

FACTORS THAT HINDERS THE GROWTH OF SMALL AND MEDIUM ENTERPRISES (SMEs): EVIDENCE FROM NEPAL'S SMEs

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ABSTRACT

SMEs play a huge factor in a nation's economy as they offer huge employment opportunities, income generations, and poverty reduction. However, with increase in the necessity of SMEs in the development of a nation, there has been corresponding increase in the challenges for their growth- for instance, finance and technology. The study makes an important contribution by demonstrating the present day status of Nepali SMEs. This study has an objective to identify the barriers that the SMEs of Nepal face, which restricts the enterprises' prosperity. The author interviewed sixteen SMEs' owners with eighteen open-ended questions, and collected their responses and later decoded to do the analysis. According to their responses, the author found several factors that affect the SMEs' development. Among them lack of sufficient finance, lack of modern technology when needed, and ineffective governmental policy turned out to be the major ones. In addition, the study describes about the issues in a detail manner, and according to the causes of these distractions, the study later concludes with providing some recommendations that might be incorporated by the government to improve the SMEs' status in Nepal. Furthermore, the study brings new insights into Nepali SMEs, especially to owners' perspectives in such critical issues.

Keywords and JEL classification: D22 SMEs' empirical analysis, O16 Financial Constraints, O32 Technological Constraints, E61 Governmental Policy.

OVERVIEW

Small and Medium Enterprises (SMEs) contribute significantly to the prosperity of a nation. The key benefits of SMEs such as improvement of economic status of the country and eventually the GDP, job creation and employment opportunities, income generation sources, and poverty reduction helps uplift a nation's progress by also creating competitive market in the private sectors and integrating with large-scale industries (Qamruzzaman, Md. 2015). Nepal Rastra Bank notes that SMEs contribute about 22 per cent in the GDP of Nepal, and offers employment to millions of people- about 17 lakhs employment opportunities ([SMEs Financing in Nepal: Five key findings of the report | Neftake \(nepaleconomicforum.org\)](#)). Also, a report by UNESCO notes that SMEs of Nepal contributes around 70 per cent of the total national export. However, the SMEs of Nepal are not prospering as they should: financial and technological problems are limiting their growth. Most of the SMEs of Nepal have to rely on the ancestral property or family savings even just for their startup, leaving them behind in accessing modern technology and digitalized markets that could significantly improve their profits. In Nepal, 2,75,433 number of SMEs are registered, where about 76% are in agricultural sectors and 24% in nonagricultural sectors. Even though Government of Nepal has formulated several plans and policies to uplift the SMEs of Nepal- be it agro based or non-agro based- their contributions have not that promising. Though the Nepal Rastra Bank, the regulatory body, has fixed the lending rate at 5% for the agro-based SMEs, many banks and financial institutions are still lending at 18% which is a significant amount for the small businesses. Because of this about 33 per cent of SMEs funds from their ancestral property, 26% use the savings of their founder, and 16% take bank loans, 7% finance from remittance income, 6% from unofficial loans, 6% from the loans from cooperatives and 0.5% from venture capitals. Thus, SMEs of Nepal should be a primary concern of the Government and the private sector societies so that it will help to maximize their gains, having significant benefits to the employment generation, level of production and innovation.

Technological Constraints

The development of the IT sector and possible IT measures to apply in SMEs' growth is comparatively slower in developing countries than in developed countries (Kapurubandara &

Lawson, 2006; Uzoka et al., 2007). Firms of developing nations face numerous challenges like infrastructural limitations, relatively small number of buyers and sellers, shortage of skill and resulting high cost (Bingi et al., 2000; White et al., 2014). Study from White et al., (2014) claims that due to the poor infrastructure in developing countries, it becomes significantly harder for small firms to adopt advanced technology and get facilitated from it. Many SMEs could not embrace IT because they normally could not provide opportunities and utilize resources to train less skilled employees (Duan et al., n.d.), and this happens because of the financial constraints, and lack of effective IT policy (Maghanga, 2017). In fact, Muhammad et al., (2012) has shown that SMEs do not remain updated about the opportunities that the IT sectors provide, and could not identify the IT competency gap. Research by Hobson (2000) also depicts that even though SMEs are willing to embrace the developed technology, they can't move forward because of lacking knowledge, experience, and skills. This idea is also supported by Elbadri (2001).

