

FACTORS AFFECTING THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES (SMES) IN THE MANUFACTURING SECTOR OF CAIRO, EGYPT

Menna Allah Ahmed Fouad

Future university in Egypt (F.U.E)

E-mail: mennatala.ahmed@fue.edu.eg

menna896@hotmail.com

Abstract

This research will investigate the factors that affect the performance of Small and Medium Enterprises (SMEs) in the manufacturing sector of Cairo, Egypt. To achieve this objective, the research will hypothesize that poor management skill such as human resources, financial management, general management, production management and marketing management regarding the poor performance of SMEs in the manufacturing sector of Cairo, Egypt. The importance of this study on both the academic and the application levels is attributed to SMEs, despite their contributions to the Egyptian economy, have not been given due attention as the research of performance has been biased towards large enterprises. The aim of this study is to explore the obstacles facing the small and medium enterprises (SMEs) in the context of the manufacturing sector of Cairo, Egypt using a sample of 50 SMEs. The researcher suggests that managerial aspects which are in short supply have negative effects on the performance of SMEs in the manufacturing sector.

Key Words:

(SME)Small and medium enterprises, (MS) manufacturing sector, (PMS) poor management skills

JEL Classification

L60, M10, N67

1. Introduction

1.1 Preamble: Schlogl (2004), stated that Small and medium sized firms dominate both developed and developing economies in terms of employment and number of companies, yet their full potential remains untapped. These trends need to be changed. The ability of smaller firms to create jobs is clearly a major attraction for governments in the short term. SMEs must be encouraged and supported to flourish. This is important so that economic objectives (economic growth and development, favorable balance of trade and payment and employment) and social objectives (poverty alleviation and improving standards of living) can be realized. Governments must respond to the needs of SMEs as they form an important component of the economy.

1.2 Statement of the problem: The research seeks to investigate whether economic factors, human resources and management factors affect the performance of SMEs.

1.3 Research Hypothesis:

H₁: Poor management skills such as human resources management, financial management, general management, production management and marketing management result in the poor performance of SMEs.

H₂: Economic factors have an effect on the performance of SMEs.

H₃: The economic initiatives of the Egyptian government aimed at SME development do not affect the performance of SMEs.

1.4 Research objectives:

- To establish whether poor management skills such as human resources management, financial management, general management, production management and marketing management result in the poor performance of SMEs.
- To establish the economic factors which have an effect on the performance of SMEs.
- To establish whether the economic initiatives of the Egyptian government aimed at SME development had an effect on the performance of SMEs.

1.5 Research importance: The sector of small and medium enterprises represent about 99% of the total Egyptian facilities, and provide jobs for about 75% of the workforce in Egypt. Small and medium enterprise has a great significance in economic development and lead work side by side with the major enterprises in the integration and harmonization of economic structure, which helps to achieve social and economic development. Due to the growing need to create jobs and reduce unemployment, as well as the existence of global challenges imposed by the global economic changes, the need of generating a sector strong and competitive of small and medium enterprises is essential, to enable it to play a leading role in the development process , since that it has a role in expanding the economic base and stimulating trade and in providing employment opportunities for citizens, in addition to being a key tributary contribute significantly to the increase in exports and gross domestic production (GDP) growth.

2. Theoretical Background

2.1 Definition of SMEs: Based on Culkin and Smith (2000) stated that SMEs are often classified by the number of employees or by the value of their assets. Classification by size varies within regions and across countries in relation to the size of the economy and its resources. The classification of Egyptian SMEs is dependent on both number of employees, capital used and sales turnover as seen in Table 2.1.

