use of simple words and avoidance of complex jargon, being sensible with questions requesting personal information and a user-friendly physical appearance.

5.5.2 Pre-testing

The questionnaire used in this study was pre-tested. A pilot study was conducted as face-to face interviews with 15 selected owners of SMEs in Saudi Arabia from different economic sectors. The aim was to discuss the questionnaire and listen to comments on whether changes were necessary before distributing to the study sample. The feedback received from the pilot group and supervisor related to the length of the questionnaire, the layout of the questions, the fact that many open questions took a long time to answer, question content, relevance of items and ambiguity of some questions. It was clear that the questionnaire was too long (more than 12 pages), so it was reduced to eight pages. Also, as respondents preferred to answer mainly closed-ended questions, the number of open-ended questions was reduced from eight to one.

After revising and rephrasing the questionnaire based on the comments reviewed during the pilot testing, the questionnaire was translated into Arabic by a certified translation office. This would ensure greater reliability insofar as translation of terminology was concerned. A final draft was prepared, and printed following the necessary modifications. More details regarding the pre-testing are discussed in the survey instrument validation section of this chapter.

5.5.3 Sampling

A sample should be representative of the population of research interest, so researchers must identify a representative sample for a population before conducting a survey. There are two different types of sampling technique: probabilistic and non-probabilistic. Probabilistic sampling involves a random selection, unlike non-probabilistic sampling (Bryman 2001; Cooper & Schindler 2001). Probabilistic sampling covers techniques such as simple random, systematic, stratified and cluster sampling. The concept of random selection is ‘a controlled procedure that assures that each population element is given a known nonzero chance of selection’ (Cooper & Schindler 2001, p. 166). However, non-probabilistic sampling uses convenience and purposive sampling, which is subjective and non-random. Although probabilistic sampling ensures that each selected sample member is reached, it is time

consuming and expensive compared to non-probabilistic sampling. According to Cooper and Schindler (2001), non-probabilistic sampling often gives acceptable results when carefully controlled. Given the disadvantages of probabilistic sampling, the present study used non-probabilistic sampling because of the freedom it gave the researcher to choose whichever subjects they meet; and because it is purposive in that it confirms certain criteria through judgement and quota (Malhotra 2009; Zikmund & Babin 2010). Judgement sampling ensures selecting samples with appropriate characteristics to serve a specific purpose, whereas quota sampling is a technique by which the subgroups of the population are chosen for the exact research purpose (Cooper & Schindler 2001). In this study, convenience sampling was selected to obtain data from a large number of completed questionnaires quickly and economically (Malhotra 2009; Zikmund & Babin 2010).

As the present research employs questionnaires and interviews as the data collection methods, two samples were drawn from different populations. The first sample used the questionnaire and represented owners/managers of SMEs from three different economic sectors (trade, services and manufacturing) who were members of SCCI. The second sample used for the interviews consisted of nine Saudi financial institutions (five commercial and Islamic banks, and five public and private specialised lenders were invited). The purpose of interviewing representatives of financial institutions other than Saudi banks was to identify broader external sources of finance for SMEs and explore the difficulties they face in obtaining funds from these financial providers in the market. The SCCI provided the researcher with a list of names, addresses, emails and telephone numbers of entrepreneurs of SMEs operating in different sectors that fell within the range of the study. This information was very helpful as it contained data that rated organisations and activities into five classes: excellent, and first, second, third and fourth class. The range of the SMEs used in the study fell between the second and fourth classes. A list of approximately 6,000 SMEs was finalised; all were from the three main cities of Saudi Arabia (Jeddah, Riyadh and Dammam) and were in the manufacturing, trade and services sectors. A total of 600 of these were selected at random.

5.5.4 Instrument Distribution

The main data collection period was the beginning of January to the end of March 2013. A number of procedures were undertaken to ensure an acceptable response rate to questionnaires:

- A cover letter signed by the researcher was attached to the questionnaire, which was accompanied by a consent form explaining the purpose of the study, to be signed by participants before they answered the questions.
- The online survey was created using the Survey Monkey website and appeared in two language versions: English and Arabic. Respondents were asked to complete the questionnaire in their preferred language and submit it through the website.
- A reminder to non-respondents was achieved via the use of follow-up emails and phone calls, within two weeks of sending both the online and paper-based surveys.

Of the 300 questionnaires sent via email, only 70 were received online through Survey Monkey, representing a response rate of 25 per cent. When they were followed up, 30 participants sent their apologies for not responding, and another 50 questionnaires were returned because of incorrect email addresses. The remaining 150 did not respond. The highest response rate for a data collection method in this study was for face-to-face surveys with owners/managers of SMEs. A total of 220 questionnaires out of 300 were completed, equating to a 75 per cent response rate. One hundred and ten interviewees apologised for not participating. The time to complete the survey ranged from 20 to 35 minutes. The total of 290 responses provided 270 usable questionnaires that were entered into the computer using Survey Monkey to be analysed using SPSS and ANOVA; 20 questionnaires were excluded because they were not completed.

Of the 10 planned interviews, only nine interviewees agreed to participate. They were five Saudi banks (A, B, C, D and E), the SCSB, the Kafalah programme and private funds X & Y.

5.6 SURVEY DESIGN

This study followed the Tull and Hawkins (1990) decision process for survey construction and design, which involves seven steps: preliminary decisions, decisions about question content, question phrasing, response format, question sequence, questionnaire layout, and pre-testing

and revision (see Figure 5.1). In addition, the researcher assessed the validity and reliability of the instruments when designing and examining the study. For instance, all variables included in the study were standard measures of business activity, and resembled physical measures. Further, all variables have been used for similar purposes in previous studies (as discussed in Section 4.4) and have been subjected to the usual tests on the properties of these measures (Alfaadhel 2010; Debo 2006). According to Kerlinger (1992), this eliminates the need for fresh testing of the validity of the measures.

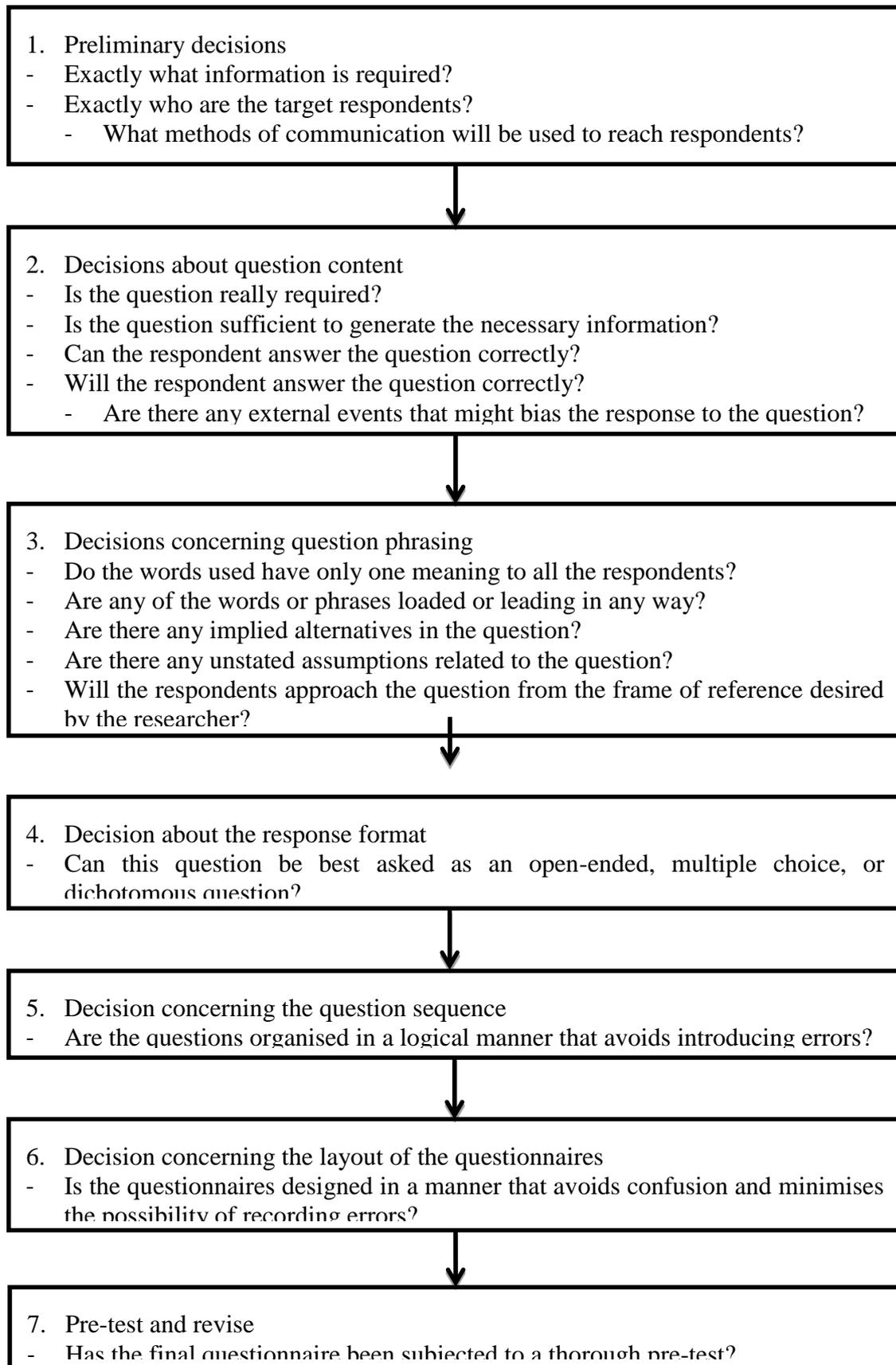


Figure 5.1: Survey Design Process. Source: Tull and Hawkins (1990)

5.7 RESEARCH HYPOTHESES RELATING TO ACCESS TO FINANCE AND BUSINESS PERFORMANCE

The study hypotheses were derived from the literature review. The focus when testing variables for this study were the characteristics of SMEs and their entrepreneurs, as adopted in previous studies (Al-Kharusi 2003; Debo 2006; Sarapaivanich 2006). Of the nine aims of the study, only the fourth required the testing of hypotheses. The hypotheses can be categorised into four broad areas representing each of the three dependent variables discussed in Section 4.4. These were used to investigate the difficulties of access to external finance encountered by SMEs in Saudi Arabia.

The Influence of Access to Finance on Performance

H1: Having access to finance has a positive effect on performance of SMEs in Saudi Arabia.

As discussed in Chapter 4, access to finance from Saudi banks is influenced by many factors. To recap, they are:

Enterprise Business characteristics: availability of business plan, business size, business growth and profit, and business type

Entrepreneurs SME owner/manager characteristics: experience, gender and education

Characteristics of financial institutions Policies, loan requirements and conditions, obstacles facing banks with loan applications by SMEs, and available Islamic products

Characteristics of SME owners/managers the experience, gender and education of the entrepreneur

The following sections provide a description of the factors and related hypotheses tested in the study.

5.7.1 Characteristics of SME Owners/Managers

This section will discuss the relationship between the characteristics of owners/managers of SMEs such as gender, level of education & training, and business experience, and access to finance from banks

5.7.1.1 Education and Training

H1a1: The level of SME owner/manager education has a significant effect on the decision to apply for finance.

H1a2: The level of SME owner/manager training has a significant effect on the decision to apply for finance.

H1b1: There is an association between the level of education of SME owners/managers and their difficulty in accessing finance.

H1b2: There is an association between the level of training of SME owners/managers and their difficulty in accessing finance.

As discussed in Section 3.4.5.2.b and Section 4.5.1.2, a number of studies have shown that education and training of owners/managers of SMEs is one of the most important factors taken into account by financial providers in making financing decisions (Coleman 2004; Saffu et al. 2006). Moreover, there is a relationship between the level of education and training courses attended by owners/managers, and SME business performance and access to finance, as education and training are associated with knowledge, skills, problem-solving ability and ability to exploit opportunities (Parker 2004; Saffu et al. 2006).

To record education, owner/manager participants were asked to identify their highest education attainment level (from high school to postgraduate degree). To record training courses, owners/managers were asked if they had received any form of training in business management and entrepreneurial development.

5.7.1.2 Experience

H2a: SME owner/manager experience has a significant effect on their decision to apply for external finance.

H2b: There is an association between the experience of SME owners/managers and their difficulty in accessing finance from Saudi banks.

A number of studies provide evidence that the owner/manager's level of experience has a significant role in improving the firm's performance as well as a positive effect on access to external finance. The belief among financial providers is that owners/managers with more experience are more likely to have more knowledge and skills to manage their businesses and thus reduce the risk of default (Bukvic & Bartlett 2003; Cron et al. 2006; IFC 2012).

To measure the experience level of owners/managers of SMEs in Saudi Arabia, respondents were asked about the number of years of experience they had when they started the business. Categories were 1–5 years, 6–10 years and >10 years.

5.7.1.3 Gender

H3a: SME owner/manager gender has a positive effect on their decision to apply for external finance.

H3b: There is a relationship between the gender of the SME owner/manager and their difficulty in accessing finance.

Many studies have reported a relationship between the gender of SME owners/managers and access to external finance and business performance. According to Belcourt et al. (1991), Saffu and Manu (2004), Shaw et al. (2006), Tigges and Green (1994), Loscocco et al. (1991), and Light and Rosenstein (1995), female SME owners/managers are less likely to gain access to external finance due to their lack of experience and management skills. The aim of this

hypotheses is to examine whether gender has a significant effect on the decision to obtain funding from external finance. In the formal Saudi credit market, women face many challenges when attempting to start their own new business. For example, restrictions arising from traditional practices that require women to obtain male permission to start a business. In addition, when Saudi women are applying for loans in their own name, they often find difficulties with banking regulations that require an external sponsor such as the head of her household, which is most likely to be a man. This study recorded the gender of the owners/managers of SMEs in Saudi Arabia by asking respondents to specify their gender.

5.7.2 Business Characteristics of SMEs

The characteristics of a firm, such as size of firm, business plan, growth and profitability rate and ownership type are very important factors that financial providers and investors examine to assess the ability of an applicant firm to repay loans.

5.7.2.1 Business Size

H4a: Business size has a significant association with the decision to apply for external finance.

H4b: There is an association between the size of a firm and its difficulty in accessing finance from Saudi banks.

The size of a business is a significant factor influencing access to external finance according to many studies (Abor & Biekpe 2005; Berger & Udell 1998; Coleman 2004; Coleman & Cohn 2000). Unlike large firms, small-sized businesses receive fewer benefits from banks and finance providers, as well as from government regulations. They also have fewer resources available to them that could positively affect their business performance (Keasey & Watson 1993).

This study measured firm size according to number of employees (Johnsen & McMahon 2005; Romano et al. 2001; Tigges & Green 1994), and sales turnover (Bennett & Donnelly 1993; Jordan et al. 1998). As discussed in Section 2.1.2, and according to a number of studies that have defined SMEs, the size of a firm in Saudi Arabia is measured by its number of employees

and sales turnover (Abalkhail 1999; Alfaadhel 2010; Alsulamy 2005; Kushnir 2010; Radwan & Al-Kibbi 2001).

5.7.2.2 Business Ownership Type

H5a: Business ownership type is significantly associated with the decision to apply for external finance.

H5b: There is an association between the ownership type of the firm and its difficulty in accessing finance from Saudi banks.

It is anticipated that the legal structure of the business may affect its ability to access external sources of finance (Barlow & Robson 1999; Binks & Ennew 1997; Merritt 1998). Owners/managers of businesses may face difficulties when attempting to obtain finance as financial providers and investors are more likely to prefer to finance incorporated firms and private limited companies, as a safer option. Consequently, this study asked owners/managers of firms to specify the legal structure type of their business.

5.7.2.3 Business Plan

H6a: The existence of a written business plan has a significant effect on the decision to apply for external finance.

H6b: There is an association between the existence of a written business plan for a firm and its difficulty in accessing finance from Saudi banks.

Most studies consider that a business plan is one of the most significant elements in determining financial assistance by most banks and financial providers. In fact, this was considered the main document required for assessing the success and future growth of the applicant's project (Barrow 1993; Berry et al. 1993a; Reid 1998). Thus, the inability of SMEs to provide a business plan will lead to major difficulties in obtaining funds from banks and investors a (Abalkhail1999; Kushnir 2010; Sajini 1997).

To record the availability of a written business plan before and after commencement of the business, the study asked the owners/managers of the SME if they had prepared a business plan (or feasibility study) before starting their business and to rate the benefit of having a business plan.

5.7.2.4 Growth Rate and Profitability Ratios

H7a1: The growth rate of a firm has a significant effect on its decision to apply for external finance.

H7a2: The profitability ratios of a firm have a significant effect on its decision to apply for external finance.

H7b1: There is an association between the growth rate of a firm and its difficulty in accessing finance from Saudi banks.

H7b2: There is an association between the profitability ratios of a firm and its difficulty in accessing finance from Saudi banks.

Financial information provides clear evidence to financial providers about the ability of a firm to repay a loan. In fact, a number of researchers have noted that firms with higher growth rates and profits have easier access to external finance, enhancing the business performance and decreasing credit costs and liquidity risk (Berger & Udell 1998; Johnsen & McMahon 2005).

To measure a firm's growth rate and profitability ratios, this study asked owners/managers to indicate (within categories ranging from 5 per cent to over 20 per cent) about their current market share and annual growth rate. The study also measured the financial ratios of the business by determining the percentage of ROI, profit margin, current ratio, annual sales turnover and financial leverage (English 2003; Hodgetts & Kuranthko 1998; Schaper & Volery 2004).

5.7.3 Business Obstacles

H8a: The SME-related business obstacles that firms face in Saudi Arabia have a negative effect on their performance.

H8b: There is an association between the SME-specific business obstacles encountered by firms in Saudi Arabia and their business performance.

Business obstacles are considered a major barrier to the growth and continuity of a business. To assess the internal and external business obstacles faced by most Saudi SMEs, this study asked the owners/managers, via the use of a point scale, to determine which factors most affected their business performance.

The following business obstacle factors were measured in this study.

Internal Factors

Entrepreneurial: gender, age of owner, work experience, availability of capital and availability of a business plan

Enterprise: technology, sales and marketing, management skills, customer satisfaction, quality of product or service, and training

External Factors

Environmental: legal issues, financial support, government support, advisory service, corruption, government bureaucracy, legal issues, chamber of commerce services and government regulations (labour)

5.7.4 Characteristics of Financial Institutions

5.7.4.1 Islamic Finance

H9a: The availability of Islamic finance products has a positive effect on the decision to apply for external finance.

H9b: There is an association between the availability of Islamic finance products and the difficulty in accessing or obtaining finance from Saudi banks.

H9c: The availability of Islamic finance products has a positive effect on access to Saudi bank finance.

One of the aims of this study was to clarify the distinctive concept of Islamic banking and finance and its suitability for SMEs. Consequently, owners/managers were asked which of the available Islamic financial products were provided by Saudi banks for SMEs. Banks also were asked during the interviews about their available Islamic products provided to SMEs.

5.8 DATA PREPARATION

After the completion of the data collection (questionnaires and interviews), the next step was the preparation and analysis of the collected data (Al-Kharusi 2003; IFC 2012; Qureshi & Herani 2011). The data preparation process began with checking the received questionnaires and deciding on their acceptability. Once this was completed, the data were edited, coded and transcribed. After the data were cleaned, the appropriate data analysis technique was selected (Qureshi & Herani 2011).

5.9 DATA ANALYSIS

The collected data underwent a preparation process to allow a myriad of assessment techniques, ranging from descriptive to correlation analysis (Roure et al. 1990). The selection of these techniques was based on the sample size and the nature and source of data and their complexity (Allison 1999).

The data were coded according to a numerical system transposed upon the Likert scale according to the nature of the questions. For example, nominal data were expressed as *n*-valued variables; ordinal data were multi-valued with an ordering relationship, where the actual distance between any two neighbouring values was unknown (Katz 2011).

5.9.1 Descriptive Techniques and Frequency Statistics

Descriptive statistics to be used depend on the type of research question and design that will be applied to the study, which can be either quantitative or qualitative. Descriptive statistics address the ‘what’ question and do not answer questions about ‘how’, ‘when’ or ‘why’. A descriptive statistic is defined as ‘a general term for methods of summarising and tabulating data that make their main features more transparent’ (Everitt 2002, p. 113). To minimise the raw data that have been collected, the analysis commenced with descriptive analysis to transform the raw data into a summary format through the calculation of averages, frequencies and percentages (Zikmund 1994).

Frequency distributions (counts and percentages) were tabulated for all questions with a categorical response (nominal or ordinal) and descriptive statistics were tabulated for all questions with a continuous response.

The questions where respondents could choose multiple categorical responses were analysed using a multiple response method as opposed to a multiple dichotomy method. The multiple response method treats each response as a separate variable (Vaus 2002) and was chosen because of its parsimony and its suitability for the purposes of this research.

Trends were summarised based on whether the majority (more than 50 per cent of the participants) agreed or disagreed with the items. The skewness of the distributions (e.g. whether the highest frequencies were located at the agreement or disagreement end of the scales) was recorded where applicable.

The findings of the questionnaire are presented in Chapter 6.

5.9.2 Correlation Analysis

Correlation analysis is useful in determining the strength and direction of the linear relationship between two variables (Sharma 2005). Spearman's correlation coefficient and its statistical significance (at the 0.05 level) were computed for indicators of access to finance, SME performance, owner/business/manager characteristics and SME characteristics. Statistically significant correlations are reported. Spearman's correlation coefficient is appropriate for both continuous and discrete variables (including ordinal variables); hence it was chosen over Pearson's correlation coefficient in computing the correlations (Muijs 2011). In keeping with standard analysis techniques, where appropriate, missing data were excluded by pairwise deletion (Selvin 2011).

5.9.3 Chi-square Tests and Contingency Tables

A difference in group memberships can be tested for statistical significance using the chi-square test of independence (Chay 2014; Qureshi & Herani 2011). The joint frequency distribution of two categorical variables can be analysed with the chi-square statistic to determine whether the variables are statistically independent or not (i.e. associated or dependent). The null hypothesis in a chi-square test of independence is that the n classifications are independent, and the alternative hypothesis is that they are not independent. Chi-square tests were used because the distribution pattern was far from random (Evans & Jovanovic 1989; Qasim & Jamil 2009).

The assumption of independence of observations was met as the sampling of one variable did not affect the choice of any other variable included in the analysis, and the assumption of mutual exclusivity of row and column variables was met as no combination of the variables overlapped with each other. The assumption of large expected frequencies was met as none of the expected frequencies were less than 5. A 0.05 level of significance was used as the criteria for statistical significance.

This study applied chi-square tests to explore the need of SMEs for finance from Saudi banks and test the existence of a relationship between independent and dependent variables of the research hypothesis. Chi-square tests were also used to measure the degree of relationship between the difficulty in accessing Saudi bank finance, and entrepreneur, enterprise and financial institution characteristics.

In addition, the chi-square statistic was employed to test for correlations among the different variables used for testing the hypotheses. Contingency tables were constructed by listing all the levels of variables on rows and columns in a table, then finding frequency tables of two variables for each cell as required.

5.9.4 Independent Sample *t*-tests

A *t*-test (independent sample) is a useful statistical technique to assess whether the means of two groups are statistically different from each other. Independent sample *t*-tests are a parametric technique that requires values to be normally distributed. The values were assumed to be normally distributed for the purposes of this work as the use of non-parametric statistics in the current dataset may lead to difficulties in the interpretability of results. Thus, parametric tests such as the independent sample *t*-test were used in the present analyses where appropriate, which is justified by the practicality and ease of interpretation of the survey information. A 0.05 level of significance was used as the criteria for statistical significance.

5.9.5 Analysis of Variance

The ANOVA technique is used to test the variation among means between two or more variables. It is an important technique for identifying the association between the dependent variable and several categories of single independent variables (Norusis 1998; Randolph & Myers 2013; Rutherford 2012). The one-way ANOVA type of analysis that is used depends on how the data are divided into groups, according to only one factor (De Vaus 1996; Malhotra

1996; Norusis 1998). Consequently, this study will use ANOVAs to examine the association between various business obstacles and business financial performance (ROI, profit margin, leverage ratio, annual sales turnover, market share, and growth rate). To measure and determine the business obstacles faced by most Saudi SMEs, owners/managers were asked to identify, via a four-point Likert scale, the factors that most affect their business performance.

5.9.6 Measurement of Variables

This study employed the appropriate scale of measurement including nominal and ordinal scales. Variables such as the type and size of the firm, and experience and education of the owner/manager are classified as interval or ratio variables because the difference between the categories is identical. Such intervals or ratios become ordinal variables when they are grouped together (Bryman & Cramer 1990; Siegel & Castellan 1988).

5.10 QUALITATIVE DATA ANALYSIS

Based on the data collected from nine interviews, the analysis was carried out using cross-case study strategies, where each financial institution is considered as a case to identify the financial constraints that face SMEs with respect to different financial institutions and to discern similarities and differences across those institutions in terms of financing SMEs (Eriksson & Kovalainen 2008; Patton 2002). In this study, the analysis of qualitative data adopted a thematic analysis approach as it provides a flexible and useful research tool that describes the data in rich detail, by focusing more on identifying and describing both implicit and explicit ideas within the data analysis (Braun & Clarke 2006; Guest et al. 2012).

Boyatzis (1998) describes thematic analysis as a process of ‘encoding qualitative information’ to transform it into qualitative data. Thematic coding ‘is a data reduction and analysis strategy by which qualitative data are segmented, categorised, summarised, and reconstructed in a way that captures the important concepts within the data set’ (Ayres 2008, p. 867). In thematic coding, the researcher frequently begins by developing ‘codes’ with a list of themes known to serve as labels to analyse the data (Gibbs 2007). This study used open coding and then organised

the codes into subcategories, resulting in comprehensive themes (Strauss & Gorbin 1997). Codes were identified and categorised with corresponding codes at different levels of analysis and were mostly descriptive, with theme names as presented in the Table 7.2 (Miles & Huberman 1994).

Therefore, the study followed the thematic analysis process described by Braun and Clarke (2006) which includes identify the data; creat initial codes; searching for themes; reviewing themes and sub-themes; definition of themes and report production. Then, the researcher began to read through all interview transcripts after they were translated into English in order to achieve a holistic overview about issues related to the research objectives. Four main themes were identified based on the three main dependent variables (access to finance, obstacles facing banks with loan applications from SMEs, availability of Islamic financial products). These themes were around the implemented conceptual framework outlined in Section 4.3 and were linked and interrelated with the research objectives and questions to provide the researcher with valuable information on these qualitative elements. The researcher then analysed those themes and sub-themes via a cross-case analysis, to allow comparisons between and within the nine cases.

5.11 SURVEY INSTRUMENT VALIDATION

This section provides information about the development of the survey instrument and its validity. Content validity is defined “as the extent to which an instrument adequately samples the research domain of interest when attempting to measure phenomena” (Wynd et al 2003, p. 508). Validity can take many forms to assess: questions in a survey must relate to the structure being measured.

5.11.1 Content Validity

A committee approach for establishing content validity was not used for this research. However, a pilot study was conducted and the opinions of pilot study respondents were gathered regarding the relevance, practicality and validity of the survey.

The pilot study involved pre-testing the survey and conducting face-to-face interviews with selected owners/managers of SMEs in Saudi Arabia. A total of 15 owners/managers from diverse economic sectors were engaged in the pilot study. The feedback from participants was mostly positive and included a reduction in the length of the survey and the inclusion of more closed-ended questions to substantiate the open-ended ones. This reduced the average length of time needed to complete the survey, while reducing the ambiguity of some questions.

The feedback obtained from participants in the pilot study was addressed by reducing the length of the survey from 12 to 8 pages and by redesigning it to include more open-ended questions. In addition, some of the questions were re-phrased to reduce their ambiguity.

A certified translation officer translated the survey questions into Arabic. This was done to ensure accurate translation especially of technical terminologies. Copies of the survey in the two languages are provided in Appendix 1.

The contents of the survey were validated through a statistical reliability analysis and an exploratory factor analysis (EFA). As these tests can only be carried out after conducting the survey, they are confirmatory in nature. There are two scales in the survey, namely the attitude to business plan scale (Question 17) and obstacles to growth of business scale (Question 23).

5.11.1.1 Reliability Analysis

To validate consistency, reliability tests were carried out on the scale items using Cronbach's alpha as a measure. A Cronbach's alpha value of 0.7 or above is considered reliable, indicating that the sets of items were internally consistent in measuring the intent of each factor.

The reliability coefficient for the attitudes to business plan scale was found to be 0.72 ($n=6$); and the reliability coefficient for the obstacles to growth of business scale was found to be 0.89

($n=22$). As both these values are greater than 0.7, the items in the scales were deemed fit (reliable) to be used in the analysis.

5.11.1.2 Exploratory Factor Analysis

EFA was performed on the six items from the attitude to business plan scale and the 22 items from the obstacles to business growth scale. The aim was to discover if the variables could be explained in terms of a smaller number of inter-correlated variables, called factors. Here, each factor could measure a different aspect of attitude to business plan or obstacles to business growth. The solution to EFA depends on the sample size, the number of variables and the structure of the correlation matrix. Less than 100 cases is a small sample for EFA and unlikely to produce a meaningful solution. A sample of 100–200 is considered fair, whereas 200 or more, as used in this study (270), is likely to produce a meaningful solution (Hair et al. 2010).

This study aims to explore the structure of the dimensions indicated using principle factor analysis (PFA) by inter-correlations between the questionnaire items.

The dimensional structure of the six items used to record the attitudes of the survey respondents towards a business plan was extracted from the pattern matrix using principal axis factoring which assumes that all items measured attitudes of survey respondents on various aspects of a business plan in the same logical direction, and that the factors would be inter-correlated. As Table 5.1 shows, a solution with two factors—each with Eigenvalues >1 —was extracted, which explains 62.14 per cent of the variance.

Table 5.1: Structure of the Attitudes to Business Plan Scale Extracted from the Pattern Matrix by Principal Axis Factoring with Direct Oblimin Rotation and Kaiser Normalisation (n=270)

		Loadings from the pattern matrix	
		Factor 1	Factor 2
Per cent variance explained by each factor (%)		43.32	18.82
Cumulative percentage		43.32	62.14
Eigenvalues		2.599	1.129
Item FACTOR 1: Positive attitudes towards a business plan			
1	Gives clear vision for the future of the business	0.596	-0.310
2	Useful to obtain finance	0.753	0.041
5	Useful to determine demand for product and customer needs	0.591	-0.273
6	Reduces manager decision-making power and ensures commitment at the top level	0.814	0.183
FACTOR 2: Negative attitudes towards a business plan			
3	Takes time to prepare and costs money	0.046	-0.839
4	Can't be prepared while the business is running	-0.044	-0.881

The dimensional structure of the 22 items used to collect the views of the survey respondents about obstacles to business growth was extracted as per the attitudes to business plan items. As shown in Table 5.2, a solution with five factors—each with Eigenvalues >1—was extracted, explaining 62.73 per cent of the variance.

The results of the EFA indicated that the items included in the survey were valid, non-repetitive and representative of the various aspects of attitudes to a business plan or obstacles to business growth being measured. The factor analysis of the attitudes to business plan scale indicated that this scale measured the positive and negative attitudes of the respondents about a business plan. In addition, a factor analysis of the obstacles to business growth scale indicated that this scale measured obstacles related to legal and compliance factors, market factors, business owner/manager demographics, employee quality and technology and government factors. The results of the factor analysis were consistent with the intent of what these scales were designed to measure. Therefore, the EFA confirmed the validity of the items used in the two scales.

Table 5.2: Structure of the Obstacles to Business Growth Scale Extracted from the Pattern Matrix by Principal Axis Factoring with Direct Oblimin Rotation and Kaiser Normalisation (n=270)

		Loadings from the pattern matrix				
		Factor 1	Factor 2	Factor 3	Factor 4	Factor 5
Per cent variance explained by each factor (%)		33.73	10.19	7.22	6.74	4.86
Cumulative percentage		33.73	43.92	51.14	57.87	62.73
Eigenvalues		7.421	2.241	1.588	1.482	1.069
Item FACTOR 1: Legal and compliance factors						
7	Availability of capital	-0.694	0.127	0.135	0.438	-0.262
11	Chamber of commercial services	0.523	0.003	0.172	0.186	-0.328
14	Legal issues	0.546	0.073	0.043	0.203	-0.407
16	Advisory services	0.540	0.121	-0.066	0.301	-0.317
17	Training	0.578	0.297	0.079	0.211	-0.003
18	Product and services quality	0.447	0.347	0.119	0.211	-0.132
FACTOR 2: Market factors						
1	Sales and marketing	-0.065	0.540	-0.128	0.107	0.443
20	Competitors	0.097	0.793	0.149	-0.076	-0.056
21	Customer satisfaction	0.139	0.794	0.043	0.024	-0.050
22	Government regulations (labour)	-0.079	0.678	-0.060	-0.070	-0.258
FACTOR 3: Business owner demographics						
2	Gender	-0.066	0.108	0.879	-0.190	0.054
3	Age of owner	0.038	-0.041	0.819	0.188	0.052
FACTOR 4: Employee quality and technology						
4	Education level	0.381	-0.116	0.034	0.619	0.033
5	Management skills	-0.123	-0.024	-0.155	0.885	0.076
6	Work experience	0.053	0.047	0.019	0.808	0.076
8	Technology	0.184	-0.087	0.271	0.481	-0.187
9	High cost of labour	0.162	-0.041	0.223	0.518	-0.267
10	Availability of skilled employees	-0.083	0.192	0.110	0.477	-0.196
FACTOR 5: Government factors						
12	Government bureaucracy	0.037	0.314	-0.385	0.021	-0.494
13	Corruption	-0.030	0.041	-0.059	0.092	-0.751

15	Government support	0.257	0.123	0.056	0.014	-0.589
19	Financial support	-0.134	0.356	0.247	0.097	-0.478

5.12 SUMMARY

This chapter has highlighted the importance of the research methodology and the research design applied in this study. A number of studies of SMEs were reviewed in order to select the most appropriate methods to be used for this study. Accordingly, the mixed methods (quantitative and qualitative) approach was selected for collecting the necessary primary data: questionnaire and interviews. The survey-based research method was conducted with the owners and managers of SMEs through online and face-to-face surveys in order to achieve an adequate response rate. Interviews formed the primary source of data from the financial institutions in order to study the constraints on financing the SME sector from a Saudi financial provider's perspective. The SPSS software, which is an integrated system of computer programs, was used for analysis of the data. Also, ANOVA was used to examine the association between various business obstacles and business financial performance (ROI, profit margin, leverage ratio, annual sales turnover, market share, and growth rate). Frequency, percentage and correlations were the initial estimates employed, and then statistical techniques were applied, including descriptive analysis, chi-square and contingency tables, hypotheses testing and correlation analysis. The following chapters will present the results of these analyses.

