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The Choice Between Internal and External Sources of Financing of SMEs in Pakistan: A Provincial-Level Analysis

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This survey research covered 341 SMEs operating across seven districts of Khyber Pukhtunkhwa (KP) province of Pakistan to assess the financing preferences of SMEs' owner-managers and determining the preferred funding options for enterprises operating in sampled districts of the province. The study used descriptive statistics followed by extended analysis of the survey data by using a range of different statistical analysis techniques to describe and to validate the interrelationship among diverse characteristics of the survey respondents. The findings confirm that angel financing, leasing and hire purchase are preferred by majority of SMEs that are owned by men. Surveyed SMEs that are owned by families and sole proprietors have a strong preference for capital provided by family and friends. However, extreme preference for retained earnings is also reported by SMEs engaged in partnership businesses. Leasing and hire purchase are highly preferred by SMEs that are operating in the agriculture sector and service sector of the surveyed districts respectively. The survey findings reveal that VC funds are highly preferred by enterprises which are a branch of a foreign company. The findings for a government scheme verify that female entrepreneurs and SMEs working in industrial sectors do not prefer borrowings from government.

Key words: *angel financing, leasing, venture capital, retained earnings, hire purchase, government scheme, family and friends financing*

1. Introduction

Organisations require resources to operate, though, some businesses have much greater trouble in acquiring funds than others. In spite of contributing to the creation of job opportunities and wealth generation, SMEs face multiple hindrances in getting required funds (Newman, Borgia, & Deng, 2013; Van Caneghem & Van Campenhout, 2012). These obstacles related to capital acquisition are due to discrepancies in the financing framework, bias in consumer lending, and underdeveloped financial markets for SMEs. Over the past few years, SMEs have become very imperative in the international business set-up because of their strategic importance in the inclusive economic growth and development (Pawar & Sangvikar, 2019). Their contribution to exports and industrial output makes them the vital engine of economic growth. A considerable role is also played by these enterprises in reducing poverty by generating extensive employment opportunities for the less privileged. Their huge contribution in provision of new employment opportunities and overall inclusive growth and sustainable development is widely documented both in developing and developed countries (Quaye, Abrokwah, Sarbah, & Osei, 2014; Newman, Borgia & Deng, 2013).

Studies have been carried out by the World Bank, the International Finance Corporation (IFC) and the Asian Development Bank (ADB) to understand the dynamics of SMEs in Pakistan and to assess their constraints to growth. In Pakistan, in the late 90s, SMEs have largely been neglected and the core focus remained on corporate sectors, mainly large-scale manufacturing industries. The emphasis of government, financial institutions and banks was more on large scale industrial units than on SMEs. The success and strength of SMEs exists in novelty, distinctive skills, strong network, effective communication, less bureaucratic burdens and understanding the industry and market trends. Another group of scholars believe that the success of SMEs is influenced by expertise, knowledge and experience of owners and management. Deficiencies of tangible assets such as financial and physical capital are critical for the growth of SMEs, while proper utilisation of intangible resources is significant for sustainable development. SMEs face major challenges in getting access to finance. The majority of the SMEs do not have sufficient collateral without which sanction of a loan from lending institutions and/or banks becomes very difficult. Most of the SMEs rely either on borrowing from relatives and friends, suppliers' credit and/or personal finances. The role of banks is limited as high interest rates, corruption and taxes are the major grievances (Dar, Ahmed & Raziq, 2017).

The objective of the study is related with the financing preferences of the SMEs' owner-manager and in determining the preferred funding options for enterprises operating in KP, one of the four provinces of Pakistan. Indigenous research and evidence from developed markets have identified distinct sources of financing available to businesses. In this study, the sources of capital for entrepreneurs are classified in ten (10) financing options. This approach may provide handy information towards achieving the objective of this research study and could also help providing input to finding reasons and the extent to which SMEs are benefiting from available financing options offered by banks in Khyber Pukhtunkhwa.

2. Literature Review:

According to the Trade-Off Theory (TOT) proposed by Kraus and Litzenberger (1973), an optimal capital structure is the one having just the appropriate level of debt. On the other hand, the Pecking Order Theory (POT) developed by Myers (1984) and Myers and Majluf (1984) states that there is no such thing as the right or optimum level of debt. According to POT, there is a hierarchical order of financing preferences. Businesses tend to prefer internal funds over external sources of finance and in external financing, debt is preferred rather than equity.

