

THE IMPORTANCE OF SMALL AND MEDIUM ENTERPRISES SECTOR IN DEVELOPING COUNTRIES THE AUTHORS:

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Abstract: The aim of the paper is to explore the importance of small and medium enterprises (SMEs) sector in developing countries. From the results of the study it was observed that SMEs are essential to the economy development. The researcher used qualitative research methods to conduct a secondary research on the topic. Several academic journals, published online papers and books were used to achieve a high level of understanding and exploring for the topic. This paper glanced at the literature review and established a base for exploring the importance of small and medium enterprises sector in developing countries. The hypotheses presented in this study are tested, and the findings are presented. The presented findings discovered that SMEs are key player in ending developing economy problems such as poverty, unemployment, etc. but it can not be done without the government's support to SMEs and protection from developing economy problems like inflation, black market, etc.

Keywords: Small and Medium Enterprise, Developing Countries, Economic Development, Economic problems, Small and Medium Enterprise problems

I. INTRODUCTION

Background of the study

Small and medium enterprises (SMEs) contributes a lot to the global economy. For example, 99% of enterprises in the European Union (EU) are SMEs and they provide almost 55% of private sector employment (OECD, 2004). Unlike large firms and organizations, SMEs have great capability of quick adaptation which makes them less affected from economic crisis. And that's exactly why they are seen as the main actors in the development of emerging and developing countries. Because SMEs are flexible and can cope with hard conditions, they are an inspiration for innovation specially in emerging and developing countries. As stated by The World Bank, formal SMEs contribute up to 60% of total employment and up to 40% of national income (GDP) in developing economies. Moreover, The World Bank also estimates that in the next 15 years 4 out of 5 jobs will be generated by SMEs in emerging economies and developing countries, mainly in Asia and Sub-Saharan Africa. So nowadays governments in developing countries are initiating different programs to strengthen SMEs and support their future. However, SMEs financial status is often their major weakness. SMEs are usually working on low budget, that's why they will always face obstacles in obtaining sufficient capital for operation and growth. Dalberg Global Development Advisors report that SMEs' role in private sector growth rate is often too low because SMEs' growth in developing economies is often slowed down due to the difficulty to obtain financial capital. Moreover, they argue that local financial systems do not sufficiently cater to the needs of SMEs.

II. RESEARCH OBJECTIVES

General objective: The aim of this study is to explore the importance of SMEs to the economy development in developing countries.

Specific objectives:

1. To assess SMEs' performance and profitability in developing countries.
2. To investigate SMEs role in ending economic problems.
3. To investigate the governments' efforts in supporting SMEs.

III. STATEMENT OF THE PROBLEM:

SMEs proved to be the backbone that supports the economy of many countries. Whether it's a country with high income economy, emerging economy or even developing economy. For instance, in the OECD economies, SMEs represents over 95% of firms, 60-70% of employment, 55% of GDP. And in the case of emerging and developing economies, the situation is not very different, in Morocco, 93% of firms are SMEs and account for 38% of production, 33% investment, 30% export and 46% employment. Similarly, in Bangladesh, enterprises of less than 100 employees account for 99% of all firms and 58% employment. Also, in Ecuador, 99% of all private companies have less than 50 employees and account for 55% of employment. It is due to their efficient operations, innovative leadership and endurance to surrounding changes, supporting SMEs have proven to be one of the best strategies to support the growth and development of the economy.

However, till this moment and after it has been proven that well-managed and healthy SMEs can be effective to both citizens and the government, yet SMEs in most of the emerging and developing countries still faces many constrains (Davidsson, 2004). Like for example the technological backwardness, lack of human resources skills, weak management systems and entrepreneurial capabilities, unavailability of appropriate and timely information, insufficient use of information technology, poor product quality. As a result, there exists a low level of performance (Asian Productivity Organization, 2006, 2011). We hypothesized that if SMEs in developing countries were given the right access to funds and got the chance to work in a formal way under the umbrella of facilitated rules, taxes and regulation, SMEs would help end many of the largest problems of the undeveloped economy. Like for example, black market, unemployment, shortage of resources, poor infrastructure, poverty, foreign trade and foreign currency rates in case of inflation.

