

## Establishing the Factors Affecting the Growth of Small and Medium-sized Enterprises in Algeria

**Asma Benzazoua Bouazza<sup>1</sup>**

PhD Scholar, School of Management  
Shanghai University  
Building V-905 Shang  
BaoShan District Shanghai  
P.R. China

**Diabate Ardjouman**

PhD Scholar  
School of Management  
Shanghai University  
Shanghai city, China

**Dr. Othman Abada**

School of Management  
Shanghai University  
Shanghai 20044  
China

### Abstract

*The study presented in this paper analyzes the factors influencing the growth rate of small and medium-sized enterprises (SMEs) in Algeria and explores the extent to which their success or failure depends on the wider business climate. This study also examines different internal factors that may be responsible for the unstable and limited growth of SMEs. Our research reveals that the growth of SMEs in Algeria is hampered by several interrelated factors, which include business environmental factors that are beyond the SMEs' control and internal factors of the SMEs. The external factors include the legal and regulatory framework, access to external financing, and human resources capacities. The internal factors comprise entrepreneurial characteristics, management capacities, marketing skills, and technological capacities.*

**Keywords:** Algeria, business climate, business environment, external factors, growth, internal factors, Small and medium-sized enterprises (SMEs)

### 1. Introduction

Algeria is a developing country characterized by a minimally diversified economic structure. The country's economic activity suffers from a dominant hydrocarbons sector and high unemployment among the country's youth (approximately 21% per IMF, 2011). The country's economic performance strongly depends on changes in oil prices. The oil sector generates more than 70% of the country's budgetary revenue and approximately 45% of the country's GDP and more than 97% of the country's export.

Algeria's economic attention began to turn to the private sector, particularly on SMEs due to their major role in economic development and their ability to provide jobs. Since the opening of the Algerian economy and the progressive adoption of a market economy in the early 1990s, the SME sector has realized a net augmentation in numbers. Statistics from the Algerian Ministry of Industry, SMEs and Investment Promotion indicate that the SME sector has ensured its increasingly important role in the national economic structure. By the end of 2013, Algeria's registered small- and medium-size enterprises exceeded 748,000, comprising 99% of the country's total enterprises.

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<sup>1</sup>**Corresponding author:** Asma benzazoua Bouazza, Building V-905 ShangDa Road No 99 BaoShan District Shanghai, P.R. CHINA

Despite the vital role of SMEs in building a competitive private sector and contributing significantly to economic growth and job creation, SMEs are facing more challenges around the world in general and in developing countries in particular. Likewise, Algerian SMEs face numerous and serious challenges to their growth: the cumbersome legal and regulatory constraints, lack of access to external financing, low human resources capacities, lack of management skills and training, and low technological capacities. The study presented in this paper uses data from the World Bank Enterprise Surveys 2007-2012 to identify the most binding constraints on SMEs' operations in Algeria and compares them with the constraints faced by other surveyed firms located in the Middle East and North Africa (MENA) region and in member countries of the Organization for Economic Cooperation and Development (OECD). They are also compared to the world average. Several relevant recommendations are provided to the Algerian authorities and policy makers, entrepreneurs, and SME managers to ascertain the appropriate strategy to remove the most prominent factors constraining the development of SMEs. The purpose of this study is to analyze the key factors affecting the growth of SMEs in Algeria. The study is guided by the following objectives:

- To review the literature and show how this study relates to it.
- To present a conceptual framework on factors affecting the growth of SMEs in Algeria.
- To analyze the external and internal factors affecting the growth of SMEs in Algeria.

The research is conducted in order to investigate the potential factors that affect the start-up and hinder the development of SMEs in Algeria. In order to achieve the research goals, this study employed a multi-methodology approach in which both quantitative and qualitative methods are used. We apply a qualitative approach to review the literature in an exploratory nature and to explain and comprehend the research findings. We also employ a quantitative method to measure the factors that affect the development of SMEs in Algeria. For this purpose we use the data from the World Bank Enterprise Surveys 2017-2012 to identify the most binding constraints on SMEs' operations in Algeria and compare them with the constraints faced by other MENA and OECD surveyed firms and the world average.

This study analyzes the different factors that affect the performance of SMEs and impede their growth in Algeria. It finds that the growth of SMEs in Algeria is hampered by several interrelated factors. Those factors involve the business environmental factors that the SMEs cannot control and the SMEs' internal factors. The external factors include the legal and regulatory framework, access to external financing, and human resources capacities. The internal factors include entrepreneur characteristics, management capacities, marketing skills, and technological capacities.

The remainder of this paper is structured as follows. Section 2 summarizes the theoretical perspective and the empirical evidence regarding the factors affecting the growth of SMEs. Section 3 outlines the conceptual framework that is used while conducting our analysis. Sections 4 and 5 present analyses of the external and internal factors, respectively, that affect the growth of SMEs in Algeria. Finally, Section 6 presents the conclusions and some relevant recommendations.

## ***2. Literature Review***

Small firm growth, regardless of its industry sector, has been a hot research topic for decades concerning strategy, organizations, and entrepreneurship. Despite extensive research that has explored the factors affecting small firm growth, no specific theory or empirical evidence has been put forth that would help scholars reach a consensus on the factors that affect small firms' growth.

Our literature review is divided into three areas. In the first area, we provide various definitions of SMEs from different institutions because there is no universally agreed upon definition. In the second area we explore the theoretical perspective from which we investigate the factors affecting small firms' growth, and in the last area, we present the different empirical evidence on the factors affecting the growth of SMEs.

### **2.1. Definition of SMEs**

SME has no standard definition. SMEs have been identified differently by various individuals and organizations, such that an enterprise that is considered small and medium in one country is viewed differently in another country. Some common indicators employed in the various definitions include total assets, size of the labor force employed, and annual turnover and capital investments (Baenol, 1994). In addition, no single definition of SMEs exists among officials of multilateral development institutions, as represented in Table 1

## **Theoretical Perspective on Factors Affecting the Growth of Small Firms**

### **Law of Proportionate Effect**

Gibrat (1931) developed a theoretical model to measure the relationship between firm growth and its initial size. Gibrat's Law, or the "Law of Proportionate Effect," states that firm growth is independent on initial size. While the results of some studies concur with Gibrat's Law, especially the early studies (e.g., Hart and Prais, 1956; Simon and Bonini, 1958), the results of other studies do not, even support a negative relationship between growth and size and confirm that smaller and younger firms grow faster than larger firms (e.g., Evans, 1987; Pasanen, 2007)

### **Theory of the Growth of the Firm**

In her book, *The Theory of the Growth of the Firm*, Edith Penrose (1959) offered some strong principles governing the growth of firms and the rate at which firms can grow successfully. She claimed that firms are a bundle of internal and external resources that help a firm to grow and to realize a competitive advantage. According to Penrose, firm size is incidental to the growth process, whereas firm growth is determined by the effective and innovative managerial resources within the firm. She further explained that the availability of top managerial and technical talent serves as an engine to a firm's growth. Penrose has also suggested that ignorance of these factors results in failure and loss of competitive advantage.