SMEs do not intend to attain an optimal capital structure. They may desire to borrow when funding of an investment exceeds the internally generated cash flow; albeit they will face the cost of transaction in their loan credit relationship. The costs may be zero for internal sources of funds, although it is higher for issuing new shares, while the costs of debt financing stand in between. The objective of SMEs' owner-manager is to make the most of their own wealth, while securing control in the decision-making process. For that reason, SMEs will first choose internal financing to alleviate the shortage of capital and if such funds prove insufficient, they have a preference for debt financing rather than raising their capital (Adair & Adaskou, 2015). Research studies have affirmed that in comparison to large corporations, SMEs find greater limitations in accessing external finance, and these restrictions arise mainly due to the issue of asymmetric information between the borrowers and the lenders (Bebczuk, 2010). For that reason, it is imperative to study the financial decisions of SMEs, and focus on the composition of their capital structure pertaining to the existence of financial constraints.

The seminal contributions by Modigliani and Miller (1958) on the theory of capital structure asserts that the proportions of equity and debt is irrelevant to the firms' value, assuming rational behaviour, perfect asset markets, no taxes, absence of bankruptcy and transaction costs, among others. The theory, on the other hand, is limited in applicability to small enterprises primarily due to the conditions of the perfect market and unrealistic assumptions of rationality. Afterwards, theories, for instance the agency theory, the TOT and the POT were developed, while Ang (1991) argued that the capital structure theory was not developed with small businesses in mind; these theories do offer some essential insights into the capital structure choices of both small and large organisations.

The TOT takes into consideration the impact of agency costs, taxation and the costs associated with financial distress and bankruptcy on the firms' capital structure. The theory states that the businesses aim for and keep a certain proportion of debt and equity that is determined by trading-off the benefits and the borrowing costs. A number of research studies, though, do not provide a strong support for the applicability of the TOT to small and medium sized businesses.

According to the principal-agent theory, agency relationships can be established among several parties in a firm and these associations entail agency costs that arise from the potential conflicts of interests among the parties. According to this theory, debt financing can reduce the agency cost of equity by means of aligning the interests of managers with those of owners and in disciplining and monitoring management. Therefore, the agency theory predicts that businesses with few growth opportunities and/or high levels of excess cash flows are highly levered firms. It is massively probable that agency conflicts in the form of asymmetric information will arise among the small enterprises and its external providers of capital and in fact will be greater in small-sized enterprises because of the nature of close businesses (Romano, Tanewski & Smyrnios, 2001; Jensen & Meckling, 1976).

Dasanayaka (2011) mention in his study that banks providing finance to SMEs in rural areas of Pakistan need to assess local demands and opportunities before offering financial products. This study generates a good discussion in raising pertinent questions like the need for quantitative research for searching relationships between the SMEs employment share, value added and GDP growth. Bashir, Khan & Malik (2010) argues that SMEs in Pakistan faced neglect of banks and other financial institutions. This paper builds an interesting relationship that the lack of innovation by SMEs in Pakistan has been due to the dearth of finance and credit, partially because of the non-intervention of the governments in providing seed funds for the R&D and partly because financial institutions have had cumbersome procedures and have the barriers of additional security requirements. Rashid (2012) has developed a mathematical model for measuring the sickness or failure risk of an SME. Such a model could be handy for financial institutions thinking of extending finance to SMEs.

3. Methodology:

3.1. Sampling Design

Population size (i.e. number of SMEs in KP) differs as the Pakistan Bureau of Statistics, Sarhad Development Authority, and SMEDA report different numbers about it. SMEDA has a walk-in facility for troubled SMEs; it is deemed as a most relevant sampling frame for this study. Their latest set of KP SMEs comprises of 2504 walk-ins which would be used as a most suitable population in getting a random sample for this study, as it is believed that the core problem of a troubled SME is financial hardships. Since N=2504, we take the most common margin of error = 5% and a confidence interval = 95%. Now utilising the following standard objective procedure for sample size determination:

$$X = Z({}^{c}/_{100})^2 r(100\text{-}r);$$
$$N = {}^{Nx}/_{((N\text{-}1)E^2 + x)}$$
$$E = \text{Sqrt}\left[{}^{(N - n)x}/_{n(N\text{-}1)}\right]$$

Where N is the population size, r is the fraction of responses that we are interested in, and $Z(c/100)$ is the critical value for the confidence level c. Following this sample size determination procedure our computed sample size (n) is 377. These 377 SMEs are going to be surveyed from the major districts of KP. According to Small Industries Development Board of KP, following is the break-up of small industrial estates in the province which could be used as a reference for sampling SMEs from different districts:

Table 1: District Sample of SMEs in KP

District	No of Industrial Estates
Peshawar	7
Nowshehra	2
Mardan	3
Charsadda	1
Kohat	2
Karak	3
Swat	2
Chitral	4
Dir Lower	1
Abbotabad	2
Haripur	1
Mansehra	5
Batagram	1
Bannu	5
D.I.Khan	3

Adopting a stratified sampling procedure and keeping in view the greater concentration of small industrial business, seven (7) districts are suggested for sampling the SMEs. The total industrial estates for these 7 districts is 30, which could be used for sampling SMEs proportionally from these major districts. The detailed sampling plan for surveying firms is mentioned below in Table 2:

Table 2:Stratification By Districts

District	Peshawar	Mardan	Karak	Chitral	Mansehra	Bannu	D.I.Khan	
No of industrial Estates	7	3	3	4	5	5	3	30
Total Number of SMEs Stratified By Districts (Target Survey Respondents)								
Firms to be surveyed	88	38	38	51	62	62	38	377

According to proportional allocation sample size from each stratum is $n_i = (N_i/N_0)*n$. Where N_i is number of industrial estates in a district, n_i is number of sampled SMEs from each district, N_0 is the number of total industrial estates in all districts.