IV. LITERATURE REVIEW:

INTRODUCTION

Conceptual literature and theoretical framework related to the study. The conceptual literature starts with the concept of SMEs then struggles of SMEs in emerging economy and developing countries. Also, it illustrates Financing, infrastructure, informality, regulation and taxes of SMEs in emerging economy and developing countries and its effect on profitability and performance. Then the demonstration of SMEs profitability and performance in developing economy under the shadow of inflation. And theoretical framework is presented.

Conceptual literature

The concept of small and medium enterprises

SMEs definition according to the European Union (EU) is the micro, small and medium enterprises that meets the following criteria.

SME CATEGORY	EMPLOYMENT	TURNOVER (MILLION €)	BALANCE SHEET (MILLION €)
Medium	250	501	43
Small	50	10	10
Micro	10	2	2

Table 1: Criteria set in 2005 for the definition of SME in European Union (KESKGN, 2010)

SMEs differs from large scale enterprises in almost everything. And like everything in this world, it has its advantages and disadvantages. For instance, advantages are for example, being more efficient, coping up with economic crisis and having a competitive structure. And disadvantages are for example, having lower level of profitability, intense employment, low level employment and lack of experts. Differences between SMEs and Large Enterprises are elaborated in the following table.

	SMEs	Large Enterprises
Marketing	Re-active marketing	Pro-active marketing.
Management	Lack of bureaucracy, more dynamic, react quickly to new opportunities and more willing to accept risk.	Professional managers that control complex organizations to establish corporate strategies.
Communications	Efficient and informal internal communication networks, lack of time or resources to identify and use important external sources.	Heavy internal communications that often lead to slow reaction to external threats / opportunities. Better ability to fund important external sources

Qualified Technical Manpower	Frequent lack of suitably qualified technical specialists. Often unable to support a formal R&D effort.	Ability to attract highly skilled technical specialists. Can support a large R&D scale.
Finance	Great difficulty in attracting capital, especially risk capital. Innovation can represent a financial risk.	Ability to borrow on capital market. Ability to spread risk over a portfolio of projects.
The Systems Approach	Inability to offer integrated product lines or systems.	Ability to offer a range of complementary products
Economies of Scale	In some areas scale economies form entry barriers to small firms.	Ability to gain scale economies in R&D, production and marketing.
Growth	Can experience difficulty in acquiring resources necessary for rapid growth.	Ability to finance expansion of production and fund growth via diversification and acquisition.
Government Regulations	Often cannot cope with complex regulations. Costs of compliance unit in small firms often high.	Ability to fund legal services to cope with complex regulatory requirements.

Table 2: A Comparison of Small and Large Firms (Xhepa, 2006).

It is proven that no matter if it is a developed or developing country, SMEs play an important role in the overall growth of economy. And contributes a lot to countries having low level of investment by offering many socio-economic benefits (Gamage, 2003). However, the share of SMEs differs according to the surrounding economic status. As shown in the following table, the share of SMEs in the economy differ globally from group of countries to another.

European Union (EU)	99% of enterprises in the EU are defined as SMEs and employ around 75 million. On average each SME provides employment for 4 people, including the owner/manager and the average turnover is 500,000€
OECD Countries	Over 95% of enterprises in most of OECD countries are SMEs and it generates over 50% of private sector employment. Also, most OECD governments promote and develop SMEs with policies and programs. Like for example including tax breaks or reducing interest loans for starting new businesses in rural areas.
Latin America	Around 80-90% of enterprises are micro, and the governments have vastly reduced bureaucratic obstacles to ensure SMEs needs are attended to swiftly. These businesses flourished especially in Brazil and Mexico.
Asia	The world's best performing economies, notably Taiwan and Hong Kong, are heavily based on small enterprises. Also, SMEs contribute 81% to employment in Japan where on average SMEs employs nine staff as opposed to four in the EU.
South Africa	It is estimated that 60% of the share of employment is located in the SMEs while the sector generated about 40% of output.