Table 2.1: Classification of Egyptian SME's

	Labor	Fixed Assets, excluding Land & Building in L.E.	Sales in LE
Manufacturing & Construction			
Small	5 - 49	5,000,000	10,000,000
Medium	50 – 99	10,000,000	20,000,000
Services and Trade			
Small	5 - 9	500,000	1,000,000
Medium	10 - 19	2,000,000	4,000,000

(Source: Finance and Banking Consultants International 2004)

2.2 The importance of SMEs: ElMahdi, (2002) mentioned that the Egyptian manufacturing SMEs, as the engine of growth in the economy, have a crucial need to continue to be a major supplier in the domestic market and to increase their exports and contribute to the Egyptian economy. World business council for sustainable development (2007) summed up the importance of the SMEs from three different point of views. **For governments;** Well-managed and healthy SMEs are a source of employment opportunities and wealth creation. They can contribute to social stability and generate tax revenues. **For large corporations;** SMEs can constitute an important source of local supply and service provision to larger corporations. They usually have extensive local knowledge of resources, supply patterns and purchasing trends. By working closely with SMEs, large corporations can develop a new customer base that may not be accessible to the traditional distribution networks of these corporations. **For local communities;** SMEs provide goods and services tailored to local needs and at costs affordable to local people.

2.3 Challenges facing SMEs: To sum up the constraints of the SMEs sector, it was also concluded by Hussein (2009) that SMEs are often confronted with problems that are uncommon to the larger companies and multi-national corporations. These problems include the following:

- **Lack of IT Support:** It is very difficult for SMEs to attract good IT personnel. Moreover, good IT personnel are expensive and may not be affordable by most SMEs.
- **Lack of Formal Procedure and Discipline:** Most SMEs do not have formal procedure or often these are not documented change frequently. This makes it difficult for third party and newcomer to understand the existing business practices and match them with the IT process.
- **Uneven IT Awareness and Management Skill:** As company grows, new managers are often introduced into the company. Some of these managers may not been trained in the leadership and management skill. These often caused conflicts during the implementation.
- **Lack of Financial Resources:** SME, financial resources are often limited. This often forces company to select a solution, which appear to be cheap initially. However, the hidden costs will start to emerge during implementation. This sometime causes the project to be abandoned or sometime sent the company into further financial crisis.

- **Lack of Human Resources:** Implementations of some bigger scale IT project especially those that involve business process across different departments or require large amount of initial data entries require human resource during the implementation. Some SMEs are often in the stage of frequent firefighting and shortage of manpower. This makes it very difficult for them to allocate time to carry out implementation.

2.4 Suggested solutions to some of the SMEs constraints:

The World business council for sustainable development (2007) suggested the following for building better SMEs:

- **The government contribution:** SMEs require a favorable institutional framework. Most are overlooked by policy-makers and legislators, who tend to target larger corporations. SMEs often miss out on tax incentives or business subsidies. They suffer more than big companies from the large burden and cost of bureaucracy.
- **Implement inclusive reforms:** Governments must simplify business registration procedures and paperwork to make them cheaper, simpler and speedier. Efforts are also required to tackle corruption. The World Bank report concludes that the greater a country's ease of doing business, the greater the number of jobs created in the formal sector "because the benefits of being formal (such as easier access to credit and better utility services) often outweigh the costs (such as taxes)."
- **Provide financial and tax incentives:** To encourage SMEs to join the formal sector, governments need to provide tax incentives for SMEs and subsidies, and to make provisions for start-up funds for SMEs.
- **Encourage friendly regulatory environments:** Governments should promote public-private partnerships to attract venture capital funds and higher levels of investment, and put in place measures to create investor friendly environments. Potential investors need guarantees that their investments and infrastructure are not going to be expropriated.
- **Build capacity:** Governments can contribute to capacity building through the provision of vocational training, by creating municipal-level agencies for SME start-up development and management, such as "Enterprise Advice Bureaus", and by encouraging SMEs to engage with large corporations.

- **Procure more goods and services for the public sector from SMEs:** In Bolivia reverse trade fairs are held where municipalities market their needs – such as meals for hospitals and schools, cleaning of public buildings – to prospective SMEs who can then bid for business.
- **Providing access to financial services:** SMEs require greater access to financial services and investment capital. Large corporations have little difficulty securing sizeable bank loans and private investments. At the same time, microfinance, consisting of very small loans, tends to benefit individual entrepreneurs.