### **Empirical Evidence on the Factors Affecting the Growth of SMEs**

Scholars have used different approaches to identify the factors affecting the growth of small firms, however there is considerable variation in the results of previous researches. According to Coad (2007), the growth of small firms is a particularly erratic phenomenon. Entry rates of new firms are high; however, a large number of these entrants can be expected to go bankrupt within a few years. Bartelsman et al. (2005) analyze the post-entry performance of new firms in seven OECD countries, they results reveal that about 20-40 percent of entering firms fail within the first two years, while only about 40-50 percent survive beyond the seventh year. One of the reasons they do not survive is that they face several obstacles over time. Empirical studies on factors affecting the growth of SMEs can be roughly divided into two groups: internal factors of the firm and external factors that are beyond the SMEs' control.

### **External Factors**

Researchers have used different approaches to explain the factors affecting the growth of SMEs. Some of them have considered environmental and external factors to have a big impact on the performance and growth of small firm's (Lumpkin and Dess, 1996;). We can summarize the external factors affecting the growth of SMEs as follows:

#### **i. Legal and Regulatory Framework**

According to Lumpkin and Dess, (1996) the growth of SMEs are affected by its business climate. Clement et al., (2004) noted that an unfavorable business climate has negative affect on small firm growth. Brown (2007) identified competition as one of the major hindrances to the growth of small firm. Davidsson (1989) noted that an unfavorable tax system, complicated rules and regulations can heavily hamper small firms' growth. Krasniqi (2007) showed that corruption is a major source of the rise in unfair competition. He further emphasized that the cost of complying with regulations and increased tax rates increases small firms' expenses while limiting their growth. Likewise, St-Jean et al. (2008) noted that unfair competition from the informal sector, cumbersome regulations, and tax rates are the main obstacles on small business growth.

A study done by International Finance Corporation (IFC; 2013), based on responses of more than 45,000 firms in developing countries, found that the top obstacles to their operations are a poor investment climate, especially red tape, high tax rates, and competition from the informal sector, and inadequate infrastructure, especially an insufficient or unreliable power supply. Whereas informality is a major hindrance of SMEs in middle-income countries, an inadequate power supply is the most important challenge for companies in low-income countries.

#### **ii. Access to Finance**

Lack of access to external financing is considered a major challenge to the growth of SMEs, and it has accounted for high rates of failure among those SMEs.

According to Shah et al.(2013),financial institutions behave more cautiously when providing loans to SMEs, and SMEs are usually charged comparatively high interest, high collateral and loan guarantees. Krasniqi (2007) finds that loan policies and collateral requirements discourage firms from obtaining loans from banks. In consonance with Berger and Udell (1998), Galindo and Schantiarelli (2003) find that in both developing and developed countries, small firms have less access to external financing, which leads small firms to be more restrained in their operations and growth compared to large firms. A recent study done by Beck et al. (2005) in developing countries provides further evidence that SMEs face greater financing obstacles than large firms do. Ayyagari et al. (2006) show that financing, crime, and political instability directly affect the rate of growth of small firms, with financing being the most significant constraint affecting small firms' growth. Rocha. et al (2010) analyze the most binding constraint on firm growth in developing countries: they find that each country faces a different set of constraints and that these constraints also vary by firm characteristics, especially firm size. However, across all countries, access to financing is among the most binding obstacle while other obstacles appear to matter much less.

### **iii. Human Resources Capacities**

Human resources capacities form one of the most significant factors for the development of small firms. According to Hewitt and Wield (1992), firms with a skilled and well-educated workforce are probably to be more efficient. As noted by Lee (2001), human resource capacities form one of the most significant areas for the success of SMEs. Chandler and McEvoy (2000), indicate that human resource capacities have a positive effect on the growth of small firms, which increase employee skills and motivation, and eventually result in improving the productivity and long term sustainability of small firms. Similarly, Batra and Tan (2003) note that a well-educated and skilled workforce has more learning and innovative abilities. However, various studies recognize low human resource capabilities as a major challenge for the development of SMEs in developing countries (Lee, 2001;Batra and Tan, 2003).

### **Internal Factors Affecting SMEs**

Success and failure of SMEs is not only related to business environment aspect. It also depends on the firm internal factors and many more key strategic factors, which can be summarized as follows:

#### **i. Characteristics of Entrepreneurs**

Entrepreneur characteristics have been extensively studied, with mixed results on his impact on small firm growth. Several studies convincingly confirmed that some characteristics have positive and significant relationships with small firm growth while other studies find insignificant relationships (Sidika, I. 2012). Some authors have approached their studies from the perspective of the mindset and personality of the entrepreneur (Wijewardena, et al., 2008), while others have looked at it from the perspective of the entrepreneur's education, family background, and capability ( Brown, 2007; Kor, 2003). A third group of scholars has considered the personal role of the entrepreneur and his growth aspirations (Pasanan, 2007; Wasserman, 2008). Ciavarella et al. (2004) noted that the entrepreneurs' stable and inherent characters influence how they manage their businesses. In addition, they will tend to conduct their business based on the strengths of their specific characteristics (Sidika, I. 2012). Many aspects have been examined regarding the characteristics of entrepreneurs, such age, gender, motivation, experience, educational background, risk-taking propensity, and preference for innovation ((Pasanan, 2007; Sidika, I. 2012).

#### **ii. Managerial Capacities**

Several studies have considered the management capacities of the top management team as key factors for small business growth. According to Olawale and Garwe (2010), management capacities are sets of knowledge, skills, and competencies that can make the small firm more efficient. Singh et al. (2008) emphasize that management skills are necessary for SMEs to survive and achieve growth. Aylin et al. (2013) state that management skills are a crucial factor for the growth of SMEs and that the lack of management skills is a barrier to growth and is one of the factors that can lead to failure. Pasanen (2007) suggests that the growth pattern of small firms is associated with their managerial capacities. Bhide (1996) notes that a shortage of core competence and a skilled top management team is one of the main challenges faced by SMEs.