Table 3: Share of SMEs in Global Economy (Lukacs, 2005).

Struggles of SMEs in emerging economy and developing countries

Despite the initiatives done by governments to support SMEs and boost their growth, there is still a gap in financing and there is scope for government interventions to close this gap and enhance SMEs operating environment (Bouri et al., 2011). SMEs are still struggling to reach their economic potential because of issues like informality and absence of well-established lending system (Bouri et al., 2011). Even though SMEs are strong weapon to fight poverty and unemployment and it is a fact that SMEs are vital to emerging economy and developing countries, yet governments still don't act against the five most significant obstacles that threaten SMEs. Those five obstacles are access to finance, tax rate, competition, electricity and political factors. And among those five obstacles, access to finance appears to be the biggest barrier (Wang, 2016).

Financing of SMEs in emerging economy and developing countries and its effect on probability and performance

According to HFC Bank (2004), SMEs in some of the developing countries, like Ghana, tend to have limited access to credit. Also, it was revealed in recent report of central bank of Egypt that only 8% of small businesses in Egypt have bank loans (CBE, 2017) and in Jordan the share of credit to SMEs declined from 11% to 8.5% of total credit available to private sector (CBJ, 2016). It has been proven that SMEs are 23.1 percentage more likely to distinguish access to finance as the biggest obstacles to their growth than large firms (Wang, 2016). Survey

showed that smaller firms experience more severe financing problems than larger firms. And the answer of the question of “How severe is access to finance as an obstacle to the current operation of the firm?” mainly depends on the firm’s size (Wang, 2016). As elaborated in the following table, internal funds are the main source of financing for SMEs. It is shown that 54.53 percent of SMEs did not need loan for financing their business. And among SMEs that needs financing, it is evident that 14.35 percent suffer from high interests and 9.61 percent suffer from complexity of application procedures.

Main reason for not applying for new loans or new lines of credit	Percent
Don't know	1.17
Refuse to answer	0.06
No response	0.01
Still in process	1.42
Skip	0.01
No need for a loan	54.53
Application procedures for loans are complex	9.61
Interest rates are not favorable	14.35
Collateral requirements are too high	6.95
Size of loan or maturity are insufficient	1.85
It is necessary to make informal payments	3.07
Did not think it would be approved	6.24
Other	0.73
Total	100

Table 4: Reasons for not applying for a loan (Wang, 2016).

With Financing being a major constraint facing SMEs, it has direct effect on productivity and profitability. By doing meta-analysis on developing countries, Kersten (2017) found that SMEs finance programs have a positive and significant impact on performance key indicators, such as capital investment and employment and but an insignificant effect on profitability and wages. Beck and Demirgüç-Kunt (2006) warned that access to financing is not the only thing that affects performance but also the type of finance, especially for SMEs in developing countries. He suggested that out of the box lending strategies, such as factoring, credit-scoring and leasing are better alternatives to traditional debt financing due to the absence of developed institutions and the presence of weak business environment like that of emerging and developing countries.

Infrastructure in emerging economy and developing countries and its effect on SMEs’ probability and performance

Lack of infrastructure can have negative impact on SMEs performance and profitability. This is particularly accurate in cases of emerging economies and developing countries where bad infrastructures like electricity, water, telecommunication, etc. can burden SMEs extra cost to obtain such services. Also, such bad conditions it will result in bad working environment affecting performance. And all of this will result in obstacle the SMEs growth (Mambula 2002). In a case study Anwar (2010), proved how governments combines with local SMEs came up with solution that betters infrastructure. This process generated social benefits for the entire industrial district. Similarly, Akuru and Okoro (2014) highlighted that SME villages or clusters can be built in Nigeria to promote industrial activities. Such strategic development would enable the provision of basic infrastructures, such as electricity, needed for spin-off, as well as operations, in a more affordably which is particularly important in the case of developing economies, where infrastructure may be undeveloped or underdeveloped. Because lack or decay of infrastructure can lead to the failure of SMEs (Ndiaye, 2018).

