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TOWARDS UNDERSTANDING FINANCIAL BEHAVIOR OF SMES: ROLE OF SOCIO-PSYCHOLOGICAL FACTORS OF OWNER-MANAGER

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ABSTRACT. Purpose - Understanding SMEs' use/adoption of financial services is prerequisite for policy makers and managers of financial institutions interested in their growth and development. The study seeks to explore influence of personal characteristics of owner-manager on firms' financial behavior to use financial services.
Design/Methodology/Approach – Qualitative methodology has been employed to propose alternate model of understanding financial behavior of firms as influenced by socio-psychological factors of owner-managers. Study makes use of Theory of Planned Behavior and its variants to support the proposed model.
Findings - The study suggests that theories of behavior need to be applied to better understand the owner-manager's intentions to use financial services, which in turn reflect SMEs' financial behavior.
Research limitations/implications - The proposed model and relationships would help policy makers, managers and research scholars to better understand SMEs financial behavior. There is need for comparative empirical studies examining the propositions made by the study.
Originality/Value – The papers discusses the demand side issues and proposes a general model of socio-psychological factors of owner-manager that affect SMEs' decisions toward usage of financial services.

Keywords: SMEs, Financial Behavior, Socio-psychological Factors, Pakistan

JEL Classification: M1, M31, Z33

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1. Introduction

Small and Medium Enterprises (SMEs) are considered nursery of entrepreneurship in the economy and meeting their financial needs is vital for entrepreneurship and new venture creation. SMEs are the backbone of economies for both developed and developing countries, in terms of employment generation, sustainability, poverty alleviation and growth.

Globally, there are approximately 125 million micro, small and medium enterprises (MSMEs) in 132 covered economies, which make-up 90 to 95 percent of global entrepreneurs. Out of these, 89 million are in developing countries (Robu, 2013). Micro, small and medium firms are contributing around 43.5 percent of total employment and 57.8 percent of total new jobs created. In Pakistan, almost 90 percent of SMEs are actively working and contributing nearly 30 percent towards GDP, 25 percent towards export of manufactured goods, and 78 percent towards non-agriculture workforce employment, respectively (Chugtai, 2014).

SMEs are facing various challenges such as unpredictable legal and regulatory environments; macroeconomic instability; increased transaction costs as a result of corruption and access to finance is one of the major obstacles, which is focus of the present study. About, 45 to 55 percent of formal SMEs (11-17 million) in the emerging markets do not have access to finance from formal institutions. Moreover, about 55 to 68 percent of SMEs in developing countries are either financially underserved or not served at all, resulting in lost opportunity to realize their full potential (JWB-IDB, 2015).

International Finance Corporation (IFC) reported that, in Pakistan, 67 percent of SMEs are un-served, 22 percent under-served and only 11 percent are well served. A large proportion of SMEs are not getting any finance facilities because they are not satisfied with current financing options offered by financial institutions. However, out of 22 percent of SMEs who are able to access finance facilities, less than 20 percent are satisfied. As a result, SMEs move towards non-financial services e.g. friends and family or personal savings. Few studies have been conducted by the scholars on the demand side of SME financing investigating the role of owner manager's behavior in financial decision making of SMEs. Within context of SMEs, most of the studies have focused on firm size, demographic and personal characteristics of owner-managers regarding their financial behavior (IFC, 2014a).

The purpose of this conceptual paper is to identify socio-psychological factors affecting SME owner-managers' behavioral intentions towards use of formal financing. The proposed model is supported by theory of planned behavior (TPB). The main objective of this study is to evaluate the extent to which SME owner-managers intend to use financial services; identify and understand socio-psychological factors that influence their intentions. Next sections define the context of study which presents a review of literature and develops the conceptual framework.

2. Financing for SMEs in Pakistan

SMEs have been defined by the related institutions of Pakistan such as Federal Bureau of Statistics, Pakistan (FBSP) and Small and Medium Enterprises Development Authority (SMEDA). However, this study makes use of one stated by State Bank of Pakistan.

A small Enterprise employs not more than 50 persons with annual sales turnover up to Rs.150 million and finances can be extended up to Rs.25 Million (SBP, 2016). Whereas, a medium enterprise employs not more than 250 persons (for manufacturing and services firms) and 100 persons for trading firms. Annual sales turnover up to Rs.800 million and finances can be extended up to Rs.25 Million.