#### **iii. Marketing Skills**

Marketing skills has been considered as one of the most effective factor to firm survival and growth. According to Van Scheers (2012) the lack of marketing skills has a negative impact on the success of small businesses.

Pandya, V. (2012) noted that marketing limitations of an SME resemble other limited resources such as financial and human resources.

#### **iv. Technological Capacities**

Drucker (1985) noted that new technologies improve efficiency, enable greater production, and are a source of profit for SMEs. According to Morse et al. (2007), technological capabilities benefit SMEs in several ways: they enhance SME efficiency, reduce costs, and broaden market share, both locally and globally. As noted by Lee(2001), a small business that adopts greater levels of technological sophistication can be expected to grow more rapidly than a similar firm that does not. Romijn (2001), and Yusuf et al. (2003) point out that low technological capabilities hinder and discourage SMEs from fully reaching their potential. As noted by Wendel Clark (2012), countries with high levels of technological growth tend to have high levels of entrepreneurial growth.

From the above literature review, we conclude that the growth of SMEs is dependent on a range of internal and external factors. However, there is no clear understanding or specific theory as to whether an SMEs will sustain, grow, succeed, or fail. Scholars have put forward a number of factors concerning the important elements of the growing firm, such as Storey's (1994) identification of three necessary factors for growth: the entrepreneur, the firm, and strategy. However, there appears to be no unified pattern. Rather, the evidence points towards a complex set of interrelated factors that affect small business growth.

### **3. Conceptual Framework**

In our study, we analyze the different factors that affect the performance of SMEs and impede their growth in Algeria. Based on the literature review and the current research undertaken in the area, we formulated the research model presented in Figure 1 to investigate the factors affecting the growth process of SMEs in Algeria.

Figure 1 illustrates how the concepts in the framework are related. The external factor (the business environment factors) square includes the "legal and regulatory framework," "access to external financing," and "human resources capacities." The internal factor square represents the "entrepreneur characteristics," "management capacities," "marketing skills," and "firm technological capacities." This model is used while conducting the analysis.

### **4. Business Environmental factors Affecting the Growth of SMEs in Algeria**

A conducive business environment is an important enabler of an effective SME sector. The Algerian government has undertaken major reforms to improve the business environment by streamlining their regulations, reforming the financial sector, and removing trade and investment barriers. However, despite these efforts, the business environment in Algeria remains inefficient for reinforcing the competitiveness of SMEs, particularly with regards to bureaucracy, corruption, informal sector competition, access to land, and access to financing. According to World Bank Doing Business Indicators (2015), the business environment in Algeria has not changed significantly and is even getting worse in some cases. For example, the country currently ranks 141 in terms of establishing new business, down from 139 last year. Starting a new business in Algeria is time-consuming and costly, requiring the completion of at least 13 tasks in the start-up process.

For analyzing the business environment challenges facing the development of SMEs in Algeria, we use the available data from the World Bank Enterprise Survey for Algeria and compare it to that of other MENA and OECD surveyed firms and the world average.

Although the business environment in the Algeria is inconvenient for private sector development as a whole, obstacles still vary with the size of firms. As Figure 2 illustrates, corruption, informal sector competition, access to industrial land, and access to finance are a serious challenges for Micro, Small and Medium Enterprises (MSMEs). In the case of access to industrial land, access to finance, and the tax system, Micro enterprises identify themselves as most acutely affected. The cumbersome bureaucracy procedures could weigh more heavily as an obstacle for SMEs.

## **4.1 Legal and Regulatory Framework**

### **4.1.1 Unfair Competition from the Non-official Sector**

SMEs in developing countries suffer more than large firms from many policy and institutional constraints arising from imperfect markets, and, as a consequence, they benefit disproportionately from reforms.

Unfair competition arising from the low cost of doing business in the informal sector is a serious challenge for a significant section of SMEs, especially small sellers and producers. According to a report by the Algerian Governing Council(2011), the informal sector in Algeria is composed of SMEs. Its share in the Algerian economy is estimated between 45-50 percent of GDP. Moreover, the informal sector is the main employer of young Algerians, especially young women.

Unfair competition from companies operating in the non-official sector is a serious challenge affecting both SMEs and large firms in the Algerian economy. Because of savings on registration and licensing costs as well tax evasion, non-official companies gain a substantial cost advantage. That can allow them to produce and sell goods at a low price compared to companies that operate in the formal sector, which prevents genuine competition and increases the relative costs of the formal firms.

As Figure 3 illustrates, more than 66 percent of Algerian surveyed firms (both SMEs and large firms) are aware of having unofficial competitors compared to 40 percent and 30 percent for MENA and OECD surveyed SMEs, respectively. Moreover, more than 50 percent of the Algerian SMEs identify practices of competitors in the informal sector as a major challenge compared to 30 percent and only 13 percent for MENA and OECD surveyed SMEs, respectively (Figure 3).

The informal sector not only prevents genuine competition and increases the relative costs of enterprises operating in the formal sector, but also weakens worker protection and reduces workers' social benefits. The informal sector also has a negative impact on the fiscal budget and the entire infrastructure of the country

### **4.1.2 Access to Industrial Real Estate**

Access to industrial real estate is continuously mentioned by Algerian entrepreneurs as serious challenge to the development of SMEs. There is a large unsatisfied demand for industrial land, yet, around half plot is unused, either because it belongs to the Algerian authorities or because private owners are holding onto it for speculative (Jean-Louis Sarbib. et al.; 2003). The market is not unified, with a large price differential between publicly and privately owned land that supports speculation and corruption. Consequently, Algerian entrepreneurs complaining about a lack of access to industrial land are often referring to different things. The scarcity issue appears to be artificial, considering that more than half of serviced land lies idle. Moreover, Algerian entrepreneurs do not choose where they locate their firms; rather, they set them up wherever they can find a plot (Figure 4). The plot that they find is often smaller than their needs, and, consequently, they are forced to scale back their investment plan.