Financial Constraints

In context of Nepal, the SMEs which take loans from the banks pay 12.5% interest rate with 1% service charge on loans (Nepal Rastra Bank, 2019). Due to this high interest rates, and lack of collaterals, most of the SMEs face difficulty even in getting both concessional and SMEs refinancing loans from the financial institutions (Nepal Rastra Bank, 2019). Though Microfinance, to some extent, was established to address the finance for SMEs and self-employment by providing financial assistance (Adhikari, D.B., & Shrestha, J., 2013), it was not sufficient to minimize the financial hurdles faced by the SMEs. Evidence shows that due to the in-qualitative management experience and insufficient collateral of the small firms, they face financial constraints (Nyanzu & Quaidoo, 2018). The Small Firms lack strategy to influence pricing of their product in the international market because of their size constraint. Due to their small size, they also lack financial capital and funding from external sources (Kalantaridis, 2004). With no funding from external sources and bank loans (or loans with high interest rates), SMEs of the underdeveloped countries are halted from expanding their business. However, Oum et al., (n.d.) claims that SMEs of developed countries receive better funds from external financial institutions. Those SMEs of developed countries tend to get larger loans for longer terms and at lower interest rates than that of the SMEs of underdeveloped countries.

Similarly, banks call it a high risk to provide loans to such small firms as banks are aware about the difficulties encountered by SMEs in attracting new financial resources (Sharpe, 1990).

Objectives

The overall objective of this study is to identify the constraints faced by the SMEs in Nepal. The specific objectives include: To identify the technological and financial constraints faced by SMEs of Nepal.

Scopes

As, in Nepal, there has been corresponding decrease in the performance of SMEs with the increase in its importance in the economic development, the study analyzes the difficulties that such SMEs face regarding finance and technology. The study also covers the limitations faced by the SMEs, such as lack of finance, lack of technology, and ineffective governmental policy.

Limitations

The study collected information about the SMEs from Nepal. Also, the study only chose 5 categories of the SMEs, and sample space was limited to 16 SMEs as respondents of the semi-structure questionnaire, that sounds a small sample size compared to the total SMEs in Nepal. However, the responses seem homogenous, which makes such sample space considerable to investigate those hindering factors on financing and technology.

Methodology

This study design covered mainly the qualitative approach to understand the technological and financial status of SMEs in Bharatpur Municipality, Chitwan, Nepal. Sample SMEs were chosen on a non-randomized basis. Five categories– including Offset Presses, Manufacturing Industry, Farming Industry, Trading Industry and Wholesalers firms– in the form of SMEs were chosen for this study. The SMEs were actually identified through the purposive approach.

In the questionnaire part, altogether, we designed 18 open-ended question. The questionnaire aimed at collecting information of the SMEs on three main characteristics: Demographic, Financial, and Technological. From the prepared list of questionnaire, we asked them three open-ended questions on the Governmental Aspects plus 2 general questions.

For the data collection, we adopted a semi-structured questionnaire during the interviews with the self-employed owner of the SMEs. All the participants responded to all the prepared questions. In order to analyze the data, a thematic analysis technique was followed. Responses were translated and decoded.

Results and Discussions

The report analyzed the responses of sixteen SMEs, and concluded that most of the SMEs are affected by the financial and technological issues. Furthermore, respondents tended to feel strongly that the ineffective policies of the government are resisting the growth of their business. Respondents complained about the lack of international market for exporting their products. The SMEs, overall, were struggling to prosper, and respondents demanded a great effort from the government in order to prosper SMEs.