4. Validity and Reliability Tests

On the basis of convenient accessibility, the survey research pilot study is carried out on a group of 50 respondents from district Peshawar. The result for Cronbach's alpha reliability coefficient for the questionnaire related to SMEs owner-manager is 0.639, indicating an overall consistency and accuracy of the instrument that has been developed. The content validity of the instrument is established through the calculation of Content Validity Ratio (CVR). According to Lawshe (1975), with a panel of 10 experts, the minimum required CVR for each item is 0.62. To evaluate the content validity and internal consistency of the questionnaire, at least eight (8) members must agree in order for the items to be included in the final form of a questionnaire. In this study, the CVR for each item ranged between 0.8 and 1, pointing towards the significance and the need to add relevant items in the scale.

5. Results and Analysis

5.1. Descriptive Analysis:

To understand the financing preferences of SMEs' owner-manager, descriptive statistical methods aided by tabulation of data extracted from survey questionnaire is found to be a primary analysis technique to comprehend the issues identified by the respondents. The survey covered 341 SMEs operating across seven districts of KP. Out of the total firms, a large number of SMEs are operating in Peshawar (75 firms), followed by Chitral (47 firms) and D.I. Khan (43 firms) [(Table 3)]. The sample is represented by three (3) main industries: agriculture, industrial and service. The majority of the respondent SMEs belong to service sector, 36.4 percent, while industrial and agriculture sector account for 35.2 percent and 27.3 percent respectively. Within the service sector, Peshawar makes up the largest share of firms (30 SMEs) followed by district Bannu (25 SMEs). Entrepreneurs in the agriculture sector are more prominent in Peshawar (22 firms), Bannu (15 firms) and D.I. Khan (15 firms). The highest number of enterprises servicing the industrial sub-sectors such as electricity generation and distribution, gas distribution and construction, mining and quarrying are in Chitral (23 firms), Peshawar (22 firms) and Bannu (22 firms) [(Table 3)].

Table 3: Distribution of SMEs According to Different Districts and Sectors

	Peshawar	Mardan	Karak	Chitral	Mansehra	Bannu	D.I. Khan	Total
	Frequency	Frequency	Frequency	Frequency	Frequency	Frequency	Frequency	
Agriculture	22	10	12	9	10	15	15	93
% of total	29.3%	27%	30%	19.1%	27.8%	23.8%	34.9%	27.3%
Industrial	22	11	14	23	12	22	16	120
% of total	29.3%	29.7%	35%	48.9%	33.3%	34.9%	37.2%	35.2%
Service	30	16	13	14	14	25	12	124
% of total	40%	43.2%	32.5%	29.8%	38.9%	39.7%	27.9%	36.4%
Total	74	37	39	46	36	62	43	337
% of total	98.7%	100%	97.5%	97.9%	100%	98.4%	100%	98.8%
Missing	1	------	1	1	------	1	------	4
% of total	1.3%		2.5%	2.1%		1.6%		1.2%
Total	75	37	40	47	36	63	43	341
	100%	100%	100%	100%	100%	100%	100%	100%

Table 4 shows the distribution of small and medium businesses by gender. The market for SMEs in KP has traditionally been male dominated. The findings show that the proportion of men-owned enterprises is high, almost 75 percent, then that of women-owned SMEs. Regarding the legal form of business organisation, the survey findings (Table 5) reveal that the majority of the SMEs (80 firms; 23.5 percent) are in family businesses followed by 19.6 percent (67 firms) engaged in a partnership form of ownership. Bannu (23 firms) and Chitral (19 firm) have the highest percentage of family-owned SMEs. On the other hand, partnership-based SMEs dominate Peshawar (15 firms), Bannu (13 firms) and Manshera (12 firms) districts (detail mentioned in Table 5)

Table 4: Gender

	Frequency	Percent
Male	255	74.8
Female	85	24.9
Total	340	99.7
Missing	1	0.3
Total	341	100

Table 5: Distribution of SMEs According to Different Districts and Legal Form of Business Organization