Across the world, generally three main sources of finances are used by SMEs. In Pakistan, small and medium firms have following options for financial needs.

a) Formal sources: Banks and non-banks financial institution.
b) Informal sources: Family and friends, advance payments from customers and credit from suppliers.
c) Personal savings: Internal funds, retained earnings and equity.

In Pakistan, main source of financial services used by SMEs is banking sector. Several conventional and Islamic banks (both public and private) are operating to provide financial products and services to their clients. However, banks feel hesitation while offering financing services to small and medium firms. There are only 7 percent of SMEs in Pakistan who obtained formal credit from banks, compared to a much higher percentage in neighboring countries like India and Bangladesh where it stands at 33 and 32 percent respectively (Khan, 2015). Banks and other financial institutions 54 percent portfolio of total advances comprises on the corporate sector and only 19 percent of SMEs. Private and public banks are more supportive in providing finance to SMEs. Total outstanding SME financing is 69 percent in private and 25 percent in public sector banks (SBP-SME finance review, 2015).

International Finance Corporation (IFC) report highlighted that, a large proportion of SMEs (around 25 percent) are not taking any finance facilities due to religious factor or may be interested in Islamic financing. Though, Islamic banks are more careful while financing to SMEs (IFC, 2014a). Full-fledged Islamic banks share towards SME financing is only 2 percent as compare to Islamic banking divisions (IBDs) which is around 3 percent. IBDs financing ratio to SMEs increasing constantly, but full-fledged Islamic banks share is same from last three quarters. Statistics of SBP report (2014) uncovered that in Islamic banking industry most neglected sector is SMEs, as the financing share stands only 5.1 percent, though, percentage much higher towards corporate sector which is around 71.8 percent.

The reasons behind reluctant behavior of banks in providing finance is informal set up and less experience of SMEs, since most of the enterprises are quite young and unable to meet compliance requirements. Such limitations place this sector as a high risk borrower and banks show reserved behavior in lending to SMEs. Also owner-managers of SMEs do not show flexible attitude to financial institutions as they never maintain their records properly, most of the entrepreneurs are not much educated, hence they are not much aware about financial products and banking procedures. In addition, misalignment between banking products and consumers' needs as well as religious beliefs disapproving use of interest based banking. Lack of professional and management skills such as age, ownership and firm size also create problems while applying for financing from financial institutions (IFC, 2014b; Khan, 2015).

In Pakistan, SMEs prefer informal sources and personal savings to fulfill their financial needs to avoid banks lengthy procedures, non-supportive behavior and high interest rates. International Finance Corporation reported that in Pakistan 67 percent of SMEs are un-served means they are approaching non-financial servicess for their financial needs. Khan (2015) estimated that approximately 61 percent of informal finances are based on friends, relatives and family members followed by 30 percent landlords, professional money lenders, shopkeepers and merchants 2.12 percent. In informal financial sector small amount of credit for short period of time given by the lender without interest in case of borrowed from friends and family members. About, 90 percent of rural areas SMEs such as farmers obtain finances from informal sources or money lenders. These money lenders offer finance mostly for the rental machinery, purchase of fertilizers and working capital requirements. They never require any collateral like banks but at the time of harvesting they take share in profit and interest rate they offer is more than 5 times higher than interest rate offer by banks and other financial institutions (Khan, 2015; IFC, 2014a).

Despite, SMEs prefer informal market one of the reasons is low opportunity cost of equity as compare to formal sector financing options. Small businesses who have good business proposal they never approach financial institutions for financing purpose because of inflexible attitude and strict policies of financial institutions. Studies supported that SMEs financing demand from formal sector is low because they typically prefer to hire finance from informal sources (Kauser et al., 2012; Nkuah et al., 2013; Sherazi et al., 2012). Thus, several factors have impact on SMEs decisions towards usage of financial services such as firm size factors, personal and demographic characteristics and market factors. Next section discussion is based on these factors.

3. Financial decision making of SMEs

SMEs owner/managers play a major and dominant role in firm decision making. The most preferable ownership pattern among SMEs in Pakistan is sole proprietorship, whereby owner-manager asserts key influence on all management and financial decisions of firms. According to the Neneh (2011), previously researchers have categorized the characteristics of SMEs' owner-manager into following:

- Demographic/social characteristics
- Behavioral/managerial characteristics
- Economic characteristics
- Human capital characteristics

Similarly, Islam et al. (2011) studied the almost same classification of variables for owner-manager characteristics:

- Demographic characteristic
- Individual characteristic
- Personal traits
- Entrepreneur orientation
- Entrepreneur readiness

Under these classifications the most commonly used characteristics in previous studies are age, religion affiliation ethnic group affiliation, educational level, culture, owner-manager experience and networking etc. (Ogubazghi & Muturi, 2014).