Informality of SMEs in emerging economy and developing countries and its effect on profitability and performance

In developing countries informal firms gets the lion’s share, most of the people live on what’s called “Informal Economy”. And it makes up a large portion of overall employment and economic activities. As found by La Porta and Shleifer (2008), informal SMEs are extremely unproductive when compared to formal SMEs. And even though informal SMEs can be a great source employment, yet informality can impact productivity negatively. So, the formalization of SMEs is often associated with better performance. Also, the same thing was proven by Rand and Torm (2012) when they studied the effects of formalization on firm level outcomes in SMEs in Vietnam. And the results proved that formalization leads to an increase in firm gross profits and investment, as well as in the empowerment of workers. However, they found no evidence that formalizing leads to a higher share of wages in total value added.

Regulation and taxes of SMEs in emerging economy and developing countries and its effect on profitability and performance

Regulation and taxes can work for the favor of SMEs or against them. It can be used to create a good business environment that allow SMEs to grow and expand or it can have negative impact on profitability and performance. All depend on how it is used and how it allows and gives opportunity to new business or SMEs. Klapper et al. (2006) used a database of developed and developing European countries and found that costly regulations ease the creation of new industries. But argued that in developing countries or countries where corruption is a severe problem, where entry regulations are unlikely to help screen out cheats. The study concluded that poor business environment might affect SME performance because restrictions and market imperfections dampen competition and slow firm growth. While Troilo (2011) concluded that poor performance among SMEs in emerging economies is an effect of corruption and non-competitive banking. The study also stated that the persistence of non-competitive banking is a result of governments' regulatory choice in restricting the entry of foreign banks.

SMEs profitability and performance in developing economy under the shadow of inflation

Inflation influence the demand, interest rates, exchange rates, unemployment and consumption, so it directly impacts the growth of SMEs. Because all these factors can affect sales, revenues and market potential of SMEs (The Economist, 2009). It also impacts the market potential not only growth opportunities of SMEs. The findings show that economic matters such as sustained inflation suppress entrepreneurial activities, especially the small businesses (Thompson, 2017). The result reveals that persistent inflation is one of the major constraints affecting the activities and growth of businesses across all sectors and industries. It results in high production costs, lower profits and often zero profits. Hence, putting all SMEs that operates in inflamed economy under the risk of failure.

SMEs role in ending economic problems in developing countries

As noted in the research conducted by Hidayet KESKÖN, Canan ğENTÖRK, Onur SUNGUR and Hakan M. KÖRÖğ (2010), developing countries are interested in SMEs for two main reasons. The first is that SMEs development is an effective antipoverty program. The second is that SMEs development is one of the best inspirations for innovation and sustainable growth. Several studies have been conducted on the importance of SMEs to the economy development in developing countries. According to Kachembere (2011), SMEs play vital role in economic growth and sustainable development. And since economic growth goes hand in hand with poverty reduction and social growth. Therefore, SMEs is considered vital for poverty reduction and social growth as well as economic growth which by its turn can put an end to unemployment, inflation, black market, corruption, low standard of education and many other economic and social problems. That is why most of the now developed countries, depended on the growing of SMEs sector to solve economic and social problems.