	Peshawar Frequency	Mardan Frequency	Karak Frequency	Chitral Frequency	Mansehra Frequency	Bannu Frequency	D.I. Khan Frequency	Total Percent
Individual/ Sole Proprietorship	12	4	3	4	4	1	3	31
% of total	16%	10.8%	7.5%	8.5%	11.1%	1.6%	7%	9.1%
Partnership	15	12	9	8	4	13	6	67
% of total	20%	32.4%	22.5%	17%	11.1%	20.6%	14%	19.6%
Private limited company	13	6	5	2	4	12	6	48
% of total	17.3%	16.2%	12.5%	4.3%	11.1%	19%	14%	14.1%
Public limited company	10	4	6	5	10	7	6	48
% of total	13.3%	10.8%	15%	10.6%	27.8%	11.1%	14%	14.1%
Family owned business	8	7	7	19	7	23	9	80
% of total	10.7%	18.9%	17.5%	40.4%	19.4%	36.5%	20.9%	23.5%
Branch of a foreign company	10	1	5	7	3	2	9	37
% of total	13.3%	2.7%	12.5%	14.9%	8.3%	3.2%	20.9%	10.9%
Co-operative Society	5	2	4	2	4	3	4	24
% of total	6.7%	5.4%	10%	4.3%	11.1%	4.8%	9.3%	7.0%
Total	73	36	39	47	36	61	43	335
% of total	97.3%	97.3%	97.5%	100%	100%	96.8%	100%	98.2%
Missing	2	1	1	-------	-------	2	-------	6
% of total	2.7%	2.7%	2.5%			3.2%		1.8%
Total	75	37	40	47	36	63	43	341
	100%	100%	100%	100%	100%	100%	100%	100%

SMEs were asked to report the proportion of their fixed assets PPE (property, plant and equipment) to total assets. The proportion of PPE/ assets for a high fraction (31.4 percent) of reporting enterprises fall into a range of 41 percent to 60 percent. The collateral requirement for 29.3 percent of the respondents ranges between 61 to 80 percent, followed by 21 to 40 percent for 19.9 percent of the surveyed firms.

Table 6: Proportion of PPE to Total Assets

	Frequency	Percent
1%-20%	30	8.8
21%-40%	68	19.9
41%-60%	107	31.4
61%-80%	100	29.3
81%-100%	34	10
Total	339	99.4
Missing	2	0.6
Total	341	100

5.2. Chi Square Test of Association and Residual Analysis:

In this study, the sources of capital for entrepreneurs are classified in ten (10) financing options: owner 's saving, retained earnings, family and friends, angel financing, venture capital, trade credit, leasing, hire purchase, loan from bank, and government scheme. The chi-square test is used to determine the financing preferences of SMEs across the major districts of KP. The sources of capital in terms of preference by SMEs is cross-tabulated by the gender of the entrepreneur, industrial sectors, legal form of business organisations and proportion of PPE (fixed assets) to total assets. Table 7 presents the survey findings. The ratio of PPE/total assets is found to be insignificant for all the sub-categories identified as the sources of capital in terms of preference by SMEs.

Table 7: Chi-Square Test for Association

	Gender	Classify your main business under the following sectors	Legal form of business organisation	Proportion of your property, plant and equipment's
Owners' Saving	2.389 (0.665)	6.891 (0.548)	16.530 (0.868)	22.946 (0.115)
Retained Earnings	0.980 (0.913)	13.153 (0.107)	40.481 (0.019) **	15.669 (0.476)
Family and Friends	3.800 (0.434)	7.546 (0.479)	43.188 (0.009) *	18.935 (0.272)
Angel Financing	12.744 (0.013) **	10.382 (0.239)	34.070 (0.083) ***	16.302 (0.432)
Venture Capital (VC)	4.709 (0.318)	11.931 (0.154)	40.011 (0.021) **	21.395 (0.164)
Trade Credit	2.361 (0.670)	9.901 (0.272)	27.620 (0.276)	18.330 (0.305)
Leasing	14.474 (0.006) *	14.492 (0.070) ***	33.377 (0.096) ***	14.808 (0.539)
Hire Purchase	15.602 (0.004) *	15.661 (0.047) **	26.080 (0.349)	12.341 (0.720)
Loan From Bank	1.035 (0.904)	6.089 (0.637)	31.359 (0.144)	11.918 (0.750)
Government Scheme	8.973 (0.062) ***	13.741 (0.089) ***	22.266 (0.563)	10.653 (0.830)

Asymp. Sig (2-Sided) in parenthesis *p<0.01; ***p<0.05; ***p<0.1*

The chi-square test does not identify the combination of factors affecting the desired level of significance. If a difference is statistically significant, the study moves forward to conduct a post hoc analysis using the standardised residual method to determine which combination of categories contributes to statistical significance. If the absolute value of the residual in the detailed cross-tabulation analysis is greater than 2 (Miller, 2017), it can be concluded that the categories (cells) are having a major contribution to the chi-square test results.