Most of the scholars in context of financial behavior and decision making of SMEs owner-manager never used any underpinning theory (Osman & Ali, 2008; Gair & Worthington, 2009; Xiang et al., 2011). Low & Mazzarol (2006) discussed owner-manager's preferences for finances by using Pecking Order Theory (POT). In this study, POT theory explained that for financing decisions there is a preferred hierarchy, in which internal finances are on the top. Few studies measure financial behavior of SMEs owner-manager by applying Theory of Planned Behavior (Brettel & Breuer, 2009; Jaffar & Musa, 2013 and Tolba et al., 2014). Thus, for better understanding of financial behavior of SMEs as influenced by socio-psychological factors of owner manager, there is need to further explore this area by using behavioral theories.

4. Role of socio-psychological factors of owner-manager in financial decision making of SME's: A Critical Review

SMEs that are individual proprietorship-based have single owner-manager. The owner manager assumes the dominant role in the firm's decision making process (Osman & Ali, 2008). Since its establishment, the most preferable ownership pattern among SMEs in Pakistan is sole proprietorship. Therefore, it is possible that one of the key issues is lack of professionalization and formalization that may be linked with SMEs, owner-manager demographic characteristics, affecting their management and financial decisions. There is a growing concern in financial institutions for understanding factors influencing SME owner-manager's decision making regarding use/adoption of various financial products (IFC, 2014). Understanding SMEs' financial behavior towards various financial products is prerequisite for policy makers and managers of financial institutions. To understand financial behavior of SMEs, researchers (Ogarca, 2010; Gait & Worthington 2008; Abdulsaleh & Worthington, 2013; Jaffar & Musa, 2013; Low & Mazzarol, 2006; Ogubazghi & Muturi, 2014; Xiang, 2011) studied both demographic and firm level characteristics of SMEs.

Ogarca (2010) discussed that firms owners are central element of management processes. Large firms are more rationale then small and medium firms. In large firms, decision making is more formalized and less influenced by personal characteristics of owners/shareholders (Gait & Worthington, 2008). However, in small and medium firms the decision making process is opposite, whereas, small and medium firms decision affect by different factors such as firm level factors, personal and demographic characteristics of firm owner-manager as well as market elements.

Study revealed that firms who prefer profit and growth ask for additional finance as well as smaller and young enterprises face more problems while approaching for finances, because of firm size and age. Moreover, study found business objective is an important determinant which affects financial decision making of SMEs (Xiang, 2011). Along with firm characteristics demographic factors such as gender, age, education and experience of owner-manager influence SMEs financial behavior. For instance, female owner-managers used less capital then male owner-manager and face much more issues while applying for finances. Young, owner-managers are more likely to apply for finance and used own sources as well, but older one prefers their own personal savings or informal finance sources. Moreover, more educated and experienced owner-managers are more confident while dealing with bankers instead of those who have less experience and education (Abdulsaleh & Worthington, 2013; Ogubazghi & Muturi, 2014).

In context of Singapore, Low & Mazzarol (2006) studied socio-psychological factors and concluded that owner-managers rigid attitude affect growth of firm. Further stated that, owner-manager's personal characteristics effect their financial decision making, thus, management education and awareness of financial products/ services among owner-manager is an important issue. Study suggested that owner-managers should show flexible attitude towards financing decisions to get better financing offers from financial institutions. Similarly, in Pakistan, study examined that attitude of owner-manager considered as negative due to individual characteristics such as lack of knowledge, age and gender as well as firm level determinants have impact on SMEs owner-manager behavior (e.g. size of organization and nature of business) (Siddique et al., 2016).

Correspondingly, scholars presented a conceptual model of SMEs owner-manager attitude towards Islamic financing. By applying, Theory of Planned Behavior (TPB) to understand the salient belief factors (e.g. awareness, religious obligations, cost benefits, business support and reputation) study supported that these attitudinal factors have strong impact on SMEs owner-manager financial decision making (Jaffar & Musa, 2013). Study by Ahad et al. (2012) explored the factors that influence SMEs intention to adopt mobile banking. Banking status, advantages for SMEs, perceived usefulness, perceived ease of use, perceived credibility, perceived risk, cost and demographic factors such as; age, gender, education, SME category, income, profession are the factors that have impact on intention of m-banking adoption. According to the findings of study banking status, perceived credibility, cost, gender, education and SME category are the significant factors.