1. Demographics Analysis of the Enterprises

The respondent SMEs are classified according to their nature of economic activities. It reflects that 12.5 % firms are in trading, 31.25% firms are in Farming, 12.5% firms are in Offset Press, 25% firms are in Manufacturing, and 18.75 % are in Wholesalers Categorization. All the interviewed respondents from 16 SMEs were men. They were the self-employed owners of their business. Talking about the age of the respondents, all were in the age group of 31-40 years followed by the age groups of 41-50 years. They possess necessary skills and degrees with them: BBA degree and Technical degrees (CTEVT). Some owners, however, only hold High School Degrees. Nevertheless, all of them have strong experience in their respective fields.

Table 1 “Categorization of the Enterprises, and the demographic details of the owners”

No. of firms	Field of Enterprises	Percentage	Level of Education	Age Group	Ethnicity	Experience(year)	Location
2	1. Printing Books 2. Printing Calendars,	12.5	1. BB A 2. BB	31-40	Brahmin	5-10	Bharatpu r, Nepal
4	1. Dairy Products 2. Poultry Farm 3. Poultry Feeds	25	1. High School Graduat	31-50	Brahmin	10-20	Bharatpu r, Nepal
5	1. Domestic cattle farming 2. Vegetables	31.5	All the owners were High	31-40	Kshetree	10-20	Bharatpu r, Nepal
2	1. Bicycle Trade 2. Garments Trade	12.5	1. BBA 2. High School	31-40	Brahmin	1-10	Bharatpu r, Nepal
3	1. Clothing stores 2. Supermarkets	18.75	1. High School Gradu	31-40	Gurung	1-10	Bharatpu r, Nepal

Category of Enterprises	Offset Press	Manufacturing Industry	Farming Industry	Trading Industry	Wholesale Companies
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2. Financial Analysis of the Enterprises

2.1 Source of Finance:

All the interviewed enterprises do not receive any funds from the foreign institutions. Because of this reason, most of the SMEs finance their startups either from borrowing from relatives and friends- which may cause to pay them 15% to 18% interest rate- and from their ancestral property- few apply for bank loans and few finance by group investment. Some enterprises also fund from their savings.

2.2 Financial Issues:

Interviewing 16 SMEs of Nepal, we found that finance is the one of the major causes that hinders the growth of the SMEs. People during the time of their Business's startups do not receive sufficient funding to sustain their business. It is found that due to the different policies of banks themselves, there comes a significant difference in the amount owners have to pay to the banks during amortization. Also as banks do not provide loans without considering the financial status of the borrower applying for the loans, 25% of the owners of the enterprises were arguing that while providing loans, banks should look after the company rather than their financial status. Although, government has dropped the interest rate's policy for the agricultural enterprises, their own financial issues have become the major obstacle for their progression. We found that, in the last fiscal year, most of the SMEs were either balanced with their previous fiscal year's status or were in loss (**Table 2.2**).

Table- 2.2 “Profit and Loss status of the Enterprises

Category of Enterprises	Field of Enterprises	Status*	Financial Status in Figures (approximate)
Offset Presses	1. Printing Books 2. Printing Calendars, Booklets, Souvenirs, Marriage Cards.	1. Profit 2. Profit	1. 9 lakhs in profit 2. 6 lakhs in profit
Manufacturers	1. Dairy Products 2. Poultry Farm 3. Poultry Feeds Manufacture	1. Remained same 2. Loss 3. Loss	1. 15 lakhs revenue generated in total ** 2. 1 Crore in loss 3. 9 lakhs in loss
Farming Industry	1. Buffaloes, Cows, and Goats farming 2. Vegetables Production	1. Remained Same 2. Loss	1. 3 lakhs revenue generated in total 2. 2 lakhs in loss
Trading Industry	1. Bicycle Trade 2. Garments Trade	1. Loss 2. Loss	1. 24 lakhs in loss 2. 8 lakhs in loss
Wholesale Companies	1. Clothing stores 2. Supermarkets	1. Profit 2. Profit	1. 6 lakhs in profit 2. 8 lakhs in profit

*Profit or Loss or Remained Same as the previous fiscal year

|** it corresponds to the one generated at the previous year.