CHAPTER 6: QUANTITATIVE DATA PRESENTATION AND ANALYSIS

6.1 INTRODUCTION

Previous chapters laid the foundations for this study via a discussion of the framework to be used for this research. This chapter presents the results gathered from face-to-face questionnaires and online surveys with 270 Saudi SME entrepreneurs. It tests the research hypotheses discussed in Chapter 5. The statistical analyses in this study have been divided into five sections. The first provides an overview of the survey data; the second provides detailed descriptive statistics for all the data collected through the surveys; the third tests hypotheses relating to the association between the owner/manager and business characteristics, and access to finance; the fourth tests for relationships among various factors including access to finance, SME obstacles, owner/manager and business characteristics, and SME performance through a correlation analysis approach; and the fifth validates the relationship between access to finance and SME performance via a multiple regression analysis. This is followed by concluding remarks in a summary section.

6.2 SURVEY DATA OVERVIEW

A list of approximately 6,000 SMEs was compiled for the three main cities in Saudi Arabia (Jeddah, Riyadh and Dammam). The main source of this information was the business directory provided by the SCCI. The compiled list of SMEs represented the manufacturing, trade and services sectors. A total of 600 SMEs that have between 6-99 workers were selected at random from the pool of 6,000 businesses (10 per cent). The final sample that responded to the questionnaire comprised 290 members of the Saudi SME sector. A response rate of 48.3 per cent was obtained from the entire sample, of which 93.1 per cent were deemed usable responses. A small proportion (6.89 per cent) was classified as unusable due to incomplete surveys. The usable survey response rate in this study compares favourably with that in similar SME studies conducted by Al-Kharusi (2003) in Oman, Hajjar (1989) in Saudi Arabia, and Dabo (2006) in

Nigeria, who achieved overall responses of 48.2 per cent (397/588), 40.36 per cent (819/2029), and 51.22 per cent (502/980).

6.3 DESCRIPTIVE STATISTICS

Descriptive statistics provide a detailed description of the study sample and enable the reader to understand the value and nature of its characteristics. Frequency distributions (counts and percentages) for each response were tabulated and commented upon. Questionnaires were implemented for the quantitative aspect of this study as per the conceptual framework mentioned in Section 4.3 and linked and interrelated to the research objectives and questions. As previously noted, the questionnaire is divided into three parts: 17 questions that collect background information about the firm and its owner; 33 questions that aim to identify the business obstacles that the firms face; and 23 questions that aim to identify the constraints to financing for SMEs. The questionnaire used in this study was designed for the owners and managers of SMEs and their businesses.

The aim of the data analysis in these sub-sections was to describe and understand a range of characteristics of the participants and businesses that participated in the study including:

1. Demographic characteristics of participants
2. Characteristics of the businesses represented by the participants
3. Obstacles faced by SMEs and their effect on business performance
4. Various facets of SME access to finance.

6.3.1 Entrepreneur (Owner/Manager) Characteristics

In the first section, background information was collected about entrepreneur (owners/managers) characteristics in terms of four main factors: experience, gender, nationality, and training and education.

6.3.1.1 Gender

The majority ($n=211$, 78.40 per cent) of the respondents were male entrepreneurs, and the remainder ($n=58$, 21.60 per cent) were females (Table 6.1). The proportion of females represented in this study was higher than the proportion of female entrepreneurs in Saudi Arabia: at a professional women's conference in Al Khobar in 2012, it was reported that only 8 per cent of sampled SMEs in Saudi Arabia were operated/owned by females. The high female participation rate in the current study might be indicative of the increasing proportion of female entrepreneurs in Saudi Arabia. The number of Saudi female-owned enterprises registered at the Chamber of Commerce of Saudi Arabia in 2012 was 72,494 firms (Badir 2012; ArabianBusiness 2012). In 2010, this number was only around 47,400 (UNDP 2011).

Table 6.1: Gender of the Owner

Category	Number	Percentage
Male	211	78.40
Female	58	21.60
No response	1	0.34

6.3.1.2 Nationality

On the practical side of conducting business, it is relatively difficult for non-Saudis national to do business in Saudi Arabia since they have to find a local Saudi business partners (James, 2013). This poses additional problems like inability to find a business partner, partner not being strong in a certain region of operation, partner not having experience in a certain sector, and difficulties brought about by partner expectations. As far as the nationality of the business owner was concerned in order to find out if there is a relationship between the nationality of the owner /mangers of SMEs and the access to finance from banks and other financial institutions. The survey indicated that the majority ($n=172$, 63.70 per cent) were Saudi nationals (Table 6.2). This proportion is comparable with nationality responses in similar SME studies conducted by Alfaadhel (2010) and Binzomah (2008), which had 88.35 and 65.8 per cent Saudi national respondents, respectively. According to the Central Department of Statistics and Information

(CDSI) (2012), the total number of enterprises owned by Saudis in that year exceeded 750 thousand firms, or around 99 per cent of the total businesses in the Saudi market. However, a large proportion of workers in these firms are non-Saudi nationals. This holds true for the SME sector in Saudi Arabia: most SMEs are owned by Saudis, but the proportion of Saudi workers who manage and operate this sector is less than 9 per cent.

Table 6.2: Nationality of Entrepreneurs Interviewed in this Study

Category	Number	Percentage
Saudi	172	63.70
Non-Saudi	78	28.89
No response	20	7.41

6.3.1.3 Business Owner as Manager

The management of an SME plays a critical role in determining its success in business. The respondents were asked whether the founder of the business is also the manager of the business. This helps identify the extent to which they would be involved in the strategic decision making of the business (e.g. financing decisions). In almost two-thirds of the cases ($n=178$, 65.93 per cent), the owner of the business also acts as the manager (Table 6.3).

Table 6.3: Business Owner acts as Manager

Category	Number	Percentage
The business owner acts as manager	178	65.93
The business owner does not act as manager	91	33.70
No response	1	0.37

6.3.1.4 Experience

The experience of the entrepreneur is one of the factors that plays an important role in the success of the business. The question relating to the experience of the entrepreneur was asked to determine whether this variable has any relation to obtaining funds from Saudi banks. The question asked the respondents about the total number of years of experience that they have in

the relevant industry of work. It was hypothesised that there will be a positive relationship between the number of years of experience and success in obtaining bank credit. This hypothesis has been proven correct, as will be evident later in this chapter. More than one-third ($n=121$, 44.81 per cent) of the respondents indicated that they had 6–10 years of experience when they started the business. A similar proportion ($n=109$, 40.37 per cent) indicated that they had 1–5 years of experience (Table 6.4). Overall, the responses indicated that the majority of respondents have 6 years or more of experience. These results mirror those of Binzomah (2008) in Saudi Arabia; where 30.6 per cent of the sample had no experience, 28.8 per cent had 1–5 years of experience, 29.7 per cent had 6–10 years of experience, and 10.9 per cent had more than 10 years of experience.

Table 6.4: Experience of the Entrepreneur

Category	Number	Percentage
≤5 years	109	40.37
6–10 years	121	44.81
>10 years	39	14.44
No response	1	0.37

6.3.1.5 Level of Education

Respondents were asked about their level of education to identify whether there is a link between this variable and obtaining finance from Saudi banks. Table 6.5 shows that more than one-third of the respondents have a bachelor's degree ($n=113$, 41.85 per cent) and around one-quarter had only a high school certificate ($n=64$, 23.70 per cent), and 14.81 per cent ($n=40$), a diploma. These proportions are similar to those reported by Binzomah (2008) and Alfaadhel (2010), who found that the majority of the people surveyed had a bachelor degree, 14.4 per cent and 26.71 per cent had a postgraduate degree, and 15.3 per cent and 11.64 per cent hold a high school degree. According to the CDSI (2013), only 5.5 per cent of the total population in Saudi Arabia are illiterate: more than 50 per cent of the population that are 15 years old and above have a high school certificate or higher education degree. The trends in level of education in the current sample are consistent with the findings for the general population.

Table 6.5: Level of Entrepreneur Education

Category	Number	Percentage
High school	64	23.70
Bachelor degree	113	41.85
Diploma	40	14.81
Postgraduate degree	32	11.85
Vocational diploma	21	7.78

6.3.1.6 Training

In order for SMEs to succeed and develop, the owners/managers need training and investment in developing their managerial and technical skills. This allows them to keep their competitive advantage and improve their business performance. Therefore, a question was included that asked participants whether they had attended any training programmes. Table 6.6 indicates that almost two-thirds ($n=170$, 62.96 per cent) of the respondents had received some form of training in business management or entrepreneurial development via courses or workshops.

Table 6.6: Training

Category	Number	Percentage
Have undergone training	170	62.96
Have not undergone training	100	37.04

6.3.2 Business Characteristics

This section analyses the characteristics of businesses in terms of the number of employees, business type and area, market value of the business, annual sales turnover, legal structure form, business plan, target market, market share, and annual growth rate.

6.3.2.1 Number of Employees

It is important that this study sample only SMEs defined as in Section 2.4—any enterprise with between 6 and 99 employees—so respondents were asked about their number of employees. Any survey not satisfying this condition was rejected. The total number of respondents was 270, of which more than two-thirds came from small enterprises ($n=115$, 42.59 per cent) that had between 11 and 30 employees, and a similar proportion ($n=113$, 41.85 per cent) had between 6 and 10 employees (Table 6.7).

Table 6.7: Number of Employees

Category	Number	Percentage
6 to 10	113	41.85
11 to 30	115	42.59
31 to 59	32	11.85
60 to 99	10	3.70

6.3.2.2 Business Type and Area

The study adopted the SCCI classifications for business sectors, where the services sector includes businesses that provide services to people, such as education, health, hospitality or consultation offices. Table 6.8 shows that 39.45 per cent of the businesses that participated in this study represent the services sector, whereas 41.28 per cent indicated affiliation with the retail sector and the manufacturing sector ranked third at 8.26 per cent of the total sample.

No clear pattern was apparent with respect to the area in which the business operates. Businesses from many different areas were represented in the sample including clothing/jewellery, restaurant, trade (import/export), real estate, furniture and health (Table 6.9). According to CDSI (2013), SMEs in Saudi Arabia are distributed among the trade, manufacturing, agriculture, construction and real estate, and services sectors. The commercial and services sectors dominate SME activities, comprising two-thirds of all SMEs.

Table 6.8: Business Type

Category	Number	Percentage
Retail	135	41.28
Services	129	39.45
Wholesale	36	11.01
Manufacturing	27	8.26

Multiple response question

Table 6.9: Business Area

Category	Number	Percentage
Clothing, jewellery	54	16.12
Restaurant	40	11.94
Trade (export/import)	30	8.96
Real estate	23	6.87
Furniture	20	5.97
Health	19	5.67
Education	18	5.37
Grocery	14	4.18
Vehicles	10	2.99
Agriculture	8	2.39
Finance	5	1.49
Other	94	28.06

6.3.2.3 Current Market Value of the Business

The majority ($n=152$, 56.30 per cent) of respondents indicated that the estimated current value of their business' current assets was 1–5 million SR. The other notable cohort ($n=66$, 24.44 per cent) was businesses with an estimated current value of <1 million SR (Table 6.10). Respondents were asked about the market value of their business assets in order to determine whether there is any relationship between this variable and the difficulties in accessing finance from Saudi banks.

Table 6.10: Current Market Value of the Business

Category	Frequency	Percentage
<1 million SR	66	24.44
10–20 million SR	8	2.96
1–5 million SR	152	56.30
20–30 million SR	4	1.48
5–10 million SR	38	14.07
>30 m SR	2	0.74

6.3.2.4 Annual Sales Turnover of the Business

Sales turnover has been used this study as an indicator of firm size. As mentioned in Section 2.4, this study has adopted the definitions of SMEs given by the Ministry of Finance and MCI in Saudi Arabia. According to their classification system, firms with an annual sales turnover up to 5 million SR (US\$1.3 million) are small enterprises, and firms with between 5 and 30 million SR (US\$8 million) in annual sales turnover are medium enterprises.

Table 6.11 illustrates that the majority ($n=147$, 54.44 per cent) of the respondents gave the estimated annual turnover of their business as 1–4 million SR. The other notable cohort ($n=61$, 22.59 per cent) was businesses with an estimated annual turnover of between 500,000 and 1 million SR (Table 6.11). Thus, there were more small-sized enterprises (90 per cent) than medium-sized ones (10 per cent) in the sample.

Table 6.11: Annual Sales Turnovers of the Business

Category	Number	Percentage
≤500,000 SR	35	12.96
500,001–1 million SR	61	22.59
>1–4.99 million SR	147	54.44
5–9.99 million SR	25	9.26
>10 million SR	2	0.74

6.3.2.5 Business Legal Structure

A question was included to determine the type of business ownership of the sampled SMEs. The distribution of the firms listed in Table 6.12 demonstrates that the major ownership type ($n=205$, 75.95 per cent) was firms with sole proprietorships. In addition, some responses ($n=38$, 14.07 per cent) indicated the legal structure of the business to be a partnership. Hence, the preference of most Saudi SMEs owners is to structure their companies as sole proprietorships as opposed to partnerships. This indicates a preference to have more independence and avoid facing difficulties that can occur when having a business partner (Rosa 1999). These results strongly support the findings of other studies related to SMEs in Saudi Arabia (Binzomah 2008; Hajjar 1989), in which the majority of businesses were structured as sole proprietorships. A recent report by the Saudi Central Department of Statistics and Information showed that approximately 85 per cent of the 850,000 SMEs licensed by the MCI by the end of 2013 had sole proprietorship (CDSI 2013).

Table 6.12: Business Legal Structure Form

Category	Number	Percentage
Sole proprietorship	205	75.92
Partnership	38	14.07
Company	27	10.00

6.3.2.6 Business Plan or Feasibility Study

A business plan has been ranked by banks as the most important requirement to be demonstrated in SMEs owners/manager loan applications. Hence, respondents were asked whether they had prepared a business plan before commencing their business. The majority ($n=155$, 57.41 per cent) indicated that they had not prepared a business plan or done any feasibility study before starting their business (Table 6.13). As business plans are an essential eligibility criterion for banks to finance companies, it was hypothesised that businesses with no business plan will face difficulties in obtaining funds. This is later demonstrated in the hypothesis testing section of this chapter. The presence of a business plan variable has been used by different studies in Saudi

Arabia (Binzomah 2008; Hajjar 1989) and Oman (Al-Kharusi 2003) to determine if there is a relationship between a business plan and ease of access to finance.

Table 6.13: Business Plan

Category	Number	Percentage
Had developed a business plan	115	42.59
Did not have a business plan	155	57.41

6.3.2.7 Attitudes to Various Aspects of Business Plan

Respondents were asked to indicate their level of agreement with certain statements relating to a written business plan. The respondents' attitudes to business plans were collected using six items with a three-point Likert scale (Agree, Not Sure and Disagree) to measure the extent of their feelings about each statement in the questionnaire. A three-point Likert scale was chosen over the more common five- or seven-point Likert scales as the extent of agreement or disagreement was not a main focus of this research. The frequency distributions of the item responses are summarised in Table 6.14. The vast majority (84.07 per cent) of respondents were in agreement with the statement that 'Business plans give a clear vision for the future of the business'. Almost two-thirds (61.48 per cent) also agreed with the importance of business plans for obtaining funds, as reflected in the statement 'Business plans are useful to obtain finance'. Despite acknowledging the importance of a business plan to acquire finance, the majority of respondents (57.04 per cent) commented that preparing a business plan costs time and money. This could explain why 57.41 per cent of the companies did not have a business plan before starting their business (see Table 6.13). Further, just over half (53.33 per cent) of the respondents agreed with the statement 'A business plan is useful to determine demand for product and customer needs', whereas 47.41 per cent of respondents believed that the owners of a business 'Can't make a business plan while the business is running'. There was no outright consensus for the statement 'A business plan reduces manager decision-making power and ensures commitment at the top level': excluding the people who were not sure, more people were in agreement with this statement (39.63 per cent) than in disagreement (20.74 per cent). The results of the survey agree with studies related to SMEs in Oman (Al-Kharusi 2003) wherein 64 and 76 per cent of the respondents from the manufacturing and trade sectors, respectively, agreed on the importance of a business plan for obtaining finance from banks.

Table 6.14: Attitudes to Various Aspects of Business Plan [Q: How strongly do you agree/disagree with each of the following statements?]

Item	Agree	Not sure	Disagree	Missing
A business plan gives clear vision for the future of the business	227	33	10	0
	(84.07)	(12.22)	(3.70)	(0.00)
A business plan is useful to obtain finance	166	86	17	1
	(61.48)	(31.85)	(6.30)	(0.37)
A business plan takes time to be prepared and costs money	154	74	41	1
	(57.04)	(27.41)	(15.19)	(0.37)
Difficult to prepare business plan while the business is running	128	99	43	0
	(47.41)	(36.67)	(15.93)	(0.00)
A business plan is useful to determine demand for product and customer needs	144	93	32	1
	(53.33)	(34.44)	(11.85)	(0.37)
A business plan reduces manager decision-making power and ensures commitment at the top level	107	106	56	1
	(39.63)	(39.26)	(20.74)	(0.37)

Percentage in parenthesis

6.3.2.8 Target Market

The respondents were asked several questions about their marketing and sales strategies, as well as the marketing performance of their firms. Respondents were initially asked about their target market. Table 6.15 shows that the majority ($n=258$, 58.77 per cent) of respondents identified the target market for their business as being individual consumers. This could be explained by the fact that the majority (80 per cent; see Table 6.8) of businesses in the sample are in the retail and services industries. The next most cited target market for respondents was retailers, at 21.64 per cent.

Table 6.15: Target Market

Category	Number	Percentage
Individuals	258	58.77
Retailers	95	21.64
Wholesalers	37	8.43
Health (hospitals)	22	5.01
Education (schools)	17	3.87
Manufacturing	10	2.28

6.3.2.9 Market Share

The respondents were asked to estimate the percentage of current market share for their businesses as compared to competitors in the same industry within their own city. The purpose was to determine the key indicator of market competitiveness—that is, how well a firm is doing against its competitors and to evaluate demand in their market. Most of studies emphasize on using subjective measures or financial aspects to evaluate the business performance such as sales growth, profitability, ROI, and market share of the business among other competitors in the industry (Feng et al. 2008, Simpson et al. 2012, Sulaiman et al. 2010, Morgan & Strong 2003). Firms need to obtain sufficient financial support, In order to achieve a sustainable growth and expand their market share. In general, high growth rate with a big market share may have an effect on a firm’s ability to access finance from banks and other financial institutions: banks and other financial providers are probably more willing to fund SMEs that have high potential growth in the market (Ahmed & Hamid 2011).

As a measure of the business performance of SMEs, respondents in this study were asked about the estimation of their business’ current market share, based on estimation of dividing their business’s revenues or sales by industry’s total sales over a fiscal period. One of the aims of this question was to determine the status of the business with respect to competitors in their industries and within their own city. Almost two-thirds ($n=162$, 60.00 per cent) of respondents indicated that the current market share of their firm was between 1 and 5 per cent; and just over one-quarter ($n=76$, 28.15 per cent) indicated theirs was 6–10 per cent (Table 6.16). Thus, most SMEs in the sample who are in retails and services sector have a small market share. This result strongly supports the findings of the report by Chironga et al. (2012), that most SMEs in

emerging market (including MENA) countries have low market shares that do not exceed 10 per cent. The study by Laforet and Tann (2006), found that the reasons behind the low market share in most SMEs are unclear organisational strategy and absence of innovation, which is the key to business growth and accompanying competitive advantages.

Table 6.16: Market Share

Category	Number	Percentage
1–5 per cent	162	60.00
6–10 per cent	76	28.15
11–15 per cent	24	8.89
16–20 per cent	5	1.85
No response	3	1.11

6.3.2.10 Annual Growth Rate

Respondents were asked about the growth rate of their businesses in order to gauge their business' performance. The results in Table 6.17 show that almost equal proportions of respondents indicated the annual growth rate of their firm was 1–5 per cent ($n=109$, 40.37 per cent) and 6–10 per cent ($n=103$, 38.15 per cent). This suggests that SMEs in Saudi Arabia have low growth rates in general. This could indicate low business performance (Daniels and A. 1993; Chutta 1990) as growth rates influence the longevity of a firm; thus SMEs with a low growth rate face difficulties surviving in the market.

Table 6.17: Annual Growth Rate

Category	Number	Percentage
1–5 per cent	109	40.37
6–10 per cent	103	38.15
11–15 per cent	44	16.30
16–20 per cent	11	4.07
No response	3	1.11

6.3.2.11 Availability of Accounting System

Participants were asked several questions relating to the financial performance of their organisation and financial constraints faced by their firms. This was done to determine whether there is a relationship between the financial metrics of the firm and obtaining access to finance from Saudi banks. This section of the survey commenced by asking participants whether they had an accounting system at their firm and whether they regularly recorded each financial transaction. As shown in Table 6.18, the vast majority ($n=188$, 69.63 per cent) of the respondents indicated that they have a financial and accounting system at their firm, and also that their firm reports its financial transactions on a monthly basis ($n=238$, 88.15 per cent). Most ($n=153$, 56.67 per cent) respondents also prepared their cash flow forecasting for the financial year at the beginning of the year.

Table 6.18: Accounting System

Item	Category	Number	Percentage	Number of non-responses (%)
Availability of accounting system	Yes	188	69.63	5 (1.85)
	No	77	28.52	
Report financial transactions regularly	Yes	238	88.15	5 (1.85)
	No	27	10.00	
Prepare cash flow forecasting for the financial year	Yes	153	56.67	4 (1.48)
	No	113	41.85	

6.3.3 Obstacles Faced by SMEs in Saudi Arabia

The second section of the survey sought to measure and understand the obstacles that could impede the growth of SMEs, which ultimately affects their business performance. This section contains two sub-sections that relate to the obstacles that SMEs face: internal business environment including enterprise; entrepreneurs factors; and external business environment factors.

6.3.3.1 Business Environment Obstacles

SMEs around the world face many and varied challenges to their sustainable growth. These challenges reflect one major concern, to improve business performance. The respondents' attitudes to obstacles to growth of their business were collected using 21 items with a four-point Likert scale (major, moderate, fewer and no obstacles). The participants were asked to establish where lack of finance sits in the larger fabric of obstacles to SME business performance. The items were classified into two categories: (1) internal environmental factors related to the entrepreneur and enterprise; and (2) external environment factors. The internal factors included variables specifically related to the owner of the SME such as gender, age, work experience, availability of capital, and availability of a business plan. Enterprise factors affecting the business included technology, sales and marketing, management skills, customer satisfaction, quality of product or service, and training. External environment factors considered the economic and infrastructure situation of Saudi Arabian SMEs. Variables include legal issues, financial support, government support, corruption, competitors, availability of skilled employees, high cost of labour, government bureaucracy, legal issues, chamber of commerce services and government regulations (labour).

Table 6.19: Internal and External Business Environment Obstacles

Business environment obstacles	Major obstacle	Moderate obstacle	Weak obstacle	No obstacle	No response
Internal factors					
Sales and marketing	63	182	19	0	6
	(23.33)	(67.41)	(7.04)	(0.00)	(2.22)
Gender	41	106	81	40	2
	(15.19)	(39.26)	(30.00)	(14.81)	(0.74)
Age of owner	24	105	106	33	2
	(8.89)	(38.89)	(39.26)	(12.22)	(0.74)
Education level	35	94	102	37	2
	(12.96)	(34.81)	(37.78)	(13.70)	(0.74)
Management skills	50	123	74	18	5
	(18.52)	(45.56)	(27.41)	(6.67)	(1.85)
Work experience	64	113	74	17	2
	(23.70)	(41.85)	(27.41)	(6.30)	(0.74)
Availability of capital	108	127	27	4	4
	(40.00)	(47.04)	(10.00)	(1.48)	(1.48)
Technology	29	90	123	24	4
	(10.74)	(33.33)	(45.56)	(8.89)	(1.48)
Training	42	100	97	26	5
	(15.56)	(37.04)	(35.93)	(9.63)	(1.85)
Product and services quality	45	102	103	16	4
	(16.67)	(37.78)	(38.15)	(5.93)	(1.48)
Customer satisfaction	116	99	49	3	3
	(42.96)	(36.67)	(18.15)	(1.11)	(1.11)
External factors					
High cost of labour	39	82	122	23	4
	(14.44)	(30.37)	(45.19)	(8.52)	(1.48)
Availability of skilled employees	81	100	72	15	2
	(30.00)	(37.04)	(26.67)	(5.56)	(0.74)
Chamber of commercial services	27	69	120	50	4
	(10.00)	(25.56)	(44.44)	(18.52)	(1.48)
Government bureaucracy	94	96	53	25	2
	(34.81)	(35.56)	(19.63)	(9.26)	(0.74)
Corruption	87	73	88	20	2
	(32.22)	(27.04)	(32.59)	(7.41)	(0.74)
Legal issues	27	60	137	39	7
	(10.00)	(22.22)	(50.74)	(14.44)	(2.59)
Government support	50	85	103	28	4
	(18.52)	(31.48)	(38.15)	(10.37)	(1.48)
Financial support	117	92	51	6	4
	(43.33)	(34.07)	(18.89)	(2.22)	(1.48)
Competitors	116	101	47	4	2
	(42.96)	(37.41)	(17.41)	(1.48)	(0.74)
Government regulations (labour)	168	93	7	0	2
	(62.22)	(34.44)	(2.59)	(0.00)	(0.74)

The frequency distributions of the item responses are summarised in Table 6.19. The aspects of the business that were considered major to moderate business environment obstacles are sales and marketing, gender, management skills, work experience, availability of capital, availability of skilled employees, government bureaucracy, corruption, training, product and services quality, financial support, competitors, customer satisfaction and government regulations (labour). It should be noted that a larger proportion of female business managers/owners ($n=110$, 52.13 per cent) considered gender to be a moderate to major business obstacle. The aspects of the business that were considered less or no obstacle are education level, technology, high cost of labour, chamber of commercial services and legal issues. No apparent trends were visible as far as the age of owner and government support are concerned.

6.3.4 Access to Finance Profile

In this section the participant were asked questions related to their sources of finance, if they face any difficulties in obtaining bank and government finance, and what the requirements and conditions impose by financial institutions in order to identify the obstacles that affect Saudi SMEs access to banks' credit.

6.3.4.1 Financial Obligations and Firm Credit

Credit reports are generated by the Saudi Credit Bureau (SCB), offering consumer and commercial credit information services to respective members in the Kingdom of Saudi Arabia. Businesses and individuals can access their credit reports under certain conditions from the SCB. The participants were also asked if they had any obligations to other financial institutions to measure their creditworthiness. Table 6.20 shows that the majority ($n=137$, 50.74 per cent) of SMEs indicated that their firm does not have any loan or financial obligations to any financial institutions. Most ($n=172$, 64.07 per cent) respondents indicated that they rate their credit scoring at the Saudi Credit Bureau to be good.

Table 6.20: Financial Obligations and Firm's Credit

Item	Category	Number	Percentage
Have any loan or financial obligations	Yes	125	46.30
	No	137	50.74
	No response	8	2.96
Credit scoring at the Saudi Credit Bureau	Very good	13	4.81
	Good	173	64.07
	Acceptable	76	28.15
	Poor	4	1.48
	No response	4	1.48

6.3.4.2 Source of Finance at the Start-up Stage

The source of finance at the start-up stage of a business' life can be obtained from both internal and external sources. SMEs are usually more reliant on informal sources such as personal savings or loans from close family members or friends. To identify the main sources of start-up capital for SMEs, the respondents were asked questions about this area. Questions were classified into six broad categories; personal resources, relatives and friends, commercial bank, Islamic bank, VC, and government supported funds. Table 6.21 presents a summary of the results, which indicate that almost half ($n=265$, 47.71 per cent) of the respondents had used personal resources to finance the commencement of their business; whereas less than one-third ($n=165$, 29.52 per cent) had obtained funds from their relatives or friends to start their business. This indicates that around 75 per cent of respondents relied on an informal source of finance compared to only 8 per cent that obtained their start-up finance from banks. Another 5.72 per cent cited access to government funds and 8.9 per cent from VC. An interesting finding is that a very low percentage of people (1.43 per cent) used Islamic banks for financing their start-up business.

Table 6.21: Source of Finance for Business Start-up

Item	Category	Number	Percentage
Source (s) of finance used when started the business	Personal resources	265	47.41
	Relatives or friends	165	29.52
	Venture capital	50	8.94
	Commercial bank	39	6.98
	Government supported fund	32	5.72
	Islamic bank	8	1.43

6.3.4.3 Financial Risks

The participants were asked about the financial risks that faced their businesses. The risks were classified into six types: interest rate risk, foreign exchange risk, credit scoring, commodity price risk, liquidity risk and funding risk. One-third of the respondents cited liquidity problems ($n=214$, 33.75 per cent) whereas just over one-quarter cited commodity price ($n=172$, 27.13 per cent) as the major financial risk facing their business (see Table 6.22). This suggests that Saudi Arabian SMEs face difficulties in providing, or finding, liquidity to pay for their short-term liabilities and that fluctuating commodity prices are a concern to a sizable number of SMEs. These results confirm previous findings by the SMIT (2012) and Brancia (2011), which demonstrated that liquidity was the most common financial difficulty faced by SMEs.

6.3.4.4 Source of Finance after the Establishment Stage

The respondents of this study were asked about their financial resources after the establishment stage for their ongoing operation. The access to finance profile presented in Table 6.23 shows that more than one-third ($n=265$, 37.70 per cent) indicated that they had used equity from their business' retained earnings as the first source of finance when they required additional funds for their business. Further, just under one-quarter indicated that they had obtained equity from their own personal savings or from family ($n=157$, 22.33 per cent), and 19.91 per cent borrowed from friends to obtain the necessary capital to expand their business. A small number (3.13 per cent) of owners/managers sought finance from banks or resorted to government funding (3.84 per cent) to obtain more funds for their business.

Table 6.22: Major Financial Risk

Category	Number	Percentage
Liquidity	214	33.75
Commodity price risk	172	27.13
Credit scoring	95	14.98
Funding risk	73	11.51
Foreign exchange risk	46	7.26
Interest rate	34	5.36

Table 6.23: Sources of Finance after the Establishment Stage

Category	Number	Percentage
Retained earnings	265	37.70
Own savings or family assistance	157	22.33
Borrowed from friends	140	19.91
Trade credit	45	6.40
Venture capital	39	5.55
Loan from government fund	27	3.84
Loan from bank	22	3.13
Loan from private sector fund	8	1.14

Multiple response question

6.3.4.5 Reasons for Seeking Finance

SMEs seek finance for several reasons including expanding their business, replacing equipment and purchasing fixed assets. To understand why entrepreneurs who participated in this study sought finance, they were asked to indicate the purposes for which additional capital was sought. Table 6.24 shows that the main purpose for seeking finance was to increase their working capital to prevent liquidity problems (22.28 per cent). This was followed by SMEs that needed to purchase raw materials (16.07 per cent), seek production process costs (14.79 per cent), purchase fixed assets (12.42 per cent), or purchase equipment or vehicles (11.51 per cent).

This indicates that the additional capital was sought for reasons of growth and management of liquidity.

Table 6.24: Reasons for Finance

Category	Number	Percentage
Working capital	244	22.28
Purchasing raw material	176	16.07
Production process	162	14.79
Purchasing fixed assets	136	12.42
Equipment/vehicle	126	11.51
Exporting/importing	77	7.03
Enter new market	74	6.76
Expand the business	52	4.75
Rent	48	4.38

Multiple response question

6.3.4.6 Applying for Bank Finance

In order to obtain credit for commencing or expanding ongoing operations, SMEs usually depend on financial intermediaries, particularly commercial banks. In this study the participants were asked if they had applied for a bank loan. As shown in Table 6.25, the majority ($n=159$, 58.89 per cent) of respondents indicated that they had. Questions were asked about the kind of loans owners/managers had applied for, and the interest rate they were being charged in order to identify the more popular financial products as well as the price (cost) that businesses are willing to pay for those products. Similar proportions of responses indicated that people had applied for either a Murabaha ($n=125$, 36.55 per cent) or a conventional commercial loan ($n=127$, 37.13 per cent). Most SMEs in this study preferred to apply for Islamic finance products, which is consistent with the findings of previous studies in Oman (Al-Kharusi 2003), Nigeria (Dabo 2006) and Saudi Arabia (Abalkhail 1999; Hajjar 1993; Sejjine 2000), which showed that the majority of entrepreneurs in SMEs prefer to apply for Islamic finance products.

As mentioned in Section 3.4, one of the main difficulties facing SMEs in obtaining finance from banks is applying for credit, as this increases their cost of capital (Bryant 2013; Bukvic & Bartlett 2003). Given this, respondents were asked to select the interest rate on their loan from four options. The results show that around two-thirds (61.96 per cent) of respondents were charged an interest rate between 6.1 and 8 per cent, whereas 19.1 per cent were charged more than 8 per cent for their loans (Table 6.25).

Table 6.25: Apply for Bank Finance

Item	Category	Number	Percentage
Applying for loans from any bank	Yes	159	58.89
	No	109	40.37
	No response	2	0.74
The type of financial product applied for ¹	Conventional commercial loan	109	36.95
	Murabaha	109	36.95
	Tawarq	56	18.98
	Ijara	18	6.10
	Mudaraba	1	1.02
Interest rate for your loan ¹	2.1–4 per cent	3	1.40
	4.1–6 per cent	40	18.69
	6.1–8 per cent	127	59.35
	>8 per cent	44	20.56

¹Multiple response questions

6.3.4.7 Reasons for not Applying for Bank Finance

This section reports the respondents' opinions on why owners/managers did not seek finance from banks. Table 6.26 shows that almost one-third ($n=109$, 32.63 per cent) of respondents indicated that they did not apply for funds from Saudi banks due to religious reasons, whereas just under one-quarter indicated that it was because the Saudi banks asked for high collateral ($n=74$, 22.16 per cent). A further 18.86 per cent ($n=63$) cited high interest rates. The respondents who had decided not to obtain funds from Saudi banks because of religious issues mentioned

the following main reasons: there was a limited choice of Islamic finance products ($n=23$, 25.84 per cent); they did not feel comfortable with the current Islamic finance products ($n=22$, 24.72 per cent); they had doubts about Islamic finance products ($n=19$, 21.35 per cent); and Islamic banks always asked for high profit (Murabaha) ($n=17$, 19.10 per cent). This indicates that the majority of respondents who did not apply for bank credit for religious reasons are not satisfied with the current Islamic financial products that the banks offer.