Most of the above studies discussed about the non-supportive behavior of SMEs owner-manager and impact of their personal characteristics and socio-psychological factors. Unfortunately, there is limited studies that can clearly define attitude and behavior of SMEs owner-manager towards financial institutes. Available studies are either conceptual or providing very limited empirical evidences. Therefore, for better understanding to SMEs owner-manager behavior there is need to explain their financial behavior and socio-psychological factors affecting their attitude. This study aims to explain socio-psychological factors of SMEs owner-manager with help of underpinning Theory of Planned Behavior.

5. Linking Theory of Planned Behavior with SMEs' Financial Decision Making: The Proposed Model

Ajzen & Fishbein (1975) identified some gaps during usage of Theory of Reasoned Action. Thus, in 1991, Ajzen extended Theory of Reasoned Action (TRA) into what is known as Theory of Planned behavior (TPB). Along with Ajzen, some other researchers (e.g. Godin & Kok, 1996) argued that TRA's assumption of an individual's self-control is insufficient to explain actual behavior in real life (Ajzen, 1988; 1991). Most of the behaviors lies between two extremes which are total control and lack of control totally (Godin, Valois, Lepage & Desharnais, 1992). For balancing of these observations, Ajzen (1985) added an additional determinant of intention perceived behavioral control (PBC). Spite of two different names, TPB and TRA are actually similar. TPB is a modified version of TRA in which Ajzen (1985) covered the flaws mentioned by researchers in their studies (Conner & Sparks, 2005). TPB has been also used by researchers extensively to measure behavioral intention and actual behavior as well as to find out further construct of variables.

The TPB has been extensively used by scholars to measure individuals' behavioral choices in different contexts (Souiden and Rani, 2015; Ya'gobi and Rad, 2015; Hockerts, 2015; Schlaegel and Koenig, 2013). However, there are a few studies which have applied it to understand and explain firms' behavior. To predict individual behavior, TPB is the most useable underpinning theory which makes it appropriate to explain behavioral intention of owner managers of small firms where owner manager's assert key influence in firm decision making. A meta-analysis by Southey (2011) mentioned very few studies which applied the TRA and TPB to examine the business decisions or behavior of firms towards financial, strategic and professional decision making. This study concluded that there is need to use the frameworks of these theories to design the behavioral models to explain decision making in small and medium enterprises (Southey, 2011; Jin et al., 2012). Present conceptual model is an extended model of TPB to predict SMEs owner-manager's financial behavior towards formal financing.

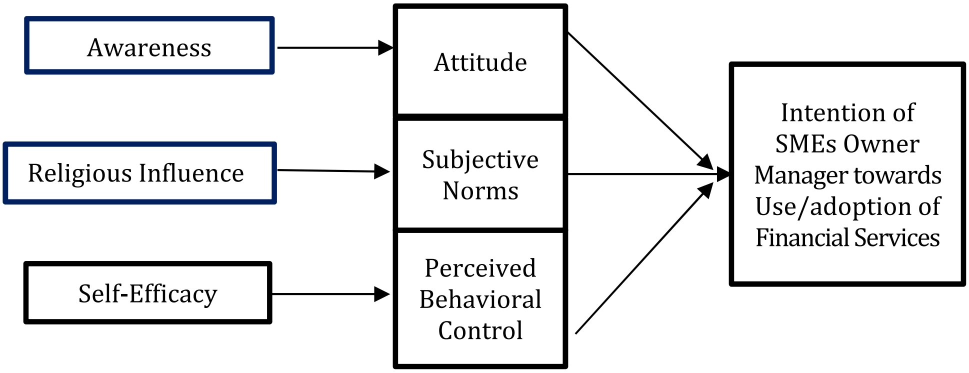

Figure 1. Conceptual Framework for Linking SMEs financial behavior with owner-manager's socio-psychological factors

5.1. Behavioral Intention

Behavioral intention means persistent motivation of an individual towards performing certain behavior (Armitage & Conner, 1998). Study by Ajzen I (1991) explained that a person's intention to perform a certain behavior is the determinant of his/her actions. By understanding a person's intention it's easy to predict his/her behavior. In addition, this study explained that a person performs certain action according to his/her intention and it can be used as a proximal measure of behavior. But it doesn't mean that between intention and behavior there is always a perfect correlation as the construct of behavior also includes some other contingent factors (Francis, et al., 2004; Ajzen & Fishbein, 1980; Ajzen & Fishbein, 1977, Armitage & Conner, 1998).