### **4.1.3 Bureaucracy**

The Algerian SMEs face serious difficulties in developing administrative and operational procedures to deal with the requirements of government regulations, such as costly and timely procedures to obtain licenses and permits, register property, and move collateral. As Figure 5 illustrates, the proportion of Algerian SMEs who report business licensing and permits as a major constraint is the highest among the selected region (more than 25 percent), whether compared to Algerian large firms or to other SMEs in MENA and OECD as well as to the world average. Moreover, SMEs in Algeria suffer more from many policy and institutional challenges than large firms do. As illustrated by the figure 5, senior managers of SMEs in Algeria spend a higher percentage of their time (around 25 percent) dealing with the requirements of government regulations.

In particular, Algerian SMEs identify regulatory policy uncertainty as a serious obstacle. As illustrated in Figure 5, more than 35 percent of SMEs report regulations and customs as major challenges to their operations.

### **4.1.4 Corruption**

In particular, Algerian SMEs significantly stand out in the degree to which they identify corruption as a heavy challenge compared to large firms. For instance, senior managers of SMEs are more likely to report that informal payments to public officials are required "to get things done" (Figure 6).

#### **4.1.5 Tax System**

High tax rates reduce firms' internal sources of financing. In some developing countries, including Algeria, SMEs are discouraged from expanding their operations and becoming visible to governmental officials, since being visible or operating formally is likely to increase the cost of operating.

As Figure 7 illustrates, tax rates present an extra cost and a serious challenge to SMEs where more than 25 percent of SMEs identify tax rates a major constraint in the selected regions. In Algeria, more than 50 percent of the SMEs identify tax rates as a major challenge. This fact clearly emphasizes that Algerian SMEs experience heavy tax rates that discourage them from expanding their operations.

#### **4.2 Access to Finance**

Despite their vital role in building a competitive private sector and contributing significantly to employment growth, SMEs are facing more challenges in accessing financial resources. In Algeria, financial constraints are high for both SMEs and large firms, but SMEs are particularly constrained by gaps in the financial system, such as high interests' rate, high collateral requirements, and lack of experience with financial intermediaries.

The Algerian banking system is large but is dominated by state-owned banks; moreover, Algerian banks have some of the highest rates of credit concentration in the world. SME financing in Algeria is dominated by banks, with capital markets and non-bank financial institutions (NBFIs) being insignificant financing sources. Bank lending to SMEs is low. As Figure 9 illustrates, only 16.4 percent of Algerian SMEs have loans, and the average share of SME investment financed by bank loans is only 7.15 percent, which is the lowest ratio among SMEs in other MENA and OECD countries and the world average.

SME growth potential is also restricted when entrepreneurs are denied credit, despite having adequate cash flow or purchase orders, due to collateral requirements or to high interest rates.

As the Figure 9 illustrates, a high proportion of loans for both small and large firms among the selected region in the world require collateral; however, Algerian banks tend to impose high collateral values as a ratio of the SME's loan amount. For this reason, SMEs rely on their personal savings and informal financing to finance different investments and operations. Access to financing remains highly unfavorable for SMEs in Algeria. By the end of 2012, only 3.3 percent of aggregate SMEs benefited from bank loans. The high interest rates and high collateral requirements among banks makes it very difficult for SMEs to receive credit.

#### **4.3 Human Resources Capacities**

Human resources in developing countries in general and in Algeria in particular are weak in terms of market research, marketing strategies, innovation, and financial management. As Figure 10 illustrates, more than 50 percent of the workforce in Algerian SMEs are unskilled, and this ratio is relatively high in large firms as well in other MENA surveyed firms. However, this rate is relatively small in OECD surveyed firms. The World Bank Enterprise Surveys show that between 20 and 40 percent of SMEs in most developing countries identify the lack of appropriate skills as a major constraint to their development. Likewise, in Algeria, more than 30 percent of surveyed firms report that inadequate skills and an uneducated workforce are obstacles to their growth (Figure 10). This issue can be explained by either the long history of state-led industrialization, in which the focus of the education system in Algeria is still oriented toward the preparation of future employees for the public sector, or by the insufficient training offered by the Algerian enterprises.

The workforce engaged in SMEs in Algeria suffers from poor training and a low level of skills. Those personnel consider "learning on the job and by practice" as the most important method of training and skill acquisition. They have a low regard for the usefulness of formal education and training. As the Figure 10 illustrates, only 13.95 percent of Algerian surveyed SMEs offer formal training versus 40.9 percent of large firm. Regarding firms that offer formal training to their employees, less than one third of workers in SMEs benefit from such training (Figure 10). This situation is the same for large firms as for other MENA surveyed SMEs, whereas for OECD surveyed SMEs, more than 60 percent of workers in receive training.

#### **5. Internal Factors Affecting the Growth of SMEs in Algeria**

Apart from the serious business environment challenges to the development of SMEs, the firm-specific factors such as entrepreneur characteristics, poor management competence, lack of skilled managers, deficiencies in marketing strategies, low efforts of R&D and low technological capacities are also prominent factors responsible for limited growth of SMEs in Algeria.

## **5.1 Characteristics of Entrepreneurs**

By number, the majority of the SMEs in Algeria are microenterprises (approximately 97 percent).

Only a small portion of those small firms can reach a medium size, and, eventually, only a portion of them have the potential to further develop into large firms depending upon the entrepreneur of those firms (Sidika, I. 2012). One of the main differences between small and large companies is the dominant role that the entrepreneurs play in the development of SMEs. Based on their powerful and influential position in their firms, entrepreneurs' subjective worldviews greatly affect their firms' choice of strategic direction (Sidika, I. 2012) and therefore will affect the firm growth. Furthermore, the entrepreneur's characteristics such as age, gender, motivation, experience, educational background, risk-taking propensity, preference for innovation, mindset, and personality can have a big influence on the firm's performance and success, and the growth of the SMEs can be hugely dependent on him.

## **5.2 Management Capacities**

SMEs in developing countries in general and in Algeria at particular lack the managerial skills and connections to effectively conduct their business and to deal with the cumbersome legal and regulatory framework. We can analyze the managerial challenges affecting the development of SMEs in Algeria according the following factors:

### **5.2.1 Lack of Managerial Skills**

Management skills are the critical success factors of all businesses, and small business is no exception. The lack of managerial skills places significant challenges on SME development. The scarcity of management talent in Algeria has a magnified impact on SMEs and can hamper the progress of their development. Moreover, the lack of support services or the irrelatively higher unit cost can hamper SMEs' efforts to improve their management, because new and inexperienced entrepreneurs may not have the required skills and managerial capacity to fully exploit new opportunities and markets.