5.2.1. Angel Financing:

The findings show high preference for angel financing *(residual= 5.5, Table 8)* by a large number of male entrepreneurs (242 males). With regard to the legal form of business organisation, the findings show that angel financing is also moderately preferred *(residual= 5.6, Table 9)* by SMEs involved in partnership business. Business angels are individuals with a high net worth, willing to make investments in new businesses, typically SMEs, without having any personal and family networks, in order to have some shares in that business. A large number of projects are financed by angel investors. Studies report that the amount of funding offered by business angels is almost the same as provided by formal financial institutions (Sohl, 2012; Mason & Harrison, 2008). Business angels are a core constituent of a growing and successful entrepreneurship ecosystem. The investors and their networks are significant providers of funds to start-up businesses in their seed and early stage, in comparison to venture capital investment funds which comes into the later stages of development. The importance of business angel networks is apparent not only in United States but also in other G20 countries such as India, Canada and the EU (Ernst & Young, 2015; Joint WB-IDB Policy Report, 2015). Small enterprises have little recourse to bank lending products or other instruments of financing. Pakistan is deficient in business angel networks that could provide funds or assist entrepreneurs. According to Mian & Qureshi (2010) Global Entrepreneurship Monitor (GEM) survey report, in Pakistan, the funding for majority of start-up businesses is obtained from entrepreneurs' own resources, close relatives and family members. A comparatively minor role is played by financial markets, banks and other financial institutions in raising capital for start-up businesses. Government assistance programs account for the smallest share of financing sources. Angel investors, as colleagues at workplace, friends, family networks, and neighbors are also a major source of venture funds.

Table 8: Angel Financing * Gender

		Gender		Total
		Male	Female	
Not Preferred at all	Count	9	9	18
	Residual	-4.6	4.6	
Slightly Preferred	Count	52	16	68
	Residual	0.6	-0.6	
Moderately Preferred	Count	91	25	116
	Residual	3.3	-3.3	
Highly Preferred	Count	72	16	88
	Residual	5.5	-5.4	
Extremely Preferred	Count	18	12	30
	Residual	-4.7	4.7	
Total	Count	242	78	320

Table 9: Angel Financing * Legal Form of Business Organization

		Legal Form of Business Organization							Total
		Individual/ Sole Proprietorship	Partnership	Private limited company	Public limited company	Family owned business	Branch of a foreign company	Co-operative Society	
Not Preferred at all	Count	4	2	1	1	9	1	0	18
	Residual	2.3	-1.7	-1.6	-1.6	4.8	-1.0	-1.3	
Slightly Preferred	Count	8	9	14	15	13	3	6	68
	Residual	1.7	-4.8	4.1	5.1	-2.8	-4.6	1.3	
Moderately Preferred	Count	8	29	17	14	29	11	7	115
	Residual	-2.6	5.6	0.2	-2.8	2.3	-1.8	-1.0	
Highly Preferred	Count	8	17	11	12	15	14	6	83
	Residual	0.4	0.1	-1.1	-0.1	-4.2	4.8	0.2	
Extremely Preferred	Count	1	7	3	4	7	6	3	31
	Residual	-1.9	0.7	-1.5	-0.5	-0.2	2.6	0.8	
Total	Count	29	64	46	46	73	35	22	315

5.2.2. Venture Capital (VC):

The survey findings reveal that VC funds are highly preferred by enterprises which are a branch of a foreign company *(residual= 7.2, Table 10)*. Around the globe, VC industry has played a key role in the success of business enterprises particularly SMEs. The strategic role of venture capitalists as a potential source of finance is growing both in developed and developing economies. There is generally a direct association between the venture capital funds available to organisations and its pace of growth and development. Funding by venture capitalists differs from traditional funding sources. Venture capitalists fund innovative ideas that have high growth potential with inherent level of uncertainties. This makes it a high return, high risk investment. In addition to financing, venture capitalists also provide management, marketing support services and networking. In the broader sense, venture capital investors and investee firms work closely together in an enabling business environment that allows the entrepreneurs to focus on value creation. This combination of risk financing and hand holding of prospective entrepreneurs by the VC industry creates an ideal work environment predominantly suitable for technology and knowledge-based enterprises. In Pakistan, some of the local brokerage houses such as Jehangir Siddiqui, AMZ Group, AKD Securities and BMA Capital have started their own venture capital firms. BMA Capital has received funding from UAE's Abraaj Capital Group, Jehangir Siddiqui from International Finance Corporation (IFC) and AKD Securities from Pakistan Kuwait Investment Company. Some of these firms are specialised in only one sector, for instance, AMZ Group and Jehangir Siddiqui invests in technology related businesses while BMA Capital focuses on real estate projects (Kumar & Abdullah, 2008). Venture capital industry in Pakistan is still at its nascent stages. According to an estimate, Pakistani start-ups have raised US$ 71.1 million in 2015. Although this is dwarfed by the US$ 7.9 billion elevated in India, the trajectory guarantees promise for the future nevertheless (Ahmed, 2016).