Table 6.26: Reasons for not Applying for Bank Funds

Item	Category	Number	Percentage
Reasons not to apply for bank fund	Religious issue	39	33.91
	High collateral	26	22.61
	High interest	18	15.65
	Don't meet acceptance criteria	18	15.65
	Requires too much paperwork	14	12.17
Religious concerns	Limited Islamic financial products	23	25.84
	Not comfortable with current products	22	24.72
	Doubts about Islamic financial products	19	21.35
	Ask high profit (Murabaha)	17	19.10
	High collateral	8	8.99

Multiple response questions

6.3.4.8 Difficulties in Obtaining Funds from Saudi Banks

The participants in this study were asked to indicate the ability of their business to access finance from Saudi banks. Table 6.27 shows that the vast majority ($n=206$, 76.30 per cent) of respondents indicated that they had difficulties in obtaining funds from Saudi banks. The survey participants were instructed that they could answer 'Yes' to this question even if they only had reached the stage of applying for a loan. This is one of the most important questions in this research and was asked so that the characteristics of businesses that did or did not get access to finance could be identified. The top three difficulties that people faced when they applied for

loans from Saudi banks were high collateral requirements ($n=143$, 20.94 per cent); high interest rates ($n=125$, 18.30 per cent); and excessive paperwork ($n=121$, 17.72 per cent). It should be noted that only a minuscule percentage (0.44 per cent) of participants indicated they had faced no difficulties in obtaining finance. Thus, it would seem that most SMEs do not have adequate collateral to provide as a guarantee. As this is one of the main requirements to obtain bank credit it would translate to difficulties in obtaining finance from providers.

Table 6.27: Difficulties Faced with Accessing Funds from Saudi Banks

Item	Category	Number	Percentage
Faced difficulties when apply for loan	Yes	206	76.30
	No	64	23.70
Difficulties faced by SMEs applying for a loan ¹	High collateral requirements	143	20.94
	High interest rate	125	18.3
	Excessive paperwork	121	17.72
	Insufficient amount of finance	71	10.4
	Complexity of application and loan procedures	63	9.22
	Time to get loan is too long	61	8.93
	Loan duration is too short	58	8.49
	High service fees	38	5.56
	No difficulty	3	0.44

¹Multiple response question

6.3.4.9 Effect of Difficulties in Accessing Finance on Business Performance

Table 6.28 shows the potential effect of problems in accessing finance on business performance. Of those that faced difficulty accessing finance, 92.72 per cent believed it adversely affected their business performance ($n=191$, 92.72 per cent). The participants that answered ‘Yes’ were asked an open-ended question about how it affected their business performance (see Table 6.29) and around half ($n=88$, 46.07 per cent) felt it affected negatively their liquidity and working capital, which resulted in difficulties paying their short-term liabilities. A smaller proportion

(*n*=65, 34.03 per cent) that had difficulties accessing bank credit experienced a negative effect on their plans for expansion and productivity, which could seriously affect their competitive position in the market.

Table 6.28: Difficulties in Obtaining Funds from Saudi banks

Item	Category	Number	Percentage
Affect the business performance	Yes	191	92.72
	No	1	0.49
	No response	14	6.80

Multiple response question

Table 6.29: Affected Business Performance

Item	Category	Number	Percentage
Business affected	Working capital and liquidity	88	46.07
	Expansion plans	65	34.03
	Purchasing new equipment and vehicles	25	13.09
	Renovation and development	13	6.80

6.3.4.10 Business Financial Performance

Information relating to some of the key accounting ratios and metrics (Table 6.30) was collected from respondents. They were asked about the average rate of some of their financial ratios, such as ROI, profit margin, leverage and annual sales turnover, over the previous three years, in order to measure the financial performance of their business. During the data collection process, a number of owners/managers indicated that they were not aware or did not know how to calculate the financial ratio of their firms and they were only focusing on the profit and loss numbers at the end of the year. This could be one reason why most SMEs provide incomplete financial information to financial providers. The study found a mean ROI of 8.74 per cent (SD=4.68 per cent), mean profit margin of 5.23 per cent (SD=3.40 per cent), mean leverage

ratio of 27.18 per cent (SD=10.85 per cent) and mean annual sales turnover of 1.13 (SD=1.95) million SR.

Table 6.30: Accounting Ratios (n=194)

Financial metric	<i>n</i>	Minimum	Maximum	Mean	SD
ROI = Net profit BI&T* (%)	194	1.00	30.00	8.74	4.68
Profit margin (net income/net sales) (%)	194	1.00	17.00	5.23	3.40
Leverage = total debt/total equity (%)	194	0.00	65.00	27.18	10.85
Annual sales turnover (million SR)	194	0.00	10.00	1.13	1.95

*Before interest & tax

6.3.4.11 Financial Products Provided by Banks for SMEs

As shown in Table 6.31, the most commonly known type of finance products provided to SMEs from banks included commercial loans and Islamic finance products. Also, of those that chose 'Other' ($n=25$, 5.76 per cent), most included credit cards and personal finance.

Table 6.31: Financial Products Provided by Banks

Item	Category	Number	Percentage
Type of financial product provided to SMEs from Saudi banks	Commercial loans	258	59.45
	Islamic finance product	137	31.57
	Personal finance	12	2.76
	Receivables finance	2	0.46
	Other	25	5.76

Multiple response question

6.3.4.12 Reasons for Failed Access to Bank Finance

Table 6.32 lists the reasons given by owners/managers of SMEs for their failure to obtain finance from Saudi finance providers. The top four reasons were lack of collateral ($n=141$,

16.57 per cent); inadequate business planning ($n=119$, 13.98 per cent); provision of insufficient information ($n=95$, 11.16 per cent) and start-up business ($n=94$, 11.05 per cent).

Table 6.32: Reasons for Failed Access to Bank Finance

Category	Number	Percentage
Lack of collateral	141	16.57
Don't meet requirements	119	13.98
Lack of financial information	95	11.16
Project too risky	94	11.05
Poor business performance	92	10.81
Insufficient information	80	9.4
New business start-up	78	9.17
Inadequate business planning	62	7.29
Lack of credit record history	55	6.46
No credit history	21	2.47
Lack of accurate and comprehensive financial information	14	1.65

6.3.4.13 Government Funds

The second main external source from which most SMEs sought finance is GSCIs. Several questions were asked relating to government funds and programmes to help identify current trends in Saudi Arabian SMEs seeking financing from the government and other related aspects. Table 6.33 shows that the vast majority ($n=199$, 73.70 per cent) of respondents indicated that they had not applied for any government funds to obtain capital.

Table 6.33: Applied for Government Funds

Category	Number	Percentage
Yes	69	25.56
No	199	73.70
No response	2	0.74

Of those who had not applied for government funds, the study asked why. Table 6.34 shows that 43.55 per cent ($n=152$) of respondents indicated that they were not aware of the programmes/services offered, whereas just over one-third ($n=121$, 34.67 per cent) did not meet the criteria for government funding. A further 16.05 per cent indicated the process to apply for funds took too long. Thus, approximately three-quarters of respondents either did not know about government funding or were not eligible to access it.

Table 6.34: Reasons for not Applying for Government Funds

Category	Number	Percentage
Not aware of the programmes/services offered	152	43.55
Not meet the acceptance criteria	121	34.67
Acceptance process is too long	56	16.05
Do not need these programmes/services	13	3.72
Procedure is too complicated	7	2.01

Multiple response question

The top three government funds that respondents applied for are shown in Table 6.35. They are SCSB funds ($n=41$, 47.67 per cent), the SIDF ($n=11$, 12.79 per cent) and the HRDF ($n=11$, 12.79 per cent).

The participants that did apply ($n=69$) were asked if their loan applications were successful, and if not, what reason were they given for the refusal. Table 6.36 shows that just under one-third ($n=23$, 32.59 per cent) of respondents indicated that their loan application to government funding institutions was not successful. The top three reasons given by government financing institutions when rejecting a loan or funding application were not meeting bank requirements ($n=40$, 30.53 per cent); the business being an existing business ($n=29$, 22.14 per cent); and the project not being in the domain of the economic activities listed by the funding agency ($n=27$, 20.61 per cent).

Table 6.35: Applications to Government Specialized Credit Institutions

Category	Number	Percentage
The Saudi Credit and Saving Bank (SCSB)	41	47.67
The Saudi Industrial Development Fund (SIDF)	11	12.79
Human Resources Development Fund (HRDF)	11	12.79
Bab Rizq Jameel (BRJ) (Private sector fund)	9	10.47
Centennial Fund (CF)	8	9.3
Agricultural Development Fund (ADF)	5	5.81
Real Estate Development Fund (REDF)	1	1.16

It would seem that the majority of participants were unaware of the criteria for GSCI funding. This suggests that government funding agencies need to work on awareness campaigns to increase the awareness of their services. These results are consistent with previous reports (Al-Kharusi 2003; Haron et al. 2000) that the awareness level of SMEs about government funding in Malaysia and Oman are low.

Table 6.36: Applied to Government Specialized Credit Institutions

Item	Category	Number	Percentage
Application been accepted from the government funding institutions	Yes	10	15.19
	No	23	32.59
	No response	36	52.22
Reason not accept the loan application	Not meeting requirements	40	30.53
	Existing business	29	22.14
	The project not in the domain of economic activities listed	27	20.61
	Do not qualify for the programme	10	7.63
	Have other existing business	10	7.63
	Insufficient information	6	4.58
	Lack of collateral or sponsors	5	3.82
	Project not feasible	2	1.53
	High risk of the project	2	1.53

Multiple response questions

Table 6.37 shows that half ($n=135$, 50.00 per cent) of the respondents indicated that they had not received any technical or vocational training from any government training institution. Only

a small percentage ($n=25$, 9.26 per cent) of respondents indicated that they have received any technical or vocational training from any government training institution.

Table 6.37: Received Technical or Vocational Training

Category	Number	Percentage
Yes	25	9.26
No	135	50.00
No response	110	40.74

6.3.4.14 Kafalah Programme

The Kafalah programme is a loan guarantee programme initiated by the Saudi government to encourage business and simulate business activity in the economy. Some questions were asked about this programme because it can be a crucial element in the decision of a bank to grant finance to an SME. As shown in Table 6.38, almost two-thirds ($n=173$, 64.07 per cent) of respondents indicated that they had not heard of the Kafalah programme, and of those that had heard of the programme, a large proportion ($n=74$, 80.43 per cent) had not applied.

Table 6.38: Kafalah Programme

Item	Category	Number	Percentage
Knew about Kafalah programme	Yes	92	34.07
	No	173	64.07
	No response	5	1.85
Applied to the programme	No	74	80.43
	Yes	9	9.78
	No response	9	9.78

According to the respondents who applied to the Kafalah programme (see Table 6.39), the top four difficulties faced when applying for the Kafalah programme were excessive paperwork

($n=6$, 22.22 per cent); the need to find a guarantor or sponsor ($n=5$, 18.52 per cent); high collateral requirements ($n=5$, 18.52); and the long time it takes to receive a loan ($n=4$, 14.81 per cent).

Table 6.39: Difficulties faced by Kafalah Programme

Item	Category	Number	Percentage
Difficulties faced by Kafalah programme	Excessive paperwork	6	22.22
	Requirement for guarantor or sponsor	5	18.52
	High collateral requirement	5	18.52
	Time to application acceptance is too long	4	14.81
	Time to get loan is too long	2	7.41
	High service fees	2	7.41
	Complexity of application and loan procedures	1	3.7
	Reliable feasibility study	1	3.7
	Insufficient amount of finance	1	3.7

Multiple response question

6.3.4.15 Islamic Banking

Participants were asked about their preferred financing methods for their businesses. Since Islamic banks are an important stakeholder in the financing landscape of Middle Eastern countries (Rocha et al. 2011b), owners/managers were asked about their preference for Islamic vs. conventional banking as well as their preferences among Islamic banking products, to establish current trends in SME preferences. Table 6.40 shows that the majority ($n=183$, 52.74 per cent) of respondents indicated they would prefer Islamic banking for their business activities. Further, the majority ($n=231$, 57.18 per cent) indicated that Murabaha (cost-plus sale or trade with mark-up) is provided by the banks for SMEs. Most owners of SMEs prefer Islamic banking to finance their businesses. Further, if the prevalence of different Islamic finance products is an indicator of bank preferences, it would appear that banks focus mostly on Murabaha and Ijara as the main financial products offered to SMEs. This could be because these products are less risky than Musharaka or Mudharaba, where the bank shares the profit and loss with the lender.

Table 6.40: Islamic Banking

Item	Category	Number	Percentage
Type of financing available and preferred by businesses	Islamic banking	183	52.74
	Conventional banking	86	24.78
	Both	78	22.48
Islamic financial products provided by Saudi banks ¹	Murabaha—cost-plus sale or trade with mark-up	231	57.18
	Ijara—Lease finance	72	17.82
	Mudharabah—Profit-sharing finance	61	15.1
	Musharakah—Equity and profit–loss sharing finance	40	9.9

¹Multiple response question

6.4 RESEARCH HYPOTHESES ABOUT ACCESS TO FINANCE AND BUSINESS PERFORMANCE

This section presents the results of hypothesis testing around associations between owner/manager characteristics, business characteristics and access to finance. As discussed in Section 5.7, access to Saudi bank finance is influenced by the following factors:

- owner/manager characteristics: education and training, experience and gender
- business characteristics: business size, business type, business plan, market share, growth and profit.

The decision to apply for, and obtain finance from Saudi banks has been chosen as an indicator of access to finance. Although applying is not a direct indicator of being able to access finance, it provides general insights about the characteristics of SMEs that decide to apply for finance. As previously shown (Table 6.26), a proportion of owners/managers were discouraged or deterred for various reasons from applying for finance in the first place. Therefore, it is important to analyse the characteristics of such owners/managers and businesses.

The aim of the data analysis in these sub-sections is to assess via statistical hypothesis testing the significance of any associations between owner/manager and business characteristics, and access to finance.

6.4.1 Characteristics of Owners/Managers of SMEs

Several studies have found that SME owner/manager characteristics such as gender, level of education and training, and business experience affect access to finance from banks (Sarapaivanich 2006). Therefore, a business' ability to obtain funds is dependent on its owner/manager's characteristics.

6.4.1.1 Education and Training

H1a₁: The level of SME owner/manager education has a significant effect on the decision to apply for finance.

H1a₂: The level of SME owner/manager training has a significant effect on the decision to apply for finance.

H1b₁: There is an association between the level of education of SME owners/managers and their difficulty in accessing finance.

H1b₂: There is an association between the level of training of SME owners/managers and their difficulty in accessing finance.

As discussed in previous chapters, a numbers of studies have shown that the education and training of SME owners/managers is one of the most important factors that financial providers assess in making decision about granting finance (Coleman 2004; Saffu et al. 2006). Moreover, a relationship exists between the levels of education and training of owners/managers and business performance, as education is associated with knowledge, skills, and the ability to solve problems and exploit opportunities (Parker 2004; Saffu et al. 2006).

Survey respondents were asked to indicate the highest level of education they have attained, ranging from high school to postgraduate degree. With respect to training, they were asked if they had received any form of training in business management or entrepreneurial development. The variables relating to the level of education of the owners/managers were collapsed into two categories to meet the minimum expected count criterion for chi-square tests.

A chi-square test of independence was performed to examine the association between the education level of an SME owner/manager and their decision to apply for finance (Table 6.41). The association between these variables was not significant ($\chi^2_{(1, n=268)} = 0.15, p = 0.70$). Although previous studies have shown an association between education and applying for finance, other studies, such as Dabo (2006) and Al-Kharusi (2003), report no significant association between level of education of owners/managers of SMEs and their decision of apply to funds.

Table 6.41: Chi-square Test of Independence between Level of Education of the Owner/Manager and Decision to Apply for Finance (n=268)

		Have you applied for loans from banks?		Total
		Yes	No	
Level of education	Less than bachelor's degree	72 (58.06%)	52 (41.94%)	124
	Bachelor's degree or higher	87 (60.42%)	57 (39.58%)	144
Total		159 (59.33%)	109 (40.67%)	268

$$\chi^2_{(1, n=68)} = 0.15, p = 0.70$$

A chi-square test of independence was performed to examine the association between level of owner/manager education and difficulties in obtaining finance from Saudi banks (Table 6.42). The results show that the association between these variables was not significant ($\chi^2_{(1, n=268)} = 0.57, p = 0.45$).

Table 6.42: Chi-square Test of Independence between Level of Education of the Owner/Manager and Difficulties in Accessing Finance from Saudi Banks (n=270)

		Have you faced difficulties in obtaining funds from Saudi banks?		Total
		Yes	No	
Level of education	Less than bachelor's degree	98 (78.4%)	27 (21.6%)	125
	Bachelor's degree or Higher	108 (74.48%)	37 (25.52%)	145
Total		206 (76.3%)	64 (23.7%)	270

$$\chi^2_{(1, n=268)} = 0.57, p = 0.45$$

A chi-square test of independence was performed to examine the association between the training of owners/managers and their decision to apply for finance (Table 6.43). The association between these variables was not significant ($\chi^2_{(1, n=268)} = 1.84, p = 0.17$).

Table 6.43: Chi-square Test of Independence between Training of the Owner/Manager and Decision to Apply for Finance (n=268)

		Have you applied for loans from banks?		Total
		Yes	No	
Training	Yes	95 (56.21%)	74 (43.79%)	169
	No	64 (64.65%)	35 (35.35%)	99
Total		159 (59.33%)	109 (40.67%)	268

$$\chi^2_{(1, n=268)} = 1.84, p = 0.17$$

A chi-square test of independence was performed to examine the association between the training of owners/managers and difficulties they face in obtaining finance from Saudi banks (Table 6.44). The association between these variables was not significant ($\chi^2_{(1, n=268)} = 1.20, p = 0.27$).

Table 6.44: Chi-square Test of Independence between Training of the Owner/Manager and Difficulties in Accessing Finance from Saudi Banks (n=270)

		Have you faced difficulties obtaining funds from Saudi banks?		Total
		Yes	No	
Training	Yes	126 (74.12%)	44 (25.88%)	170
	No	80 (80%)	20 (20%)	100
Total		206 (76.3%)	64 (23.7%)	270

$$\chi^2_{(1, n=268)} = 1.20, p = 0.27$$

6.4.1.2 Experience

H2a: SME owner/manager experience has a significant effect on their decision to apply for external finance.

H2b: There is an association between the experience of SME owners/managers and their difficulty in accessing finance from Saudi banks.

Kvale (1996) found that lack of prior experience for an SME owner/manager may lead the business to face a high risk, which affects ability to access external finance. Hustede and Pulver (1992) argue that the less the experience of entrepreneurs, the less likely they are to obtain external finance.

Variables relating to the level of experience of the owners/managers were collapsed into fewer categories, chi-square analysis was performed to determine if level of experience of the owner/manager is associated with the decision to apply for external finance and difficulty in accessing finance from Saudi banks. These variables were collapsed to meet the minimum expected count criterion for a chi-square test.

A chi-square test of independence was performed to examine the association between owner/manager experience and the decision to apply for finance (Table 6.45). The association between these variables was not significant ($\chi^2_{(1, n=267)} = 0.14, p= 0.70$).

Table 6.45: Chi-square Test of Independence between Level of Experience of the Owner/Manager and Decision to Apply for Finance (n=267)

		Have you applied for loans from banks?		Total
		Yes	No	
Level of experience	<10 years	136 (59.65%)	92 (40.35%)	228
	>10 years	22 (56.41%)	17 (43.59%)	39
Total		158 (59.18%)	109 (40.82%)	267

$\chi^2_{(1, n=267)} = 0.14, p= 0.70$

A chi-square test of independence was performed to examine the association between owner/manager experience and difficulties in accessing finance from Saudi banks (Table 6.46). The association was not significant ($\chi^2_{(1, n=269)} = 0.09, p = 0.77$).

Table 6.46: Chi-square Test of Independence between Level of Experience of the Owner/Manager and Difficulties in Accessing Finance from Saudi Banks (n=269)

		Have you faced difficulties to obtain fund from Saudi banks?		Total
		Yes	No	
Level of Experience	<10 years	176 (76.52%)	54 (23.48%)	230
	>10 years	29 (74.36%)	10 (25.64%)	39
Total		205 (76.21%)	64 (23.79%)	269

$\chi^2_{(1, n=269)} = 0.09, p = 0.77$

6.4.1.3 Gender

H3a: SME owner/manager gender has a positive effect on their decision to apply for external finance.

H3b: There is a relationship between the gender of the SME owner/manager and their difficulty in accessing finance.

The association between owner/manager gender and access to external finance has been captured by many studies. According to some studies, this may influence access to capital (Saffu & Manu 2004; Shaw et al. 2006). Several empirical studies have emphasised the negative association between gender and access to finance. According to numerous studies, female owners/managers are less likely to access external finance due to their lack of experience and management skills (Belcourt et al. 1991; Light & Rosenstein 1995; Loscocco et al. 1991; Saffu & Manu 2004; Shaw et al. 2006; Tigges & Green 1994). In this study, the gender of owners/managers of SMEs in Saudi Arabia was recorded.

A chi-square test of independence was performed to examine the association between the gender of owners/managers and their decision to apply for finance (Table 6.47). The association between these variables was not significant ($\chi^2_{(1, n=267)} = 1.09, p = 0.29$).

Table 6.47: Chi-square Test of Independence between Gender of the Owner/Manager and Decision to Apply for Finance (n=267)

		Have you applied for loans from banks?		Total
		Yes	No	
Gender	Male	121 (57.89%)	88 (42.11%)	209
	Female	38 (65.52%)	20 (34.48%)	58
Total		159 (59.55%)	108 (40.45%)	267

$$\chi^2_{(1, n=267)} = 1.09, p = 0.29$$

A chi-square test of independence was performed to examine the association between the gender of owner/manager and difficulties in accessing finance from Saudi banks (Table 6.48), which was not significant ($\chi^2_{(1, n=269)} = 0.17, p = 0.68$). A similar percentage of male and female owners/managers had difficulties in obtaining finance from Saudi banks.

Table 6.48: Chi-square Test of Independence between Gender of the Owner/Manager and Difficulty Accessing Finance from Saudi Banks (n=269)

		Have you faced difficulties obtaining fund from Saudi banks?		Total
		Yes	No	
Gender	Male	162 (76.78%)	49 (23.22%)	211
	Female	43 (74.14%)	15 (25.86%)	58
Total		205 (76.21%)	64 (23.79%)	269

$$\chi^2_{(1, n=269)} = 0.17, p = 0.68$$

6.4.2 Business Characteristics of SMEs

The characteristics of the firm are very important factors that financial providers and investors use to analysis and examine the ability of firms to repay funds. Typically, SMEs pose higher risks. There are three main factors that affect SME access to bank credit: size of firm (Berry et al. 1993a); business plan (Barrow 1993; Berry et al. 1993; Reid 1998); and ownership type (Barlow & Robson 1999; Binks & Ennew 1997; Merritt 1998).

6.4.2.1 Business Size

H4a: Business size has a significant association with the decision to apply for external finance.

H4b: There is an association between the size of a firm and its difficulty in accessing finance from Saudi banks.

The size of a business is considered to be a significant factor influencing access to external finance (Abor & Biekpe 2005; Berger & Udell 1998; Coleman 2004; Coleman & Cohn 2000). Unlike large firms, small-sized businesses receive less benefit from banks and other financial providers (Keasey & Watson 1993).

This study measured the size of the firm according to its number of employees (Johnsen & McMahon 2005; Romano et al. 2001; Tigges & Green 1994) and sales turnover (Bennett & Donnelly 1993; Jordan et al. 1998). As discussed previously, a number of studies measured the size of SMEs using number of employees and sales turnover (Abalkhail 1999; Alfaadhel 2010; Alsulamy 2005; Kushnir 2010; Radwan & Al-Kibbi 2001).

The variables relating to the number of employees and sales turnover were collapsed into fewer categories in order to meet the minimum expected count criterion for a chi-square test. A chi-square test of independence was then performed to examine the association between the number

of employees in an organisation and the decision to apply for finance (Table 6.49). The association was not significant ($\chi^2_{(1, n=263)} = 0.58, p = 0.45$).

Table 6.49: Chi-square Test of Independence between Number of Employees and Decision to Apply for Finance (n=263)

		Have you applied for loans from banks?		Total
		Yes	No	
Number of employees	1–10	63 (56.25%)	49 (43.75%)	112
	≥11	92 (60.93%)	59 (39.07%)	151
Total		155 (58.94%)	108 (41.06%)	263

$$\chi^2_{(1, n=263)} = 0.58, p = 0.45$$

A chi-square test of independence was performed to examine the association between the number of employees in an organisation and its difficulties in accessing finance from Saudi banks (Table 6.50). The association was not significant ($\chi^2_{(1, n=265)} = 2.93, p = 0.09$).

Table 6.50: Chi-square Test of Independence between Number of Employees and Difficulties in Accessing Finance from Saudi Banks (n=265)

		Have you faced difficulties obtaining funds from Saudi banks?		Total
		Yes	No	
Number of employees	1–10	92 (81.42%)	21 (18.58%)	113
	≥11	110 (72.37%)	42 (27.63%)	152
Total		202 (76.23%)	63 (23.77%)	265

$$\chi^2_{(1, n=265)} = 2.93, p = 0.09$$

A chi-square test of independence was performed to examine the association between the annual turnover of a business and the decision to apply for finance (Table 6.51). A relatively larger proportion of larger organisations (>1 million SR annual turnover) reported applying for a loan, but this difference was not significant ($\chi^2_{(1, n=268)} = 3.25, p = 0.07$).

Table 6.51: Chi-square Test of Independence between Annual Turnover of Business and Decision to Apply for Finance (n=268)

		Have you applied for loans from banks?		Total
		Yes	No	
Annual turnover of business	<1 million SR	50 (52.08%)	46 (47.92%)	96
	>1 million SR	109 (63.37%)	63 (36.63%)	172
Total		159 (59.33%)	109 (40.67%)	268

$$\chi^2_{(1, n=268)} = 3.25, p = 0.07$$

A chi-square test of independence was performed to examine the association between the annual turnover of a business and the difficulties in obtaining funds from Saudi banks (Table 6.52). The association between these variables was significant ($\chi^2_{(1, n=270)} = 4.08, p = 0.04$): a relatively larger proportion of smaller organisations (<1 million SR annual turnover) reported having difficulty obtaining funds from Saudi banks. There is a significant association between large annual turnover of a business and less difficulty in obtaining finance from Saudi banks (Table 6.66).

Table 6.52: Chi-square Test of Independence between Annual Turnover of Business and Difficulty Accessing Finance from Saudi Banks (n=270)

		Have you faced difficulties to obtain fund from Saudi banks?		Total
		Yes	No	
Annual turnover of business	<1 million SR	80 (83.33%)	16 (16.67%)	96
	>1 million SR	126 (72.41%)	48 (27.59%)	174
Total		206 (76.3%)	64 (23.7%)	270

$$\chi^2_{(1, n=270)} = 4.08, p = 0.04$$

6.4.2.2 Business Ownership Type

H5a: Business ownership type is significantly associated with the decision to apply for external finance.

H5b: There is an association between the ownership type of the firm and its difficulty in accessing finance from Saudi banks.

It is anticipated that the legal structure of a business may affect its ability to access external sources of finance. Investors prefer the less risky option of investing in incorporated firms and private limited companies (Barlow & Robson 1999; Binks & Ennew 1997; Merritt 1998). This study asked owners/managers of firms to specify their business' legal structure type.

A chi-square test of independence was performed to examine the association between business ownership type and the decision to apply for external finance (Table 6.53), which was significant ($\chi^2_{(2, n=268)} = 6.00, p = 0.05$): a lower proportion of partnerships and companies reported applying for loans from banks compared to sole proprietorships.

A chi-square test of independence was performed to examine the association between business ownership type and having difficulties obtaining funds from Saudi banks (Table 6.54). The association between these variables was significant ($\chi^2_{(2, n=268)} = 47.92, p < 0.001$). A noteworthy observation was that a larger proportion of sole proprietorships reported having difficulties in obtaining financing from Saudi banks compared to partnerships and companies. The trends between business ownership type and the decision to apply for finance and the difficulties faced in obtaining finance are consistent with findings of other relevant studies (Barlow & Robson 1999; Binks & Ennew 1997; Merritt, 1998) that indicate that investors prefer the less risky option of investing in incorporated firms and private limited companies compared to sole proprietorships.

6.4.2.3 Business Plan

H6a: The existence of a written business plan has a significant effect on the decision to apply for external finance..

H6b: There is an association between the existence of a written business plan for a firm and its difficulty in accessing finance from Saudi banks.

Previous studies noted that a business plan is a significant element that most banks and financial providers consider when assessing the likely success and future growth of a venture (Barrow 1993; Berry et al. 1993a; Reid 1998). The business plan acts as a guide to the business owner/manager to organise day-to-day business activities and operations (Berry et al. 1993a). Therefore, financial providers do not provide a loan without an appropriate and feasible business plan so they can evaluate whether or not the applicant's firm is likely to repay the loan.

Table 6.53: Chi-square Test of Independence between Business Ownership Type and Decision to Apply for Finance (n=268)

		Have you applied for loans from banks?		Total
		Yes	No	
Business legal structure	Sole proprietorship	128 (63.05%)	75 (36.95%)	203
	Partnership	16 (42.11%)	22 (57.89%)	38
	Company	15 (55.56%)	12 (44.44%)	27
Total		159 (59.33%)	109 (40.67%)	268

$$\chi^2_{(2, n=268)} = 6.00, p = 0.05$$

Table 6.54: Chi-square Test of Independence between Business Ownership Type and Difficulties in Accessing Finance from Saudi Banks (n=270)

		Have you faced difficulties obtaining funds from Saudi banks?		Total
		Yes	No	
Business legal structure	Sole proprietorship	175 (85.37%)	30 (14.60%)	205
	Partnership	13 (34.21%)	25 (65.79%)	38
	Company	18 (66.67%)	9 (33.33%)	27
Total		206 (76.3%)	64 (23.7%)	270

$$\chi^2(2, n=268) = 47.92, p < 0.001$$

In light of this, the survey asked participants if they had prepared a business plan or conducted a feasibility study, prior to starting their business. They were also asked about some of the benefits of having a business plan.

A chi-square test of independence was performed to examine the association between the existence of a business plan before the business was started and the decision to apply for finance (Table 6.55). The association was significant ($\chi^2(1, n = 268) = 4.72, p = 0.03$): a higher proportion of businesses that did not have a business plan at the time of starting a business reported applying for a loan, compared to businesses that did have a business plan at the time of starting a business.

Table 6.55: Chi-square Test of Independence between the Existence of a Business Plan and Decision to Apply for Finance (n=268)

		Have you applied for loans from banks?		Total
		Yes	No	
Existence of a business plan	Yes	59 (51.75%)	55 (48.25%)	114
	No	100 (64.94%)	54 (35.06%)	154
Total		159 (59.33%)	109 (40.67%)	268

$$\chi^2(1, n = 268) = 4.72, p = 0.03$$

A chi-square test of independence was performed to examine the association between the existence of a business plan before the business commenced and difficulties in obtaining finance from Saudi banks (Table 6.56). The association was significant ($\chi^2_{(1, n=270)} = 7.95, p = 0.005$). A higher proportion of businesses that did not have a business plan at the time of starting a business reported facing more difficulties in obtaining financing from Saudi banks compared to businesses that did have a business plan at the time of starting a business. These findings agree with those of earlier relevant studies (Barrow 1993; Berry et al. 1993a; Reid 1998)—that a business plan is a crucial consideration by banks and other financial institutions in determining the success of a venture, and eventually in the decision to grant finance.

Table 6.56: Chi-square Test of Independence between Existence of a Business Plan and Difficulty Accessing Finance from Saudi Banks (n=270)

		Have you faced difficulties obtaining funds from Saudi banks?		Total
		Yes	No	
Existence of a business plan	Yes	78 (67.83%)	37 (32.17%)	115
	No	128 (82.58%)	27 (17.42%)	155
Total		206 (76.3%)	64 (23.7%)	270

$$\chi^2_{(1, n=270)} = 7.95, p = 0.005$$

6.4.2.4 Growth Rate and Financial Ratios

H7a1: The growth rate of a firm has a significant effect on its decision to apply for external finance.

H7a2: The profitability ratios of a firm have a significant effect on its decision to apply for external finance.

H7b1: There is an association between the growth rate of a firm and its difficulty in accessing finance from Saudi banks.

H7b2: There is an association between the profitability ratios of a firm and its difficulty in accessing finance from Saudi banks.

Financial performance indicators of a firm provide clear evidence to financial providers about the ability of a firm to repay a loan. This association has been widely studied. A number of researchers have noted that firms with higher growth rates and profits have easier access to external finance. This enhances business performance by decreasing credit costs and liquidity risk (Berger & Udell 1998; Johnsen & McMahon 2005).

To measure the growth rate and the SME profitability ratios, this study asked owners/managers of businesses to indicate their average current market share and annual growth rate for the last three years. The response categories ranged from 5 to 20 per cent. The study also sought information about the financial ratios of the business through percentage of ROI, profit margin, annual sales turnover and financial leverage.

The variables relating to current market share of the firm and annual growth rate of the firm were collapsed into fewer categories in order to conduct a chi-square analysis. A chi-square test of independence was performed to examine the association between the current market share of the firm and the decision to apply for finance (Table 6.57). This association was significant ($\chi^2_{(1, n=267)} = 4.27, p = 0.04$). A significantly larger proportion of organisations with a relatively smaller market share (1–10 per cent) reported applying for a loan from Saudi banks.

Table 6.57: Chi-square Test of Independence between Current Market Share of the Firm and Decision to Apply for Finance (n=267)

		Have you applied for loans from banks?		Total
		Yes	No	
Current market share	1–10 per cent	146 (61.34%)	92 (38.66%)	238
	≥11 per cent	12 (41.38%)	17 (58.62%)	29
Total		158 (59.18%)	109 (40.82%)	267

$$\chi^2_{(1, n=267)} = 4.27, p = 0.04$$

A chi-square test of independence was performed to examine the association between the current market share of a firm and its difficulties in obtaining finance from Saudi banks (Table 6.58). The association between these variables was significant ($\chi^2_{(1, n = 267)} = 15.39, p < 0.001$): a significantly larger proportion of organisations with a relatively smaller market share (1–10 per cent) reported having difficulties obtaining finance from Saudi banks.

Table 6.58: Chi-square Test of Independence between Current Market Share of the Firm and Difficulties in Accessing Finance from Saudi Banks (n=267)

		Have you faced difficulties obtaining funds from Saudi banks?		Total
		Yes	No	
Current market share	1–10 per cent	192 (80.67%)	46 (19.33%)	238
	≥11 per cent	14 (48.28%)	15 (51.72%)	29
Total		206 (77.15%)	61 (22.85%)	267

$$\chi^2_{(1, n = 267)} = 15.39, p < 0.001$$

A chi-square test of independence was performed to examine the association between the annual growth rate of a firm and its decision to apply for finance (Table 6.59). The association between these variables was not significant ($\chi^2_{(1, n = 267)} = 0.20, p = 0.65$).