Governments' efforts in supporting SMEs

Different initiatives were taken by governments and policy makers to solve SMEs major problem i.e. financing. Like for example the New Ventures Investor Forums which are forums that brings together financial and business committees to provide support to SMEs. Also, governments try to offer other non-financial solutions, like mentoring and management trainings to be provided to SMEs owners and managers (Pandya, 2012). Many governments have put into action plans to support SMEs which included financial aspect like Forums and programs that include facilitated loans and bank services. Also, as mentioned, governments try developing entrepreneurs and managers through mentoring programs and training to fill in the SMEs management and leadership needs. But unfortunately, these efforts are not enough because SMEs problems fall beyond financing and managers' development. SMEs needs support in many aspects like Marketing, Research and development (R&D), Technology, Human Resources (HR) Governance, etc. In fact, Marketing has been recognized as one of the biggest obstacles facing SMEs operations and one of the most essential element for business survival (Simpson & Taylor 2002). Also, globalization got SMEs pressured specially in the field of manufacturing (Raymond and St-Pierre, 2004). Therefore, it is essential for developing countries to support R&D in order to gain competitive advantage over foreign competitors. Despite globalization, most SMEs in developing countries work with traditional approach resulting in low productivity, quality and locality which is why the usage of latest technology and having the maximum utility of machinery will positively affect the production.

Theoretical Frameworks

Recent studies confirmed that economic growth is directly linked to the development of SMEs within the country. As noted by various researchers like Beck, 2005, Ardic, Mylenko & Saltane, 2011, the relationship between the size of the SMEs sector and economic growth is a direct relation. And majority of employment opportunities are only generated through the growth of SMEs sector. But it is worth highlighting that despite the proven influence of

SMEs on developing economies, yet SMEs still need support to grow and overcome its obstacles. It is proven in many studies that there is no standard model for SMEs as it is a highly adaptive enterprise that differs according to its environment, yet we can say that there are main areas where most SMEs need support. According to Güttler (2001), SMEs mainly need support during the startup phase, so it can have the chance to grow and be visible in the local economy and political processes and this can only be done through governments' support. According to Smith (2000), Small business owners tend to be detached from local economic initiatives. This appears to be due to historical trends that have reduced the role of small business in local political processes (Smith, 2000). And even though it is observed that the role of SMEs is increasing significantly in respective national economies, SMEs are generally underrepresented in world trade (OECD, 2005). Therefore, measures are required to be taken to make its share significant.

Furthermore, in order to activate the magic of SMEs which will save the economy of developing countries through contributing to the national income, employment, poverty reduction and export revenues, SMEs need to address some challenges (OECD, 2004). One of these challenges is how the enterprise is going to expand in the shadow of establishing new innovative firms every day. Therefore, SMEs must be competitive and productive; in fact, it must reach a certain level of competitiveness that enables it to integrate through trades and investments, like exports and internationalization.

In conclusion, there are different definitions of SMEs among to different countries and there is no standard business model to SMEs. SMEs has an important role in terms of economic growth, poverty reduction, social growth and sustainability. SMEs has gained popularity specially in developing economies due to its flexibility and ability to adapt fast and not being affect by economic crisis. Also, SMEs are the vital actors that represent entrepreneurship, innovation and competitiveness. And that is why governments need to exert efforts to help and support SMEs to overcome obstacles like finances and business continuity and also, encourage the formation of formal SMEs.

V. RESEARCH METHODOLOGY

INTRODUCTION

The researcher used in this study qualitative research method to investigate the importance of small and medium enterprises sector in developing countries. Research was conducted through utilizing the results of searching numerous scholarly journals that have conducted research on the importance of small and medium enterprises sector in developing countries and how governments support this sector.

Data Gathering

The study used qualitative research approach. To identify the result of the study, secondary research has been conducted. Gathering data that has been collected by someone else; it aims to improve the understanding, validity, and establish reliability of the topic (Kitchenham et al, 2009). The data has been collected from various research works from textbooks, international journals and scientific articles which are available online.

Discussion of Findings

The main objective of this study is to explore the importance of SMEs to the economy development in developing countries. From the results of the study it was observed that SMEs has a significant impact on ending many of the economic problems in developing countries. This study found that supporting SMEs is vital for economic development in developing countries. Also, it was found that SMEs in developing countries are suffering from many obstacles which is considered a major barrier in SMEs performance and profitability and hence, the economic development. Moreover, it was found that governments' effort to support SMEs are not completely sufficient to end SMEs problems in developing countries.