### **5.2.2 Weak Managerial Structure**

Most SMEs in Algeria are owned and managed by the entrepreneur, who takes charge of all the managerial functions of the enterprise, such as organization, production, accounting, marketing, and many other functions. Such a heavy burden on the entrepreneurs prevents them from devising proper strategic plans for their businesses as they are usually bogged down with the day-to-day problems of running their businesses.

### **5.2.3 Lack of Management Training**

Entrepreneurship training and education facilitate entrepreneurial activities, mainly by stimulating entrepreneurial activity and performance. The importance of entrepreneurship education and training is well established. From an economic perspective, education is seen as a crucial agent in promoting long-term employment and economic growth (Romjin, 1989). Several empirical investigations have positively, linked management training with the subsequent growth of small businesses (Pasanen, 2007). Therefore, training for small business owners and managers allows them to develop the substantial skills to ensure the survival and success of their firms. However, despite the numerous institutions providing training and advisory services in Algeria, there is still a skill gap in the SME sector. This is because entrepreneurs cannot afford the high cost of training and advisory services while others do not see the need to upgrade their skills due to complacency.

## **5.3 Marketing Skills**

Another important factor contributing to success or failure of SMEs is marketing skills. There is extensive evidence to prove that marketing plays a significant role in the success of SMEs. Marketing is also one of the biggest challenges SMEs face in their business operations. SMEs in Algeria are weak in terms of market research and have inadequate marketing skills because most Algerian SMEs are owned and managed by one person. Such entrepreneurs take care of all the managerial functions of the enterprise and lack the time and funds to invest in research to establish their target market or identify customer trends.

## **5.4 Technological Capacities**

Among the major challenges facing the development of SMEs in Algeria is the huge lack of technological capabilities, which is the key to developing the competency of SME owners and managers. Technological capacities are considered as tools for strengthening the competitiveness of SMEs (Romijn, 2001).

By improving their technological capabilities, SMEs can largely improve their production abilities and profitability: the latter can be improved in several ways, such as through R&D spending, technology and know-how agreements with domestic and foreign firms.

In most cases, Algerian SMEs acquire foreign technology licenses because local patents are scarce and difficult for SMEs to obtain. As Figure 11 illustrates, in Algeria, only a small portion of SMEs (about 13.3 percent) have acquired technology licenses from foreign companies, and the situation is the same for large firms and even worse in other MENA surveyed SMEs. This fact may be explained by the small scale of SME operations and their weak financial base, which means that they cannot afford expensive new technology or spend on R&D activities. Moreover, many SMEs in Algeria manage their businesses according to a traditional approach, using obsolete or inappropriate technology. This results in a low level of productivity, low quality products, and a small local market share. As Figure 11 illustrates, only a small portion of Algerian SMEs (about 4.85 percent) acquire an internationally recognized quality certification.

## **6. Conclusions and Recommendations**

Despite the vital role of SMEs in building a competitive private sector and contributing significantly to employment creation, innovation, and economic development in general, SMEs are facing more challenges around the world in general and in developing countries in particular. Likewise, Algerian SMEs are hampered by several factors, which may differ from region to region within the country, between rural and urban areas, between sectors, or between individual enterprises within a sector. However, there are certain challenges that are common to almost all SMEs. These challenges arise from the interaction between external and internal factors.

The results reflected in the study indicate that unfair competition from the informal sector, cumbersome and costly bureaucratic procedures, burdensome laws, policies, and regulations, an inefficient tax system, a lack of access to industrial real estate, a lack of access to external financing, and low human resources capacities are the key business environmental factors affecting Algerian SMEs. On the other hand, entrepreneurial characteristics, low managerial capacities, lack of marketing skills, and low technological capacities are the main internal factors responsible for the unstable and limited growth of SMEs in Algeria.

As a result of the findings of this study, the following recommendations are made:

- The Algerian government should make a greater effort to create a meaningful and comprehensive policy to improve the country's business climate, which is currently not conducive to the development of the private sector.
- Policy makers should strengthen the legislative and regulatory framework for the creation and development of SMEs by designing rules according to the "Think Small First" principle; in addition, policies to promote SMEs need to be tailored to each sector.
- The government should improve SMEs' access to financing by deepening the reforms of the banking system. These measures should include a reform of interest rates, collateral requirements, and the credit registration system as Algerian entrepreneurs continuously complain about high interest rates and the high collateral requirement for loans.
- Further efforts should be undertaken to develop, expand, and promote a range of financial instruments for SMEs: a diversified array of financial instruments could benefit the SME sector and provide a way forward. For instance, leasing as a financial option is not fully utilized and only a few credit guarantee schemes operate in Algeria. In addition, special attention should be devoted to increasing young people's access to financing.
- More effort should be undertaken to reform the tax system. A favorable tax system as well as streamlined regulatory procedures will encourage an increased number of SMEs operating in the non-official sector to enter the formal economy.
- Bilateral cooperation should be undertaken between the Algerian authorities and SME owners for the purpose of promoting and developing an entrepreneurial culture by supporting cooperation between schools and SMEs, such as increasing the number of student internships in SMEs and encouraging the establishment of business incubators within universities.
- SMEs owner should offer more training for their personnel. In addition, they have to invest more in R&D activities and technology and know-how agreements with foreign firms to improve their technological capacities.

- The government should establish special economic zones (SEZs) in the north of the country, with various preferential treatments, governed by a comprehensive and integrated set of laws and regulations. SEZs can create a good investment climate and provide a good quality, reliable infrastructure.

Through SEZs, the government can support the diversification of exports, support local industry and clusters, attract Foreign Direct Investment (FDI), create jobs, and solve land-rights issues. SEZs also provide improved physical infrastructure and services to investors in a sustainable and environmentally friendly manner and allow for more efficient government supervision of enterprises.

