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Success or failure: Barriers to innovation in family-owned in SMEs

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ABSTRACT

This paper aims to highlight the issues and barriers to innovation in family-owned SMEs in Pakistan. Barriers to innovation have been categorized into internal and external factors. Endogenous or internal factors were based on the nature of the industry, business or firms. Exogenous or external factors are related to the external culture or environment in which industry or business or firms are operating. Endogenous factors include; *personnel-related, administration relation, technology-related and system support*. Exogenous factors include; *market-related, law & regulatory related, economic-related, access to finance*. Family-owned SMEs of Pakistan are contributing a significant portion in total exports of Pakistan and economic growth. However, over the period of last two-decade contribution of family-owned businesses in total exports of Pakistan is declining and only 30% businesses survive in first-generation, 13% to 15% businesses survive in second-generation and only 3% to 5% businesses survive in the third generation. Family-owned businesses lacking in innovation and ultimately leads to failure. The current study covers the barriers to innovation faced by family-owned businesses internally and externally. Internal and external factors further sub-categorized for better understanding barriers to innovation so, regulatory authorities and family-owned SMEs should take appropriate action for sustainable growth.

Keywords:
Innovation
Barriers
Success or Failure
SMEs
Family-Owned
Sustainable Growth.

I. Introduction

More intensive competition has been observed in domestic as well as in international markets followed by the globalization and trade liberalization, the presence of Small and Medium Enterprises (SMEs) in international markets is acknowledged in literature while domestic markets are mostly predominantly occupied by the domestic SMEs (Cerrato & Piva, 2012; Hessels & Parker, 2013; D'Angelo, Majocchi, & Buck, 2016). Integration among the markets and trade free agreements among the trading partners increases pressure on SMEs in terms of competitiveness, innovativeness (Haggard & Maxfield, 1996; Lothian, 2002). Innovation is a vital component in the strategic management area of each enterprise so, there is no unique way or single approach for innovation. Moreover, literature documented various methods for the measurement of innovative behavior among the companies which vary from SMEs to large-scale companies and differ from culture to culture and industry to industry (Krause, 2004; Dobni, 2008; Nečadová & Scholleová, 2011). Undoubtedly, innovation strategy and innovation performance are the key factors in their competitiveness in the market. It is presumed that SMEs are more innovative as compared to large-scale firms however, literature revealed that the situation is opposite (Vossen, 1998; Premkumar & Roberts, 1999; Keskin, 2006; Gnyawali & Park, 2009; Nieto & Santamaría, 2010). Particularly, in developing countries, SMEs are less innovative as compare to developed or technically advanced economies (Vivarelli, 2014). Amabile (1997), explains that entrepreneurship as a systematic process starts with generation and implementation of creative or novel products/ ideas, similarly other definitions have been documented in literature nevertheless underpinning concept in each definition includes innovation (Huda, et al., 2018). Moreover, family-owned SMEs are based on long-term survivability and is considered as an underpinning theme of strategies designed in family-owned businesses (Miller & Le Breton-Miller, 2006). Survivability of businesses/ SMEs is presumably based on the innovation strategy and family-owned businesses considered it an integral part of strategies designed. Literature documented the only 30% of businesses survived in first-generation, 13%-15% of businesses survived in second-generation and 3% to 5% family-owned businesses survived in third generation (Fayyaz, 2016). In addition to that, literature explains the key reasons for the failures or selling the family businesses is due to lack of leadership skills, networking, selection of successor, lack of commitment towards the family-owned business and innovation (Cooper, Upton, & Seaman, 2005; Ibrahim, Angelidis, & Parsa, 2008; Fayyaz, 2016). Innovation is recognized as a positive phenomenon which ultimately reflected in financial and non-financial performance (Nečadová & Scholleová, 2011). Moreover, normative theory of dynamic capability is explains "*the firm's ability to integrate, build and reconfigure internal and external competencies to address rapidly changing environments*" which as continuous process and founding stone of this process is innovation because addressing the rapidly changing environments is only possible through innovation to achieve the comparative advantage (Teece, Pisano, & Shuen, 1997). However, Comparative advantage may differ from culture to culture, industry to industry or even at firm-level and nature of businesses (Hickman & Silva, 2018). Moreover, innovation is considered a critical factor for comparative advantage (Tabas, Beranová, & Jan, 2011).

So far, literature revealed that large-scale companies are spending a great amount of resources on research and development for the innovativeness in processes and products to achieve the comparative advantage not only in domestic markets as well as in regional markets (Patterson, Kerrin, Gatto-Roissard, & Coan, 2009). Amount of resources invested in innovation which increases the efficiency of processes and quality of a product as considered as expenditures in terms of books of accounts and management considered it as an investment because they perceived that future expectations are based on the innovativeness (Tabas, Beranová, & Polák, 2013). Innovation is considered a process it includes the supply chain as well as supporting activities which ultimately increases the effectiveness and efficiency of the production process as well as organizational process. However, SMEs are usually registered as sole-proprietors, partnerships or single-member company so this leads to high overheads cost which ultimately increases the operating cost and its make difficult for SMEs to compete with foreign competitors especially from Europe, Asia or South-Asia (Tiwari & Buse, 2007). SMEs in family-owned businesses are unable to spend a sufficient amount of resources for research and development or innovation processes because due to limited access to finance firms were unable to spend a big chunk of resources on the innovation process. Barriers to innovation are not limited to access to finance that is common factor moreover, numerous other barriers faced by the SMEs in family-owned businesses were documented in the literature (Madrid-Guijarro, Garcia, & Van Auken, 2009; De Massis, Frattini, & Lichtenthaler, 2013; Cowling, 2016).