Table 10: Venture Capital * Legal Form of Business Organization

		Individual/ Sole Proprietorship	Partnership	Private limited company	Public limited company	Family owned business	Branch of a foreign company	Co-operative Society	Total
Not Preferred at all	Count	1	2	3	2	8	2	3	21
	Residual	-1.0	-2.3	-0.1	-0.9	3.0	-0.2	1.6	
Slightly Preferred	Count	6	13	7	16	14	5	4	65
	Residual	0	-0.2	-2.7	6.9	-1.6	-1.9	-0.5	
Moderately Preferred	Count	8	25	16	6	24	7	8	94
	Residual	-0.8	6	1.9	-7.2	1.5	-3.0	1.6	
Highly Preferred	Count	14	21	13	17	20	19	7	111
	Residual	3.6	-1.5	-3.6	1.4	-6.6	7.2	-0.6	
Extremely Preferred	Count	1	4	9	4	11	1	0	30
	Residual	-1.8	-2.1	4.5	-0.2	3.8	-2.2	-2.1	
Total	Count	30	65	48	45	77	34	22	321

5.2.3. Leasing and Hire Purchase:

The findings in relation to other factors show that leasing and hire purchase are preferred by majority of SMEs that are owned by men. A high residual value of leasing *(residual=6.4,*

Table 13) is also observed for SMEs involved in partnership business. Leasing and hire purchase are highly preferred by SMEs that are operating in agriculture sector *(residual=4.4, Table 13)* and service sector *(residual=3.2, Table 15)* of the surveyed districts respectively. Hire-purchase is a type of leasing in which the lessee and the lessor have the ownership share in the asset, and with every payment, a large share of the ownership of equipment is retained by the lessee. In many countries, hire-purchase is common for financing small retail items, such as, sewing machines, motorcycles, refrigerators, etc. (Nair, Kloeppinger-Todd & Mulder, 2004). A large number of options are available to businesses regarding the capital expenditures and financing of fixed assets. The assets could be acquired outright, rented, hired or leased. The accounting methods and procedures vary substantially depending on the financing options preferred by businesses. Leasing comes in various forms, shapes, and sizes; however, four (4) types of lease transactions are made i.e. financial lease, service lease, sale-and-leaseback and average lease payment. Leasing is preferred over a bank loan by low profit businesses due to factors related with rental payments, tax benefit, simple documentation and no collateral requirement. Lease financing allows enterprises to better forecast its future cash flows as the loan is advanced at a fixed interest rate, though a floating interest rate is set aside in case of bank credit, which exposes the business to the volatile markets. The market for lease financing is very active in the US and Japan. However, the contribution in leasing is by world's fastest growing economies like India and China is interestingly less. On the other hand, Pakistan has experienced a commendable growth in leasing industry. In Pakistan, lease financing began in 1983. The leasing market was regulated by the State Bank of Pakistan till the year 1983 and after that the regulatory supervision of the industry moved towards the Security and Exchange Commission Pakistan (SECP). SMEs have been the major clients of the leasing sector in our country. Transporting businesses are used to obtain informal sources of credit on higher rates of interest. Currently, the leasing facilities are availed by these enterprises concerning various repair items and spare parts. The initiative by leasing companies for auto loans and consumer financing is contributing towards improving the standards of living and wellbeing of the citizens. Following in the footsteps of leasing companies, commercial banks have also started the leasing business and ultimately gained a significant edge in the market for lease financing (Mubarik, 2012).

Table 11: Leasing * Gender				Total	Table 12: Leasing * Classify your main business under the following sectors			Total
		GENDER			Classify your main business under the following sectors			
		Male	Female		Agriculture	Industrial	Service	
Not Preferred at all	Count	18	16	34	7	16	10	33
	Residual	-7.6	7.6		-2.0	4.1	-2.2	
Slightly Preferred	Count	40	18	58	21	20	15	56
	Residual	-3.6	3.6		5.7	-0.1	-5.6	
Moderately Preferred	Count	71	24	95	22	39	35	96
	Residual	-0.4	0.4		-4.2	4.5	-0.4	
Highly Preferred	Count	78	17	95	30	22	42	94
	Residual	6.6	-6.6		4.4	-11.8	7.4	
Extremely Preferred	Count	38	6	44	8	19	17	44
	Residual	4.9	-4.9		-4.0	3.2	0.8	
Total	Count	245	81	326	88	116	119	323