3. Technological Analysis and Training Aspects of the SMEs

3.1 Technological Issues:

Due to the lack of sufficient finance in such SMEs, most of the SMEs can't import advanced technology from their starting phase, pushing them to use either Ancestral property or loans from relatives and friends to import such required technology. We saw that less than 60% of the interviewed enterprises brought advanced technologies, from their company's revenue, within the 2nd year of their startup. Rest were compelled to borrow loans again- at high interest, not from banks but from their relatives. (Table 3.1).

Table - 3.1 “Categorization of Enterprises using Advanced Technology and the time they imported technologies.”

Enterprises	Used from Startups or after some years of starting phase	Source of Funding for Technology
1. Offset Press	<ul style="list-style-type: none"> • Local Technology: Startups • Advanced Machines: after 2 years 	<ul style="list-style-type: none"> • Ancestral Property • Revenue Generated • Loans from friends and relatives
2. Manufactures	Only local machines are used.	Revenue Generated plus Loans from friends and relatives
3. Farming Industry	After a few years of starting phase	Loans from Friends and relatives plus small amount of revenue generated
4. Trading Industry	No Technology used except by Garments Industry (used at startups)	The Garments Industry funded from their Bank loans at the beginning phase.
5. Wholesales Companies	Computers used from the beginning phase	Bank loans used

3.2 Issue in Importing Machines:

The enterprises not only face problems in accessing modern technology, but also while importing them from foreign countries. All the technologies imported from foreign nations, especially from India and China, were paid high tariffs. Also, reports stated that the majority of the enterprises couldn't access technology because they lack finance: lack of effective monetary policy and High Interest Rates with utility. The so-called *mafias* also obstruct those SMEs in the border by claiming unformulated laws of the Government. Such enterprises also face trouble while dealing with the market to sell their products, as one of the enterprises' owners asserted the difficulty he faced due to the price fluctuation of their products.

3.3 Issue in Training Aspects.

Training programs are one of the most important factors that should be taken into consideration while reflecting upon the progress of the SMEs. Almost all the SMEs, however, reported that they have not received any information about the training programs for the people- except trading enterprises. SMEs also said that after some years of their starting phase, instead of waiting for the Government to carry out training programs, they themselves provide training in the related fields to their employees (Table 3.3).

Table- 3.3 “Training Programs and Hiring preferences of the Employers.”

Enterprises	Training Programs*	Hiring Employees	Training programs provided by the owners
1. Offset Press	Don't know. Train their employees by themselves.	Hire Trained Person	Provides training to their employees within 3-months interval
2. Manufacturers	Don't know. Train their employees by themselves.	Hire Trained Person	Provides training to their employees within 3-months interval,

			except “Dairy Products” manufacturer which provides training within 6-months interval.
3. Farming Industry	Don’t know. Train their employees by themselves.	Hire Trained Person	Provides training to their employees within 6-months interval
4. Trading Industry	Know about a program. Provides training within their company.	Hire Trained Person	Provides training to their employees within 3-months interval
5. Wholesales Companies	Don’t know. Train their employees by themselves.	Usually, they hire trained person, but sometimes they hire untrained person and then train him regarding his field.	Training programs provided by the owners

* Owners either knew or didn’t know about governmental programs regarding their field of enterprises.

4. Governmental Policies and Works

Neither the Government has succeeded in providing several training programs with respect to the enterprises, nor does it listen to the respective demands of the SMEs. While asking those enterprises about the works of the Government in their respective field, about 60% of enterprises reported the Government is not doing good but can do better to uplift such SMEs.

4.1 Governmental Programs and Policies:

One of the most important steps of the Government regarding the fostering of SMEs should be launching several training programs. However, when we asked the respondents about such programs, we found that respondents (except from a trading company) have not known about any such training camps launched by the Government.

Instead they reported that they, themselves, provide necessary training to their employees, with respect to their field of employment.

4.2 Global Connection of the Enterprises:

Most of the SMEs said that they limit their export within Nepal because they lack friendly relations with the international companies to sell their products globally. Enterprises such as Offset Press, Manufactures (only Poultry Industry) and Trading Industry only import the equipment from the India and China, but can't export their services to the global markets. Manufactures (Dairy Industry), Wholesalers, Farming Industry neither import product from India and China nor export their services to the global market. This shows the lack of international markets for Nepal's SMEs. (Table 4.2).