1.1. State of SMEs in Pakistan

Approximately 3.2 million businesses were registered in Pakistan, 99% of firms were recognized as SMEs and 70% of firms from listed companies are owned or under the influence of families (SMEDA, 2018). SMEs in Pakistan contributes 40% of gross domestic product which is quite low as compared to other developing countries in the Asian region, for example, SMEs contribute 45% to GDP in India, 41% in Malaysia, 45% in Thailand (ASEAN, 2016; Government of Pakistan, 2016/17; Ata, 2018). Moreover, around 90% of SMEs owned and operated by the families similarly around 70% on average listed companies are also influenced and operated by the families (Carney, 2016; Ramadani & Gërguri-Rashiti, 2017). Similar patterns have been reported by the developed countries for example 80 to 90% in the USA business, around 80% in Europe, 70 to 90% in the middle east, 80% businesses in the South-Asian region are owned by families (Deloitte, 2013). In addition to that in Pakistan family-owned businesses dominant and significantly contributing to economic growth and development (Ghani & Ashraf, 2005; Khalique, Bontis, Abdul Nassir bin Shaari, & Hassan Md. Isa, 2015; Aparicio, Urbano, & Audretsch, 2016). A significant number of studies have been documented on SMEs and a significant portion of the literature discusses the family-owned businesses. Limited literature considers the barriers to innovation in SMEs and a limited portion of that consider the barriers to innovation in family-owned SMEs particularly with respect to emerging economies (Dyer & Hatch, 2006; Chua, Chrisman, & Bergiel, 2009; Amit & Villalonga, 2014).

1.2. Innovation and Family-owned Businesses

A researcher from the domain of strategic management focuses a lens on the family-owned businesses for the last two decades and a number of studies have been documented based on the significance and contribution of family-owned firms towards the economic growth (Litz, Pearson, & Litchfield, 2012). Still, several questions remain unanswered by the emerging studies that were conducted in the domain of family-owned businesses for example why the growth of family-owned businesses is low? success or failure of family-owned businesses? Barriers to innovation in family-owned businesses? Why family-owned businesses losing share and competitive positions in the market? (De Massis, Chua, & Chrisman, 2008). The nature of businesses is versatile and rapidly changing over the period due to a dynamic business environment, so this makes subject area worthy and fascinating researchers to keep investigating. A number of studies has been documented in literature from succession planning and its significance (Mandl, 2008; Gilding, Gregory, & Cosson, 2015; Julius Giarmarco, 2017), family influence, involvement and conflict management (Chrisman, Chua, Pearson, & Barnett, 2012; Zattoni, Gnan, & Huse, 2015), governance and family-owned businesses (Gubitta & Gianecchini, 2002; Hillman & Dalziel, 2003; Nordqvist, Sharma, & Chirico, 2014; Madison, Holt, Kellermanns, & Ranft, 2016), networking (Al-Dajani, Bika, Collins, & Swail, 2014; Leppäaho, Plakoyiannaki, & Dimitratos, 2016) and Innovation (Dyer & Hatch, 2006; De Massis, Frattini, & Lichtenthaler, 2013; Cowling, 2016). Moreover, limited literature has been reported in the domain of barriers to innovation particularly in the domain of SMEs (Sarstedt, Ringle, Smith, Reams, & Hair Jr, 2014; Chrisman, Chua, De Massis, Frattini, & Wright, 2015; Ward, 2016). Studies reported by Dyer and Hatch (2006); Madrid-Guijarro, Garcia, and Van Auken (2009); Tabas, Beranová, and Jan (2011), deals with barriers to innovation in family-owned SMEs however, there is ambiguity and the questions remained unanswered in what are possible barriers to the innovation in family-owned SMEs. This study will discuss the dimensions and barriers to innovation in family-owned SMEs. The literature on the barrier to innovation in family-owned businesses documented few important dimensions and those are widely application, however, this study is going to discuss the dimensions of the barrier to innovation with respect to family-owned SMEs from developing economies. A comprehensive framework has been suggested based on the dimensions of barriers to innovation in family-owned SMEs particularly in Pakistan, the framework has been categorized into internal factors and external factors in model 1. How internal and external factors affect each other in unidirectional and bi-directional relationship has been suggested in model 2. Internal factors consider the factors directly related to family-owned SMEs and external factors consider the factors related to the business environment, market and government policies.