3. Research methodology

A sample of 50 employees from SMEs, located in the manufacturing sector of Cairo, Egypt (Misr Ismailia desert road-gesr elsuez) This geographical area has been chosen as they represent a large number of SMEs in Cairo, Egypt. Data collection was accomplished by a personal interview. The population of the study consisted of managers and owners of SMEs in those areas mentioned earlier. A self-designed questionnaire was used to gather the research data. The questionnaire consisted of three parts. The first part comprised of demographic, characteristic, and profile information of the respondents. The respondents were asked to rank statements on contextual condition related to each success factor faced by the respondents in the second part. This part consisted of questions which were intended to measure factors of business success, using 5-point Likert scale anchored by strongly agree to strongly disagree. The factors were characteristic of SMEs, management and know-how, resources and finance, and governmental issues. In the third part, the respondents were asked to score the importance of perceived of business success. A total 50 sets of questionnaires were distributed among managers of SMEs, all participants were responded.

4. Results, Conclusions, and Recommendations

The results of the data gathered from the questionnaires have assisted the researcher to reach certain conclusions on the formulated hypotheses. The researcher discovered that SMEs in the manufacturing sector still suffer from inadequate managerial skills. This result supports both the hypothesis that poor management skills such as human resources management, financial management, general management, production management and marketing management result in the poor performance of SMEs in the manufacturing sector of Cairo, Egypt. In addition, a lack of skilled human resources also contributes to the poor performance of SMEs in the manufacturing sector of Cairo, Egypt. The results also support the second and third hypothesis which states that

economic factors have a direct influence on the performance of SMEs in the manufacturing sector of Cairo, Egypt and that the economic initiatives of the Egyptian government aimed at SME development do influence the performance of SMEs in the manufacturing sector of Cairo, Egypt.

The most important factors influencing the development of SMEs

Factor 1, Shortage of finance: SME development is severely affected by a shortage of finance. For expansion purposes SMEs require adequate finance, banks and credit institutions which have stringent requirements when SMEs want to borrow from them, primarily in the form of collaterals. Furthermore, sources of finance which are available to SMEs such as bank loans and mortgage bonds are expensive which results in an increase in the cost of production.

Recommendation: To address the issue of borrowing constraints the government should act as a guarantee to banks and credit institutions for SMEs. That is by making an undertaking to pay the banks in the event of the SMEs failing to pay back. The government can also liaise with the banks and credit institutions to lessen their requirements. This should be done so that SMEs can get enough access to finance for their business activities. The banks will get the assurance that they can recover their money from the government and also receive interest on the funds they would have given the SMEs. SMEs should also form groups and make use of pooled negotiating power for borrowing purposes. They can use such negotiating power to purchase raw materials and receive discounts which might lead to a reduction in the cost of production. Through networking, SMEs can be able to exchange services such as bookkeeping, tax calculations and advertising amongst themselves for free. This will enhance their competitiveness through a reduction in the cost of production. The benefit of sharing such skills for the owners or managers of SMEs is that it will strengthen the future survival, and eventual growth, of SMEs.

Factor 2, Skills shortages: The economic performance of SMEs is highly affected by skills shortages are experienced in the fields of financial management, and marketing management SMEs fail to attract qualified personnel since the majority of Egyptians view SMEs as offering insecure employment opportunities due to the high rate of failure. The skilled personnel involve those employees with the necessary skills required in the SME sector.

Recommendation: SME owners and the Egyptian government must form more direct partnerships to improve the skill levels in the sector. This can be done

through increased funding for SME staff training by the government. Currently the Egyptian government does provide training through business incubators to increase the sustainability and growth of SMEs in Egypt. However, such training is only mainly provided in the larger metropolitan areas and need to be extended to other cities. Furthermore there is need to establish SME consulting and training centers in certain areas or provinces to assist SMEs with their challenges. The number of centers will be determined by the number of SMEs in a specific city or rural area.