Table 6.59: Chi-square Test of Independence between Annual Growth Rate and Decision to Apply for Finance (n=267)

		Have you applied for loans from banks?		Total
		Yes	No	
Annual growth rate	1–10 per cent	124 (58.49%)	88 (41.51%)	212
	≥11 per cent	34 (61.82%)	21 (38.18%)	55
Total		158 (59.18%)	109 (40.82%)	267

$$\chi^2_{(1, n = 267)} = 0.20, p = 0.65$$

A chi-square test of independence was performed to examine the association between the annual growth rate of the firm and its difficulties in obtaining finance from Saudi banks (Table 6.60). A significantly larger proportion of organisations with smaller annual growth rate (1–10 per cent) reported having difficulty obtaining funds from Saudi banks ($\chi^2_{(1, n = 267)} = 6.71, p = 0.01$).

Table 6.60: Chi-square Test of Independence between Annual Growth Rate and Difficulty Accessing Finance from Saudi Banks (n=267)

		Have you faced difficulties obtaining funds from Saudi banks?		Total
		Yes	No	
Annual growth rate	1–10 per cent	170 (80.19%)	42 (19.81%)	212
	≥11 per cent	35 (63.64%)	20 (36.36%)	55
Total		205 (76.78%)	62 (23.22%)	267

$$\chi^2_{(1, n = 267)} = 6.71, p = 0.01$$

An independent sample t-test was used to test if there is a relationship between various financial ratios of firms and the decision to apply for finance (Table 6.61). The results of the independent sample t-test indicate that the relation between ROI, profit margin and the leverage ratio of a firm, and its decision to apply for finance is significant. The mean ROI for companies that applied for finance (M=8.15, SD=3.35, n=127) was significantly lower than the mean ROI for companies that did not (M=9.87, SD=6.38, n=67), $t_{(85.596)} = -2.06, p = 0.043$. The mean profit margin for companies that applied for finance (M=4.69, SD=2.82, n=127) was significantly lower than the mean profit margin for companies that did not (M=6.358, SD=4.070, n=67), $t_{(100.337)} = -3.09, p = 0.003$. The mean leverage ratio for companies that applied for finance (M=29.37, SD=8.85, n=127) was significantly greater than the mean leverage ratio for companies that did not (M=23.03, SD=12.97, n= 67), $t_{(99.228)} = 3.58, p = 0.001$.

An independent sample t-test was used to test for a relationship between various financial ratios of firms and difficulties in obtaining finance from Saudi banks (Table 6.62). The results indicate

that the relationship between ROI, profit margin and annual turnover of the firm and the difficulties in obtaining finance from Saudi banks is significant. The mean ROI for companies that have difficulties obtaining finance from Saudi banks ($M=7.66$, $SD=2.42$, $n= 169$) is significantly lower than the mean ROI for companies that had no such difficulties ($M=16.08$, $SD=8.42$, $n= 25$), $t_{(24.59)} = -4.97$, $p < 0.001$. The relationship was also significant for profit margin ($t_{(30.10)} = -9.88$, $p < 0.001$) and annual sales turnover ($t_{(26.026)} = -2.384$, $p = 0.025$). Other similar studies (e.g. Berger & Udell 1998; Johnsen & McMahon 2005) found that firms with better financial indicators are looked upon more favourably by banks when it comes to lending. Results here are similar, and have specifically established that lower levels of ROI, profit margin and annual sales turnover are associated with difficulties in obtaining finance from Saudi banks.

Table 6.61: Independent Sample t-test for Various Financial Ratios of Companies and Decision to Apply for Finance

Financial ratios		Have you applied for loans from banks?			Test statistic	p-value
		N	Mean	SD		
ROI = Net profit BI &T (%)	Yes	127	8.150	3.348	-2.056	0.043
	No	67	9.866	6.384		
Profit margin (net income/net sales) (%)	Yes	127	4.638	2.822	-3.090	0.003
	No	67	6.358	4.070		
Leverage = total debt/total equity (%)	Yes	127	29.370	8.847	3.585	0.001
	No	67	23.030	12.973		
Annual sales turnover (million SR)	Yes	127	1.071	1.920	-0.616	0.539
	No	67	1.255	2.005		

Table 6.62: Independent Sample t-test for Various Financial Ratios of Companies and Difficulties in Obtaining Finance from Saudi Banks

Financial ratios		Have you faced difficulties obtaining funds from Saudi banks?			Test statistic	p-value
		N	Mean	SD		
ROI = Net profit BI &T (%)	Yes	169	7.657	2.420	-4.971	0.000
	No	25	16.080	8.421		
Profit margin (net income/net sales) (%)	Yes	169	4.438	2.663	-9.885	0.000
	No	25	10.600	2.944		
Leverage = total debt/total equity (%)	Yes	169	27.325	11.051	0.538	0.594
	No	25	26.200	9.552		
Annual sales turnover (million SR)	Yes	169	0.940	1.640	-2.384	0.025
	No	25	2.447	3.096		

6.4.2.5 Islamic Finance

H8a: The SME-related business obstacles that firms face in Saudi Arabia have a negative effect on their performance.

H8b: There is an association between the SME-specific business obstacles encountered by firms in Saudi Arabia and their business performance.

As one of the aims of this study is concerned with clarifying the distinctive concept of Islamic banking and finance, and its suitability for SMEs, the study examines Islamic financial products for financing SMEs by asking respondents about Islamic financial products provided by Saudi banks for SMEs.

A contingency table (Table 6.63) was created to assess the trends between the availability of Islamic finance products and the decision to apply for external finance. A chi-square test was not suitable to analyse responses to this multiple response question. It is notable that a higher proportion of firms that reported a preference for Islamic banking (66.87 per cent) over conventional banking (36.3 per cent) applied for loans from Saudi banks, than did firms that

solely prefer both Islamic and conventional banking (32.48 per cent). This could be a reflection of the hardship encountered in obtaining conventional finance or dealing with conventional banking.

Table 6.63: Availability of Islamic Finance Products and Decision to Apply for Finance (n=263)

		Have you applied for loans from banks?		Total
		Yes	No	
Type of financing available and preferred	Islamic banking	105 (66.87%)	78 (73.58%)	183
	Conventional banking	57 (36.30%)	29 (27.35%)	86
	Both	51 (32.48%)	27 (25.47%)	78
Total		157 (59.69%)	106 (40.3%)	263

A contingency table (Table 6.64) was created to assess the trends between the availability of Islamic finance products and difficulties in obtaining finance from Saudi banks. A chi-square test could not be conducted because this was a multiple response question. A relatively higher proportion of firms that reported a preference for Islamic banking faced more difficulties in obtaining finance from Saudi banks (72.77 per cent) compared to firms that reported a preference for conventional banking (34.65 per cent) or a mix of conventional banking and Islamic banking (24.25 per cent).

Table 6.64: Availability of Appropriate Islamic Finance Products and Difficulties in Accessing Finance from Saudi Banks (n=263)

		Have you faced difficulties obtaining funds from Saudi banks?		Total
		Yes	No	
Type of financing available and preferred	Islamic banking	147 (72.77%)	36 (59.01%)	183
	Conventional banking	70 (34.65%)	16 (26.22%)	86
	Both	49 (24.25%)	29 (47.54%)	78
Total		202 (76.81%)	61 (23.19%)	263

6.4.2.6 Business Obstacles

H9: The business obstacles that firms face in Saudi Arabia have a negative effect on their performance (ROI, profit margin, leverage ratio, annual sales turnover, market share, and growth rate).

Business obstacles are considered a major constraint that can stunt the growth and longevity of businesses. To identify the business obstacles that most Saudi SMEs confront, this study asked owners/managers to determine, via a four-point Likert scale, the factors that most affect their business performance.

The factors that the study measured were:

Internal Obstacles

Entrepreneurial factors: gender, age of owner, work experience, availability of capital, and availability of a business plan

Enterprise factors: technology, sales and marketing, management skills, customer satisfaction, quality of product or service, and training

External Obstacles

Environmental factors: legal issues, financial support, government support, corruption, government bureaucracy, legal issues, chamber of commerce services and government regulations (labour).

a) Business Obstacles and ROI

One-way ANOVA was performed to examine the association between various business obstacles and business financial performance (ROI, profit margin, leverage ratio, annual sales turnover, market share, and growth rate).

The results (see Table A-1, Appendix A) indicate a significant association between mean ROI and sales, and obstacles related to sales and marketing, availability of capital, competitors and customer satisfaction. The mean ROI is the highest when there are fewer such obstacles.

b) Business Obstacles and Profit Margin

The results in Table A-2 (Appendix A) section indicate that there is a significant association between mean profit margin and customer satisfaction as an obstacle. The mean profit margin is the highest when there are less customer satisfaction-related obstacles.

c) Business Obstacles and Leverage Ratio

Table A-3 (Appendix A) shows that there is a significant association between mean leverage ratio and gender, age of owner, technology and financial support as obstacles. The mean leverage ratio is the highest when there are fewer such obstacles.

d) Business Obstacles and Annual Sales Turnover

A chi-square test of independence was performed to examine the association between various business obstacles and the annual turnover of a business (Table A-4, Appendix 1). The results indicate that the association between annual turnover and obstacles related to sales and marketing, gender, age of owner, technology, chamber of commerce services, legal issues, advisory services, training, and product and service quality is significant. Firms with higher annual turnover view sales and marketing, and gender as moderate obstacles for business; and age of owner, technology, chamber of commerce services, legal issues, advisory services, training, and product and service quality as smaller obstacles.

e) Business Obstacles and Market Share

A chi-square test of independence was performed to examine the association between various business obstacles and the market share of a business (Table A-5, Appendix 1). The association between market share of a business and obstacles related to technology, chamber of commerce services, legal issues, advisory services and training is significant. Firms with higher market share view age of owner and training as moderate business obstacles; and education level, technology, chamber of commerce services, legal issues, and advisory services as smaller business obstacles.

f) Business Obstacles and Annual Growth Rate

A chi-square test of independence was performed to examine the association between various business obstacles and the annual growth rate of a business (Table A-6, Appendix 1). The results indicate that the association between chamber of commerce services, government support and training, and annual growth rate of a business is significant. Firms with a smaller annual growth rate view chamber of commerce services, government support, advisory service and training as smaller business obstacles.

The results of hypotheses testing with respect to owner/manager and business characteristics, and decision to apply for finance from Saudi banks are summarised in Table 6.65.

Table 6.65: Decision to Apply for Finance from Saudi Banks

Variable	Test result	Hypothesis	
SME owner/manager characteristics			
Education	Not significant	H1a1: Level of owner/manager education has a significant effect on the decision to apply for bank finance.	
Training	Not significant	H1a2: Level of owner/manager training has a significant effect on the decision to apply for bank finance.	
Experience	Not significant	H2a: Owner/manager experience has a significant effect on the decision to apply for bank finance.	
Gender	Not significant	H3a: Owner/manager gender has a positive effect on the decision to apply for bank finance.	
SME business characteristics			
Business size			
	Number of employees	Not significant	H4a: Business size has a significant association with the decision to apply for bank finance.
	Annual sales turnover	Significant	
Business type	Significant	H5a: Business ownership type is significantly associated with the decision to apply for external finance.	
Business plan	Significant	H6a: Existence of a written business plan has a significant effect on the decision to apply for bank finance.	
Market share	Significant	H7a1: Market share and growth rate of the firm has a significant effect on the decision to apply for finance from Saudi banks.	
Growth rate	Not significant		
Financial ratio			
	ROI	Significant	H7a2: Financial ratios of the firm have a significant effect on the decision to apply for finance from Saudi banks.
	Profit	Significant	
	Leverage	Significant	
Islamic finance	Not significant	H8a: Availability of Islamic finance products has a positive effect on the decision to apply for bank finance	

The results of hypotheses testing for significant associations between owner/manager and business characteristics, and access to finance from Saudi banks are summarised in Table 6.66.

Table 6.66: Difficulties with Access to Finance from Saudi Banks

Variable	Test result	Hypothesis	
SME owner/manager characteristics			
Education	Not significant	H1b₁ : There is an association between level of education of SME owners/managers and their difficulty in accessing finance.	
Training	Not significant	H1b₂ : There is an association between level of training of SME owners/managers and their difficulty in accessing finance.	
Experience	Not significant	H2b : There is an association between experience of SME owner/managers and their difficulty in accessing finance.	
Gender	Not significant	H3b : There is a relationship between gender of SME owners/managers and their difficulty in accessing finance.	
SME business characteristics			
Business size			
	Number of employees	Not significant	H4b : There is an association between firm size and difficulty in accessing finance.
	Annual sales turnover	Significant	
Business type	Significant	H5b : There is an association between ownership type and difficulty in accessing finance.	
Business plan	Significant	H6b : There is an association between the existence of a written business plan and difficulty in accessing finance.	
Market share	Significant	H7b₁ : There is an association between market share and growth rate, and difficulty in accessing finance.	
Growth rate	Significant		
Financial ratio			
	ROI	Significant	H7b₂ : There is an association between financial ratios and difficulty in accessing finance.
	Profit	Significant	
	Leverage	Not significant	
Islamic finance	Not significant	H8b : There is an association between availability of Islamic finance products and difficulty in accessing or obtaining finance.	

The results for hypothesis testing related to associations between business obstacles and business performance are summarised in Table 6.67.

Table 6.67: Business Obstacles and Financial Ratios

Variable	Test result	Hypothesis
ROI	Significant	Sales and marketing, availability of capital, competitors and customer satisfaction
Profit margin	Significant	Customer satisfaction
Leverage	Significant	Gender, age of owner, technology and financial support
Annual sales turnover	Significant	Sales and marketing, gender, age of owner, technology, chamber of commerce services, legal issues, advisory services, training, product and service quality
Market share	Significant	Technology, chamber of commerce services, legal issues and training
Annual growth rate	Significant	Chamber of commerce services, government support and training

6.5 CORRELATION ANALYSIS

The aim of the data analysis in the following sections is to identify significant relationships among owner/manager and business characteristics, SME obstacles and various facets of SME access to finance and SME performance. Correlation matrices using Spearman's rank non-parametric correlation coefficients are provided in subsequent sections. Three sets of correlation coefficients have been computed that test for significant associations between owner/manager/business characteristics and access to finance; SME obstacles and access to finance; and access to finance and SME performance. The significant correlations are flagged in the following sections. Correlation coefficients of between 0.1 and 0.3 are considered to represent weak correlations; those between 0.3 and 0.5 are considered to represent moderate correlations; and values between 0.5 and 1 are considered to represent strong correlations.

6.5.1 Access to Finance, and Owner/Manager Characteristics

Difficulties in obtaining funding from Saudi banks, and the acceptance of loan applications by government funding institutions were chosen as indicators of access to finance. In addition, all survey questions relating to owner/manager or business characteristics were chosen as indicators of owner/manager and business characteristics. The results from the correlation

analyses are provided in Table 6.68, suggesting a significant negative correlation between facing difficulties in obtaining funds from Saudi banks and preparing a business plan (weak correlation); doing a feasibility study before starting a business (weak correlation); or having a company website (weak correlation). Businesses that do not have much difficulty obtaining funds from Saudi banks have a business plan in place or have done a feasibility study before starting a business, and have a website that they may use for online sales and services.

The results also indicate a positive correlation between loan applications being accepted by a government funding institution and nationality of the owner (moderate correlation); the founder of the business acting as a manager (weak correlation); whether the owner/manager received any form of training in business management or entrepreneurial development through courses or workshops (weak correlation); having a business plan in place or doing a feasibility study before starting the business (moderate correlation); having a company website (weak correlation); and use of the company website for online sales and services (moderate correlation). There is a negative correlation between loan applications being accepted by a government funding institution and the number of employees at the firm (weak correlation); and the gender of the owner (weak correlation). Businesses whose loan applications are accepted by funding institutions tend to have a Saudi national as the owner; have the founder of the business acting as the manager; have an owner/manager who received training in business management or entrepreneurial development through a course or workshop; have a business plan in place or have done a feasibility study before starting the business; have their own website; and use the company website for online sales and services. Additionally, such businesses are associated with having a female owner and a relatively large number of employees.

Table 6.68: Correlations between Access to Finance Indicators and Owner/Manager/Business Characteristics

	Faced difficulties obtaining funds from Saudi banks	Loan application accepted by a government funding institution	Number of employees at the firm	Gender of owner	Nationality of owner	Founder of the business acts as manager	Training in business management
Loan application accepted by a government funding institution	-0.206*						
Number of employees at the firm	0.126*	-0.186*					
Gender of owner	0.025	-0.178*	-0.260*				
Nationality of owner	-0.159*	0.369*	-0.151*	-0.258*			
Business founder acts as manager	-0.024	0.224*	-0.222*	0.025	-0.013		
Training in business management	-0.067	0.232*	-0.111	-0.048	0.160*	0.198*	
Existing business plan	-0.172*	0.366*	-0.219*	-0.099	0.361*	0.200*	0.381*

*Significant correlation ($p < 0.05$)

6.5.2 Access to Finance, and Business Characteristics

Facing difficulties in obtaining funding from Saudi banks and having loan applications accepted by government funding institutions were chosen as indicators of access to finance; and all survey questions relating to owners and business were chosen as indicators of characteristics of owners/managers and business. The results from the correlation analysis are shown in Table 6.69.

Facing difficulties in obtaining funds from Saudi banks was significantly negatively correlated with having a strategic plan for the business (weak correlation); and positively correlated with both current market share and annual growth rate of the firm (weak correlation). Businesses that do not face much difficulty in obtaining funds from Saudi banks have a strategic plan for the business in place and have a relatively high market share and annual growth rate.

Further, there is a negative correlation between loan applications being accepted by a government funding institution and annual growth rate for the firm (weak correlation). There is a positive correlation between loan applications being accepted by a government funding institution and having a financial and accounting system at the firm (weak correlation); performing cash flow forecasting for the financial year at the beginning of the year (weak correlation); and having any loan or financial obligations to any financial institutions (weak correlation). Businesses whose loan applications are accepted by funding institutions are those with relatively high levels of growth rate; having a financial and accounting system at the firm; and preparing cash flow forecasting for the financial year at the beginning of the year.

6.5.3 Access to Finance and SME Financial Performance

Facing difficulties in obtaining funding from Saudi banks, and acceptance of loan applications by government funding institutions were chosen as indicators of access to finance. Accounting ratios and metrics, and growth rate of the firm (collapsed into two categories of 1: 1–10% and 2: $\geq 11\%$) were chosen as indicators of SME performance. The results from the correlation analysis are shown in Table 6.70.

Table 6.69: Correlations between Access to Finance Indicators and SME Obstacles

	Faced difficulties to obtain fund from Saudi banks	Loan applications been accepted from the government funding institutions	Current market share of the firm	Annual growth rate of the firm	Financial and accounting system for the firm	Prepare cash flow forecasting for the financial year at the beginning of the year
Loan applications accepted by government funding institutions?	-0.206*					
Current market share of the firm	0.220*	-0.107				
Annual growth rate of the firm	0.150*	-0.187*	0.513*			
Financial and accounting system at your firm?	-0.118	0.234*	-0.350*	-0.278*		
Cash flow forecasting for the financial year at the beginning of the year?	-0.114	0.214*	-0.306*	-0.420*	0.457*	
Any loan or financial obligations to any financial institutions?	0.056	0.271*	-0.269*	-0.365*	0.213*	0.307*

* Significant correlation ($p < 0.05$)

There was a negative correlation between facing difficulties in obtaining funds from Saudi banks and ROI (strong and significant correlation); profit margin (strong and significant correlation); and annual sales turnover (weak correlation). A positive relationship was observed between facing difficulties in obtaining funds from Saudi banks and leverage ratio of firms (weak correlation). Businesses that faced difficulties in obtaining funds from Saudi banks have low ROI, low profit margin, low sales turnover and high leverage ratios.

There was a negative correlation between loan applications being accepted by a government funding institution and ROI (weak correlation), and annual growth rate of the firm (weak correlation). Businesses whose loan applications were accepted by funding institutions have higher ROI and growth rates.

6.6 SUMMARY

The results of the descriptive statistics provide a demographic profile of the surveyed owners/managers and businesses. Further, they provide insights into current trends in the obstacles faced by SMEs in Saudi Arabia, and various aspects of access to finance. A large proportion of trends observed in the sample are in agreement with the results of similar studies, and some additional new findings have been made. Statistical analyses were performed on the relationships among various measures of owner/manager and business characteristics, SME obstacles and access to finance, and between business obstacles and SME performance.

Cross-tabulation with chi-square results identified some significant associations among variables of interest. Significant results indicate that the market value of assets of a firm, annual turnover of a firm, availability of business plan, annual growth rate of a firm and financial ratios are significantly associated with access to finance. The annual turnover is an indicator of the size of the firm. These findings are consistent with findings from similar studies. Size of business is considered to be a significant factor influencing access to external finance and, unlike large firms, small-sized businesses receive less benefit from banks and other finance providers (Keasey & Watson 1993). One of the most important findings from this study was that existence of a business plan was significantly associated with access to finance. Businesses that did not have a business plan at the time of starting their business were found to face more

problems accessing finance. Inability to access finance has a detrimental effect on the performance of a business. A business plan is one of the most important elements considered by banks and financial providers in assessing the success and future growth of a venture (Barrow 1993; Berry et al. 1993a; Reid 1998). Studies conducted by Sajini (1997), Abalkhail (1999) and Kushnir (2010) indicate that lack of a business plan for a firm leads to failure in obtaining finance from banks, which in turn has a detrimental effect on business performance. This study confirms these findings and also identifies other factors that are important for access to finance, for example some of the financial metrics associated with firms. These include the current market share and annual growth rate of the firm, leverage ratio, ROI, current ratio and annual sales turnover. These findings are important because they identify the specific financial metrics that are significantly associated with access to finance. Firms with higher growth rates and profits have easier access to external finance, and demonstrate better business performance (Berger & Udell 1998; Johnsen & McMahon 2005).

Using ANOVA to investigate relationships among internal and external business obstacles and business financial performance (ROI, profit margin, leverage ratio, annual sales turnover, market share, and growth rate), it was found that there is a significant association between ROI and obstacles relating to sales and marketing; availability of capital; competitors; and customer satisfaction. Also, there is a significant association between mean profit margin and customer satisfaction as an obstacle. Moreover, associations among technology, chamber of commerce services, legal issues, advisory services, and training and market share of a business is significant. The results also indicate that the association between chamber of commerce services, government support, advisory, and training and the annual growth rate of a business is significant.

Correlation analysis identified some significant relationships among the variables of interest. The results validated some of the findings established through cross-tabulation with chi-square, and identified some new associations. These included that businesses whose loan applications are accepted by funding institutions tend to have a Saudi national as the owner; have the founder of the business acting as the manager; have an owner/manager that has received training in business management or entrepreneurial development through a course or workshop; and have a business plan in place or have done a feasibility study before starting the business. Further, it

was found that businesses whose loan applications are accepted by funding institutions are those with a relatively high market share and growth rate; clear marketing strategies in place; financial and accounting systems; cash flow forecasting for the financial year done at the beginning of the year; no loan or financial obligations to financial institutions; and higher ROI, profit margin and leverage ratios. The results of the correlation analysis confirm the relationships asserted in the theoretical framework presented earlier.

Overall, the statistical analysis has identified specific and significant relationships between the various characteristics of owners/managers and businesses, SME obstacles, and access to finance; and access to finance and SME performance.

The next chapter will present the qualitative analysis carried out to explore the problems faced by the Saudi SME sector in obtaining finance from Saudi banks and other financial institutions, and the reasons behind these financial institutions' reluctance to finance this sector.

Table 6.70: Correlations between Access to Finance and SME Performance Indicators

	Have you faced difficulties obtaining funds from Saudi banks?	Have your loan applications been accepted by government funding institutions?	ROI = net profit BI&T (%)	Profit margin (net income/net sales (%))	Leverage = total debt/total equity (%)	Annual sales turnover (million SR)
Have your loan applications been accepted by government funding institutions?	0.158					
ROI = net profit BI&T (%)	-0.447*	-0.159				
Profit margin (net income/net sales (%))	-0.633*	-0.073	0.274*			
Leverage = total debt/total equity (%)	0.146	-0.254	-0.108	-0.206*		
Annual sales turnover (million SR)	-0.150	-0.030	0.146	0.134	-0.181	
Annual growth rate of the firm	-0.098	-0.215	0.126	0.008	0.092	-0.276*

* Significant correlation ($p < 0.05$)

CHAPTER 7: QUALITATIVE ANALYSIS

7.1 INTRODUCTION

Chapter 6 presented quantitative analyses of business obstacles that affect Saudi SME access to bank finance from the perspective of owners/managers of SMEs, and how these could affect SME performance, using information obtained via a survey questionnaire. The results showed that 76.3 per cent ($n=209$) of the business owner participants in this study had difficulties accessing finance from Saudi banks. Of those, 92.72 per cent believed this lack of access adversely affected their business performance. However, these results are limited in context as they present only the personal views of the SME owner/managers. In order to overcome this limitation, the study also followed a qualitative approach via interviews to explore why banks and other financial institutions are reluctant to finance this sector. The objective of these interviews was to gather a basic understanding of the constraints of financing SMEs in Saudi Arabia, and to identify the factors that influence SMEs' ease of access to the current financial services provided by Saudi banks and other government financial institutions, which in turn affects SMEs' performance. The chapter also seeks to gain insight into the loan conditions and requirements of Saudi banks in relation to SMEs, determine the current funding terms and conditions offered by banks and ascertain if suitable financial products are presently available that meet the business needs of SMEs; as well as, to identify the factors that preventing Saudi SMEs from obtaining finance from Saudi banks.

To further explore the problems faced by the Saudi SME sector in obtaining finance from banks and other financial institutions, qualitative data were collected and analysed. The qualitative approach adopted a cross-case studies strategy as its research design, supported by in-depth structured interviews using open-ended questions as a method of data collection, as outlined in Chapter 5. Inductive qualitative thematic analysis was employed to identify recurring factors to help establish themes related to access to external finance from financial institutions. In addition, interviewee responses generated answers, discussion and analysis of questions around the implemented conceptual framework outlined in Section 4.3, and linked and interrelated the research objectives and questions to provide valuable information on these qualitative elements.

Interview responses from officers responsible for SME funding at five commercial banks, two different types of private funding agencies and two different types of government agencies were subjected to thematic analysis. Data from these nine cases studies related to three main dependent variables—access to finance, obstacles facing banks with loan applications from SMEs, and availability of Islamic financial products—that measure six main themes, where each theme has several sub-themes that were extracted from the analysis of the interviews. Following the inductive thematic analysis, the researcher went through a process of identifying and exploring codes, and the findings are depicted graphically through concept maps (see Table 7.2). The analysis concludes with a discussion of the factors that would significantly influence SMEs in successfully obtaining finance from banks and other financial institutions.

The distribution and type of interview subjects is shown in Table 7.1.

Table 7.1: Sample Sizes for Interviews

Stakeholder type	Number and coding of interviewees
Private sector money lenders	2 (X and Y)
Saudi banks	5 (A,B,C,D and E)
Saudi government agencies	2 (Kafalah and SCSB)

Table 7.2: Main and Sub-themes Linked to the Theoretical Framework

Dependent variable	Main theme	Sub-themes
Access to external source of finance (Objectives 1,2,4 ,6)	Loan requirement	<ul style="list-style-type: none"> • Loan conditions and policies • Loan conditions and interest rates
	Application process and evaluation	<ul style="list-style-type: none"> • Definition of SMEs • Lending techniques • Application process • Qualified projects • Document requirements
Obstacles facing banks with loan applications by SMEs (Objectives 4, 8)	Reasons for rejecting the application	<ul style="list-style-type: none"> • Owner and business factors • Meeting requirements • Risks involved • Reasons for reluctance to fund SMEs
Availability of Islamic finance products (Objectives 6,7)	Financial facilities available	<ul style="list-style-type: none"> • Product and services • Recovery procedure • Relationship with SMEs • Areas for improvement

7.2 ACCESS TO EXTERNAL SOURCES OF FINANCE

Financial constraints in obtaining loans from commercial banks and other credit providers are one of the biggest obstacles influencing the success of SMEs. In order to measure access to finance by SMEs, this study considered three main themes: loan requirements; evaluation of applications; and the process of applying for a loan (Bukvic & Bartlett 2003; Coleman 2004; Chittenden et al. 1996; Holmes et al. 1994; Kariuki 1995; Levy 1993; Pissarides 1999).

7.2.1 Loan Requirements

The discussion in this main theme is designed around the study objectives (1, 2, 4 and 6) to answer the research questions (1, 2, 4 and 7) related to these objectives. There are two sub-themes—the lending policies and requirements frequently adopted by banks and other financial institutions before they approve a loan—designed to identify financial constraints of access to finance by SMEs.

7.2.1.1 Lending Policies

Most financial institutions have policies guiding their commercial and personal lending (Abor & Biekpe 2005). Therefore, interviewees were asked about their lending policies with respect to financing SMEs (see Table 7.3). All five participating banks admitted that they only lend to existing businesses; none were willing to fund start-up businesses as the Kafalah programme does not guarantee loans. As one said:

We don't finance any new start-up business; they can apply for government funds (Interviewee D).

Three out of five banks said that according to their lending policy, only ongoing SMEs can apply for loans through the Kafalah programme, which is the only guaranteeing agency for bank loans to SMEs. Further, they said that the upper limit on these loans is 2 million SR because the guarantee given by the Kafalah programme has an upper limit of 1.6 million SR, which is 80 per cent of a 2 million SR loan. The banks take a calculated risk and are willing to absorb 400,000 SR in the event of a default. One respondent said:

We grant financing to SMEs only under the Kafalah programme umbrella because it's the only way to guarantee our funds, due to the lack of financial guarantee for SMEs (Interviewee B).

An additional requirement of the Kafalah programme is that applicants should produce three years of audited financial statements to provide evidence of acceptable cash flow. On the other hand, banks A and E offer to ongoing concerns the option of either Kafalah-supported or direct funding, provided they deem the project is feasible and has growth potential, and the business is able to provide adequate collateral. These requirements are too restrictive for many SMEs (Al-Kharusi 2003; Beck & Kunt 2006; Sarapaivanich 2006).

In contrast to this policy, the lending policy of SCSB and private fund X provide interest-free loans for Saudi entrepreneurs who plan start-up business and have no other existing businesses. These two financial institutes are not covered by the Kafalah programme as the scheme is designed to guarantee bank loans only.

The lending policy of private fund Y includes loans to both existing and start-up business with direct funding, especially those that have been unsuccessful in securing funds from banks or government sources. The only requirement of this institution is that they can assess the responsible officers and the financial viability of the business for the duration of the loan.

Table 7.3: Lending Policies of Different Agencies

AGENCY	LENDING POLICY
Banks (A,B,C,D,E)	Lends only through the Kafalah programme; no loans for start-up businesses
Banks (A,E)	These two banks can lend via the Kafalah programme if the project is feasible and has enough collateral
Kafalah	Guarantee only bank-referred applications
Private fund Y	Lends to all kinds of businesses even if other banks have refused them, if they fulfil lending conditions
Private fund X	Provides no-interest loans for start-up business entrepreneurs who have not had a business before
SCSB	Provides loans for start-up business entrepreneurs who have not had a business before

7.2.1.2 Loan Conditions and Requirements

In many cases, banks enforce several conditions on loan contracts, and the interviewees were asked about the conditions and terms imposed by their lenders. The terms and requirements differ between the banks and other financial institutions. All lenders in the study imposed conditions of some sort, as summarised in Table 7.4. As justified by the lenders in the sample,

these requirements are important for measuring the capacity of firms and owners to repay the loan.

Table 7.4: Loan Conditions, Interest Rate and Fees

BANKS	<ul style="list-style-type: none"> - business plan - 3-year financial statements - collateral - acceptance from Kafalah - good credit scoring - pass the interview - project should be within the business activity domain approved by Kafalah - interest rates of 6–8 per cent, or up to 12 per cent - loans of up to 2 million SR - loan duration of 7 years
SCSB	<ul style="list-style-type: none"> - entrepreneur must be Saudi - entrepreneur must have experience or a professional degree in area of business they want to start in - applicant should undergo Riyadh training for preparing business plans - applicant must work full-time on the project - business plan - good credit scoring - has no other business - free interest rate - maximum 8 years
X	<ul style="list-style-type: none"> - only Saudis - maximum amount 150,000 SR - pass the interview and related training courses - personal guarantee - business plan - good credit scoring - has no other business - free interest rate - maximum 5 years
Y	<ul style="list-style-type: none"> - has fixed income not less than 7,500 SR per month - personal guarantee - good credit scoring - interest rates of 12–15 per cent - loan duration of 18–60 months
Kafalah	<ul style="list-style-type: none"> - apply directly to a Saudi bank involved with the programme in your area - loans not exceeding 2 million SR - project should be within the domain of approved business activities - business plan - good credit scoring

Banks normally charge between 6 and 8 per cent interest on their loans, but this may vary depending on risk level. For instance, banks A, B and E could charge up to 12 per cent if the project is too risky. Banks also charge administration and application fees.

Some economic activities do not qualify for the Kafalah programme, such as real estate, contracting, or any business depending on non-Saudi labour. This can exclude a large number of SMEs from accessing finance as most depend on non-Saudis for doing business.

The lending conditions are slightly different in SCSB and the other two private sector funds identified as X and Y. These lenders do not require collateral or financial statements; instead applicants must provide a personal guarantee for loan repayments. Also, SCSB and X require applicants to be Saudi citizens holding qualifications and professional experience in the area of the business for which they are applying for funding. Further, applicants to SCSB must pass a personal interview and accomplish training courses provided by the Riyadhah programme.¹

In terms of fees, SCSB charges the client administration fees ranging from 4,000–35,000 SR. The loan period is up to eight years. In contrast, fund X is a non-profit private sector lender providing interest-free loans for new micro-ventures with project costs of no more than 150,000 SR. Thus, a business requiring less than 150,000 SR can approach fund X, and a business requiring above that amount and up to 300,000 SR can approach SCSB. SCSB also gives opportunities to those with special projects in the industrial and service sectors that apply innovative technology and have a capital requirement between 300,000 and 4 million SR. Hence, these two lenders collectively cater to a large portion of the market with comparable service packages and interest-free access to funds.

¹ The Riyadhah programme is an independent non-profit national organisation founded on the initiative of the Ministry of Petroleum and Mineral Resources and the General Organization for Technical and Vocational Training under the title *National Entrepreneurship Institute*, for preparing business plans.

Fund Y requires applicants to have a fixed income of not less than 7,500 SR per month and provide a personal guarantee, in order to apply for a loan. The only test carried out is the legitimacy of owners and their assets, and their financial capacity to repay the loan. However, the organisation charges a higher interest rate than the other lenders interviewed in this study. Thus, businesses that are unable to meet the requirements of the lower-interest lenders resort to such funds to meet their financial needs. The following is a statement from one respondent on how fund Y provides finance to SMEs:

The fund sells a vehicle to an SME owner and repurchases it at a price lower than its market value in order to provide cash. The vehicle's value and agreed high annual interest rate (12–15 per cent) applied to the original price of the vehicle are to be repaid in monthly instalments of certain duration, usually between 35 and 60 months (Interviewee Y).