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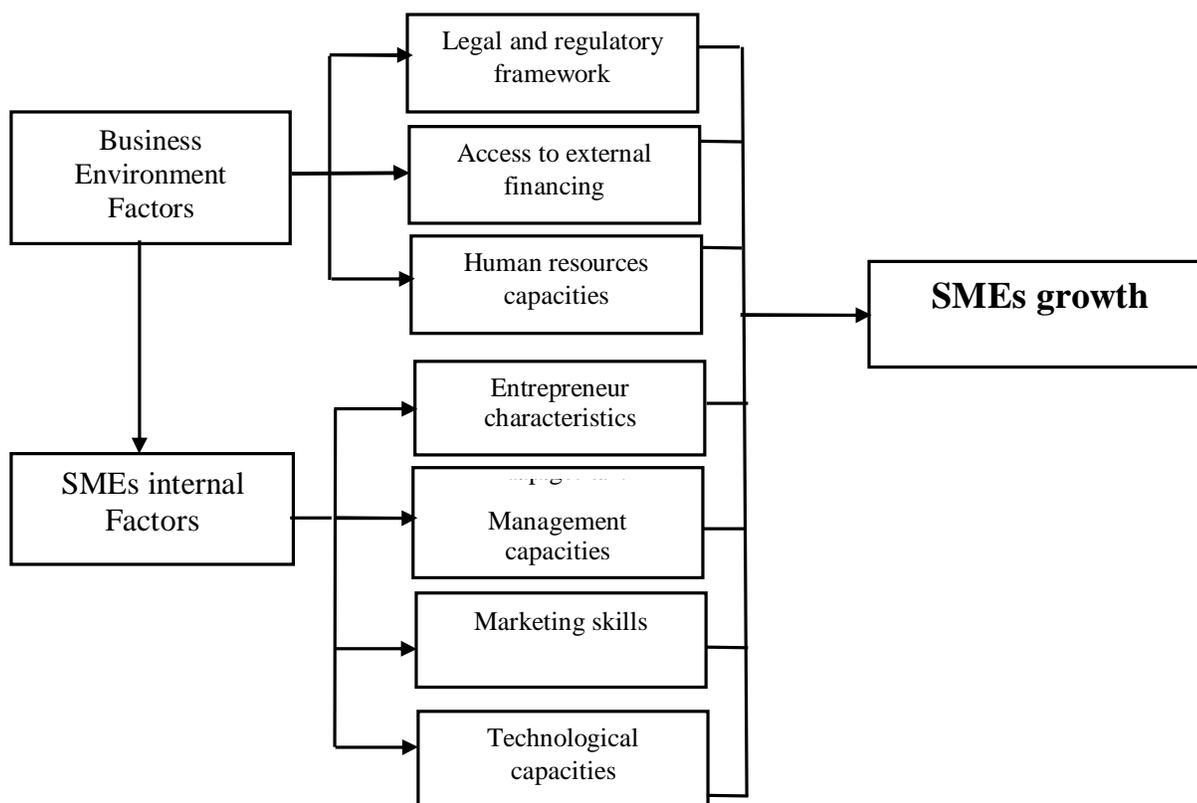
**Appendix 1 Tables and Figures**

**Table 1: SME Definitions Used by Multilateral Institutions**

Institution (region or country)	Max of employee	Max revenue or turnover	Max assets
EU	10 - 250	40 million Euros	-
WB	300	15,000,000\$	15,000,000\$
IMF-IADB	100	3,000,000\$	-
African Development Bank	50	-	-
Asian Development Bank	No official definition. Uses only definitions of various national governments.		
UNDP	200	-	-
OECD	20 - 500	-	-
Algeria	10 - 250	>20 millionEuros	-
China	> 2000 employee	300 million yuan	400 million yuan

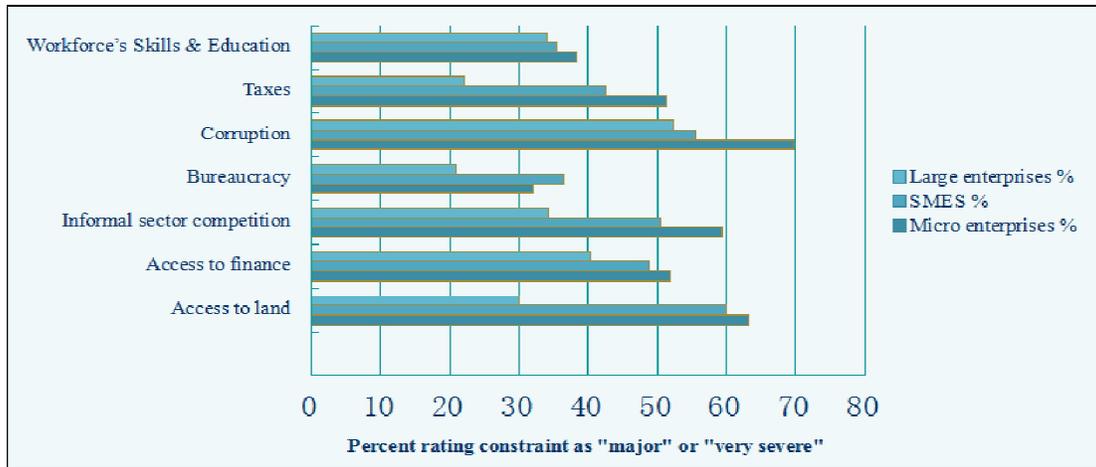
**Source:** Author’s from different institution definition.

**Figure 1 Conceptual Frame on Factors affecting the growth of SME in Algeria**



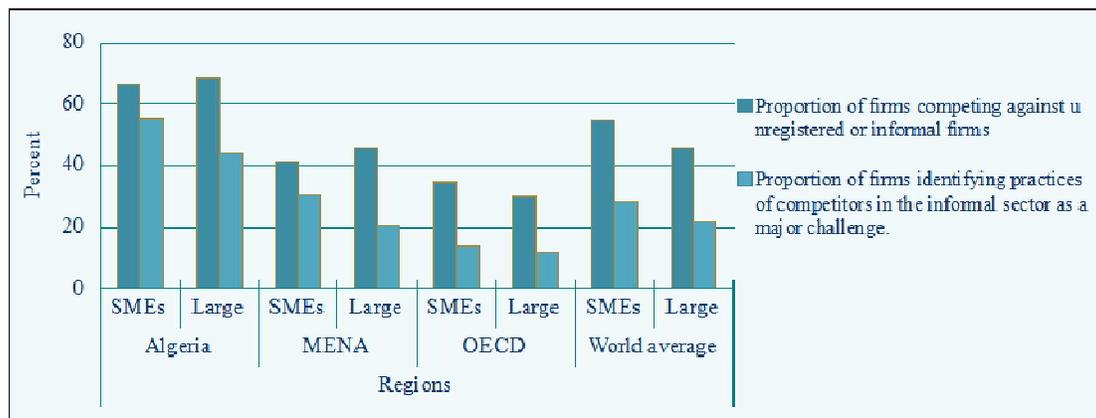
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**Figure 2: Leading Constrains Affecting the growth of SME in Algeria by Firm Size**