The impact of developing economy on SMEs performance and profitability

The results of this secondary research reveal that the economic environment have a great impact on the performance and profitability of SMEs operating in it. Starting with SMEs major problem which is finances. In developing economies most SMEs depend on internal fund including savings, retained earnings or assets sales funding because either they don't have access to financing resources or they don't get financial support during their growth stage to invest in new technology, equipment, infrastructure or other business needs. Moreover, operating in developing economy have its extra constrains that affect the performance and profitability, like undeveloped infrastructure, corruption, inflation, black market, etc.

The role of SMEs in developing countries in ending economic problems and boosting economic development.

The investigation shows that SMEs sector is a main player in achieving economic development. It can help solve major economic and social problems like unemployment, poverty, etc. Actually SMEs, if well supported, can positively impact the GDP. Economic growth can be achieved in developing countries by launching anti-poverty

programs that support micro, small and medium enterprise which was proven to be a major concept that was already adopted by developed countries to fight poverty, unemployment and other economic crisis.

Government efforts in supporting SMEs

Governments usually focus on the financing aspect and managers training when launching programs to support SMEs. Yes, it is a fact that financing is the major issue facing SMEs but that doesn't mean that in different stages SMEs needs support in different aspects. That is why governments' efforts are not enough and the majority of SMEs come to failure in their early years.

Conclusion

The main objective of conducting this secondary research was to explore the importance of small and medium enterprises (SMEs) sector in developing countries. Furthermore, SMEs is a key factor in economic development. It plays a vital role in solving economic and social problems and it is not much affected by economic crisis. But it needs support from policy makers and government to enhance its power in innovation and ensure its business continuity.

This research glanced at literature reviewed and established a base for exploring the importance of SMEs in developing countries. The hypotheses presented in this study are tested, and the findings are presented. The presented findings discovered that supporting SMEs will result in economic and social development. This support can be done through fulfilling SMEs' needs in the start phase and continue to support it in the development phase in order to overcome its obstacles and to ensure business continuity and competition survival. Moreover, the study also shows that supporting SMEs does not only come down to finances and training owners and managers. But instead policy makers and government should support SMEs in different aspects like Technology, Marketing, Human Resources, Infrastructure, Governance, etc.

Dealing with findings the Governments have these following points as:

Recommendation from the study

Finally concluding this study, it is found that SMEs has direct impact on economic and social development depending on governance support to SMEs in the country. Thus, it should be extremely important for the governments of developing countries to support SMEs from all required aspects and on all business stages. For that this number of recommendations are provided based on the findings of the study:

- **Formulating different action plans to specifically meet the needs of SMEs in each phase (Start-up phase / Development phase/ Business continuity phase) in order to reduce its early failure and guarantee continuous development.**
- **Facilitating the loan process for SMEs through providing low interest rate, simple application procedure and flexible collateral requirements.**
- **Facilitating other ways of financing SMEs, like leasing, angel investors, partnership investing, etc.**
- **Developing out of the box ideas that act as win-win for economy development and SMEs. For example, creating milestones for SMEs and when they reach it the enterprise get support of the government, this support could be in the form of interest free loan, consultation service, tax free for a certain period of time, etc. The milestones could be having a certain employment rate, gender equality in employment opportunities, doing community services (Providing low priced good to the poor, give opportunities to the youth as interns, etc), etc.**
- **Providing SMEs with consultation services in all aspects, not financial only but also technological aspect, HR aspect, organizational structure and strategy aspect, etc.**
- **Developing programs for SMEs which are about to fail to provide guidance and offer solutions like merging with other SMEs or increase the cash flow, etc.**
- **Protecting SMEs from developing economy's obstacles like for example in case of black market; government is to provide SMEs with the needed materials or foreign currency, etc.**
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