Table 13: Leasing * Legal Form Of Business Organization									
		Individual/ Sole Proprietorship	Partnership	Private limited company	Public limited company	Family owned business	Branch of a foreign company	Co-operative Society	Total
Not Preferred at all	Count	4	2	2	4	10	3	1	26
	Residual	1.5	-3.5	-1.8	0.2	4.1	0.2	-0.7	
Slightly Preferred	Count	8	12	8	5	17	4	3	57
	Residual	2.6	0	-0.4	-3.4	4.1	-2.2	-0.8	
Moderately Preferred	Count	8	27	14	14	17	11	7	98
	Residual	-1.4	6.4	-0.4	-0.4	-5.2	0.4	0.4	
Highly Preferred	Count	9	24	18	14	15	10	6	96
	Residual	-0.2	3.8	3.9	0	-6.7	-0.4	-0.4	
Extremely Preferred	Count	1	1	4	9	12	6	4	37
	Residual	-2.5	-6.8	-1.4	3.6	3.6	2.0	1.5	
Total	Count	30	66	46	46	71	34	21	314

Table 14: Hire Purchase * Gender				Total	Table 15: Hire Purchase * Classify your main business under the following sectors			Total
		GENDER			Classify your main business under the following sectors			
		Male	Female		Agriculture	Industrial	Service	
Not Preferred At All	Count	18	8	26	9	10	7	26
	Residual	-1.6	1.6		2.0	0.9	-3.0	
Slightly Preferred	Count	36	22	58	10	26	22	58
	Residual	-7.6	7.6		-5.6	5.8	-0.2	
Moderately Preferred	Count	71	29	100	22	36	41	99
	Residual	-4.2	4.2		-4.6	1.5	3.1	
Highly Preferred	Count	82	16	98	37	26	34	97
	Residual	8.3	-8.3		10.9	-7.8	-3.1	
Extremely Preferred	Count	33	4	37	7	12	17	36
	Residual	5.2	-5.2		-2.7	-0.5	3.2	
Total	Count	240	79	319	85	110	121	316

5.2.4. Retained Earnings and Family and Friends:

The results in Table 17 indicate that surveyed SMEs that are owned by families *(residual=4.9, Table 17)* and sole proprietors *(residual=5.2, Table 17)* have a strong preference for capital provided by family and friends. Extreme preference *(residual=7.0, Table 16)* for retained earnings is also reported by SMEs engaged in partnership businesses. Most of the developing economies have relatively underdeveloped capital markets. Financial institutions particularly banks are either reluctant or are unable to undertake term financing. Financial institutions prefer to provide credit to large, well-established businesses with comprehensive book-keeping methods and credit histories (Hossain, 2013). The share of SMEs as a percentage of formal credit obtained from the banking sector in Pakistan is 7 percent as compared to 32 percent in Bangladesh and 33 percent in India (Khan, 2015; State Bank of Pakistan, 2010). SMEs either make use of their internal funds or retained earnings or rely largely on other informal sources of credit (Khan, 2015). Even though the infrastructure of the banking sector is developed in Pakistan, there are number of reasons why SMEs rely mostly on informal financing sources. It entails collateral, lengthy and overly complex documentation, costs of the debt and other requirements. From the perspective of SMEs, a small loan from commercial banks involves an average of 9 meetings with the clients and 27 steps in the lending process. On the other hand, informal finance includes family and friends, input retailers or dealers, committees, farm equipment holders, landlords, commissioning agencies and other non-institutional lenders. The informal sector operates at low servicing requirements. Entrepreneurs can access capital in a little time with no or little documentation. This type of lending typically occurs within a borrower's social network, where the lender and the borrower know each other (Yaldiz, Altunbas & Bazzana, 2011; Nenova, & Niang, 2009). The plethora of research suggests that SMEs face great difficulties in accessing finances as compared to large enterprises and for that reason these organisations carry out a small proportion of their funding requirements from formal sources of financing (Berger & Udell, 1998).

Table 16: Retained Earnings * Legal Form of Business Organisation

		Individual/ Sole Proprietorship	**Partnership**	**Private limited company**	**Public limited company**	**Family owned business**	**Branch of a foreign company**	**Co-operative Society**	**Total**
Not Preferred at all	**Count**	5	8	6	2	15	3	4	
	Residual	0.9	-0.6	-0.4	-4.1	4.8	-1.5	0.9	43
Slightly	**Count**	2	17	14	15	26	7	6	
Preferred	**Residual**	-6.3	-0.5	1.1	2.6	5.3	-2.1	-0.2	87
Moderately	**Count**	15	20	18	16	17	17	9	
Preferred	**Residual**	4.3	-2.5	1.4	0.1	-9.6	5.2	1.0	112
Highly	**Count**	4	7	8	11	12	6	4	
Preferred	**Residual**	-1.0	-3.4	0.3	3.6	0.4	0.5	0.3	52
Extremely	**Count**	5	13	2	2	7	1	0	
Preferred	**Residual**	2.1	7.0	-2.4	-2.6	-0.1	-2.1	-2.1	30
Total	**Count**	31	65	48	46	77	34	23	324