5. General Concerns for SMEs

5.1 Other issues:

Even if the Government brings some programs for SMEs, other factors such as corruption and politics come into play that restricts the SMEs to gain the advantages of such programs. When SMEs were asked about their main cause for their hindrance in the market, most of them mentioned Lack of Finance and Governmental Policies. Offset Press mentioned Lack of Governmental policy in the first; manufactures mentioned Lack of Finance; Farming Industry also mentioned lack of finance; Trading Industry mentioned lack of Governmental Policy; finally, wholesalers mentioned lack of finance.

5.2 Financial Organizations:

Many of the respondents of the SMEs are unaware about various national and international programs launched to uplift their status. Only Manufacturing enterprises knew about YSEF, while Trading and Offset Press enterprises knew about FNCCI. Rest didn't know about any other organizations. And it becomes one of the main reasons for the restriction of the prosperity of the SMEs. No familiarization with the programs that are related to the development of the SMEs means lacking the opportunities to grow.

CONCLUSIONS AND RECOMMENDATIONS

Author attempted to find out the factors that affect the growth and development of SMEs in Nepal, and this report demonstrated their difficulties mostly affected by the lack of finance, effective governmental policy, and proper technology. SMEs lack proper funding mechanism for their business establishment; in addition, they don't know about the financial programs such as RSRF, IFC, IMF launched by national and international organizations. Consequently, they could not access the modern equipment required to establish, and maximize their production. Lacking such innovative and technological information that could support to optimize SMEs also remains one of the major causes that restricts the growth of the SMEs. Likewise, corruption and red-tape, high tariffs on importing machineries, lack of effective monetary and fiscal policies, lack of efficient training campaigns for SMEs are also some impeding factors.

The government must emphasize a few amendments in the policy that represents SMEs, and soon incorporate them. One effective amendment could be made as the reduction of tariffs while importing several items, including machinery. Likewise, the government could also work further to not only launch training campaigns with respect to the classification of the SMEs of Nepal but also effectively inform the owners of SMEs so that they could get the best out of its services.

Measures such as improving SMEs' access to finance, providing a better market- both within Nepal and Internationally- for the export of the products of SMEs could also be taken by the Nepal Government to bolster such SMEs. As external Finance is an important factor to the prosperity of the SMEs, the Government should focus on launching programs relating international investments. Alternately, the government could also focus on issuing Initial Public Offering (IPOs) of such small firms in order to attract national investors. With effective monetary policy, the Government should prioritize the development of the small and medium scale enterprises as they are the major contributors to the GDP of Nepal.

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[Annex- questionnaire](#)

Demographic Questions.

1. Are you the Owner of this enterprise?
2. Where is your enterprise's headquarter located?
3. What is your name and age?
4. What is the highest degree you have achieved?
5. How many years have you been working in this field?

Financial Questions.

1. In the very beginning phase of your firm, how did you finance it?
2. Have you taken any loans to invest in your company? If yes, from which source?

3. Have you faced any obstacle while applying for Bank loans? Are you satisfied with the bank's policy?
4. What was your financial status in the last 2 years? Were you in profit, loss, or remained the same?

Technological Questions.

1. Do you have any advanced technology in your enterprise? During your startups were the machines with you? If not, what is causing you trouble to access such equipment?
2. How did you fund such equipment? And from where do you import such equipment?
3. How do Tariffs affect you while importing Machineries?
4. While hiring the employees do you see whether they are trained in using technology or not?

Governmental Policy and Efforts Questions.

1. How would you address the Government's work and effort for the development of the category of Business like yours? [giving best, doing good, not doing enough but can do better, not doing anything at all]
2. Over the years of running your business, have you heard about the governmental training programs addressing your enterprise? Were you facilitated with the policy? Also, have you provided your employees any sort of training over 24 months?
3. What is the reach of your products - Regional, National or Global?

General Questions.

1. What do you think is becoming a barrier for your firm's growth?
2. Have you heard about any of these organizations? (YSEF, RSRF, FNCCI, MEDEP, IMF, IFC)