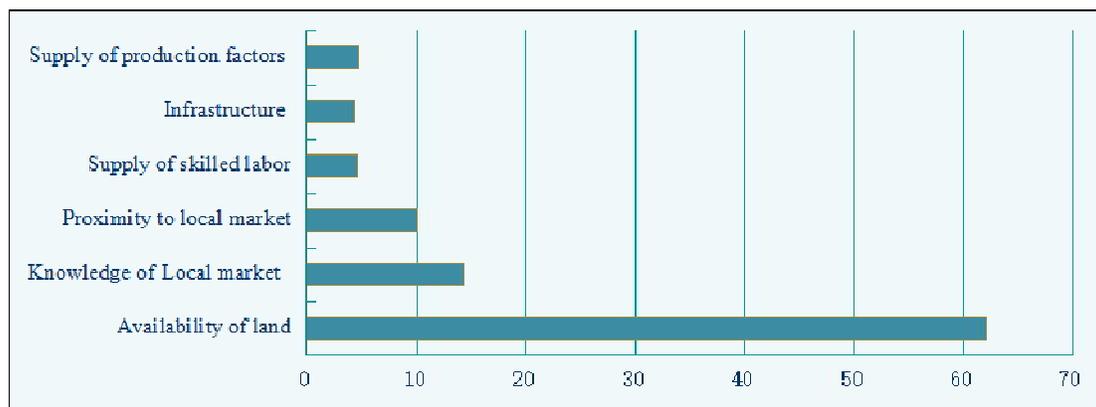
Source: Performed by author based on data from World Bank Enterprises Surveys

**Figure 3: Unfair Competition Challenge Affecting the growth of SME in Algeria, with a Comparison Versus MENA, OECD and the World Average**



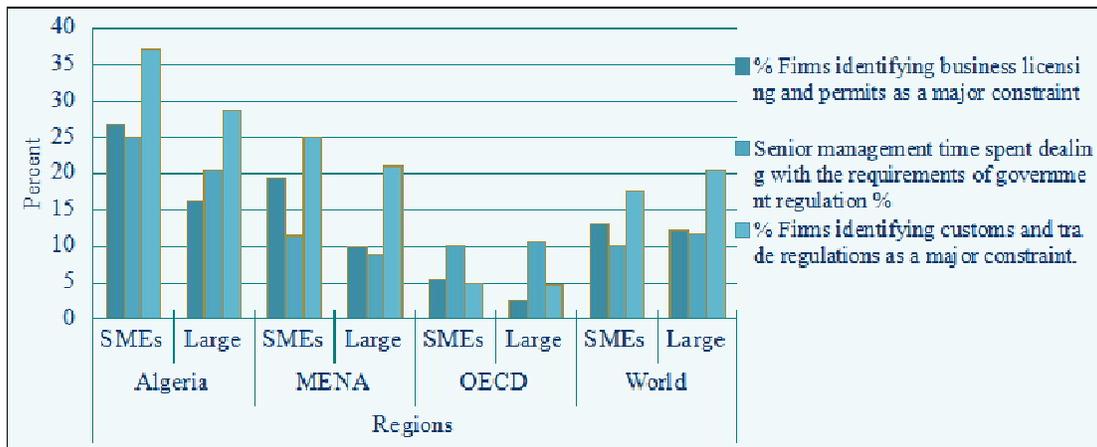
Source: Performed by author based on data from World Bank Enterprises Surveys

**Figure 4: Reasons for SMEs's Location Choice**



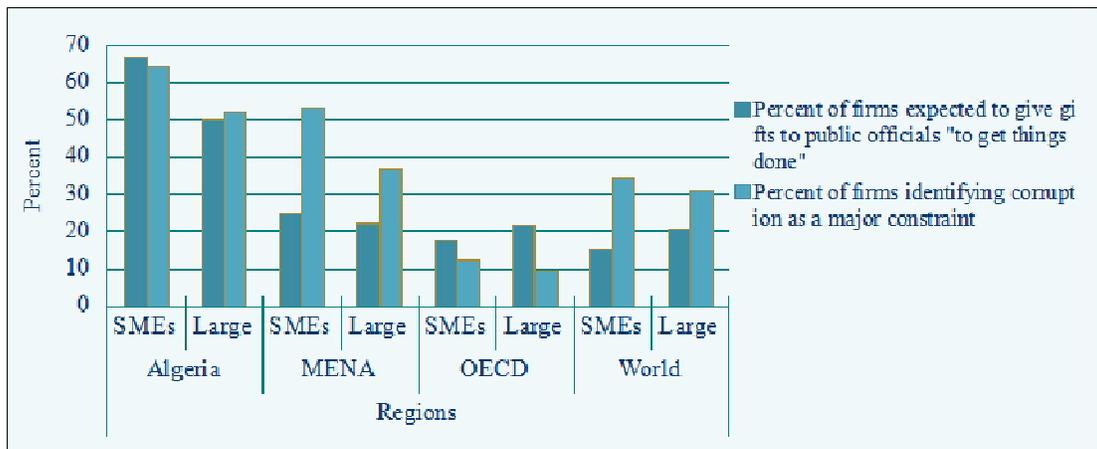
Source: Performed by author based on data from Algeria' investment climate assessment, The World Bank.

**Figure 5: Bureaucracy Challenges affecting the growth of SME in Algeria, with a Comparison versus MENA,OECD and the World Average**



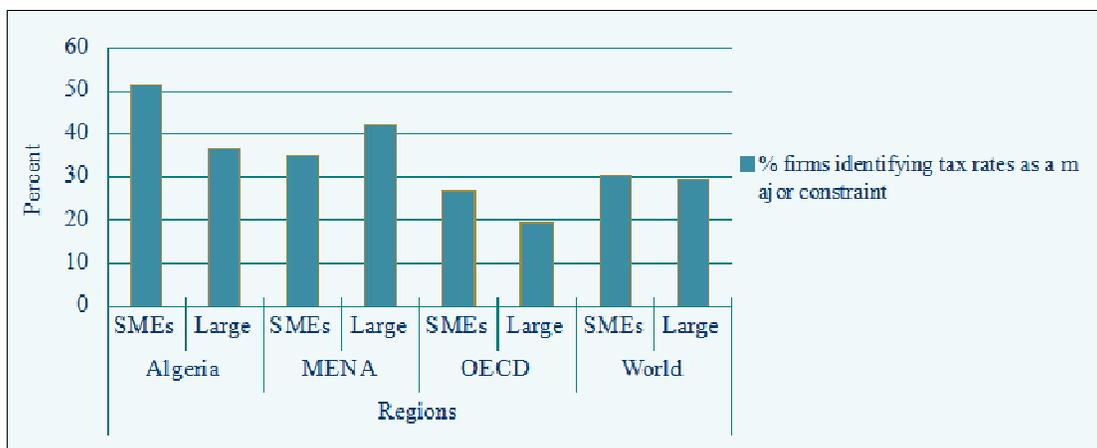
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**Figure 6: Corruption Challenge Affecting the growth of SME in Algeria,with a Comparison Versus MENA,OECD and the World**