Table 17: Family and Friends * Legal Form of Business Organization

Not Preferred at all	**Count**	1	1	6	2	5	0	0	
	Residual	-0.5	-2.1	3.8	0	1.6	-1.5	-1.1	15
Slightly Preferred	**Count**	4	12	14	7	17	2	7	
	Residual	-2.1	-1.2	4.6	-1.7	2.6	-4.5	2.3	63
Moderately Preferred	**Count**	12	31	17	21	25	19	13	
	Residual	-1.4	2.1	-3.7	2.0	-6.5	4.8	2.7	138
Highly Preferred	**Count**	6	14	8	11	22	10	4	
	Residual	-1.3	-1.7	-3.2	0.7	4.9	2.3	-1.6	75
Extremely Preferred	**Count**	8	9	3	3	4	2	0	
	Residual	5.2	2.9	-1.3	-1.0	-2.6	-1.0	-2.2	29
Total	**Count**	31	67	48	44	73	33	24	320

5.2.5. Government Scheme:

The findings for government schemes verify that female entrepreneurs *(residual=7.1, Table 18)* and SMEs working in industrial sectors *(residual=6.2, Table 19)* do not prefer borrowings from the government. SMEs in Pakistan experience unfavourable policies of government, lack of skilled labour workforce and lack of entrepreneurial aptitude. The cost of doing business is quite high in our country because of possession of land and other restrictions by the local authorities or government. The rising cost of land causes a shift in interest towards other businesses, for instance real estate, in which money is tied up in expensive land which is used for expanding one's business. Further, government policies favour big businesses while they overlook small business and entrepreneurial ventures (Raza et al. 2018).

Table 18: Government Scheme * Gender				**Total**	**Table 19: Government Scheme * Classify your main business under the following sectors**			**Total**
		GENDER			**Classify your main business under the following sectors**			
		Male	**Female**		**Agriculture**	**Industrial**	**Service**	
Not Preferred at all	**Count**	23	17	40	2	20	17	39
	Residual	-7.1	7.1		-8.7	6.2	2.6	
Slightly Preferred	**Count**	54	20	74	20	25	28	73
	Residual	-1.6	1.6		0	-0.9	1.0	
Moderately Preferred	**Count**	74	18	92	30	28	33	91
	Residual	4.9	-4.9		5.0	-4.3	-0.7	
Highly Preferred	**Count**	61	16	77	21	28	28	77
	Residual	3.1	-3.1		-0.2	0.7	-0.5	
Extremely Preferred	**Count**	36	11	47	17	15	15	47
	Residual	0.7	-0.7		4.1	-1.7	-2.4	
Total	**Count**	248	82	330	90	116	121	327

6. Conclusion and Discussion

The present study provides comprehensive data to assess the gap between the financing products offered to SMEs by loaning institutions and the financial needs of SMEs in KP. The survey covered 341 SMEs operating across the seven districts of KP: Peshawar, Mardan, Karak, Chitral, Manshera, Bannu and D.I. Khan. The sample is represented by three main industries: agriculture, industrial and service. The majority of the respondent SMEs belong to the service sector. The study used descriptive statistics followed by extended analysis of the survey data by using a range of different statistical analysis techniques to describe and to validate the interrelationship among diverse characteristics of the survey respondents. The findings confirm that angel financing, leasing and hire purchase are preferred by the majority of SMEs that are owned by men. Surveyed SMEs that are owned by families and sole proprietors have a strong preference for capital provided by family and friends. However, extreme preference for retained earnings is also reported by SMEs engaged in partnership businesses. Leasing and hire purchase are highly preferred by SMEs that are operating in the agriculture sector and service sector of the surveyed districts respectively. The survey findings reveal that VC funds are highly preferred by enterprises which are a branch of a foreign company. The findings for a government scheme verify that female entrepreneurs and SMEs working in industrial sectors do not prefer borrowings from the government. Government, regulatory authorities and financial institutions should take measures to enhance access to finance for SMEs. Regulators should encourage and promote financial innovation by ensuring prudential regulation of a fast-growing lending market. The gap between the limited outreach to formal funding sources and popularity of informal financing, pooled with the perception gap between minimum requirements of the informal sector and complex documentation driven formal sector, calls for developing linkages with the informal financial sectors. Strengthening the infrastructure of the financial system through the expansion of credit information bureaus and other payment mechanisms, would allow the lending institutions to lower their capital binding requirements, for example immovable collateral and guarantors, as a result attracting new clients among the poor, women, and residents in rural communities.

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