5.2. Attitude

Allport, (1935) defined that an attitude is a mental state of willingness to respond in a persistent manner to some situation or object. In context of SMEs financial behavior few scholars examined the influence of attitude of owner manager on financial decision of SMEs (Jaffar & Musa, 2013); Gait and Worthington (2008; 2009).

Proposition 1: There is a positive relationship between attitude and SMEs owner-manager behavior towards usage of financial services

5.2.1. Awareness

According to the Kotler & Armstrong (2001), a company needs to create customer awareness as a first step in order to influence customer preference, interest and desire towards a product. A customer with ability to recognize products brand and features has higher customer awareness. If a customer never spends time in getting information about products, he/she will have low level of awareness. People with more awareness, have strong intention towards usage of these products (Naser et al., 1999). Within context of present study, awareness is defined as knowledge and better understanding of financial products and services. Experts suggest to financial institutions that they should create better awareness techniques, which are influential in attracting customers (Haron et al., 1994; Ahmad & Haron, 2002).

Proposition 1a: There is a positive relationship between owner-manager awareness and his/her attitude towards financial services

5.3. Subjective Norms

Subjective norms are social values and their pressure which effect the customer decisions and behavioral intention (Ajzen, 1991). Subjective norm is an individual assessment regarding social and religious pressure to determine whether to perform or not perform a certain behavior (Ajzen & Fishbein, 1980). As an important factor of all intention based theories, researchers found mix results about subjective norms.

Proposition 2: There is a positive relationship between subjective norms and SMEs owner-manager behavior towards usage of financial services

5.3.1. Religious Beliefs

Religion is a cause, principle, or a system of beliefs, practices held to with ardor and faith (Kirkpatrick, 2005). Moreover, religion is a psychological connection and dominant emotional relationship to things. Metawa & Almossawi (1998) found religion as main factor which affects customer perception while selecting financial institution. This study further concluded that religiosity has highest rank among other factors. Similarly, Haron et al. (1994); Othmen & Owen (2001); Tara et al. (2014) found that religion is a major influential factor in adoption of financial products. Religion is an important factor which affects the consumer behavior towards banking products (Amin et al., 2011; Sun et al., 2011)

Proposition2a: There is a positive relationship between owner-manager's religious beliefs and his/her subjective norms towards financial services.

5.4. Perceived Behavioral Control

The construct of Perceived Behavioral Control is exclusive as it serves in two case: 1) direct determinant of behavior and 2) predictor variable of intention (Ajzen, 1991). This construct's propositions got the higher attention from scholars such as it has been applied in the Protection Motivation Theory (Conner & Norman, 1996) and in model of Health Belief (Armitage & Conner, 2000). A study by Johan (2014), concluded that psychological factors such as attitude, subjective norms and perceived behavioral control influence consumer intention towards halal product compliance in financial service.

Proposition 3: There is a positive relationship between perceived behavioral control and owner-manager's behavior towards financial services.

5.4.1. Self-Efficacy

Self-efficacy or degree of confidence is the adopter's ability to make use of the initiative and innovation. Ajzen (1991) argued that it is positively related to perceived behavioral control. It is basically based on the past experience and attainment (Bandura, 1994). Self-efficacy is one of the most frequently studied characteristic of entrepreneur. Study examined that entrepreneurs and managers have higher confidence or self-efficacy as compared to non-entrepreneurs (Chen et al., 1998; Tyszka et al., 2011).

Preposition 3a: There is a positive relationship between owner-manager's perceived behavioral control and his/her self-efficacy towards financial services.

6. Significance of Study

Theoretically, this research paper would add to the body of knowledge in the area of decision making behavior of SMEs in use/adoption of financial services. The proposed model of the study will enable better understanding of influence of socio-psychological factors of owner managers on intention to use financial services by SMEs. On the practical front, the study would be helpful to explain how these factors may affect financial decision making of SMEs' usage of financial services in Pakistan.

7. Conclusion

This study integrates the socio-psychological factors with the Theory of Planned Behavior to develop a systematic approach in examining and predicting intention towards use/adoption of financial services by SMEs. The proposed model will be helpful for the governments, Central Banks and banking sector to work on new policies and procedures based on better understanding of socio-psychological factors that may constrain adoption of financial products by SMEs. The theoretical propositions need to be further scrutinized by using empirical data.

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