By the time the loan is paid off, the borrower would have made a total payment exceeding 140 per cent of the initial loan, which is generally five times as high as what a normal commercial bank would charge for the same size loan.

7.2.2 Evaluation of Loan Application

This theme under qualitative analysis covers study objectives 4, 6 and 8, which in turn address research questions 4, 10 and 12. The sub-themes of this theme are definition of SMEs used by lenders, lending techniques, application process, qualified projects and document requirements. Following is a discussion on the strict requirements and loan conditions imposed by financial institutions that may prevent SMEs from applying for finance, to identify the problems faced by Saudi SMEs in obtaining finance.

7.2.2.1 Defining SMEs

Lenders using the Kafalah scheme adopt the definition of SME used by the Kafalah agency. Accordingly, an SME is defined as any business with an annual sales turnover of not more than 30 million SR; however, bank E adds the stipulation that it cannot have more than 100 employees, although it does not seem to apply this condition strictly.

Of the two private funds, agency Y is not concerned very much with the definition because it is interested in providing loans to SMEs that have been unsuccessful in obtaining loans from banks. Their aim seems to be one of earning high interest by exploiting the vulnerability of SMEs. The other funding agency, X, is a non-profit organisation providing interest-free loans for new micro-ventures with project costs of less than 150,000 SR. Thus, SME definition is not relevant; what is important is project cost and not sales figures.

As shown in Table 7.5, Kafalah is the basis for banks to give loans and hence their definition is the most pertinent. Kafalah defines SME as businesses with an annual turnover of 2–30 million SR. However, banks do not set a lower limit on this and consider applications from businesses with sales turnover anywhere up to 30 million SR. This confusion of definition between Kafalah and the banks introduces uncertainty for businesses with turnover of less than 2 million SR. This lack of consistency may result in businesses in this category being excluded from funding.

In contrast, SCSB defines SMEs as any project that costs up to 300,000 SR; and any project costing up to 4 million SR is considered a medium enterprise. SCSB only gives interest-free loans for new ventures. These amounts are project costs and not annual sales.

Table 7.5: Comparison of SME Definitions

BANKS	Y	X	Kafalah	SCSB
30 million SR annual sales maximum	NA	Project cost 150,000 SR	2–30 million SR annual sales	Project and business costs up to 300,000 SR are small, and up to 4 million SR are medium enterprises

7.2.2.2 Lending Techniques

As shown in Table 7.6, banks use asset-based lending in the absence of Kafalah support, as the assets can be used as collateral. This is supplemented with credit scoring even for short-term

loans of one to three years in the case of SMEs. Besides these two techniques, banks E and C sometimes use audited financial statements for evaluating the financial ability of existing businesses. Funds Y and X use credit history supplied by the Saudi Credit Bureau to assess the creditworthiness of the applicant.

Kafalah evaluates loan applications received from banks for guarantees using both financial statements and asset-based evaluations, whereas SCSB and the two private funds use only credit scoring in order to evaluate loan applications.

Table 7.6: Comparison of Lending Techniques by Different Agencies

BANKS A, B, D	Banks E, C	Y	X	Kafalah	SCSB
- asset-based - credit scoring	- asset-based - credit scoring - financial statement	- credit scoring	- credit scoring	- asset-based - financial statement	- credit scoring

7.2.2.3 Activities Qualifying for Funding

Funding is available for a range of activities from bank D; however, all banks finance only those businesses that are acceptable to the Kafalah programme:

Our bank finances only activities that are acceptable by the Kafalah programme to guarantee it (Interviewee bank D).

According to interviewees from Kafalah, business activities that are not guaranteed are:

- real estate contracting
- activities with annual sales volume exceeding 30 million SR
- speculative financing projects
- businesses depending on non-Saudi labour
- service businesses such as restaurants and medical clinics; educational programmes such as schools or childcare; and auto repairs.

In addition, as shown in Table 7.7 some economic activities do not qualify for SCSB funding, including activities that are not a specialty of the SCSB and that can be funded through other

financing entities: for example, livestock trade and production, fodder sales and agricultural production; refrigerators, hotels and furnished apartments; museums, recreational activities and resorts; non-profit activities; and projects that exceed the investment cost of 8 million SR. Similar to SCSB, fund X does not fund activities that rely on non- Saudi employees to run the business, and do not fund projects that exceed 150,000 SR.

Table 7.7: Funding Activities and Types of SME Activities Considered for Funding

BANKS	Y	X	Kafalah	SCSB
All activities acceptable by Kafalah	All activities are acceptable	<ul style="list-style-type: none"> - No more than 150,000 SR - Do not rely on non-Saudi labour 	<ul style="list-style-type: none"> - Do not exceed 30 million SR annual turnover - Not service businesses - Do not rely on non-Saudi labour 	<ul style="list-style-type: none"> - Do not rely on non-Saudi labour - Any project not related to the other financing entities

Fund Y does not mind financing any business activities as long the business submits all required documents and guarantees:

We finance any businesses or individuals who can fulfil our requirements and provide an adequate personal guarantee (Interviewee Y).

7.2.2.4 Application Processing by Funding/Support Agencies, Time Required, Method, Actions and Follow up

Banks follow highly standardised and formalised systems for processing applications. As shown in Table 7.8, banks have three decision stages: acceptance of the application after checking whether the required documents are attached; evaluation of eligibility of the loan application and forwarding of the application to Kafalah; and sanctioning and disbursement of the loan amount once a Kafalah guarantee is received. Evaluation by all banks of reliability, ability to repay, macro-risks, sufficient collateral and owner characteristics is done by assessing the creditworthiness of individuals and firms, financial ratios, macro aspects, collateral or sponsorship, business plan, and includes an interview with the owner to assess their business management skills, and risks and their mitigation. Overall approvals generally take three to six

months, but this can be longer in some cases. Processing applications by Kafalah itself may take two to five months as they have only one office, located in Riyadh, to which all applications are sent.

All banks have special units to handle SME loan applications. However, they are located only in the three main cities (Jeddah, Riyadh and Dammam) and are not convenient for applicants in rural areas or other cities where most SMEs operate. This accessibility problem tends to deter SMEs from approaching banks.

Kafalah follows on from where the bank left off. It checks the credentials of the applicant, business plan, risks, and capacity to repay, before guaranteeing its share. Kafalah also assesses the initial approval by the bank, credit history of the applicant and the availability of collateral or personal guarantees (or legal) in case of project failure or payment default.

In the case of fund Y, the evaluation process begins with checking the application before agreeing to buy the asset for resale to give quick funds to the SME. However, strict application of standards by banks and other fund institutions may not always occur, as one interviewee suggested:

We assess the loan application by checking the application and credit history of the applicant if all conditions are met, then we decide to sell him/her the vehicle (Interviewee Y).

However, fund X follows procedures more like SCSB as it gives smaller loans as per SCSB eligibility. It evaluates credit history and liabilities to other financial organisations, checks if the applicant has existing private business ownerships, and assesses feasibility, personality and skills through interview. Financial risk is assessed from credit history.

In all cases, the agency may accept, request amendments or request further documentation and details, or reject the application at any stage. Each of these actions depends on many factors. After disbursing a loan, lenders usually check whether the loan is being used for the approved project in the agreed manner and whether the intended outcomes are being realised. They further monitor the financial performance of the investment and continuously assess the ability of the SME to repay the loan. If the need arises, lenders even provide limited assistance to steer the project towards success and to improve performance.

Table 7.8: Processing and Decision Making by Different Agencies

AGENCY	PROCESSING AND DECISION
Banks	Standardised and formalised system, with decisions at three stages: application acceptability, evaluation and Kafalah referral, sanctioned after Kafalah approval—3–6 months overall
Kafalah	Applicant’s credentials, risks, capacity to repay, collateral or sponsor adequacy, 2–5 months
Y	Application with ownership details, assets, collateral checked for genuineness of claims, ability to pay monthly instalments and collateral adequacy
X	Creditworthiness, other liabilities, chances of project success, ability to repay, collateral or sponsorship adequacy
SCSB	Same as X

7.2.2.5 Application Procedure—Documents Required

All agencies provided elaborate description of the application procedure and documents required.

In the case of banks, the SME can obtain the application form for their activity online or from the nearest branch. Some activities are excluded from funding, as mentioned in Section 7.2.2.3. Completed forms should be submitted to the SME unit at the head office located in Riyadh, Jeddah or Dammam, along with all required documents, which typically include copies of:

- Identification
- Commercial registration
- The enterprise’s foundation contract (if the enterprise is a company)
- The location’s rental or ownership contract enabling the practice of the activity
- Economic feasibility study or business plan
- Audited financial statements for three years
- Ownership documents (real estate, cars, etc.)
- Any further documents the bank requires.

These documents are requested mainly to establish credibility of the business, the owner's identity, the current status of the business, the economic viability of the project for which funding is needed, and other related details.

Fund Y requires the following documents to be submitted with a loan application:

- Commercial registration
- Enrolment at a chamber of commerce
- Identity of the owner of the enterprise or business
- Driving license of the owner
- Lease facility
- Contract rent housing facility owner
- Availability of personal guarantee
- Bank account statements for the previous six months
- Proof that the applicant earns not less than 7,500 sr per month.

These documents are to establish the genuineness of the business and the owner, details of the asset sold and to ensure sufficiency of collateral.

Fund X requires the applicant to contact the assigned agency for training and assistance in preparation of application and required documents. Only those projects that qualify under SCSB are considered.

The requirements of Kafalah are the same as those of the corresponding banks. It further requires written consent from the owner of the firm to apply to the Kafalah programme and to endorse the collateral provided for the loan.

It takes substantial time for applicants to procure all the required documents and prepare a business plan. Finding suitable sponsorship in the absence of sufficient collateral may also be a problem.

Table 7.9: Application Procedure and Documents Required by Different Agencies

AGENCY	APPLICATION PROCEDURE/DOCUMENTS REQUIRED
Banks	Prescribed form, documents to prove ownership, regulatory validity, fund requirements, eligibility proof, viability of business and repayment ability
Y	Validity of ownership of assets and collateral, and ability to pay instalments
Kafalah	Validity of business and owner credentials, and ability to repay with collateral/guarantor support
SCSB	Viable project with developed skills
X	Same as for SCSB

7.3 OBSTACLES FACING BANKS REGARDING LOAN APPLICATIONS

Lack of access to bank credit is a key obstacle to the success of SMEs. This study asserts that SMEs face difficulties in securing finance from Saudi banks. However, some studies (e.g. Berry et al. 1993b; Junjie 2008; Torre et al. 2010) report that banks cannot lend to SMEs that are opaque or unable to meet the required conditions. Hence, banks will face difficulties in verifying the capability of SMEs to repay a loan, and it will be hard for these enterprises to build up a good relationship with banks or other financial providers. In order to measure obstacles facing banks with loan applications from SMEs, this study investigated the main factors contributing to the rejection of loan applications through three sub-themes: owner and firm characteristics; meeting loan requirements; risks involved, and reasons why banks and other financial institutions are reluctant to finance SMEs.

7.3.1 Reasons for Rejecting Loan Applications

The discussion in this main theme is designed around study aims (1, 4, 6 and 8) in order to answer research questions (1, 4, 10 and 12) related to these objectives. The following have been identified as the main factors contributing to the rejection of loan applications:

- Owner and firm factors
- Meeting requirements and risks involved
- Reasons for banks' reluctance to fund SMEs.

Financial institutions consider factors such as owner and business characteristics when evaluating loan application. The application assessment process continues to evaluate all required documents and conditions as well as the risks involved with the applicant's project. Following is a discussion on the responses of the interviewees.

7.3.1.1 Owner and Business Characteristics

All lenders interviewed consider education and experience as the main borrower-related factors to evaluate an applicant's skills and knowledge, and they are willing to substitute one for the other. One bank interviewee said:

Most of the younger generation will fulfil the education requirements. However, they may not have experience until they work in some SMEs before applying for their own independent business (Interviewee C).

Gender bias does not exist in banks or at any other financial institutions, according to an SCSB interviewee:

We at the SCSB don't differentiate between males and females in our loan policy and conditions or when we evaluate the application (Interviewee SCSB).

When bank interviewees were asked about their concerns regarding the four main business characteristics (business size, business ownership, business plan, and growth and profit of the firm) all agreed that the size of the business is an important factor:

As long as the business has an annual sales turnover of more than 300,000 SR we will consider its application; less than that, the applicant can apply only for a personal loan or credit card (Interviewee C).

Another interviewee commented that Saudi banks have been encouraged to finance SMEs through the availability of the Kafalah programme:

During the last 20 years we were focusing on serving big businesses; however, with the encouragement of the Saudi government to finance SMEs through the Kafalah programme, our bank started to consider financing this sector under this programme only (Interviewee B).

All lenders interviewed stressed the importance of an acceptable business plan, accompanied by a financial plan including cash flow statements from the business. This appears to be a strict requirement of all lenders that is used to assess the growth potential and profitability ratios of

the firm, and to identify default risk. All banks agreed that the type of business does not affect the application assessment. One interviewee said:

It's essential that the business proves its growth and financial performance (Interviewee D).

As long as the business registers officially at the Ministry of Trade we can consider the loan application; however, the requirements for large companies are different from SMEs (Interviewee E).

Of the four business characteristics mentioned above, SCSB and fund X assess only business plans, although both assess growth potential and sustainability of demand for products or services:

If the business has no or less potential of growing in the market we as a government fund won't finance such risky business (Interviewee SCSB).

Fund Y only considers the education and experience of the applicants as the main factors to assess the loan application. The requirement for a personal guarantee by this lender shifts the risk away from them and therefore the performance of the business is not relevant.

7.3.1.2 Meeting Requirements and Risks Involved

Banks are generally reluctant to fund SMEs because of repayment risks, lack of proper records, inadequate business plans, weak strategies, lack of collateral or Kafalah support, high administrative costs, and high transaction costs.

The main reasons for rejecting an application (see Table 7.10) are lack of collateral, lack of financial statements, poor business performance, poor industry conditions, unrealistic business plans, bad credit history, project not run by the owner, incomplete information, the owner has other financial obligations, the project is not on Kafalah's activities list, opaque financial conditions (which make it difficult to assess repayment capacity), shortage of skilled manpower, weak organisational structure and operations of enterprises, unclear business strategies, high business risk, not passing the personal interview, and inadequate education or experience of owners so that non-Saudis run the operations. One of the interviewees said that:

One of the problems we at the bank face when performing credit analysis of SME financial statements is that they provide improper and unaudited or opaque

financial statements, which make it hard to convince the bank of their capacity to repay the loan. The bank cannot fund such businesses as they are unable to prove their financial capability (Interviewee C).

Another participant added:

We don't receive any lending applications from SMEs without a business plan; the bank needs to know the viability of the project and its potential for market success, yet most business plans either lack reliable data or exaggerate expectations, and this could be one of the main reasons most applications are rejected (Interviewee B).

In contrast, the reasons for rejected loan applications from SMEs to fund Y are insufficient salary, financial obligations with other financial institutions, lack of a personal guarantor, and absent or insufficient collateral. Fund X rejects applications that are not qualified to undertake the approved activities, have bad credit history, or provide no or inadequate collateral or personal guarantee.

Kafalah rejections occur if there is inadequate or no collateral, an unclear or unrealistic business plan, poor financial conditions, reliance on non-Saudis for project execution, or if the activity is not eligible for support. SCSB rejects applicant that are not qualified in the domain of an approved activity or is a non-Saudi, has a poor credit history, inadequate collateral or personal sponsorship, small unlicensed business, ownership of an existing business or is not sufficiently qualified in the relevant activity.

The banks, fund X and SCSB employ credit risk assessment and scoring methods to evaluate the risk involved in the transaction. Higher risk attracts stricter conditions and higher interest, and possibly additional charges.

These problems aggravate the difficulty of SME access to funds. Although training and consultancies are provided, they are beneficial only to a small fraction of SMEs. Funding organisations cannot risk their money, so their apprehension is justified. The Kafalah programme has been ineffective in significantly increasing SME coverage.

7.3.1.3 Problems Sanctioning Loans Leading to Reluctance to Fund SMEs—Risks and Credit Scoring

Some banks cite Basel III requirements for reducing loan risks arising from recent global economic crises. Thus, all banks, as shown in Table 7.9, are reluctant to fund projects for which they are even slightly suspicious of the applicant’s repayment capacity. Although this apprehension applies equally to corporates and SMEs, the concern is less in the case of the former as they are well established with professional management and can easily provide security, as one interviewee commented:

No bank would like to carry high percentages of NPA in the form of unrecovered loans. Many countries have regulations not permitting banks to exceed certain level of NPA (Interviewee A).

Table 7.10: Reasons for Rejection and Reluctance to Fund SMEs, and Risk Assessment Methods used by Different Agencies

Agency	Rejection	Reluctance	Risk and credit scoring
Banks	Lack of collateral, lack of financial statements, poor business performance, poor credit history, poor macro-conditions, unrealistic business plans, project run by another person, non-Saudi workers, incomplete information, other financial obligations, not a listed activity by Kafalah, high business risk, inadequate education or experience of applicant, or not passing the interview	Repayment risks, no proper account keeping, inadequate business plan, weak strategies, lack of collateral or Kafalah support, high administrative and transaction costs, or labour regulations	Credit history, creditworthiness and financial conditions
Kafalah	Inadequate or no collateral, unclear or unrealistic business plans, poor financial conditions, reliance on non-Saudis for project execution, or activity not eligible for support	Not supported by bank	Credit history, creditworthiness, financial conditions, cash flow, other financial obligations, assets, income, business plan, interview to assess capability
Y	Insufficient salary, financial obligations with other financial institutions, no personal guarantor, or absent or insufficient collateral	Not reluctant	No formal risk assessment except checking with trade organisations about liabilities

Agency	Rejection	Reluctance	Risk and credit scoring
X	Not qualified under approved activities, bad credit history, or absent or inadequate collateral or personal guarantee	more than 150000 SR loan amount	Credit history records
SCSB	Not qualified in the domain of approved activities, poor credit history, inadequate collateral or personal sponsorship, non-Saudi applicant, small unlicensed business, ownership of any existing business or not sufficiently qualified in the area of the relevant activity	No fit with criteria and existing projects	Credit history, assessment of ability to repay, source of income, fixed assets owned and given as collateral, scoring is done

At the operational level, high administrative and transaction costs associated with high credit risk cannot be covered simply by charging high interest rates. One interviewee said:

Whatever is the interest rate, if the loan is unpaid, it is of little significance (Interviewee D).

Most of the banks agreed that the main reason for their reluctance to fund SMEs is because of the high risks and uncertainties:

Generally speaking, the main difficulties that our bank faces when financing this sector is the high risk of failure, especially with the lack of experience and management skills of most Saudi entrepreneurs (Interviewee B).

Another said:

Some prominent challenges that we face with SMEs are weak administrative systems, lack of collateral, blurred vision and absence of clear strategies of these firms with weak business plans for the project, lack of or insufficient information, successive regulations of the Ministry of Labour that have lifted burdens on this sector, and poor accounting and financial recording due to integrating personal and business accounts (Interviewee E).

Some banks (A, C, D) indicated that instability in the labour market introduced by the policy to increase employment of Saudi citizens has had an effect on loan approvals. The requirement for mandatory employment of Saudi workers has increased the level of risk faced by businesses and reduced the success rate of loan applications.

7.4 AVAILABILITY OF ISLAMIC FINANCIAL PRODUCTS FOR SMES

Islamic finance is witnessing significant growth and has gained significant attention in international finance over the last decade (Khan & Bhatti 2008). According to IFC (2014), up to 90 per cent of SMEs in Saudi Arabia are looking for *sharia*-compliant banking products and services. An objective of the present study was to identify currently available *sharia*-compliant financial products and services provided by Saudi banks and other financial institutions that are suitable for financing SMEs.

7.4.1 Financial Facilities Available for SMEs

This main theme is around the study objects (6, 7 and 9) and designed to answer research questions (6, 11 and 12) related to current finance products; services provided by banks and other participating financial institutions for financing SMEs; currently available *sharia*-compliant financial products in the Saudi Arabian market; and the relationship between Saudi banks and SMEs. The financial facilities available to SMEs are discussed below under the themes products and services; recovery procedures; relationship with SMEs; and future outlook.

7.4.1.1 Products and Services

All routine banking facilities are available for SMEs, without any special privileges or constraints, as shown in Table 7.11.

Apart from routine products and services like commercial loans, personal loans and overdraft facilities, SMEs are offered a choice of Islamic products. In the case of banks and Kafalah, these include Murabaha, Ijara and Tawarq. Banks are generally reluctant to share risk with borrowers and therefore do not offer *sharia*-based contracts such as Musharaka and Mudaraba, which stipulate risk-sharing contracts. Islamic credit cards are given by three banks (A, E, D). Most of the participant banks prefer Murabaha and Ijara for financing SMEs as those products

are less risky and have high profit with no involvement in sharing profit or loss with the borrowers. Other Islamic finance products like bay' al-salam and Istesnae are not provided by Saudi banks.

In the same way, SCSB and funds X and Y concentrate on lending to SMEs through either Murabaha or Ijara as these are less risky, with higher returns. However, only SCSB and fund X provide training and consultant programmes for entrepreneurs in potential new start-up businesses. They also provide guidance and embrace projects by providing a group of specialists in entrepreneurship to help SMEs obtain financing and assist them with the preparation of feasibility studies for the project.

7.4.1.2 Recovery Procedures

Participants were asked about the action taken and any assistance provided in the event of a borrower falling behind with their monthly payments, or an outright default. The responses are summarised in Table 7.12. Banks offer a three-month grace period with repeated notices to the borrower to repay balance amounts immediately. This is followed by direct legal action. If the money cannot be recovered with legal action, the lender pursues the guarantors for the balance remaining after recovering 80 per cent from Kafalah. Fund Y has a similar policy.

Table 7.11: Facilitation of SMEs by Different Agencies

Agency	Routine services accessible to all including SMEs	Specialised SME services	Islamic finance products	Training and consultancies
Banks	Account, business cards, export–import facilitation, online banking, point of sale, direct debit, employee payroll card, employee savings plan and other business services available to business	Islamic credit card	Murabaha, Ijara, Tawarq, and other products listed but not provided to SMEs (Musharaka Mudaraba) due to high risks	Kafalah programme Bank D offers a special tool kit
Y	None	None	Murabaha, Ijara	
SCSB			Murabaha, Ijara	Training and consultants, projects embraced by a group of specialists in entrepreneurship business who help obtain financing and assist in the preparation feasibility studies for the project
X			Murabaha, Ijara	Same as SCSB

Table 7.12: Recovery Procedures used by Different Agencies

Agency	Recovery Procedures
Banks	After a 3-month wait, lawsuits are raised to claim the amount and after Kafalah pays the bank, sponsors may be asked to pay the outstanding amount
Y	After 3 months of default, recovery from guarantor, legal action
X	Find reasons for default and offer solutions, help the borrower to solve problems, participate in project management or charge other management costs, sell the assets, recover from guarantor
Kafalah	Analyse causes of default and develop appropriate solutions in cooperation with the two parties. Assist the borrower to solve problem faced with the project. Participate in the management of the project directly or assign other appropriate management and charge costs to the project budget. Sell the assets of the project. Institute legal action if the borrower does not cooperate with corrective actions after a 3-month grace period
SCSB	Same as Kafalah

Fund X has a different approach to handling breaches of repayment and defaults via its own dedicated loan recovery unit. It initially attempts to find the reason for the breach and engages with the borrower to offer a range of solutions, such as helping the borrower solve the identified problems and participating in project management. Failing all of this, it then proceeds with recovering the money by selling the assets or pursuing the guarantor.

Kafalah and SCSB have approaches similar to that of fund X, but offer a three-month grace period and take legal action only if the borrower does not cooperate with the suggested corrective actions.

All the agencies charge management fees for engaging in corrective actions with the lender. Thus, all agencies follow a sequence of steps to recover default payments before finally pursuing collateral or guarantors. Sufficient time is allowed to repay the accrued amount. In some cases, restructuring of outstanding payments is also considered.

7.4.1.3 Future Outlook for Lending Market—Scope for Credit Expansion to SMEs

All agencies agree that there is much scope for increasing funding for SMEs due to their rapid growth in number, sphere of activities and locations. Thus, their contribution to economic growth and employment also increases. One bank participant said:

We at bank D are keen to develop and improve business relations between the bank and SMEs through developing new products and services to this sector (Interviewee D).

Another participant added:

Our bank looks forward to improving the loans policies for SMEs especially given the bright future for this sector in the national economy. We recognise the various needs of SME clients, and have set up dedicated credit programmes and relationship management teams to respond to their needs (Interviewee B).

However, all the banks agreed that at the same time, SMEs need to show improvement in managing their businesses to enhance performance, maintain a good credit record and improve their financial transaction recording.

In addition, participants from banks A, E, D, and SCSB suggest that in order to enhance their relationships with SMEs, they need more units, more branches in other towns and rural areas, and should expand the guarantee scheme. Bank E commented:

Besides the Kafalah programme, the government should establish interest rate-supported programmes to encourage banks to decrease the interest rate under favourable conditions (Interviewee E).

Kafalah and SCSB interviewees stated that a high percentage of SME owners are not aware of their programmes and this could be preventing SMEs from accessing finance; they attributed this to a lack of education, publicity and promotion about their programmes.

Banks also were asked about their currently available Islamic finance products and the possibility of developing suitable new products in order to meet the funding needs of SMEs. All five banks preferred to finance SMEs through Murabaha or Ijara as these are less risky than other products, such as Musharaka and Mudaraba. All the banks said that they have a special department to assess the *sharia* compliance of financial contracts.

7.5 SUMMARY

This chapter discussed data gathered from interviews conducted to further explore the problems faced by the Saudi SME sector in obtaining finance from banks and other financial institutions. The interview sample included five banks, two private agencies and two government agencies. The interview topics were categorised into four main themes related to various aspects of SME funding, and generated discussions and analysis in relation to questions around the implemented conceptual framework that linked and was related to the research objectives and questions. The following is a summary of the findings of the chapter.

Variations in the definition of SME between banks and Kafalah may exclude SMEs that have less than 2 million SR in annual sales. This needs to be rectified by removing the lower limit set by Kafalah.

A Kafalah guarantee is available only for existing SMEs and is the only guaranteeing agency for bank loans to SMEs. The policy of banks, in general, is to finance only existing SMEs that have healthy financial statements covering three years and are covered by the Kafalah programme. It appears that relaxing this restriction would lead to more SMEs having their funding needs met.

Some lenders provide interest-free loans only for new start-up projects costing between 150,000 and 300,000 SR, and exclude firms owned by non-Saudi citizens. This policy, although satisfying certain needs, could be seen as unfair under competition laws. It should be revised to be more inclusive or be modified to be accessible to all entrepreneurs with possible concessions to Saudi-owned businesses.

All lenders impose loan conditions and lending requirements before granting a loan to SMEs that are mainly around the financial viability of the applicant, feasibility of the proposed investment, and the risk of default. Certain business activities are also excluded from access to loans. These are generally in the sectors that are predominantly owned and managed by non-Saudi citizens. Private funds are more relaxed with this condition.

The predominant reason for loan applications covers the areas of procuring of fixed assets, working capital needs, and international trading where the period of the loans ranges from three to seven years. The interest charged is usually between 6 and 8 per cent, with higher risk applicants paying up to 12 per cent. Loans that are not covered by Kafalah applicants can opt for direct (asset-based) funding, requiring higher security and incurring commercial interest rates.

All lenders require detailed documentation in order for the lender be satisfied with the viability of the business and the investment being funded, and that the lender's exposure is within their policy conditions. In general, the time it takes to evaluate loan applications is between three and six months. If a Kafalah guarantee is applied for, this could add a further two to five months to the process.

All banks have special units to handle SME loan applications and the processing of these applications is carried out in regional cities and is not available in rural areas. The fact that all applications are in paper form and should be lodged in person acts as a limitation on SMEs in rural areas. It could very well be that the ones in rural areas are the most needy.

Some lenders offer training and consultancy services to borrowers, on a fee-for-service basis, with a view to improving the performance of their business.

The reasons for lack of success with a loan application relate to deficiencies in the documents furnished: lack of collateral or sponsorship, lack of financial statements, unrealistic business plans, incomplete information, and unacceptable owner and business characteristics have been identified as the main factors of large-scale rejections. These lead to reluctance among lenders to approve loans, and higher cost of borrowing. Deficiencies in documents can be minimised with proper training of owners, but only a very few attend training programmes. The capacity for training a large number of SME owners needs to be increased using multiple agencies across the country.

All agencies give three months' notice when any breach of repayments occurs. They also offer various solutions ranging from general advice to engaging with the borrower to improve the performance of their business. When all these steps fail, the loan balance is recovered from the borrower or the guarantor. When this fails, assets are sold for recovery. The final step is legal action, which does not benefit the lender because the usual punishment is imprisonment of the borrower.

Saudi banks offer a limited number of Islamic products such as Murabaha, Ijara and Tawarruq. Banks do not provide Musharaka and Mudaraba contracts because of the imbedded risk-sharing aspects of these contracts. There is a widespread desire among businesses to source funding under these contracts, and this needs to be met. The number of Islamic products provided by banks remains limited and needs reengineering to increase the number of SMEs applying for bank credit.

CHAPTER 8: SUMMARY AND DISCUSSION

8.1 INTRODUCTION

Chapters 6 and 7 presented data analysis intended to address the study questions. This chapter is divided into five sections; the first discusses the findings in relation to the study objectives and related theories. This is followed by the conclusions and implications arising from this research. Recommendations for improving access to finance for SMEs in Saudi Arabia are presented in the third section. The fourth and fifth sections, respectively, make suggestions for future research and conclude with the key findings of the study.

8.2 RESEARCH OBJECTIVES AND MAJOR FINDINGS

This research is an attempt to identify the financial constraints on Saudi Arabian SMEs with respect to access to bank credit and the effect of this on performance. Therefore, it has revolved around four important issues: the effect of the characteristics of owners/managers, businesses and financial institutions on SME access to bank finance; the effect of difficulties in obtaining finance from Saudi banks on SME performance; the effect of internal and external obstacles on SME business performance; and *sharia*-compliant finance products available to SMEs. To achieve these objectives, 270 Saudi SME entrepreneur participants were surveyed through face-to-face questionnaires and online surveys. The study also involved structured interviews to collect data from five Saudi banks and four government and private specialised credit institutions. Chi-square tests, *t*-tests, correlations and ANOVAs were used to test the hypotheses and to meet the objectives of the study.

To highlight the contributions of the research, this section combines the results of the empirical analysis to facilitate an integrated discussion of the hypotheses. Thus, this section addresses three main issues. The first is sources of finance available to Saudi SMEs, the requirements of banks and other financial institutions providing funds, and the products and services provided by Saudi banks to finance SMEs. The second section discusses the results of hypothesis testing about the association between owner/manager characteristics, business characteristics and

access to finance. The last section covers internal and external business obstacles that affect SME business performance.

8.2.1 Available Sources of Finance for Saudi SMEs

The first objective of this study was to identify available sources of finance for Saudi SMEs. As SMEs need finance at different stages of their life cycle from establishment, through to the phases of development and growth, the study identified the sources of finance at the start-up stage of a business's life and following establishment. The results showed that 77.2 per cent of SMEs in Saudi Arabia usually rely on informal sources such as their personal savings or borrowing from close family members or friends: 47.7 per cent had used their personal resources to finance the commencement of their business, and 29.5 per cent had obtained funds from their relatives or friends. Only 8.0 per cent obtained their start-up finance from banks, 5.7 per cent from government funds and 8.9 per cent from VC. Hence, most new Saudi SMEs consider personal saving or loans from family and friends as the main source of equity finance (Ganbold 2008; Porter 2008).

These results strongly support the findings of other studies of Saudi SMEs conducted by Hajjar (1989) and Binzomah (2008), which found that most SMEs obtained start-up finance from informal sources (92 and 75 per cent, respectively). This confirms that most SMEs in Saudi Arabia rely on their personal savings and support from relatives or friends for financing their start-up businesses; only a low percentage have access to banks and government funds for initial financing. One reason for this is that Saudi banks are not willing to fund start-up businesses because the Kafalah programme does not provide guarantees at the establishment stage, and the majority of SMEs lack collateral and clear financial information. This argument is supported by other studies (Abor & Biekpe 2005; Baxter & Jack 2008; IFC 2012; Kushnir 2010; Maas & Herrington 2006) showing that banks are more comfortable financing firms that have adequate tangible assets in order to mitigate the risks associated with information asymmetry and moral hazard. According to interview data from Kafalah, the programme prefers to guarantee existing businesses that have three years of audited financial statements with good cash flow. Another problem for Saudi SMEs is that government funding policies focus mainly on Saudi entrepreneurs who do not have any other existing businesses. This can exclude a large number

of SMEs from finance for their new start-up businesses from both banks and government funds. This may be another reason for low coverage of SMEs at establishment stage.

The study found also that 74.2 per cent did not apply for loans from government funds, and 65.3 per cent did not know about the Kafalah programme. Thus, 43.5 and 64.1 per cent of Saudi SMEs are unaware of government funds and the Kafalah scheme, respectively. This reflects the findings of Abor and Biekpe (2005) who attribute this lack of awareness to inadequate and ineffective marketing communication adopted by these financial providers, which thus need to spend more on advertising to increase awareness among entrepreneurs of their financial programmes.

An interesting finding is that a very low percentage of Saudi entrepreneurs (1.4 per cent) used Islamic banks for financing their start-up business; 33.9 per cent of these did not apply for bank loans for religion reasons, and 50.6 per cent were not satisfied with the limited Islamic finance products that Saudi banks currently provide. These results are consistent with the finding of Dabo (2006) that some respondents believed that Islamic products offered by Nigerian banks are not consistent with Islamic principles. This indicates that Islamic finance products offered by Saudi banks are limited and need to develop compliance with *sharia*.

However, after the establishment of a business, it goes through various stages of development that require more funds in response to changing market conditions. At this stage, most SME owners/managers are anxious to develop their businesses but are concerned about the limited availability of medium- and long-term loans, which could impede expansion (Bates 1990). At this stage, around 22.3 per cent of Saudi entrepreneurs seek finance to increase their working capital to prevent liquidity problems, 16.1 per cent to cover their short-term liabilities, 14.8 per cent seek production process costs, 12.4 per cent seek fixed asset purchasing costs, and 11.5 per cent seek costs to purchase equipment/vehicles. Overall, 37.7 per cent indicated that they had used their business's retained earnings as the first source of finance when they required additional funds for their business. Further, 22.3 per cent of owners/managers had obtained equity from their own personal savings or via family assistance, and 19.9 per cent borrowed from friends to obtain the necessary capital to expand their own business. Only a small proportion (3.1 per cent) sought finance from banks or resorted to government funding; 3.8 per

cent to obtain more funds for their business. These results are consistent with the findings of Hajjar (1989) in Saudi Arabia, Sarapaivanich (2006) in Thailand and Quartey (2003) for firms in Ghana, showing that owners/managers utilise internal equity as the main source of finance for their businesses before resorting to external sources. These findings also support the pecking order theory proposed by Myers (1984), in that Saudi SMEs choose to obtain funding from the cheapest and easiest source before gradually moving to the next least expensive option. In fact, the pecking order framework theory is relying on the implications drawn from information asymmetry. In other word, the study found that the Saudi SMEs that have no information asymmetry depend on internally generated funds to cover their financial needs. In this case, internal sources of funds such as retained earnings, personal savings and family assistance are considered to be the cheapest, followed by debt then external equity.