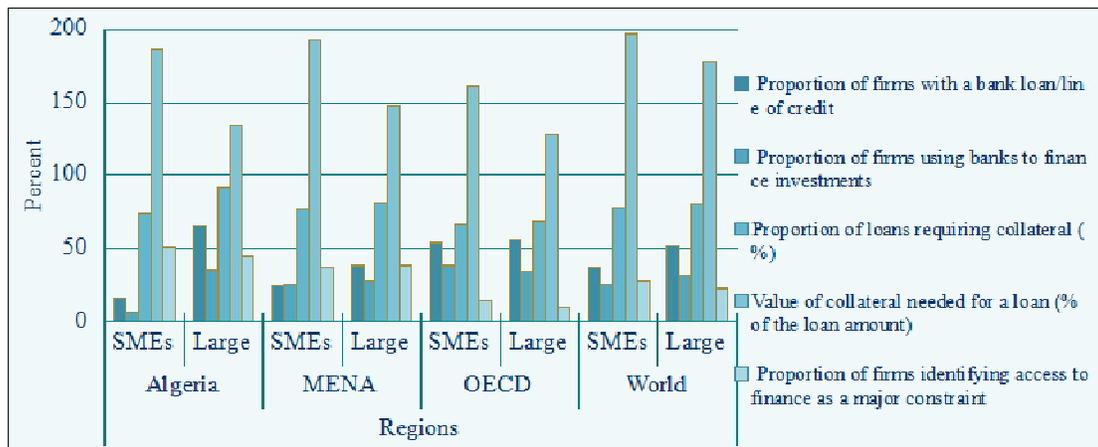
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**Figure 7: Proportion of Firms Identifying Tax Rates as a Major Challenge to their growth, In Selected Regions by Firm Size**



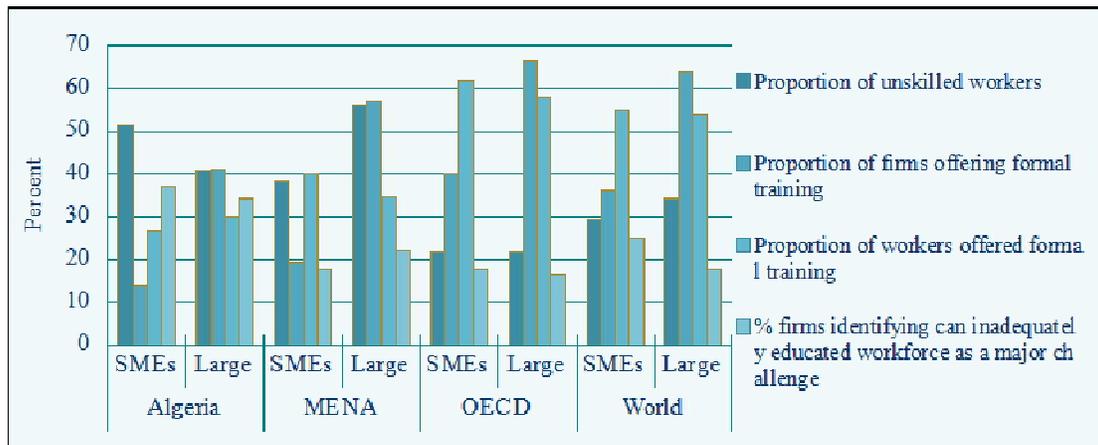
Source: Performed by author based on data from World Bank Enterprises Surveys;

**Figure 9: Financial Challenges Affecting the growth of SME in Algeria, with a Comparison Versus MENA,OECD and the World Average**



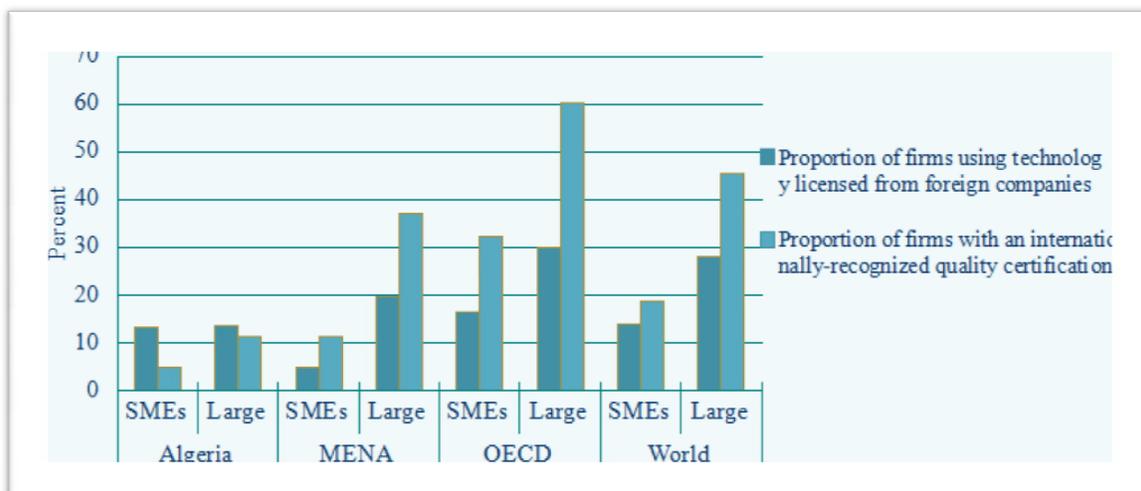
Source: Performed by author based on data from World Bank Enterprises Surveys;

**Figure 10: Human Resource Challenges affecting the growth of SME in Algeria, with a Comparison Versus MENA,OECD and the World Average**



Source: Performed by author based on data from World Bank Enterprises Surveys;

**Figure 11: Proportion of Firms Using Technology Licensed from Foreign Companies / Acquire International Quality Certification**



Source: Performed by author based on data from World Bank Enterprises Surveys;