General recommendations:

Factors affecting the performance of SMEs: SMEs must ensure that they are well acquainted with all the managerial functions that have an effect on the performance of their businesses. These managerial functions are skilled personnel, financial management skills, planning skills, customer care, marketing knowledge and skills and knowledge of human resources practices. This can be done through training programs, funded by the Egyptian government, and sending their employees on refresher courses regularly. Since SMEs are affected by finance shortages they should form partnerships with the government so that they can get funds for the proposed training programs.

Required skills for SME development: On financial management skills SMEs must send their employees on training in bookkeeping and financial statement preparation. These skills must be possessed by SMEs to ensure its continued growth. In addition, SMEs must limit debts in their enterprises. They can achieve this by ensuring that they purchase their inputs on a cash basis so that they can obtain discounts which will help them in minimizing the cost of production. This will be passed to customers in the form of lower prices and will improve the competitiveness of SMEs. On marketing management skills SMEs must regularly send their employees on customer care refresher courses which involve customer management and complaints handling. In order to benefit from advertising and promotion, SMEs must form cooperatives for advertising whereby they run joint advertising initiatives to minimize costs. SMEs must also make use of special promotions in order to lure customers. SMEs must also carry out market research in order for them to have knowledge of the market, on selling their products.

The economic factors affecting the performance of SMEs

- **Interest rates:** affect the performance of SMEs since they make the cost of borrowing expensive. Which has a negative effect on the growth

and development of SMEs, Therefore, an increase in the rate of interest is not desirable in SMEs as this might lead to the poor performance of SMEs. The government of Egypt must, therefore, subsidize the interest which SMEs pay on borrowed funds. In addition, SMEs should also search for alternative sources of finance which are less expensive than the financing offered by the banking sector of Egypt to reduce their costs of production. Instead of making use of bank loans, SMEs must use family funds from savings; also they must form partnerships and cooperatives in order to pool their financial resources together.

- **Currency:** This is the exchange value of the Egyptian pound against major currencies US dollar and the British Pound. SMEs are affected by the continual loss in value of the Egyptian pound, which result in an increase in the cost of raw materials with specific reference to imports. It is therefore recommended that the government must subsidize the SME sector when importing raw materials and inputs. This they can do by setting a special fund for SMEs that relies on imported raw materials.
- **Investment level:** The Egyptian government should try to attract investors through incentives such as Tax incentives ,a scheme whereby a small and medium sized business will be required to only pay tax after a certain period of operation,. The government can further boost investment levels by encouraging the Reserve Bank of Egypt to reduce interest rates on borrowed funds. This will ensure that SMEs have access to affordable financing options.
- **Exchange rate:** The weak currency is affecting the performance of SMEs as their products become less competitive in the world market. Currently exporters are paid a certain percentage for their exports in foreign currency and the remainder in the local currency. The Egyptian government should ensure that SMEs are paid for their exports in foreign currency after exporting.

Economic initiatives of the Egyptian government to develop SMEs: The Egyptian government's initiatives must be available and accessible to all SMEs. It must involve these SMEs in policy formulation for the small and medium enterprise sector since they are stakeholders who are affected by these policies. This can be done by involving SMEs in workshops to discuss issues which affect their daily operations and the challenges which could influence their future survival. The government of Egypt must also establish an SME association which represents the sector in direct talks with the government. Also the Egyptian government should put measures in place that make these SMEs

accountable when they get assistance from the government. They must ensure that SMEs furnish them with financial statements annually. In order for these SMEs to furnish the government with the required financial statements, the government must ensure that all SMEs are registered, they must have a data base of the SMEs they would have assisted. This will lead to these SMEs being more efficient in their operations in order not to waste and misuse resources.

5. Areas for further research

The research work suggests some lines of enquiry for further research. further research could determine if the findings of this research are consistent across different sectors, there is a need to duplicate the research in other parts of Egypt and in other sectors to confirm if the results of this research can be generalized across the whole country. Finally, this study can also be carried out in other parts of Africa for comparison purposes.

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