Only 5.5 and 8.9 per cent of the participants obtained funds from VC respectively after and before the start-up phase, which is low compared to other countries such as the US, UK and India where VC is a significant source of external funding for SMEs (Baleadi 2008; Rosly & Abu Bakar 2003). In Saudi Arabia, VC funds are still at an early stage of development and growth, although the Saudi government has recently pushed and encouraged for more VC equity financing for SMEs (MENAPEA 2012). Also, the SAGIA and the American Venture Capital Firm have established a US\$100 million Saudi VC fund to provide growth capital and late-stage VC to Saudi SMEs (OECD 2006c). None of the Saudi entrepreneurs in this study obtained finance from angel investors, which may be due to entrepreneurs taking time to find a suitable investor with the right expertise and interest—inappropriate angel investors can be disadvantageous for a business. Angel investors typically have a share of the ownership and take a certain portion of the profit; they also have the decision-making authority in some cases, which business owners/managers find disadvantageous (Iqbal & Llewellyn 2002; Wilson 2002). However, according to the Badir Programme for Technology Incubators, there are almost 290,000 angel business investors in Saudi Arabia willing to direct their investments towards potential growth projects in the field of information and communication technology (Badir 2013).

Generally, Saudi entrepreneurs preferred to use internal finance as they face restrictions from Saudi banks, which require provision of fixed assets as collateral with a value twice the amount of the funding. The majority of Saudi entrepreneurs (66.1 per cent) in this study find bank

procedures and loan conditions are complicated and say it is difficult to obtain finance. Some complain that one of the main reasons dissuading them from applying for bank loans is the length of time taken to process the loan application, which may be three to six months or more. Kafalah itself may take two to five months as they have only one head office located in Riyadh to which all the applications are sent. All banks have special units to handle SME loans applications, but these also are located only in the main cities; there are none in rural areas or other cities where most SMEs operate. This accessibility problem tends to discourage SMEs from approaching banks. Of the more than 850,000 SMEs in the country, only a few apply and very few (4,371 SMEs–7,280 guarantees) had been granted between the Kafalah programme's launch in 2006 and 2014 (SIDF 2014b).

In addition, Saudi banks normally charge between 6 and 8 per cent interest, although this may be as high as 12 per cent when the risk of the applicant is higher. These interest rates are high compared to some countries such as Hungary (1.6 per cent), Slovakia (2.2 per cent), Colombia (3.9 per cent) Switzerland (4.3 per cent), Greece (4.7 per cent) and Turkey where loans are virtually interest free (Demirgüç-Kunt et al. 2008). Most of these countries have interest rate-supported programmes to enable SME access to funds in order to benefit from bank credits at favourable conditions (KOSGEB 2012; OECD 2013). One possible reason for the high interest rates charged by Saudi banks is the information asymmetry that exists between them and Saudi SME owners that apply for loans, resulting in adverse selection. The lack of funding from Saudi banks faced by most projects equates to a financing gap as mentioned in literature (Mazanai & Fatoki 2012; Park et al. 2008). This financing gap may arise due to uncertainties associated with asymmetric information and agency problems, which increase the risks of lending. On this basis, banks operate under a moral hazard and adverse selection risk and may charge high interest rates, leaving high-risk borrowers without credit (Mazanai & Fatoki 2012). Consequently, Saudi banks charge higher interest rates (due to the cost of risk assessment and supervision) and require higher levels of collateral to reduce the negative effects of information asymmetry and to cover the high risk of bad debts (Abor & Biekpe 2005; Baxter & Jack 2008). As most Saudi SMEs (69.4 per cent) do not have adequate collateral to provide as a guarantee, Saudi banks encourage SMEs to only apply for loans through the Kafalah programme. Most studies related to financing SMEs (Al-Kharusi 2003; IFC 2012; Quartey 2003; Qureshi & Herani 2011; Sarapaivanich 2006) have found that asymmetric information affects SME access to bank credit and is therefore one of the main obstacles to them obtaining external finance.

These findings also support the information asymmetry theory of Modigliani & Miller (1963) and Stiglitz and Weiss (1981a) as outlined in Section 4.2.1. Most studies related to financing for SMEs report that asymmetric information affects SME access to bank credit (Dembe & Boden 2000; Demirgüç-Kunt et al. 2008; Mazanai & Fatoki 2012). Thus, one can consider asymmetric information as one of the main constraints to obtaining external finance. Thus, when information asymmetry exists, Saudi banks can do one of the following when evaluating loan applications from SME: (1) accept the loan application but with a high risk-adjusted interest rate and under the Kafalah programme; (2) accept the application with the imposition of high collateral requirements; or (3) reject the loan application (Lehmann & Neuberger 2001).

The results also indicate that most loan applications from SMEs failed because of 'lack of collateral, lack of financial statements, poor business performance, poor industry conditions, unrealistic business plan, bad credit history, project not run by owner, incomplete information, owner has other financial obligations, project not in the activities list for Kafalah, financial conditions are opaque which difficulties to know their capacity to pay, shortage of skilled manpower, weak organisational structure and operations of enterprises, unclear business strategy, high business risk, not passing the personal interview, and inadequate education or experience of owner so that non-Saudis run the operations. Therefore, Saudi banks emphasise the provision of adequate collateral, a reliable and feasible business plan, and audited and accurate financial information as being essential for assessing both the commercial viability of a project, and its ability to repay the debt. The results also indicate that banks are reluctant to finance start-up businesses and prefer to provide loans to established businesses that have a number of years of experience and sufficient financial information. These results suggest that firms failed to obtain finance not because of their risky projects but because they have not presented or demonstrated their projects in the form of an appropriate and viable plan. Hence, SMEs that were able to show a detailed rationale in a well-formulated business plan for the development and expansion of their business and provide adequate security (collateral) would have increased success rates in accessing bank finance (Al-Kharusi 2003).

8.2.2 Influence of Business and Owner Characteristics on Access to Finance

The second objective of this study is to determine, through statistical hypothesis testing, if there is a significant association between owner/manager or business characteristics and access to finance. Accordingly, the initial hypotheses (H1, H2 and H3) were developed to test whether SME owner/manager characteristics such as gender, level of education and training, and business experience influence access to finance from banks. Hypotheses H4–H7 were developed with regards to whether business characteristics of SMEs such as business, business type, business plan, market share, growth and profit have an effect on access to finance from Saudi banks.

H1a: The level of owner/manager education and training has a significant effect on the decision to apply for finance.

H1b: The level of owner/manager education and training has a significant effect on the difficulty in accessing finance from Saudi banks

These hypotheses were not supported. The relationship between level of education and training of SME owners/managers and access to finance was introduced in Section 3.4.5.2. Even though Saudi banks preferred applicants with high knowledge and good education, this study revealed that the level of education and training of owners/managers has no significant influence either on their decision to apply for bank credit or on the difficulties they have obtaining finance from Saudi banks. Although some studies have shown an association between education and difficulties in access to finance, Dabo (2006) and Al-Kharusi (2003) found no significant association between level of education of SME owners/managers and either their decision to apply for funds or their difficulty in accessing bank credit. However, it was observed that a higher proportion (~40 per cent) of owners/managers with at least a bachelor's degree had fewer difficulties in obtaining finance from Saudi banks. Looking at the results of this test in conjunction with the results from the previous one (Table 6.41), it could be concluded that there is a non-significant but positive association between higher levels of education of owners/managers, their decision to apply for finance, and facing fewer difficulties in accessing finance from Saudi banks. This is consistent with the findings of Saffu et al. (2006), Parker

(2004), and Irwin and Scott (2009), who found no significant effect on raising bank finance, where people with higher degrees have the least difficulty in raising finance.

H2: The owner/manager experience has a significant effect on the decision to apply for finance and the difficulty in accessing finance

An entrepreneur's level of experience plays an important role in the success of their business. In this study, more than one-third ($n=121$, 44.8 per cent) of respondents indicated that they had between 6 and 10 years of experience when they started their business (Table 6.4). An almost equal proportion ($n=109$, 40.4 per cent) indicated that they had between 1 and 5 years of experience. As reported in some other studies (e.g. Hustede & Pulver 1992; Kvale 1996), an owner/manager's business experience had no effect on their decision to apply for a loan or access to finance. Most banks (see Section 7.3.1.1) consider the experience of owners/managers as an indication of whether they have the knowledge and skills required to manage the business, and therefore the risks involved in funding them (Bukvic & Bartlett 2003). This study found that more than 63 per cent of participants with less than 5 years' experience decided to apply for loans from Saudi banks, which could indicate that relatively less experienced owners/managers need more assistance with their finance. Another way of looking at this phenomenon is that less established businesses are more likely to apply for a loan compared to more established businesses. In contrast, owners/managers with more than 5 years' experience used finance from internal equity and this may be due to the fact that they have less experience than the people with more than 5 years' experience or may not be confident in their ability to access external finance.

H3: The owners/managers' gender has a positive effect on the decision to apply for finance and have relationship with difficulty in accessing finance

This hypothesis was not supported. The majority ($n=211$, 78.4 per cent) of interviewees were male (Table 6.1) and Saudi men and women had the same difficulties with access to finance from Saudi banks. This result strongly supports the findings of Irwin and Scott (2009), who investigated the barriers to raising bank finance faced by SMEs in the UK, specifically the effect

of personal characteristics (ethnicity, gender and education), finding that gender has no significant influence on access to bank credit. The results of this study provide a good indication that Saudi banks do not differentiate between men and women in their loan policies, terms or conditions. Saudi banks and other Saudi financial institutions do not consider the gender of SME owners/managers in their loan conditions. However, a larger proportion (67.2 per cent) of female owners/managers reported applying for a loan. This could be indicative of female owners/managers needing more assistance with their finance, as in the study of Danish and Smith (2011), which analysed the challenges and constraints on SMEs owned by Saudi females. They found that less than 3 per cent of these finance their businesses through commercial banks; the main funding source was personal finance (personal savings and family or friends' resources).

H4: The business size has a significant association with the decision to apply for External Finance and the difficulty in accessing finance from Saudi Banks

As outlined in Section 2.4, this study adopted the definitions of SMEs given by the Ministry of Finance and MCI in Saudi Arabia. According to their classification system, firms with an annual sales turnover up to 5 million SR (US\$1.3 million) are considered small enterprises, and those with between 5 and 30 million SR (US\$1.3-8 million) annual sales turnovers are considered as medium enterprises. Also, any enterprise with number of employees between 6 and 99 is considered an SME. However, definitions of SMEs vary in Saudi Arabia: Saudi banks define them as any business with annual sales turnover of less than 30 million SR. However, as Kafalah is the basis for banks to give loans, its definition is the most pertinent: SMEs are businesses with 2–30 million SR in sales. Banks do not set a lower limit on sales turnover; they simply say 'not more than 30 million SR'. Thus, it is not clear where businesses of less than 2 million SR annual turnovers stand. If such a business applies for a loan, will Kafalah support it and will a bank fund it as an SME? Or is there a category of micro-enterprises that would include them? If not, the large number of small businesses that are in this category may be excluded from funding. This can contribute to low coverage of SMEs in Saudi Arabia. Differences in the definition of SMEs between banks and Kafalah may exclude those SMEs with less than 2 million SR in sales. This needs to be rectified by removing the lower limit set by Kafalah. Inconsistencies in SME definitions may lead to distortions in lending policies for this sector,

and problems for financial providers in determining the size of a business when making a financing decision (Gibson & Vaart 2008).

The hypothesis relating to the size of businesses based on their number of employees was not supported: there was no association between the employment size of small businesses, and either their need for bank finance or difficulties in the process of obtaining finance from Saudi banks. This result strongly supports the findings of Al-Kharusi (2003) for Oman SMEs: there was no significant relationship between the number of employees and the decision to apply or access to external finance.

Further, the hypothesis about an association between the size of a business (based on annual sales turnover) and the decision to apply for finance was not supported. Businesses with sales turnover less than 1 million SR were more likely to apply for bank credit, possibly because their earnings were insufficient to fund their business development and capital requirements.

However, the study did find a significant association between the annual turnover of a business and its difficulties in obtaining funds from Saudi banks, consistent with other similar studies (e.g. Keasey & Watson 1993) showing that larger firms are looked upon more favourably by banks when it comes to lending. The interviews with Saudi banks revealed that banks consider a firm's annual sales turnover when assessing their loan application. The result shows that 17.6 per cent of SMEs that earn more than 5 million SR have no difficulties in accessing bank credit, which indicates that the greater the sales turnover of a company, the greater its access to finance from banks (Bigsten et al. 2000; Pandula 2011).

H5: Business ownership type is significantly associated with the decision to apply for external finance and the difficulty in accessing finance from Saudi Banks

This hypothesis was supported: a large proportion of sole proprietorships reported applying for loans and having more difficulties than partnerships and companies in obtaining finance from Saudi banks. These findings are consistent with those of Deakins and Freel (2003), who observed that incorporated firms have more credibility with financial institutions and are more likely to have easy access to external finance than unincorporated (small business) firms.

Hence, most owners/managers of SMEs in Saudi Arabia that have sole proprietorships of their business are facing difficulties when attempting to raise capital from Saudi banks. This indicates that most Saudi banks prefer not to fund SMEs due to their lack of collateral, the higher risks associated with these types of businesses and high administrative cost for less profit.

H6: Existence of a written business plan has a significant effect on the decision to apply for external finance and the difficulty in accessing finance from Saudi Banks

This hypothesis was supported: there was a significant association between existence of a business plan before the business was started, and the decision to apply for finance and difficulties in obtaining finance from Saudi banks. A higher proportion (5.07 per cent) of businesses that did not have a business plan at the time of starting a business reported facing more difficulties in obtaining financing from Saudi banks compared to businesses that did have a business plan at the time of starting a business. These findings agree with assertions in some relevant studies (Barrow 1993; Berry et al. 1993a; Reid 1998) that a business plan is a crucial consideration by banks and other financial institutions in determining the likely success of a venture, and eventually in the decision to grant finance. Therefore, financial providers do not provide a loan without an appropriate and feasible business plan in order to evaluate whether or not the applicant's firm is likely to repay the loan. Consequently, a lack of a business plan leads to a failure in obtaining finance from banks, which in turn has a detrimental effect on business performance (Abalkhail 1999; Kushnir 2010; Sajini 1997).

Saudi banks and other financial institutions encourage entrepreneurs to present a business plan and financial plan including cash flow statements for their business as a condition to apply for a loan. Nonetheless in this study, 37.7 per cent of surveyed entrepreneurs with a business plan that applied for a bank loan still faced difficulties accessing bank credit. Saudi banks claim that most SME applicants do not have a complete business plan and that the data included in the plan are inaccurate, unclear or unrealistic. The results of this study support earlier work (Abalkhail 1999; IFC 2012; Kushnir 2010; Sejjine 2000) reporting that in the GCC region, most start-up businesses fail to obtain funding through banks and investors because of poor business plans.

However, Saudi entrepreneurs need assistance in preparing business plans that are appropriate and use realistic data. This could be done either through training support from Kafalah or government funding agencies, or by collaborating with specialised organisations in preparing economic feasibility. A relatively high proportion of businesses (62.5 per cent) that had a business plan did not apply for a loan from banks, suggesting that these entrepreneurs prepared a business plan to give them a clear vision for the future of the business and measure the feasibility of their projects, not to seek funds from financial providers (Pinson 2004).

H7₁: Market share and Growth rate of the firm has a significant effect on the decision to apply for Finance from banks and the difficulty in accessing finance from Saudi banks

This study asked SME owners/managers to indicate their average current market share and annual growth rate over the previous three years. The association between the current market share of a firm and its decision to apply for finance and difficulty in accessing finance from Saudi banks was significant. The 61.3 per cent of firms that had a less than 10 per cent market share reported applying for a bank loan and 80 per cent of these had difficulties obtaining funding from Saudi banks. There is evidence in the relevant literature that SMEs in emerging markets including MENA countries have low market shares (not exceeding 10 per cent) (Chirona et al. 2012). Therefore, it is not surprising to see a relatively large number of firms with small market share applying for loans as such firms are more common. The results from this analysis agree with the findings of other relevant studies (Berger & Udell 1998; Johnsen & McMahon 2005; Zikmund & Babin 2010) that firms with a larger market share are preferred by banks for lending purposes. This is because such firms are considered by banks to have a better ability to repay loans.

However, there was no significant association between the annual growth rate of a firm and its decision to apply for finance, although the hypothesis that examined the association between the annual growth rate of the firm and difficulties in obtaining finance from Saudi banks was supported. A significantly larger proportion of organisations with smaller annual growth rate (1–10 per cent) reported having difficulties obtaining funds from Saudi banks. Similar trends were observed for the association between the annual growth rate of a firm and its access to finance; and the market share of a firm and its access to finance. The association between the

annual growth rate of a firm and the decision to apply for finance, and the difficulties faced in obtaining finance is consistent with findings from other similar studies (Ahmed & Hamid 2011; Ayyagari et al. 2008; Berger & Udell 1998; Johnsen & McMahon 2005) that indicate that firms with larger growth rates are looked upon more favourably by banks when it comes to lending. This suggests that most Saudi banks have more confidence in firms with larger growth rates and with a high growth potential in the market as their ability to repay their loans is better than that of firms with smaller growth rates.

H7₂: Profitability ratios of the firm have a significant effect on the decision to apply for Finance from Saudi banks and the difficulty in accessing finance from Saudi banks.

To measure SME profitability ratios, this study asked their owners/managers to indicate their average financial ratios (ROI, profit margin and financial leverage) for the previous three years. There was a significant relationship between ROI, profit margin and the leverage ratio of a firm, and its decision to apply for finance. This means that firms with lower ROI and profit margin, and high leverage rate applied for loans from Saudi banks, suggesting that such firms have lower liquidation value and might not be able to generate sufficient cash flow to pay their financial obligations, hence they sought funds to cover their short-term liabilities as their financial performance are low (Harris & Raviv 1991). This may reduce the willingness of banks and other financial institutions to invest in or finance such businesses (Cassar & Holmes 2003; Deakins & Hussain 1994). There was also a strong and significant correlation between facing difficulties in obtaining funds from Saudi banks and ROI and profit margin.

These results suggest that Saudi banks place an emphasis on provision of past financial information from SME applicants to assess their performance as an indicator of their potential profitability. The association between high leverage rate and low ROI and profit ratios of a firm, and its decision to apply for finance, and difficulties it faces in obtaining finance, is consistent with findings from other similar studies (Abor & Biekpe 2005; Cassar & Holmes 2003; Sarapaivanich 2006). The results of this study also agree with those of Bigsten et al. (2000), who reported greater annual sales and profit margin ratios of businesses are associated with greater access to finance and lower credit constraints.

8.2.3 Availability of Islamic Finance Products

In this study, 69.6 per cent of Saudi SME owners/managers asserted that they would prefer to apply for Islamic banking and expressed their desire to use Islamic finance. However, less than 60.0 per cent of entrepreneurs that prefer Islamic finance over conventional banking reported applying for a loan from Saudi banks, and 72.8 per cent faced difficulties in obtaining funding from Saudi banks. Although all Saudi banks wish to offer Islamic finance products to reduce their dependence on conventional models of financing, most SMEs (33.9 per cent) that had decided not to obtain funds from Saudi banks because of religious issues did so because they do not feel comfortable with the current Islamic finance products, and they believe that Saudi banks offer a limited choice of Islamic finance products. These results are consistent with those of Dabo (2006), whose study respondents believed that Islamic products offered by Nigerian banks are not consistent with Islamic principles. Currently, Murabaha and Ijara make up the lion's share of banking transactions in Saudi Arabia and the higher percentage of Islamic banking activities because they are less risky and involve short-term monitoring contracts, which are used to finance business purposes such as purchase of raw materials, equipment, vehicles, importing and exporting, as well as for personal purchasing of cars and houses. This and other studies reveal that Murabaha is one of the most popular Islamic finance instruments provided by banks to finance SMEs in Islamic countries including Oman and Saudi Arabia (Abalkhail 1999; Al-Kharusi 2003; IFC 2012; Kushnir 2010; Quartey 2003; Sejjine 2000). However, Saudi banks fail in presenting other products, such as Musharaka and Mudaraba, which are based on profit–loss sharing schemes that are highly risky and difficult to accomplish in practice (Al-Salem 2009). Some other Islamic financial products are not considered by Saudi banks, including bay' al-salam and Istesnae, which are forward contracts (Iqbal & Mirakhor 2011). Hence, in order for Saudi banks to assert their presence in the national economy, they must develop and innovate in the area of Islamic finance products to meet the needs and demands of SMEs. The development of new Islamic financial products can be done through financial engineering techniques and meet two main conditions. It must work within the framework of Islamic law and it must achieve economic efficiency (Alsualm 2007).

8.2.4 Business Obstacles and Firm Performance

The third objective of this study was to identify business obstacles that affect Saudi SME performance. The respondents' attitudes to internal and external business obstacles for growth of their business were analysed in order to find the most significant factors that influence their performance.

H9: The business obstacles that firms face in Saudi Arabia have a negative effect on their performance (ROI, profit margin, leverage ratio, annual sales turnover, market share, and growth rate).

Using ANOVA, the study examined the association between various business obstacles and business financial performance in terms of ROI, profit margin, leverage ratio, annual sales turnover, market share, and growth rate. There was a significant association between mean ROI and sales and marketing, less availability of capital, high competition and low customer satisfaction-related obstacles; between profit margin and customer satisfaction; and between mean leverage ratio and gender, age of owner, technology, and low financial support. The study also found a significant association between annual turnover and sales and marketing, gender, age of owner, technology, chamber of commerce services, legal issues, advisory, training, product and service quality-related obstacles; and between market share of a business and technology, chamber of commerce services, legal issues, advisory services and training. These results indicate that annual growth rate of a business is significantly associated with chamber of commerce services, government support and training.

To support the findings of this research on this issue, it is important to mention Alfaadhel (2010), who found that marketing, availability of capital, competition, and government support and regulations are the main challenges that constrain the growth of Saudi SMEs, ultimately affecting their performance. Further, the results of this study compare favourably with previous studies (Khalique et al. 2011; Muhammad et al. 2010) that identified various challenges facing SMEs, such as lack of managerial experience and training, competition, lack of access to credit, technology, and heavy government regulatory burdens. The results are also similar to those of Almosallam (2008) and Binzomah (2008), which listed government regulation requirements,

bureaucratic procedures, finance, marketing, human capital, communication between SMEs and government authorities, and technical/operational factors as the most restrictive factors in Saudi SME development. Finally, Soini and Veseli (2011) identified several obstacles influencing growth and performance of SMEs, including external factors such as access to capital and competition, and internal factors such as marketing strategies, innovation level and investment in technology.

The results here would seem to confirm that most business obstacles affecting Saudi SME performance affect marketing and sales because the majority of SME owners/managers lack appropriate marketing and sales skills and experience, have less availability of capital and access to finance, and experience high competition and low customer satisfaction. These factors are the main challenges that negatively affect business performance of SMEs in Saudi Arabia.

8.3 THEORETICAL CONSIDERATIONS

This section discusses the theoretical considerations of the study implied by the results.

The study set out to find evidence on the difficulties faced by the SME operators to access finance. The study found that the most important factors affecting the performance of SMEs were high cost and a lack of finance, mainly due to stringent requirements. The study also found that entrepreneurial factors that influence the performance of SMEs and the ability to access finance include education, gender, and work experience. The results further indicated that the Pecking Order Theory (POF) and information asymmetry theory are more relevant in the Saudi context. A majority of Saudi SMEs have had a preference to finance their investment needs with internal sources of finance over external equity. They tend to prefer personal finance and funding from family and friends over debt and equity sources, providing some support for POT. (Chittenden et al. 1996; Frank & Goyal 2005; Berggren et al. 2000; Berger & Udell 1998; Cassar & Holmes 2003; Chirinko & Singha 2000). As there are a limited number of studies examining the direct and indirect relationships between SME performance and access to finance from Saudi banks, a major contribution of this study is its analysis of the application of the above theories to SMEs in Saudi Arabia. In particular, the extent to which access to finance from Saudi banks is influenced by the decision maker and business characteristics.

Another notable finding of the study is that the SMEs fail to satisfy the banks' with the information required for assessing the applications. This supports the relevance of information asymmetry theory. In circumstances of information asymmetry, there is insufficient or absence of information to financial providers from businesses due to poor , or absence of, accounting records and audited financial statements, which are vital for the banks to assess the financial viability of the projects for which funding is sought (Kariuki 1995). This in turn leads the SMEs to seek funds from alternative sources at higher costs.

8.4 IMPLICATIONS OF THIS RESEARCH

This study aimed to examine the difficulties facing Saudi SMEs in accessing finance from Saudi banks, and obstacles that affect their performance. The findings have several implications that may be helpful in developing the SME sector in Saudi Arabia.

8.4.1 Implications for Academics

This research extends the body of academic knowledge in the area of SMEs and finance. It may provoke the interest of academics working not only in Saudi Arabia but also in other countries to develop and expand the scope of SMEs in developed and developing countries. The literature review considered the finance constraints and difficulties to access to finance by SMEs from Saudi banks. This thesis identifies internal and external obstacles that affect business performance in Saudi Arabia and compares these to those reported in similar studies carried out in other countries. It is hoped that the results of this study will encourage further research to investigate the problems faced by SMEs in more specific detail.

8.4.2 Implications for Entrepreneurs

This research provides valuable knowledge to SME entrepreneurs who have failed to secure bank financing, which relates to factors affecting access to finance from banks and other

financial institutions and an understanding of why their previous attempts to obtain financing may have been unsuccessful. The findings clearly identify weaknesses in record keeping and the inability of the SMEs to provide the information required by the banks. The businesses would, therefore, benefit from developing an efficient and effective information system in conjunction with the banks. This step would greatly improve the outcome of finance applications with the banks. On the other hand, the SMEs expect the banks to provide a variety of services, indicating that there is a mismatch between what the SMEs expect from the banks and what the banks deliver in services. The SMEs expect to benefit from longer term relationships with the banks. Establishing long-term relationship will enable banks to collect information on SMEs and to improve access to credit (Boot & Milbourn 2002; Allen & Saunders 1991; Nakamura 1992; Berger et al. 1999; Boot 2000). This longer term relationship would further enable the banks to improve the knowledge of the risks faced by the businesses possibly leading to reductions in the cost of debt (Schaefer 2003; Peterson & Rajan 1994). In addition, this research has shown that many SME owners/managers in Saudi Arabia were unaware of alternative sources of finance, such as government funds and the Kafalah programme, a revelation that might help them to take advantage of these sources of finance. The findings highlight the importance of improving the skills of owners/managers in preparing financial statements and business plans and in building a good relationship with financial providers. Moreover, owners/managers are likely to find this research useful in understanding the obstacles they may face when applying for loans from banks and how they might be better off avoiding banks in some instances. This study has focused on the pecking order theory in explaining the capital structure of Saudi SMEs. The findings can be used by Saudi entrepreneurs in selecting their firms' capital structure as well as by Saudi banks in aligning their lending policies and procedures with the aspirations of SMEs' financing needs.

8.4.3 Implications for Banks

This study has revealed that most Saudi banks are reluctant to finance start-up businesses, as they lack financial information and collateral. Also, a high proportion of existing SMEs and entrepreneurs in Saudi Arabia have had negative experiences in obtaining finance from Saudi banks and they prefer internal sources and equity finance as an alternative to fulfil their needs, as they face difficulties when applying for bank loan. Banks must determine the source of these

problems and how they might remove obstacles that threaten the growth and success of the SME sector. The research made clear that bank policies mainly focus on financing existing SMEs only through the Kafalah programme to guarantee their credit; meanwhile, many owners/managers of SMEs believe that loan application requirements set by Saudi banks are challenging. The study attempted to identify difficulties experienced by the Saudi SME sector when seeking finance from Saudi banks. Therefore, this study should help Saudi banks to identify ways to encourage and provide financing to deserving SMEs. This work identified the potential need to develop new products to help banks and other financial institutions take advantage of Islamic finance, such as bay' al-salam as proposed in Chapter 3. Banks can use bay' al-salam to provide the necessary funds to buy input or raw material for SME production processes.

8.4.4 Implications for Government

Despite all of the Saudi government's efforts to overcome obstacles to financing SMEs, the loans offered by Saudi banks and other financial providers like VC and angel funds still remain weak and pose a major hindrance to development of this sector. This study demonstrates some of the obstacles facing such firms when they start-up or plan to expand their businesses, or develop their products or services. By being aware of the difficulties facing these enterprises in Saudi Arabia, government agencies are more likely to be able to support them by removing obstacles and facilitating SME development. For instance, this study found that many Saudi SME owners/managers were unaware of government funds and the Kafalah scheme. It was also made clear that some loan conditions of government funds are complicated and decisions regarding financing often take a long time. Therefore, government agencies might consider better ways of simplifying this process.

This study identified the potential need for other Islamic sources of finance for SMEs. It is anticipated that these findings will influence government authorities and Islamic investors to take advantage and consider the proposed cash *waqf*-based model presented in Chapter 3. Cash *waqf* investment funds are based on Islamic law and aim to participate and invest in types of businesses that serve community development and prosperity

8.5 RECOMMENDATIONS

The SME sector is one of the most important sectors in the Saudi national economy because it significantly contributes to job creation, lowers unemployment and adds value to the economy. Thus, the Saudi government is diverting more attention to small and medium-sized businesses by providing an appropriate environment for growth. This study has revealed that most SME owners/managers face difficulties accessing finance from Saudi bank; hence they use funds from internal sources. Further, banks are reluctant to finance this sector due to insufficient financial and non-financial information, insufficient collateral, poor business plans, low annual sales turnover, low growth rate and poor financial performance. The imperfect information provided by SMEs creates information asymmetry with the consequence that banks charge higher rates and impose high collateral requirements to mitigate the risk involved in financing SMEs and to compensate for the possibilities of failure. Therefore, this study makes some recommendations in order to develop the SME sector in Saudi Arabia, and promote access to finance from banks through establishing a trusting relationship between SMEs and banks.

The findings of this study indicate that there are a number of factors that impede Saudi SME access to finance from Saudi banks and prevent them from developing their businesses. In this regard, the ability of owners/managers of SMEs to successfully obtain bank credit is based on, among other factors, provision of a detailed rationale in a well-formulated business plan and audited financial statements, and evidence of creditworthiness, management competency and business experience. The results indicate that many owners/managers are unaware of certain sources of finance, so they need to boost their awareness of the variety of funding opportunities available, such as the Kafalah programme, government funds, VC and business angels; enhance their knowledge about currently available finance products, especially the Islamic products that banks provide; and determine how to choose the best one to finance their project at low cost. Based on the 'relationship banking' theory Saudi entrepreneurs also need to open channels of communication with Saudi banks and other funding institutions and enhance their relationship with them which considered as the appropriate lending technique (Boot and Milbourn, 2002). The findings also indicate that most SME owners/managers encounter difficulties with marketing and sales, competitors and customer satisfaction, which are the keys to success for any organisation. Hence, they need to improve their marketing skills in order to expand the

number of customers and promote their products and services in appropriate ways. In addition, they need to increase their knowledge about finance and financial tools to understand how to record financial transactions of the firm and prepare financial and cash flow statements for their firms separately from their personal accounts.

Banks and other financial institutions should simplify their lending criteria and pay attention to opportunities for financing the promising SME sector rather than requiring high collateral, charging high interest rates and having excessive paperwork and complicated loan procedures. They can provide tailored lending packages to fit the capabilities and requirements of SMEs, or develop novel collateral types. As the majority of Saudi entrepreneurs prefer to be funded through Islamic finance, banks need to diversify into this realm by using financial engineering tools to innovate and develop new Islamic finance products that are *sharia* compliant. This study has suggested two Islamic forward contract types—bay' al-salam and Istesnae—that might be considered by banks to finance SMEs. In the meantime, banks need to consider the other two important products: the Musharaka and Mudaraba models. It is known that these two Islamic contracts are extremely risky as they involve profit and loss sharing; consequently, banks avoid dealing with them. However, banks can overcome this problem by establishing a transparent relationship with potential owners/managers of SMEs to increase the trust between them, and by incorporating risk management to mitigate the risks attributed to profit and loss-sharing arrangements through Mudaraba and Musharaka contracts. Although all banks have special units to handle SME loan applications, these are located only in the main cities and are not available in rural areas or other cities where most SMEs operate. Therefore, banks should consider accepting loan applications from SMEs at any branch in the Kingdom to ensure that all enterprises have the opportunity to apply for loans. Banks also need to shorten the time taken to evaluate loan applications, which is currently three to six months.

Finally, the Kafalah programme and government funding agencies need to consider several points to ease the difficulties in SME access to finance from banks. The Kafalah programme needs to work on increasing the number and value of guarantees each year, and embrace awareness programmes to enhance the awareness of SME owners/managers. Moreover, Kafalah needs to open new offices around the Kingdom in order to serve a larger number of businesses. The programme should also decrease the time taken to evaluate loan applications

to avoid any delay in financing firms. This study found that the majority of SMEs had faced difficulties due to government regulations and bureaucracy; therefore, the Saudi government should ease labour laws for SMEs and decrease the cost of labour licenses and other related fees. Indeed, the Saudi government should pay attention to this sector by providing assistance programmes to enhance awareness among SMEs and potential young investors about the importance of entrepreneurship, and train them through seminars, workshops and one-to-one consultancy sessions to prepare them to be qualified entrepreneurs. Government agencies need to promote a consistent definition of SME for each of the three main sectors (manufacturing, services and trade) to make it easy for policy makers, financial providers and researchers to determine the size of a business. The findings also showed that government funding agencies impose restrictive requirements for financing SMEs: they only finance start-up businesses for Saudi entrepreneurs who do not have existing businesses and this may preclude a large number of SMEs from obtaining funds from government financial bodies. Thus, the Saudi government funds need to reconsider their loan criteria to make it easier for SMEs to get funding, and serve large number of both start-up and existing businesses. Last but not least, as banks charge high interest rates, the government should launch interest rate-supported programmes to enable SME access to funds from Saudi banks at low interest rates.

8.6 LIMITATIONS OF THE STUDY

As with most research, there are some limitations to this study, which do not reduce the significance of its findings. First, the study focuses only on SMEs located in the main cities of Saudi Arabia. The implications are therefore limited to businesses located in these cities, as SMEs are located in other cities or towns do not have websites or electronic mail to enable communication with them and it was hard for the researcher to reach and contact them due to time constraints on data collection. Nonetheless, around 66 per cent of SMEs are located in the three main cities been covered in this study. The second limitation of this study is its way of measuring the inability to obtain finance from Saudi banks based on the business performance of SMEs. This study focused on measuring only five financial ratios (ROI, profit margin, annual sales turnover, leverage, and growth rate) to record financial performance of businesses. Although other financial and non-financial ratios could be considered to measure financial performance, the ratios used in this study are those that are most used for this purpose.

8.7 SUGGESTIONS FOR FUTURE RESEARCH

Future research might address in more detail the main objectives of this work. Studies could increase the sample sizes for each of the three sectors (trade, service and manufacturing), and increase the number of SMEs from other parts of Saudi Arabia in order to explore the generality and significance of the findings. Future researchers might overcome the limitations of this study and examine other types of financing for SMEs.

8.8 CONCLUSION

The study has provided empirical evidence on the problems faced by the Saudi SME sector in obtaining finance from Saudi banks. It has identified ways to encourage Saudi banks to provide financing to deserving SMEs. Some factors related to characteristics of both owners/managers of businesses and enterprises that affect their access to finance from Saudi banks. The study also concludes that difficulties in accessing finance are significantly related to the financial performance of SMEs in Saudi Arabia. Moreover, some internal and external business obstacles are affecting business performance.

In conclusion, the findings of this study should enable Saudi banks and Saudi policy makers to pay attention to and enhance their serving of the needs of SMEs. It also provides owners/managers with useful insights into factors and issues relating to constraints in obtaining funds from banks and other financial institutions, and some key factors to help develop their businesses. Finally, future research should be directed to expand investigation of these issues.

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Appendix A: Statistical Results

Table A-1: Business Obstacles and ROI (ANOVA Results)

		ROI		Test statistic	df	p-value
		Mean	SD			
Sales and marketing	Major obstacles	7.907	2.520	6.475	(2, 189)	0.002
	Moderate obstacles	8.777	4.706			
	Less obstacles	14.125	10.288			
	Total	8.755	4.691			
Gender	Major obstacles	9.533	4.400	0.760	(3, 190)	0.518
	Moderate obstacles	8.243	4.271			
	Less obstacles	9.088	4.907			
	No obstacles	8.269	5.467			
	Total	8.742	4.682			
Age of owner	Major obstacles	9.933	3.035	0.563	(3, 190)	0.640
	Moderate obstacles	8.515	4.573			
	Less obstacles	8.897	4.949			
	No obstacles	8.083	4.925			
	Total	8.742	4.682			
Education level	Major obstacles	8.263	2.446	0.727	(3, 190)	0.599
	Moderate obstacles	8.177	4.283			
	Less obstacles	9.148	5.247			
	No obstacles	9.080	4.864			
	Total	8.742	4.682			
Management skills	Major obstacles	8.857	3.729	2.378	(3, 187)	0.071
	Moderate obstacles	7.893	3.755			
	Less obstacles	9.964	5.780			
	No obstacles	8.933	5.700			
	Total	8.712	4.635			
Work experience	Major obstacles	8.421	3.064	0.834	(3, 190)	0.477
	Moderate obstacles	8.407	4.682			
	Less obstacles	9.000	4.690			
	No obstacles	10.333	7.451			

		ROI		Test statistic	df	<i>p</i> -value
		Mean	SD			
	Total	8.742	4.682			
Availability of capital	Major obstacles	8.724	4.038			
	Moderate obstacles	8.053	3.895			
	Less obstacles	12.526	8.215	5.470	(3, 188)	0.001
	No obstacles	6.000	4.359			
	Total	8.729	4.704			
Technology	Major obstacles	10.632	4.573			
	Moderate obstacles	8.379	4.518			
	Less obstacles	8.602	4.552	1.190	(3, 189)	0.315
	No obstacles	8.944	5.846			
	Total	8.767	4.682			
High cost of labour	Major obstacles	10.222	5.364			
	Moderate obstacles	8.286	4.123			
	Less obstacles	8.638	4.740	0.805	(3, 189)	0.492
	No obstacles	9.095	5.176			
	Total	8.746	4.694			
Availability of skilled employees	Major obstacles	8.784	4.411			
	Moderate obstacles	8.209	3.964			
	Less obstacles	9.161	5.255	0.516	(3, 190)	0.672
	No obstacles	9.286	6.219			
	Total	8.742	4.682			
Chamber of commercial services	Major obstacles	8.571	2.593			
	Moderate obstacles	8.667	4.074			
	Less obstacles	8.854	5.167	0.032	(3, 188)	0.992
	No obstacles	8.651	4.815			
	Total	8.750	4.706			
Government bureaucracy	Major obstacles	8.422	4.011			
	Moderate obstacles	8.694	4.764			
	Less obstacles	9.100	5.420	0.256	(3, 190)	0.857
	No obstacles	9.278	5.108			
	Total	8.742	4.682			

		ROI		Test statistic	df	<i>p</i> - value
		Mean	SD			
Corruption	Major obstacles	8.719	4.920	0.060	(3, 190)	0.981
	Moderate obstacles	8.589	3.803			
	Less obstacles	8.925	5.352			
	No obstacles	8.571	3.777			
	Total	8.742	4.682			
Legal issues	Major obstacles	8.167	1.749	0.331	(3, 186)	0.803
	Moderate obstacles	8.216	4.237			
	Less obstacles	8.697	4.875			
	No obstacles	9.250	5.016			
	Total	8.663	4.628			
Government support	Major obstacles	8.567	4.454	0.222	(3, 188)	0.881
	Moderate obstacles	9.074	4.698			
	Less obstacles	8.756	4.755			
	No obstacles	8.136	5.111			
	Total	8.745	4.706			
Advisory services	Major obstacles	8.923	1.441	0.150	(3, 188)	0.930
	Moderate obstacles	8.439	4.484			
	Less obstacles	8.926	5.071			
	No obstacles	8.467	4.696			
	Total	8.750	4.706			
Training	Major obstacles	7.923	2.038	1.239	(3, 188)	0.297
	Moderate obstacles	8.391	3.836			
	Less obstacles	8.923	5.219			
	No obstacles	10.421	7.252			
	Total	8.745	4.706			
Product and service quality	Major obstacles	9.107	4.131	1.605	(3, 188)	0.190
	Moderate obstacles	7.723	3.462			
	Less obstacles	9.188	4.982			
	No obstacles	9.857	7.882			
	Total	8.729	4.704			
Financial support	Major obstacles	8.299	4.056	0.979	(3, 189)	0.404

		ROI		Test statistic	df	<i>p</i> -value
		Mean	SD			
	Moderate obstacles	8.567	3.665			
	Less obstacles	9.578	6.066			
	No obstacles	10.750	11.701			
	Total	8.741	4.694			
Competitors	Major obstacles	8.025	2.850	4.015	(3, 190)	0.008
	Moderate obstacles	8.371	4.626			
	Less obstacles	10.950	6.831			
	No obstacles	7.333	4.041			
	Total	8.742	4.682			
Customer satisfaction	Major obstacles	8.468	3.985	3.745	(3, 189)	0.012
	Moderate obstacles	7.878	3.484			
	Less obstacles	10.625	6.480			
	No obstacles	5.500	3.536			
	Total	8.658	4.545			
Government regulations (labour)	Major obstacles	8.742	4.522	0.165	(2, 191)	0.848
	Moderate obstacles	8.642	4.372			
	Less obstacles	9.714	9.394			
	No obstacles	0.000	0.000			
	Total	8.742	4.682			

Table A-2: Business Obstacles and Profit Margin

		<u>Profit margin</u>		Test statistic	df	<i>p</i> - value
		Mean	SD			
Sales and marketing	Major obstacles	4.370	3.011	3.023	(2, 189)	0.051
	Moderate obstacles	5.515	3.533			
	Less obstacles	6.750	3.012			
	Total	5.245	3.412			
Gender	Major obstacles	5.133	2.763	0.293	(3, 190)	0.830
	Moderate obstacles	4.971	3.306			
	Less obstacles	5.500	3.606			
	No obstacles	5.346	3.846			
	Total	5.232	3.397			
Age of owner	Major obstacles	5.200	2.541	0.778	(3, 190)	0.507
	Moderate obstacles	5.353	3.631			
	Less obstacles	5.414	3.585			
	No obstacles	4.250	2.289			
	Total	5.232	3.397			
Education level	Major obstacles	4.684	2.605	0.984	(3, 190)	0.401
	Moderate obstacles	5.500	3.575			
	Less obstacles	5.420	3.603			
	No obstacles	4.320	2.594			
	Total	5.232	3.397			
Management skills	Major obstacles	5.036	3.585	0.720	(3, 187)	0.541
	Moderate obstacles	5.237	3.262			
	Less obstacles	5.618	3.783			
	No obstacles	4.200	2.513			
	Total	5.236	3.412			
Work experience	Major obstacles	5.395	3.251	0.257	(3, 190)	0.857
	Moderate obstacles	5.210	3.419			
	Less obstacles	5.333	3.639			
	No obstacles	4.533	2.800			
	Total	5.232	3.397			
<u>Availability of capital</u>	Major obstacles	5.368	3.532	0.552	(3, 188)	0.647

		Profit margin		Test statistic	df	p-value
		Mean	SD			
	Moderate obstacles	5.074	3.250			
	Less obstacles	5.895	3.957			
	No obstacles	3.667	0.577			
	Total	5.250	3.409			
Technology	Major obstacles	5.895	2.787	0.467	(3, 189)	0.706
	Moderate obstacles	5.448	3.594			
	Less obstacles	5.051	3.459			
	No obstacles	4.889	3.179			
	Total	5.238	3.404			
High cost of labour	Major obstacles	5.000	2.657	1.437	(3, 189)	0.233
	Moderate obstacles	6.020	4.008			
	Less obstacles	5.000	3.208			
	No obstacles	4.476	3.027			
	Total	5.202	3.380			
Availability of skilled employees	Major obstacles	5.647	3.746	0.505	(3, 190)	0.679
	Moderate obstacles	4.940	3.302			
	Less obstacles	5.306	3.247			
	No obstacles	4.786	3.332			
	Total	5.232	3.397			
Chamber of commercial services	Major obstacles	5.929	3.540	1.270	(3, 188)	0.286
	Moderate obstacles	5.744	3.837			
	Less obstacles	5.281	3.496			
	No obstacles	4.442	2.630			
	Total	5.234	3.408			
Government bureaucracy	Major obstacles	5.188	3.337	0.549	(3, 190)	0.649
	Moderate obstacles	5.222	3.457			
	Less obstacles	5.675	3.758			
	No obstacles	4.444	2.502			
	Total	5.232	3.397			
Corruption	Major obstacles	5.544	3.433	1.637	(3, 190)	0.182
	Moderate obstacles	4.839	2.953			

		Profit margin		Test statistic	df	p-value
		Mean	SD			
	Less obstacles	5.612	3.873			
	No obstacles	3.714	1.773			
	Total	5.232	3.397			
	Major obstacles	4.750	2.701			
	Moderate obstacles	5.649	3.743			
Legal issues	Less obstacles	5.202	3.412	0.419	(3, 186)	0.740
	No obstacles	4.813	3.267			
	Total	5.195	3.402			
	Major obstacles	4.467	2.543			
	Moderate obstacles	5.667	3.608			
Government support	Less obstacles	5.302	3.508	0.840	(3, 188)	0.474
	No obstacles	5.000	3.572			
	Total	5.240	3.410			
	Major obstacles	4.846	2.996			
	Moderate obstacles	5.512	3.565			
Advisory services	Less obstacles	5.250	3.391	0.329	(3, 188)	0.805
	No obstacles	4.767	3.481			
	Total	5.203	3.401			
	Major obstacles	3.923	2.018			
	Moderate obstacles	5.768	3.730			
Training	Less obstacles	5.244	3.498	1.880	(3, 188)	0.134
	No obstacles	5.105	3.035			
	Total	5.240	3.410			
	Major obstacles	5.714	3.867			
	Moderate obstacles	5.200	3.138			
Product and service quality	Less obstacles	5.176	3.609	0.201	(3, 188)	0.895
	No obstacles	5.071	2.495			
	Total	5.255	3.407			
	Major obstacles	5.182	3.478			
Financial support	Moderate obstacles	5.015	2.992	0.396	(3, 189)	0.756
	Less obstacles	5.711	3.917			

		Profit margin		Test statistic	df	p-value
		Mean	SD			
	No obstacles	5.000	2.708			
	Total	5.244	3.402			
Competitors	Major obstacles	4.827	3.114	1.103	(3, 190)	0.349
	Moderate obstacles	5.529	3.554			
	Less obstacles	5.675	3.724			
	No obstacles	3.333	0.577			
	Total	5.232	3.397			
Customer satisfaction	Major obstacles	5.117	3.391	3.706	(3, 189)	0.013
	Moderate obstacles	4.568	2.975			
	Less obstacles	6.675	3.819			
	No obstacles	3.500	0.707			
	Total	5.212	3.394			
Government regulations (labour)	Major obstacles	5.217	3.371	0.003	(2, 191)	0.997
	Moderate obstacles	5.254	3.552			
	Less obstacles	5.286	2.628			
	No obstacles	0.000	0.000			
	Total	5.232	3.397			

Table A-3: Business Obstacles and Leverage Ratio

		Leverage		Test statistic	df	<i>p</i> -value
		Mean	SD			
Sales and marketing	Major obstacles	26.519	12.944	0.153	(2, 189)	0.858
	Moderate obstacles	27.431	10.106			
	Less obstacles	26.375	8.417			
	Total	27.130	10.875			
Gender	Major obstacles	23.767	13.680	3.368	(3, 190)	0.02
	Moderate obstacles	25.429	10.344			
	Less obstacles	30.000	10.201			
	No obstacles	28.462	8.491			
	Total	27.180	10.853			
Age of owner	Major obstacles	20.800	14.344	3.654	(3, 190)	0.014
	Moderate obstacles	25.559	11.572			
	Less obstacles	29.448	9.411			
	No obstacles	27.542	9.376			
	Total	27.180	10.853			
Education level	Major obstacles	23.895	13.812	1.661	(3, 190)	0.177
	Moderate obstacles	27.500	11.657			
	Less obstacles	28.500	8.526			
	No obstacles	24.240	13.078			
	Total	27.180	10.853			
Management skills	Major obstacles	27.321	15.449	0.439	(3, 187)	0.725
	Moderate obstacles	27.892	8.886			
	Less obstacles	26.291	10.535			
	No obstacles	25.067	13.818			
	Total	27.126	10.890			
Work experience	Major obstacles	24.868	11.892	1.125	(3, 190)	0.34
	Moderate obstacles	26.840	11.038			
	Less obstacles	28.867	9.218			
	No obstacles	28.133	12.939			
	Total	27.180	10.853			
Availability of capital	Major obstacles	26.711	11.441	0.268	(3, 188)	0.849

		Leverage		Test statistic	df	<i>p</i> -value
		Mean	SD			
	Moderate obstacles	27.149	10.681			
	Less obstacles	27.053	8.356			
	No obstacles	32.333	9.292			
	Total	27.047	10.720			
Technology	Major obstacles	24.316	10.853	2.796	(3, 189)	0.042
	Moderate obstacles	24.707	11.785			
	Less obstacles	29.327	10.437			
	No obstacles	26.778	8.186			
	Total	27.207	10.875			
High cost of labour	Major obstacles	22.111	15.327	1.878	(3, 189)	0.135
	Moderate obstacles	28.449	7.315			
	Less obstacles	27.876	11.686			
	No obstacles	25.429	7.941			
	Total	27.218	10.869			
Availability of skilled employees	Major obstacles	29.471	9.067	1.932	(3, 190)	0.126
	Moderate obstacles	24.881	12.653			
	Less obstacles	27.984	10.220			
	No obstacles	26.286	8.818			
	Total	27.180	10.853			
Chamber of commercial services	Major obstacles	21.286	12.585	1.981	(3, 188)	0.118
	Moderate obstacles	25.718	10.677			
	Less obstacles	28.271	11.046			
	No obstacles	27.628	9.619			
	Total	27.099	10.868			
Government bureaucracy	Major obstacles	28.078	10.161	0.541	(3, 190)	0.655
	Moderate obstacles	27.583	10.868			
	Less obstacles	25.650	12.238			
	No obstacles	25.778	10.316			
	Total	27.180	10.853			
Corruption	Major obstacles	27.421	12.487	0.068	(3, 190)	0.977
	Moderate obstacles	26.625	9.629			

		Leverage		Test statistic	df	<i>p</i> -value
		Mean	SD			
	Less obstacles	27.403	10.546			
	No obstacles	27.357	10.874			
	Total	27.180	10.853			
	Major obstacles	28.417	4.795			
	Moderate obstacles	23.892	12.461			
Legal issues	Less obstacles	28.092	11.127	1.428	(3, 186)	0.236
	No obstacles	27.125	9.631			
	Total	27.132	10.935			
	Major obstacles	26.233	13.885			
	Moderate obstacles	27.167	9.891			
Government support	Less obstacles	27.279	10.690	0.105	(3, 188)	0.957
	No obstacles	27.864	10.091			
	Total	27.151	10.894			
	Major obstacles	23.231	12.310			
	Moderate obstacles	25.366	10.763			
Advisory services	Less obstacles	28.204	10.173	1.272	(3, 188)	0.285
	No obstacles	27.333	12.713			
	Total	27.125	10.893			
	Major obstacles	24.423	11.462			
	Moderate obstacles	27.145	9.949			
Training	Less obstacles	28.474	10.208	1.032	(3, 188)	0.38
	No obstacles	25.737	15.481			
	Total	27.177	10.907			
	Major obstacles	25.607	9.886			
	Moderate obstacles	26.508	12.638			
Product and service quality	Less obstacles	28.376	10.419	0.645	(3, 188)	0.587
	No obstacles	26.286	6.305			
	Total	27.188	10.908			
	Major obstacles	25.818	10.935			
Financial support	Moderate obstacles	26.134	11.677	2.656	(3, 189)	0.05
	Less obstacles	31.133	8.769			

	Leverage		Test statistic	df	<i>p</i> -value	
	Mean	SD				
	No obstacles	27.000	10.614			
	Total	27.192	10.880			
Competitors	Major obstacles	27.543	11.621	0.537	(3, 190)	0.658
	Moderate obstacles	26.057	9.447			
	Less obstacles	28.575	10.896			
	No obstacles	25.000	21.794			
	Total	27.180	10.853			
Customer satisfaction	Major obstacles	27.052	11.079	1.309	(3, 189)	0.273
	Moderate obstacles	26.000	10.782			
	Less obstacles	29.325	10.598			
	No obstacles	36.500	4.950			
	Total	27.218	10.869			
Government regulations (labour)	Major obstacles	27.008	11.058	0.849	(2, 191)	0.43
	Moderate obstacles	26.940	10.253			
	Less obstacles	32.429	13.189			
	No obstacles	0.000	0.000			
	Total	27.180	10.853			

Table A-4: Chi-square Test of Independence between Business Obstacles and Annual Turnover of a Business

		Annual turnover			Test statistic	df	p-value
		Up to 1 million SR	>1 million SR	Total			
Sales and marketing	Major obstacles	34 (53.97%)	29 (46.03%)	63	17.349	2	0.000
	Moderate obstacles	60 (32.97%)	122 (67.03%)	182			
	Less obstacles	1 (5.26%)	18 (94.74%)	19			
	Total	95 (35.98%)	169 (64.02%)	264			
Gender	Major obstacles	9 (21.95%)	32 (78.05%)	41	9.501	3	0.023
	Moderate obstacles	49 (46.23%)	57 (53.77%)	106			
	Less obstacles	26 (32.1%)	55 (67.9%)	81			
	No obstacles	12 (30%)	28 (70%)	40			
	Total	96 (35.82%)	172 (64.18%)	268			
Age of owner	Major obstacles	5 (20.83%)	19 (79.17%)	24	13.854	3	0.003
	Moderate obstacles	51 (48.57%)	54 (51.43%)	105			
	Less obstacles	28 (26.42%)	78 (73.58%)	106			
	No obstacles	12 (36.36%)	21 (63.64%)	33			
	Total	96 (35.82%)	172 (64.18%)	268			
Education level	Major obstacles	16 (45.71%)	19 (54.29%)	35	5.920	3	0.116
	Moderate obstacles	39 (41.49%)	55 (58.51%)	94			
	Less obstacles	28 (27.45%)	74 (72.55%)	102			
	No obstacles	13 (35.14%)	24 (64.86%)	37			

	Annual turnover			Test statistic	df	p-value	
	Up to 1 million SR	>1 million SR	Total				
	Total	96 (35.82%)	172 (64.18%)	268			
Management skills	Major obstacles	21 (42%)	29 (58%)	50	6.367	3	0.095
	Moderate obstacles	44 (35.77%)	79 (64.23%)	123			
	Less obstacles	20 (27.03%)	54 (72.97%)	74			
	No obstacles	10 (55.56%)	8 (44.44%)	18			
	Total	95 (35.85%)	170 (64.15%)	265			
Work experience	Major obstacles	30 (46.88%)	34 (53.13%)	64	5.274	3	0.153
	Moderate obstacles	37 (32.74%)	76 (67.26%)	113			
	Less obstacles	22 (29.73%)	52 (70.27%)	74			
	No obstacles	7 (41.18%)	10 (58.82%)	17			
	Total	96 (35.82%)	172 (64.18%)	268			
Availability of capital	Major obstacles	41 (37.96%)	67 (62.04%)	108	-	-	-
	Moderate obstacles	41 (32.28%)	86 (67.72%)	127			
	Less obstacles	12 (44.44%)	15 (55.56%)	27			
	No obstacles	1 (25%)	3 (75%)	4			
	Total	95 (35.71%)	171 (64.29%)	266			
Technology	Major obstacles	11 (37.93%)	18 (62.07%)	29	10.063	3	0.018
	Moderate obstacles	39 (43.33%)	51 (56.67%)	90			
	Less obstacles	33 (26.83%)	90 (73.17%)	123			

	Annual turnover			Test statistic	df	p-value
	Up to 1 million SR	>1 million SR	Total			
	No obstacles	13 (54.17%)	11 (45.83%)	24		
	Total	96 (36.09%)	170 (63.91%)	266		
	Major obstacles	16 (41.03%)	23 (58.97%)	39		
	Moderate obstacles	34 (41.46%)	48 (58.54%)	82		
High cost of labour	Less obstacles	36 (29.51%)	86 (70.49%)	122	3.823	3
	No obstacles	9 (39.13%)	14 (60.87%)	23		
	Total	95 (35.71%)	171 (64.29%)	266		
	Major obstacles	32 (39.51%)	49 (60.49%)	81		
	Moderate obstacles	39 (39%)	61 (61%)	100		
Availability of skilled employees	Less obstacles	22 (30.56%)	50 (69.44%)	72	3.420	3
	No obstacles	3 (20%)	12 (80%)	15		
	Total	96 (35.82%)	172 (64.18%)	268		
	Major obstacles	17 (62.96%)	10 (37.04%)	27		
	Moderate obstacles	31 (44.93%)	38 (55.07%)	69		
Chamber of commercial services	Less obstacles	28 (23.33%)	92 (76.67%)	120	19.372	3
	No obstacles	18 (36%)	32 (64%)	50		
	Total	94 (35.34%)	172 (64.66%)	266		
	Major obstacles	36 (38.3%)	58 (61.7%)	94		
Government bureaucracy	Moderate obstacles	37 (38.54%)	59 (61.46%)	96	1.956	3

	Annual turnover			Test statistic	df	p-value
	Up to 1 million SR	>1 million SR	Total			
	Less obstacles	16 (30.19%)	37 (69.81%)	53		
	No obstacles	7 (28%)	18 (72%)	25		
	Total	96 (35.82%)	172 (64.18%)	268		
	Major obstacles	38 (43.68%)	49 (56.32%)	87		
	Moderate obstacles	25 (34.25%)	48 (65.75%)	73		
Corruption	Less obstacles	28 (31.82%)	60 (68.18%)	88	4.047	3
	No obstacles	5 (25%)	15 (75%)	20		
	Total	96 (35.82%)	172 (64.18%)	268		
	Major obstacles	13 (48.15%)	14 (51.85%)	27		
	Moderate obstacles	30 (50%)	30 (50%)	60		
Legal issues	Less obstacles	39 (28.47%)	98 (71.53%)	137	10.697	3
	No obstacles	12 (30.77%)	27 (69.23%)	39		
	Total	94 (35.74%)	169 (64.26%)	263		
	Major obstacles	22 (44%)	28 (56%)	50		
	Moderate obstacles	32 (37.65%)	53 (62.35%)	85		
Government support	Less obstacles	30 (29.13%)	73 (70.87%)	103	3.581	3
	No obstacles	10 (35.71%)	18 (64.29%)	28		
	Total	94 (35.34%)	172 (64.66%)	266		
Advisory services	Major obstacles	17 (60.71%)	11 (39.29%)	28	19.528	3

	Annual turnover			Test statistic	df	p-value	
	Up to 1 million SR	>1 million SR	Total				
	Moderate obstacles	29 (48.33%)	31 (51.67%)	60			
	Less obstacles	34 (24.46%)	105 (75.54%)	139			
	No obstacles	14 (35.9%)	25 (64.1%)	39			
	Total	94 (35.34%)	172 (64.66%)	266			
Training	Major obstacles	24 (57.14%)	18 (42.86%)	42	11.069	3	0.011
	Moderate obstacles	33 (33%)	67 (67%)	100			
	Less obstacles	29 (29.9%)	68 (70.1%)	97			
	No obstacles	7 (26.92%)	19 (73.08%)	26			
	Total	93 (35.09%)	172 (64.91%)	265			
Product and service quality	Major obstacles	23 (51.11%)	22 (48.89%)	45	10.100	3	0.018
	Moderate obstacles	39 (38.24%)	63 (61.76%)	102			
	Less obstacles	31 (30.1%)	72 (69.9%)	103			
	No obstacles	2 (12.5%)	14 (87.5%)	16			
	Total	95 (35.71%)	171 (64.29%)	266			
Financial support	Major obstacles	51 (43.59%)	66 (56.41%)	117	-	-	-
	Moderate obstacles	31 (33.7%)	61 (66.3%)	92			
	Less obstacles	13 (25.49%)	38 (74.51%)	51			
	No obstacles	0 (0%)	6 (100%)	6			
	Total	95 (35.71%)	171 (64.29%)	266			

		Annual turnover			Test statistic	df	p-value
		Up to 1 million SR	>1 million SR	Total			
Competitors	Major obstacles	56 (48.28%)	60 (51.72%)	116	-	-	-
	Moderate obstacles	27 (26.73%)	74 (73.27%)	101			
	Less obstacles	12 (25.53%)	35 (74.47%)	47			
	No obstacles	1 (25%)	3 (75%)	4			
	Total	96 (35.82%)	172 (64.18%)	268			
Customer satisfaction	Major obstacles	56 (48.28%)	60 (51.72%)	116	-	-	-
	Moderate obstacles	31 (31.31%)	68 (68.69%)	99			
	Less obstacles	9 (18.37%)	40 (81.63%)	49			
	No obstacles	0 (0%)	3 (100%)	3			
	Total	96 (35.96%)	171 (64.04%)	267			
Government regulations (labour)	Major obstacles	65 (38.69%)	103 (61.31%)	168	-	-	-
	Moderate obstacles	28 (30.11%)	65 (69.89%)	93			
	Less obstacles	3 (42.86%)	4 (57.14%)	7			
	Total	96 (35.82%)	172 (64.18%)	268			

Table A-5: Chi-square Test of Independence between Business Obstacles and Market Share of a Business

		Market share			Test statistic	df	<i>p</i> -value
		1–10 per cent	≥11 per cent	Total			
Sales and marketing	Major obstacles	24 (38.1%)	39 (61.9%)	63	-	-	-
	Moderate obstacles	39 (21.43%)	143 (78.57%)	182			
	Less obstacles	1 (5.26%)	18 (94.74%)	19			
	Total	64 (24.24%)	200 (75.76%)	264			
Gender	Major obstacles	8 (19.51%)	33 (80.49%)	41	4.695	3	0.196
	Moderate obstacles	33 (31.13%)	73 (68.87%)	106			
	Less obstacles	17 (20.99%)	64 (79.01%)	81			
	No obstacles	7 (17.5%)	33 (82.5%)	40			
	Total	65 (24.25%)	203 (75.75%)	268			
Age of owner	Major obstacles	3 (12.5%)	21 (87.5%)	24	10.609	3	0.014
	Moderate obstacles	36 (34.29%)	69 (65.71%)	105			
	Less obstacles	18 (16.98%)	88 (83.02%)	106			
	No obstacles	8 (24.24%)	25 (75.76%)	33			
	Total	65 (24.25%)	203 (75.75%)	268			
Education level	Major obstacles	14 (40%)	21 (60%)	35	9.235	3	0.026
	Moderate obstacles	25 (26.6%)	69 (73.4%)	94			
	Less obstacles	16 (15.69%)	86 (84.31%)	102			
	No obstacles	10 (27.03%)	27 (72.97%)	37			

	Market share			Test statistic	df	p-value	
	1–10 per cent	≥11 per cent	Total				
	Total	65 (24.25%)	203 (75.75%)	268			
Management skills	Major obstacles	17 (34%)	33 (66%)	50			
	Moderate obstacles	25 (20.33%)	98 (79.67%)	123			
	Less obstacles	13 (17.57%)	61 (82.43%)	74	-	-	-
	No obstacles	9 (50%)	9 (50%)	18			
	Total	64 (24.15%)	201 (75.85%)	265			
Work experience	Major obstacles	20 (31.25%)	44 (68.75%)	64			
	Moderate obstacles	25 (22.12%)	88 (77.88%)	113			
	Less obstacles	14 (18.92%)	60 (81.08%)	74	-	-	-
	No obstacles	6 (35.29%)	11 (64.71%)	17			
	Total	65 (24.25%)	203 (75.75%)	268			
Availability of capital	Major obstacles	32 (29.63%)	76 (70.37%)	108			
	Moderate obstacles	24 (18.9%)	103 (81.1%)	127			
	Less obstacles	9 (33.33%)	18 (66.67%)	27	-	-	-
	No obstacles	0 (0%)	4 (100%)	4			
	Total	65 (24.44%)	201 (75.56%)	266			
Technology	Major obstacles	11 (37.93%)	18 (62.07%)	29			
	Moderate obstacles	28 (31.11%)	62 (68.89%)	90	14.756	3	0.002
	Less obstacles	17 (13.82%)	106 (86.18%)	123			

	Market share			Test statistic	df	p-value	
	1–10 per cent	≥11 per cent	Total				
	No obstacles	9 (37.5%)	15 (62.5%)	24			
	Total	65 (24.44%)	201 (75.56%)	266			
High cost of labour	Major obstacles	13 (33.33%)	26 (66.67%)	39	6.235	3	0.101
	Moderate obstacles	24 (29.27%)	58 (70.73%)	82			
	Less obstacles	21 (17.21%)	101 (82.79%)	122			
	No obstacles	6 (26.09%)	17 (73.91%)	23			
	Total	64 (24.06%)	202 (75.94%)	266			
Availability of skilled employees	Major obstacles	25 (30.86%)	56 (69.14%)	81	-	-	-
	Moderate obstacles	25 (25%)	75 (75%)	100			
	Less obstacles	12 (16.67%)	60 (83.33%)	72			
	No obstacles	3 (20%)	12 (80%)	15			
	Total	65 (24.25%)	203 (75.75%)	268			
Chamber of commercial services	Major obstacles	11 (40.74%)	16 (59.26%)	27	16.114	3	0.001
	Moderate obstacles	24 (34.78%)	45 (65.22%)	69			
	Less obstacles	16 (13.33%)	104 (86.67%)	120			
	No obstacles	13 (26%)	37 (74%)	50			
	Total	64 (24.06%)	202 (75.94%)	266			
Government bureaucracy	Major obstacles	22 (23.4%)	72 (76.6%)	94	1.236	3	0.744
	Moderate obstacles	24 (25%)	72 (75%)	96			

	Market share			Test statistic	df	p-value
	1–10 per cent	≥11 per cent	Total			
	Less obstacles	11 (20.75%)	42 (79.25%)	53		
	No obstacles	8 (32%)	17 (68%)	25		
	Total	65 (24.25%)	203 (75.75%)	268		
	Major obstacles	30 (34.48%)	57 (65.52%)	87		
	Moderate obstacles	15 (20.55%)	58 (79.45%)	73		
Corruption	Less obstacles	16 (18.18%)	72 (81.82%)	88	-	-
	No obstacles	4 (20%)	16 (80%)	20		
	Total	65 (24.25%)	203 (75.75%)	268		
	Major obstacles	13 (48.15%)	14 (51.85%)	27		
	Moderate obstacles	19 (31.67%)	41 (68.33%)	60		
Legal issues	Less obstacles	24 (17.52%)	113 (82.48%)	137	13.834	3
	No obstacles	8 (20.51%)	31 (79.49%)	39		
	Total	64 (24.33%)	199 (75.67%)	263		
	Major obstacles	14 (28%)	36 (72%)	50		
	Moderate obstacles	21 (24.71%)	64 (75.29%)	85		
Government support	Less obstacles	21 (20.39%)	82 (79.61%)	103	1.516	3
	No obstacles	8 (28.57%)	20 (71.43%)	28		
	Total	64 (24.06%)	202 (75.94%)	266		
Advisory services	Major obstacles	15 (53.57%)	13 (46.43%)	28	20.627	3

	Market share			Test statistic	df	p-value	
	1–10 per cent	≥11 per cent	Total				
	Moderate obstacles	16 (26.67%)	44 (73.33%)	60			
	Less obstacles	21 (15.11%)	118 (84.89%)	139			
	No obstacles	12 (30.77%)	27 (69.23%)	39			
	Total	64 (24.06%)	202 (75.94%)	266			
Training	Major obstacles	18 (42.86%)	24 (57.14%)	42	10.171	3	0.017
	Moderate obstacles	20 (20%)	80 (80%)	100			
	Less obstacles	19 (19.59%)	78 (80.41%)	97			
	No obstacles	6 (23.08%)	20 (76.92%)	26			
	Total	63 (23.77%)	202 (76.23%)	265			
Product and service quality	Major obstacles	21 (46.67%)	24 (53.33%)	45	-	-	-
	Moderate obstacles	20 (19.61%)	82 (80.39%)	102			
	Less obstacles	23 (22.33%)	80 (77.67%)	103			
	No obstacles	1 (6.25%)	15 (93.75%)	16			
	Total	65 (24.44%)	201 (75.56%)	266			
Financial support	Major obstacles	37 (31.62%)	80 (68.38%)	117	-	-	-
	Moderate obstacles	21 (22.83%)	71 (77.17%)	92			
	Less obstacles	7 (13.73%)	44 (86.27%)	51			
	No obstacles	0 (0%)	6 (100%)	6			
	Total	65 (24.44%)	201 (75.56%)	266			

		Market share			Test statistic	df	p-value
		1–10 per cent	≥11 per cent	Total			
Competitors	Major obstacles	40 (34.48%)	76 (65.52%)	116	-	-	-
	Moderate obstacles	17 (16.83%)	84 (83.17%)	101			
	Less obstacles	6 (12.77%)	41 (87.23%)	47			
	No obstacles	2 (50%)	2 (50%)	4			
	Total	65 (24.25%)	203 (75.75%)	268			
Customer satisfaction	Major obstacles	39 (33.62%)	77 (66.38%)	116	-	-	-
	Moderate obstacles	18 (18.18%)	81 (81.82%)	99			
	Less obstacles	8 (16.33%)	41 (83.67%)	49			
	No obstacles	0 (0%)	3 (100%)	3			
	Total	65 (24.34%)	202 (75.66%)	267			
Government regulations (labour)	Major obstacles	43 (25.6%)	125 (74.4%)	168	-	-	-
	Moderate obstacles	21 (22.58%)	72 (77.42%)	93			
	Less obstacles	1 (14.29%)	6 (85.71%)	7			
	No obstacles	0 (0%)	0 (0%)	0			
	Total	65 (24.25%)	203 (75.75%)	268			

Table A-6: Chi-square Test of Independence between Business Obstacles and Annual Growth Rate of a Business

		Annual growth rate			Test statistic	df	<i>p</i> -value
		1—10 per cent	≥11 per cent	Total			
Sales and marketing	Major obstacles	53 (84.13%)	10 (15.87%)	63	-	-	-
	Moderate obstacles	145 (80.11%)	36 (19.89%)	181			
	Less obstacles	10 (52.63%)	9 (47.37%)	19			
	Total	208 (79.09%)	55 (20.91%)	263			
Gender	Major obstacles	33 (80.49%)	8 (19.51%)	41	7.712	3	0.052
	Moderate obstacles	91 (86.67%)	14 (13.33%)	105			
	Less obstacles	61 (75.31%)	20 (24.69%)	81			
	No obstacles	27 (67.5%)	13 (32.5%)	40			
	Total	212 (79.4%)	55 (20.6%)	267			
Age of owner	Major obstacles	16 (66.67%)	8 (33.33%)	24	-	-	-
	Moderate obstacles	90 (86.54%)	14 (13.46%)	104			
	Less obstacles	81 (76.42%)	25 (23.58%)	106			
	No obstacles	25 (75.76%)	8 (24.24%)	33			
	Total	212 (79.4%)	55 (20.6%)	267			
Education level	Major obstacles	27 (77.14%)	8 (22.86%)	35	0.572	3	0.903
	Moderate obstacles	74 (78.72%)	20 (21.28%)	94			
	Less obstacles	80 (79.21%)	21 (20.79%)	101			
	No obstacles	31 (83.78%)	6 (16.22%)	37			

	Annual growth rate			Test statistic	df	p-value	
	1—10 per cent	≥11 per cent	Total				
	Total	212 (79.4%)	55 (20.6%)	267			
Management skills	Major obstacles	37 (74%)	13 (26%)	50			
	Moderate obstacles	99 (80.49%)	24 (19.51%)	123			
	Less obstacles	58 (79.45%)	15 (20.55%)	73	-	-	-
	No obstacles	16 (88.89%)	2 (11.11%)	18			
	Total	210 (79.55%)	54 (20.45%)	264			
Work experience	Major obstacles	54 (84.38%)	10 (15.63%)	64			
	Moderate obstacles	85 (75.22%)	28 (24.78%)	113			
	Less obstacles	59 (80.82%)	14 (19.18%)	73	-	-	-
	No obstacles	14 (82.35%)	3 (17.65%)	17			
	Total	212 (79.4%)	55 (20.6%)	267			
Availability of capital	Major obstacles	83 (77.57%)	24 (22.43%)	107			
	Moderate obstacles	104 (81.89%)	23 (18.11%)	127			
	Less obstacles	21 (77.78%)	6 (22.22%)	27	-	-	-
	No obstacles	3 (75%)	1 (25%)	4			
	Total	211 (79.62%)	54 (20.38%)	265			
Technology	Major obstacles	19 (65.52%)	10 (34.48%)	29			
	Moderate obstacles	75 (83.33%)	15 (16.67%)	90	-	-	-
	Less obstacles	96 (78.69%)	26 (21.31%)	122			

		Annual growth rate			Test statistic	df	p-value
		1—10 per cent	≥11 per cent	Total			
	No obstacles	20 (83.33%)	4 (16.67%)	24			
	Total	210 (79.25%)	55 (20.75%)	265			
High cost of labour	Major obstacles	29 (74.36%)	10 (25.64%)	39			
	Moderate obstacles	61 (74.39%)	21 (25.61%)	82			
	Less obstacles	99 (81.82%)	22 (18.18%)	121	-	-	-
	No obstacles	21 (91.3%)	2 (8.7%)	23			
	Total	210 (79.25%)	55 (20.75%)	265			
Availability of skilled employees	Major obstacles	65 (80.25%)	16 (19.75%)	81			
	Moderate obstacles	84 (84%)	16 (16%)	100			
	Less obstacles	49 (69.01%)	22 (30.99%)	71	-	-	-
	No obstacles	14 (93.33%)	1 (6.67%)	15			
	Total	212 (79.4%)	55 (20.6%)	267			
Chamber of commercial services	Major obstacles	24 (88.89%)	3 (11.11%)	27			
	Moderate obstacles	59 (85.51%)	10 (14.49%)	69			
	Less obstacles	85 (71.43%)	34 (28.57%)	119	8.280	3	0.041
	No obstacles	42 (84%)	8 (16%)	50			
	Total	210 (79.25%)	55 (20.75%)	265			
Government bureaucracy	Major obstacles	72 (77.42%)	21 (22.58%)	93	2.777	3	0.427
	Moderate obstacles	81 (84.38%)	15 (15.63%)	96			

	Annual growth rate			Test statistic	df	p-value
	1—10 per cent	≥11 per cent	Total			
	Less obstacles	39 (73.58%)	14 (26.42%)	53		
	No obstacles	20 (80%)	5 (20%)	25		
	Total	212 (79.4%)	55 (20.6%)	267		
	Major obstacles	73 (84.88%)	13 (15.12%)	86		
	Moderate obstacles	60 (82.19%)	13 (17.81%)	73		
Corruption	Less obstacles	64 (72.73%)	24 (27.27%)	88	-	-
	No obstacles	15 (75%)	5 (25%)	20		
	Total	212 (79.4%)	55 (20.6%)	267		
	Major obstacles	23 (85.19%)	4 (14.81%)	27		
	Moderate obstacles	52 (86.67%)	8 (13.33%)	60		
Legal issues	Less obstacles	103 (75.74%)	33 (24.26%)	136	3.633	3
	No obstacles	31 (79.49%)	8 (20.51%)	39		
	Total	209 (79.77%)	53 (20.23%)	262		
	Major obstacles	46 (93.88%)	3 (6.12%)	49		
	Moderate obstacles	70 (82.35%)	15 (17.65%)	85		
Government support	Less obstacles	75 (72.82%)	28 (27.18%)	103	10.628	3
	No obstacles	20 (71.43%)	8 (28.57%)	28		
	Total	211 (79.62%)	54 (20.38%)	265		
Advisory services	Major obstacles	26 (92.86%)	2 (7.14%)	28	9.209	3

	Annual growth rate			Test statistic	df	p-value	
	1—10 per cent	≥11 per cent	Total				
	Moderate obstacles	52 (86.67%)	8 (13.33%)	60			
	Less obstacles	100 (72.46%)	38 (27.54%)	138			
	No obstacles	32 (82.05%)	7 (17.95%)	39			
	Total	210 (79.25%)	55 (20.75%)	265			
Training	Major obstacles	39 (92.86%)	3 (7.14%)	42	11.467	3	0.009
	Moderate obstacles	83 (83%)	17 (17%)	100			
	Less obstacles	67 (69.79%)	29 (30.21%)	96			
	No obstacles	22 (84.62%)	4 (15.38%)	26			
	Total	211 (79.92%)	53 (20.08%)	264			
Product and service quality	Major obstacles	41 (91.11%)	4 (8.89%)	45	-	-	-
	Moderate obstacles	84 (83.17%)	17 (16.83%)	101			
	Less obstacles	73 (70.87%)	30 (29.13%)	103			
	No obstacles	13 (81.25%)	3 (18.75%)	16			
	Total	211 (79.62%)	54 (20.38%)	265			
Financial support	Major obstacles	100 (86.21%)	16 (13.79%)	116	-	-	-
	Moderate obstacles	72 (78.26%)	20 (21.74%)	92			
	Less obstacles	36 (70.59%)	15 (29.41%)	51			
	No obstacles	3 (50%)	3 (50%)	6			
	Total	211 (79.62%)	54 (20.38%)	265			

		Annual growth rate			Test statistic	df	p-value
		1—10 per cent	≥11 per cent	Total			
Competitors	Major obstacles	103 (88.79%)	13 (11.21%)	116	-	-	-
	Moderate obstacles	78 (77.23%)	23 (22.77%)	101			
	Less obstacles	29 (63.04%)	17 (36.96%)	46			
	No obstacles	2 (50%)	2 (50%)	4			
	Total	212 (79.4%)	55 (20.6%)	267			
Customer satisfaction	Major obstacles	99 (86.09%)	16 (13.91%)	115	-	-	-
	Moderate obstacles	79 (79.8%)	20 (20.2%)	99			
	Less obstacles	32 (65.31%)	17 (34.69%)	49			
	No obstacles	1 (33.33%)	2 (66.67%)	3			
	Total	211 (79.32%)	55 (20.68%)	266			
Government regulations (labour)	Major obstacles	138 (82.63%)	29 (17.37%)	167	-	-	-
	Moderate obstacles	69 (74.19%)	24 (25.81%)	93			
	Less obstacles	5 (71.43%)	2 (28.57%)	7			
	No obstacles	0 (0%)	0 (0%)	0			
	Total	212 (79.4%)	55 (20.6%)	267			

Appendix B: Questionnaire for SME Entrepreneurs



Access to Finance by Saudi SMEs: Constraints and the impact on their Performance

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Section I: Background information

This section records background information about the firm and yourself

1. What is the name of your firm?

2. Basic business information:

a. What is your business type (s)?

- Retail
- Wholesale
- Service
- Manufacturing

b. What is your business area(s)?

- | | | |
|--|--|--|
| <input type="checkbox"/> Restaurant | <input type="checkbox"/> Health | <input type="checkbox"/> Agriculture |
| <input type="checkbox"/> Grocery | <input type="checkbox"/> Clothing, jewellery | <input type="checkbox"/> Finance |
| <input type="checkbox"/> Trade (export/import) | <input type="checkbox"/> Vehicles | <input type="checkbox"/> Education |
| <input type="checkbox"/> Real estate | <input type="checkbox"/> Furniture | <input type="checkbox"/> Other (please specify)... |

c. What is the estimated current market value of your business(s) total assets?

- | | | |
|---|---|---|
| <input type="checkbox"/> <1 million SR | <input type="checkbox"/> 10–20 million SR | <input type="checkbox"/> 1–5 million SR |
| <input type="checkbox"/> 20–30 million SR | <input type="checkbox"/> 5–10 million SR | <input type="checkbox"/> >30 million SR |

d. What is the estimated annual turnover of your business(s)?

- | | | |
|---|---|---|
| <input type="checkbox"/> Up to 500,000 SR | <input type="checkbox"/> 1–4 million SR | <input type="checkbox"/> 500,001–1 million SR |
| <input type="checkbox"/> 5–9 million SR | <input type="checkbox"/> >10 million SR | |

e. How many employees do you currently have in your business(s)?

- | | | |
|------------------------------------|------------------------------------|-----------------------------------|
| <input type="checkbox"/> 6–10 [] | <input type="checkbox"/> 31–59 [] | <input type="checkbox"/> ≥100 [] |
| <input type="checkbox"/> 11–30 [] | <input type="checkbox"/> 60–99 [] | |

f. What is your business(s) legal structure form?

- | | |
|--|--|
| <input type="checkbox"/> Sole proprietorship | <input type="checkbox"/> Partnership |
| <input type="checkbox"/> Company | <input type="checkbox"/> Other (please specify)..... |

- g. Does the founder of the business(s) act as manager?
 No Yes
- h. What is the gender of the owner?
 Male Female
- i. What is the nationality of the owner?
 Saudi Non-Saudi
- j. How many years of experience did you have when you started the business?
 1–5 years
 6–10 years
 >10 years
- k. What is your level of education?
 High school Bachelor degree
 Diploma Postgraduate degree
 Vocational diploma other (please specify).....
- l. Have you received any form of training in business management or entrepreneurial development through a course or workshop?
 No Yes
- m. Did you prepare a business plan or feasibility study for your business before it started?
 Yes No

n. How strongly do you agree/disagree with each of the following statements? (Please indicate with a tick)

	Strongly Disagree	Disagree	Not sure	Agree	Strongly Agree
Business plan gives clear vision for the future of the business					
Business plan useful to obtain finance					
Business plan takes time to be prepared and cost money					
We can't make business plan while the business is running					
Useful to determines demand for product and customer needs					
Business plan reduces manager decision-making power and ensuring commitment at the top level					

Section II: Business obstacles

This section aims to identify obstacles that face the firm (internal & external)

Using the four-point scale given below, how problematic do you consider these difficulties and issues as obstacles for growth of your business(s)?

	Factors	Major obstacle	Moderate obstacle	Less obstacle	No obstacle
1	Gender				
2	Age of owner				
3	Education level				
4	Management skills				
5	Work experience				
6	Availability of capital				
7	Technology				
8	High cost of labour				
9	Availability of skilled employees				
10	Chamber of commercial services				
11	Government bureaucracy				
12	Corruption				
13	Legal issues				
14	Government support				
15	Advisory services				
16	Training				
17	Product and service quality				
18	Financial support				
19	Competitors				
20	Customer satisfaction				
21	Government regulations (labour)				

a. Do you have a written strategic plan for the business?

No Yes

b. What is your target market?

- | | |
|--------------------------------------|---|
| <input type="checkbox"/> Individuals | <input type="checkbox"/> Manufacturing |
| <input type="checkbox"/> Retail | <input type="checkbox"/> Education (school) |
| <input type="checkbox"/> Wholesale | <input type="checkbox"/> Health (hospitals) |

c. What is the current market share of your firm?

- | | |
|---|---|
| <input type="checkbox"/> 1–5 per cent | <input type="checkbox"/> 16–20 per cent |
| <input type="checkbox"/> 6–10 per cent | <input type="checkbox"/> >20 per cent |
| <input type="checkbox"/> 11–15 per cent | |

d. What is the annual growth rate of your firm?

- | | |
|---|---|
| <input type="checkbox"/> 1–5 per cent | <input type="checkbox"/> 16–20 per cent |
| <input type="checkbox"/> 6–10 per cent | <input type="checkbox"/> >20 per cent |
| <input type="checkbox"/> 11–15 per cent | |

e. Do you have a financial and accounting system at your firm? No Yes

f. Does the firm report its financial transactions on a monthly basis?

- No Yes

g. Do you always prepare cash flow forecasting for the financial year at the beginning of the year?

- No Yes

h. Which of the following source(s) of finance did you use when you started your business? *(You may check more than one of applicable).*

- Personal resources
- Commercial bank
- Islamic bank
- Relative or friends
- Venture capital

- Government supporting fund (please specify).....
- Private sector fund (please specify).....

i. What are the major financial risks facing your firm?

- Interest rates
- Credit scoring
- Liquidity
- Funding risk
- Foreign exchange risk
- Commodity price risk

j. What are the average values for the last three years of the following ratios:

Return on investment (net income/total investment) = _____per cent

Profit margin (net income/net sales) = _____per cent

Leverage (total deb/total equity) = _____

k. How do you rate your credit scoring at the Saudi Credit Bureau (SIMAH)?

- Very good
- Good
- Acceptable
- Poor

l. Does the firm have any loan or financial obligations to any financial institutions?

- No
- Yes

Section III: Access to finance

This section aims to identify the financial constraints for funding SMEs

a. What were the sources of finance you used after the establishment stage for your business?

- Own savings
- Borrowed from friend
- Loan from government fund
- Loan from private sector fund
- Family assistance
- Loan from bank
- Venture capital
- Trade credit

b. Why did you need financing for?

- Purchasing raw material
- Working capital
- Purchasing fixed asset
- Equipment/vehicle
- Production process
- Exporting/importing
- Rent
- Enter new market
- Expand business

c. Have you applied for loans from banks?

- No Yes

d. If 'Yes', what type of financial product did you apply for?

- Murabaha Ijara Conventional commercial loan
 Musharaka Tawarq
 Mudaraba Salam

e. What interest rate were you charged for your loan?

- 0.5–2 per cent 6.1-8 per cent
 2.1-4 per cent >8 per cent
 4.1-6 per cent

e. Have you faced difficulties in obtaining loans from Saudi banks?

- No Yes

f. If 'Yes', did this affect your business performance?

- No Yes

g. If your answer was 'No' for Q.3c, then why?

- Don't meet the acceptance criteria Ask high collateral
 Religious issue
 Ask high interest
 Too much paperwork

h. If the concern is a religious issue, why don't you apply for Islamic banking?

- Still ask high profit Limited Islamic financial products
 Ask high collateral
 I doubt in their Islamic financial products
 Not feeling comfortable with the current product

i. What difficulties have you faced when you applied for loans from Saudi banks?

- High interest rates High services fees
 High collateral requirements Too much paperwork
 Time to get loan is too long Loan duration is too short
 Insufficient amount of finance
 Complexity of application and loan procedures

- No difficulty
- Other (please specify).....

j. If you failed to access finance or your financing application was rejected, what were the reasons given by the bank or other financial institution you applied to?

- | | |
|---|---|
| <input type="checkbox"/> Lack of collateral | <input type="checkbox"/> Don't meet requirements |
| <input type="checkbox"/> Lack of financial information | <input type="checkbox"/> Project too risky |
| <input type="checkbox"/> Poor business performance | <input type="checkbox"/> Insufficient information |
| <input type="checkbox"/> New business start- up | <input type="checkbox"/> Inadequate business planning |
| <input type="checkbox"/> Lack of credit record history | <input type="checkbox"/> No credit history |
| <input type="checkbox"/> Lack of accurate and comprehensive financial information | |
| <input type="checkbox"/> Other (please specify)..... | |

k. What type of financial products are provided to SMEs by Saudi banks?

- | | | |
|--|---|------------------------------------|
| <input type="checkbox"/> Personal finance | <input type="checkbox"/> Commercial loans | <input type="checkbox"/> Overdraft |
| <input type="checkbox"/> Receivables finance | <input type="checkbox"/> Islamic finance (please specify what kind) | |
-

l. Have you applied for any government funds to obtain capital?

- No Yes

m. If 'No' why?

- | | |
|---|--|
| <input type="checkbox"/> Do not need these programmes/services | <input type="checkbox"/> Acceptance takes too long |
| <input type="checkbox"/> Not aware of programmes/services offered | |
| <input type="checkbox"/> Don't meet the acceptance criteria | <input type="checkbox"/> Procedure too complicated |

n. Has your loan application been accepted from a government funding institution?

- No Yes

o. If you failed to obtain funds or your financing application was rejected, what were the reasons given by the government or other financial institution you applied to?

- | | |
|---|---|
| <input type="checkbox"/> Lack of collateral or personal guarantee | <input type="checkbox"/> Don't meet requirements |
| <input type="checkbox"/> Existing business | <input type="checkbox"/> Project too risky |
| <input type="checkbox"/> Poor business performance | <input type="checkbox"/> Insufficient information |
| <input type="checkbox"/> Not qualified for the programme | <input type="checkbox"/> Inadequate business planning |
| <input type="checkbox"/> Have other business | <input type="checkbox"/> Poor credit history |

- Project not in the domain of economic activities listed
- Other (please specify).....

p. Have you received any technical or vocational training from any government training institution?

- No Yes

q. Have you heard about the Kafalah programme?

- No Yes

r. Have you applied for financing through Kafalah?

- No Yes

s. What difficulties have you faced when applying to the Kafalah programme?

- | | |
|--|---|
| <input type="checkbox"/> Ask for collateral or personal guarantee | <input type="checkbox"/> Loan duration too short |
| <input type="checkbox"/> Start-up business | <input type="checkbox"/> Complexity of application |
| <input type="checkbox"/> High services fees | <input type="checkbox"/> Insufficient amount of finance |
| <input type="checkbox"/> Not qualified for the programme | <input type="checkbox"/> Inadequate business planning |
| <input type="checkbox"/> Time to get the loan is too long | <input type="checkbox"/> Too much paperwork |
| <input type="checkbox"/> The project not in the domain of economic activities listed | |
| <input type="checkbox"/> Other (please specify)..... | |

t. What type of financing would you prefer for your business activities?

- Islamic banking Conventional banking Both

u. Which of the following Islamic financial products are provided by banks for SMEs?

- Musharakah - Equity & profit-loss sharing
- Mudharabah - Profit-sharing finance
- Murabaha - Cost-plus sale or Trade with mark-up
- Ijarah - Lease financing
- Other (please specify).....

THANK YOU FOR YOUR COOPERATION AND PRECIOUS TIME

استبيان لمشروعات المنشآت الصغيرة والمتوسطة

تمويل المنشآت الصغيرة والمتوسطة في المملكة العربية السعودية من البنوك السعودية :
المعوقات والتحديات

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القسم الأول: المعلومات الأساسية

يهدف هذا القسم الى معرفة مزيد من المعلومات عنكم وعن شركتكم

1- البيانات الأساسية للمنشأة

* ما اسم المنشأة التي تملكها أو تديرها؟

1-1 ما هو نوع منشأتكم؟

تجارة التجزئة تجارة الجملة الخدمات الصناعة

2-1 ما هو مجال عملكم؟

مطعم صحة زراعة
بقالة ملابس ، مجوهرات تمويل
تجارة (استيراد/ تصدير) سيارات تعليم
عقارات أثاث أخرى (الرجاء حدها)

3-1 ما هي القيمة الحالية المقدرة لإجمالي أصول عملك ؟

أقل من 1 مليون ريال سعودي 1- 5 مليون ريال سعودي أكثر من 5- 10 مليون ريال سعودي
أكثر من 10- 20 مليون ريال سعودي أكثر من 20- 30 مليون ريال سعودي أكثر من 30 مليون ريال سعودي

4-1 ما هو حجم الأعمال المقدر لأعمالكم سنوياً؟

لغاية 500.00 ريال سعودي 1-5 مليون ريال سعودي 500.001 - 1 مليون ريال سعودي
أكثر من 5- 9 مليون ريال سعودي أكثر من 10 مليون ريال سعودي

5-1 ما هو شكل الهيكل القانوني لمنشأتكم؟

- ملكية فردية
- شراكة
- شركة
- أخرى (الرجاء التحديد)

6-1 كم عدد الموظفين العاملين في منشأتكم؟

- 10-6
- 30-11
- 59-31
- 99-60

7-1 هل يعمل مؤسس العمل التجاري كمدير؟

- نعم
- لا

8-1 ما هو جنس صاحب المنشأة؟

- ذكر
- أنثى

9-1 ما هي جنسية صاحبي العمل

- سعودي
- غير سعودي

10-1 كم عدد سنوات الخبرة لديك منذ بدء عملكم؟

- أكثر من عشر سنوات
- ستة إلى عشر سنوات
- منة إلى خمسة سنوات

11-1 ما هو مستوى تعليمكم؟

- شهادة الثانوية
- درجة البكالوريوس
- دبلوم
- دراسات عليا
- دبلوم مهني
- أخرى (الرجاء التحديد)

12-1 هل تلقيت أي نوع من انواع التدريب في إدارة الأعمال أو تنمية المشاريع من خلال برنامج تدريب أو ورشة عمل؟

- نعم
- لا

13-1 هل أعددت خطة عمل أو دراسة جدوى قبل البدء في هذا المشروع أو أي مشروع آخر

لا (ما السبب)

نعم

14-1 ما مدى موافقتكم على البيانات التالية؟ (الرجاء التحديد بوضع علامة صح)

لا أوافق	لست متأكد	أوافق	
			توفر خطة العمل رؤيا واضحة لمستقبل العمل
			خطة العمل مفيدة للحصول على تمويل
			تستغرق خطة العمل الوقت لإعدادها وتكلف المال
			لا نستطيع عمل خطة العمل أثناء سريان العمل
			مفيدة لتحديد الطلب المستقبلي على المنتج ومتطلبات العملاء
			تخفف خطة العمل من سلطة صنع القرار من المدير وتضمن الالتزام على أعلى المستويات

القسم الثاني: العوائق التجارية

يهدف هذا القسم الى تحديد المعوقات التي تواجه المنشأة (الداخلية والخارجية)

2.1- باستخدام مقياس النقاط الأربع الواردة أدناه ما مدى تقييمك للمسائل التالية كمعوقات لنمو أعمالكم؟

	العوامل	معوقات رئيسية	معوقات متوسطة	معوقات أقل	ليس معوق
1	الجنس				
2	عمر المالك				
3	المستوى التعليمي				
4	مهارات إدارية				
5	خبرة العمل				
6	توفر رأس المال				
7	التكنولوجيا				
8	تكلفة مرتفعة للعمالة				
9	توفر الموظفين المهرة				
10	خدمات الغرفة التجارية				
11	البيروقراطية الحكومية				
12	الفساد				
13	القضايا القانونية				
14	الدعم الحكومي				
15	خدمات الاستشارات				
16	التدريب				
17	جودة المنتجات والخدمات				
18	الدعم المالي				
19	المنافسون				
20	رضاء العميل				
21	أنظمة العمل والعمال				

2.2 هل لديكم خطة استراتيجية مكتوبة لأعمالكم وواضحة للموظفين؟

نعم

لا

2.3 ما هو سوقكم المستهدف أو من هم زبائنكم المستهدفين؟

الأفراد بشكل عام المصانع المدارس وقطاع التعليم

المحلات التجارية المستشفيات والقطاع الصحي

2-4 ما هي حصة السوق الحالية لمنشأتكم؟

من 1 - 5 % من 6 - 10 % من 11-15 % أكثر من 15 %

2.5 كم يبلغ معدل النمو السنوي لمنشأتكم؟

من 1 - 5 % من 6 - 10 % من 11-15 % أكثر من 15 %

2.6 هل لديكم نظام مالي ومحاسبي في منشأتكم؟ نعم لا

2.7 هل تعد الشركة تقرير لتعاملاتها المالية على أساس شهري؟

نعم لا

2.8 أي من المصادر المالية التالية تم إختيارها كمصدر لتمويل أعمالكم في مرحلة التأسيس؟
(اختيار أكثر من واحدة حسب وضعكم).

المصادر الشخصية

البنك التجاري

البنك الإسلامي

الأقارب أو الأصدقاء

رأسمال المال المخاطر

صندوق الدعم الحكومي (الرجاء التحديد)

صناديق القطاع الخاص (الرجاء التحديد)

2.9 ما هي مخاطر التمويل الرئيسية التي تواجه منشأتكم؟

- | | | | |
|----------------------------|--------------------------|---------------|--------------------------|
| مخاطر الصرف الأجنبي | <input type="checkbox"/> | سعر الفائدة | <input type="checkbox"/> |
| مخاطر أسعار السلع الأساسية | <input type="checkbox"/> | سجل الائتمان | <input type="checkbox"/> |
| | | السيولة | <input type="checkbox"/> |
| | | مخاطر التمويل | <input type="checkbox"/> |

2.10 هل لدى الشركة أي قرض أو التزامات مالية لأية مؤسسات مالية

- نعم لا

2.11 ما هو متوسط النسبة المئوية للثلاثة سنوات الماضية للمؤشرات المالية التالية :

- العائد على حقوق الإستثمار (صافي الدخل / حقوق المستثمرين) = _____ %
هامش الربح (صافي الدخل / صافي المبيعات) = _____ %
نسبة الدين إلى حقوق الملكية (مجموع المطلوبات / حقوق الملكية) = _____ %

القسم الثالث: الحصول على التمويل

يهدف هذا القسم الى تحديد المعوقات المالية لتمويل المنشآت الصغيرة والمتوسطة

3.1 ما هي مصادر التمويل التي استخدمتها بعد مرحلة التأسيس؟

- | | | | |
|------------------|--------------------------|---------------------------|--------------------------|
| معونة عائلة | <input type="checkbox"/> | ادخار ذاتي | <input type="checkbox"/> |
| القروض من البنوك | <input type="checkbox"/> | أقترضت من صديق | <input type="checkbox"/> |
| رأسمال المشروع | <input type="checkbox"/> | القرض من صندوق حكومي | <input type="checkbox"/> |
| الائتمان التجاري | <input type="checkbox"/> | قرض من صندوق القطاع الخاص | <input type="checkbox"/> |

3.2 لماذا إحتجت إلى التمويل؟

- | | | | | | |
|---------------------|--------------------------|--------------------|--------------------------|-----------------|--------------------------|
| ايجار | <input type="checkbox"/> | معدات/ سيارات | <input type="checkbox"/> | شراء مواد خام | <input type="checkbox"/> |
| الدخول الى سوق جديد | <input type="checkbox"/> | عملية الانتاج | <input type="checkbox"/> | رأسمال عامل | <input type="checkbox"/> |
| | | التصدير/ الاستيراد | <input type="checkbox"/> | شراء اصول ثابتة | <input type="checkbox"/> |

3.3 هل تقدمت للحصول على قروض من البنوك؟

نعم لا

3.4 إذا كان الجواب "نعم" ماهو نوع المنتج المالي الذي تقدمت به؟

مربحة مضاربة ايجاره
مشاركة سلم تورق
قرض تقليدي غير إسلامي

3.5 كم نسبة الفائدة أو المربحة على القرض؟

2-0.05% 4-2.1% 6-4.1%
 8-6.1% أكثر من 8%

3.6 إذا كان الجواب "لا" في الفقرة (3.3) . ما سبب إجمالك عن التقدم على قرض من البنك؟

عدم استيفاء المتطلبات أسباب دينية طلب فائدة عالية
طلب ضمانات مرتفعه مطلوب الكثير من أوراق لا أحتاج إلى قرض

3.7 إذا كان سبب عدم التقدم للحصول على قرض من البنك بسبب ديني . لماذا لم تتقدم بطلب قرض إسلامي ؟

عدم الثقة بالمنتجات الحالية أشك بإسلامية المنتجات التي به طلب مرابحه عالية
طلب ضمانات مرتفعه محدودية المنتجات الإسلامية المعروضه

3.8. هل واجهتك مصاعب عند التقدم لطلب قرض من البنك؟

نعم لا

3.9 إذا كان الجواب "نعم" هل أثر ذلك على أدي عملكم؟

نعم لا

3.10 ما هي الصعوبات التي واجهتها عند التقدم للحصول على قرض من البنوك السعودية؟

طلب فائدة عالية رسوم الخدمات
متطلبات الضمانات مرتفعة مطلوب الكثير من أوراق العمل
الوقت للحصول على قرض طويل جدا مدة القرض قصيرة جدا
عدم كفاية كمية التمويل
تعقيد إجراءات تقديم الطلبات والقرض لم أواجه صعوبة
أخرى (الرجاء التحديد)

3.11 إذا أخفقت في الحصول على تمويل أو تم رفض طلبك التمويل ، ما هي الأسباب التي تعطي من قبل البنوك أو مؤسسة مالية أخرى حيث تقدمت لها؟

- | | | | |
|--------------------------|--------------------------|-------------------------------------|--------------------------|
| عدم استيفاء المتطلبات | <input type="checkbox"/> | نقص الضمان | <input type="checkbox"/> |
| مخاطرة المشروع كبيرة جدا | <input type="checkbox"/> | نقص المعلومات المالية | <input type="checkbox"/> |
| المعلومات غير كافية | <input type="checkbox"/> | رداءة أداء الأعمال | <input type="checkbox"/> |
| عدم كفاية تخطيط الأعمال | <input type="checkbox"/> | بدء أعمال جديدة | <input type="checkbox"/> |
| لا يوجد تاريخ انتماني | <input type="checkbox"/> | عدم وجود تاريخ سجل انتمان | <input type="checkbox"/> |
| | | عدم وجود معلومات مالية دقيقة وشاملة | <input type="checkbox"/> |
| | | أخرى (يرجى التحديد) | <input type="checkbox"/> |

3.12 ما هو نوع المنتج المالي المقدم الى المنشآت الصغيرة والمتوسطة من البنوك السعودية؟

- | | | | | | | |
|-------------------|--------------------------|--|--------------------------|-------|--------------------------|-----|
| تمويل شخصي | <input type="checkbox"/> | قروض تجارية | <input type="checkbox"/> | السحب | <input type="checkbox"/> | على |
| المكشوف | | | | | | |
| الحسابات المستحقة | <input type="checkbox"/> | تمويل إسلامي (الرجاء تحديد النوع)..... | | | | |

3.13 هل تقدمت بطلب لأية صناديق حكومية للحصول على رأس المال؟

- لا نعم

3.14 إذا كان الجواب نعم ماهي الجهة التمويلية التي تقدمت إليها ؟

3.15 إذا كان لا ، فلماذا؟

- | | | | |
|--|--------------------------|---------------------------|--------------------------|
| لست بحاجة الى هذه البرامج / الخدمات | <input type="checkbox"/> | عملية الموافقة طويلة جداً | <input type="checkbox"/> |
| لا يوجد عندي علم بالبرامج / الخدمات المعروضة | <input type="checkbox"/> | الإجراءات معقدة بشكل كبير | <input type="checkbox"/> |
| لا أستوفي معايير الموافقة | <input type="checkbox"/> | | |

3.16 هل كانت متطلبات وإجراءات الصناديق الحكومية قابلة للتحقيق؟

- لا نعم

3.17 هل سمعت عن برنامج كفالة؟

- لا نعم

3.18 إذا كان الجواب نعم هل تقدمت للتمويل عن طريقه؟

- لا نعم

3.19 ما نوع التمويل الذي تفضله لأنشطة أعمالك؟

- كلاهما البنوك التقليدية البنوك الإسلامية

3.20 أي من المنتجات التالية المالية الإسلامية يتم توفيرها من قبل البنوك للمنشآت الصغيرة والمتوسطة؟

- | | |
|---|--------------------------|
| المشاركة – المشاركة بحقوق الملكية والربح / الخسارة | <input type="checkbox"/> |
| المضاربة – تمويل تقاسم الأرباح | <input type="checkbox"/> |
| المرابحة – البيع بأعلى من التكلفة أو المتاجرة مع هامش ربح | <input type="checkbox"/> |
| الإجارة - تمويل التأجير | <input type="checkbox"/> |
| أخرى (الرجاء التحديد) | <input type="checkbox"/> |

3.21 أي مقترحات أو ملاحظات ترغبون في إضافتها:

نشكركم على وقتكم وحسن تعاونكم معنا