II. Literature Review

2.1 Barriers to Innovation in Family-Owned SMEs

Classification of barriers to innovation faced by family-owned SMEs has been documented based on the (endogenous and exogenous) internal and external factors it would easier to understand. Similar distribution has been documented in literature since the discussion on barriers to innovation has been started. Internal factors further classified into sub-factors related to *personnel-related, administration-related, technology-related and system support*. External factors classified into sub-factors related to *market-related, law & regulatory related, economic-related, access to finance* (for example see figure 1: classification of factors related to internal and external barriers to innovation). The impact of internal factors on the external factors and impact of external factors on the internal factors has been highlighted in model 2 (for example see: figure 2: feedback relationship of internal and external factors). The explanation of barriers to innovation faced by family-owned SMEs to be discussed in detail in the next sections.

2.2 Internal Factors

Internal factors are based on the internal environment or characteristics of the SMEs owned and operated by the families over the generations. The internal environment of SMEs further categorized into sub-factors affecting the innovation of family-owned SMEs. Sub-factors of barriers include the *personnel, administration, technology, and system support*.

2.2.1 Personnel related barriers

Personnel related barriers consider personnel or employees working with the SMEs. Personnel related barriers include factors related to their technical skills, qualification, communication, training, and working environment. Employees and managers are known to be "innovation champions" and without their input, it is not possible to achieve the required level of innovation. Family-owned businesses are different from the non-family owned businesses because the structure and characteristics of family-owned SMEs are different. Prints of dictatorship has been observed in literature and all the policies and strategies has been designed and documented by the families and ignore the managers or employees and their views; and other studies documented that lack of motivation, lack of technical skills, and high staff turnover affect the top-down relationship that affects the process of innovation (López-Ortega, Canales-Sanchez, Bautista-Godinez, & Macias-Herrera, 2016). Personnel related factors include; *low qualification & technical skills, high staff turnover, top-down relationship, lack of training, flexi-time opportunities, and motivation.*

The performance of SMEs is also affected by the staff with low qualification and technical skills, a lower level of qualification and technical skills is one of the factors in barriers to innovation in family-owned SMEs. Literature documented that approximately 30% of employees in SMEs have a low level of qualification/ skills (Šoltésa & Gavurová, 2014; Thaimuta & Moronge, 2014; Hassan, Burek, & Asif, 2017). Employees turnover is high in SMEs-employees come and go and other employees take the position of first-line (Kevin C & Yukika , 2006; Thwala, Ajagbe, Enegbuma, & Bilau, 2012; Long, Ajagbe, & Kowang, 2014). Higher rate of turnover affects the firms' performance and affects the competitive advantage of family-owned firms and ultimately loses market share, for example, SMEs in Pakistan are losing their share in total exports of Pakistan and their market share in the competitive environment.

The structure of family-owned firms is not formal and there is no formal hierarchy so, employees are unable to understand and fail to establish a top-down relationship and ultimately unable to contribute towards the innovation. SMEs in Pakistan do not provide any focus on formal human resource practices like large size organizations. Managers and Owners considered that one- or two-days informal training is enough for the employee to work. Due to a lack of proper training & development employees are unable to participate in the innovation process in family-owned SMEs. SMEs usually work in one shift comparatively large firms' work in multiple shifts which facilitate employees to work as per the flexible timing that is suitable to them, which affects the employees' commitment and motivation to participate in the innovation process effectively.

2.2.2 Administration related barriers

The core objective of family-owned SMEs is not only profits but the survival of businesses over the long-term. Senior managers/owners are risk-averse or ignorant of the benefits of new technology or innovation. Family-owned SMEs face barriers even administration/ managers/ owners have the technical knowledge/ skills are unable to achieve success in planning and implementation of a strategy or unable to achieve its objectives due to lack of innovation. Barriers related to administration include; status quo, complacency, satisfaction and want to be with the present system or process due to uncertainty or unfamiliarity with the latest technology.

Low qualification & technical skills: To carry the activities of innovation managers and owners should possess enough level of qualification and technical skills. A number of studies documented that lack of required level of skills in managers/owners are underpinning the cause of failure of SMEs (Canclini, 2005; Pansiri & Temtime, 2008). Similarly, Fatoki and Odeyemi (2010), define skills, qualification, and technical knowledge that managers/owners must possess because it plays a critical role in the success of family-owned SMEs. In addition to that, Fatoki and Asah, (2011) reported that lack of required level of technical skills and knowledge leads to business failure and lower level of skills and qualification resultant lower level of innovation in family-owned SMEs. *Lack of networking*: SMEs lack of terms of networking and sharing of skills, knowledge, and resources with peers. The common platform for SMEs is exhibitions, chambers, and associations. Unfortunately, these platforms are unable to provide any formal and informal mechanism of knowledge and skills sharing across the SMEs in Pakistan. Particularly family-owned SMEs share their experiences, skills, strategies among the family members and lack in networking. Due to lack of networking and knowledge sharing, family-owned firms are unable to attain the latest knowledge and technologies available in the market and family-owned businesses face failure and lose their competitive advantage or market share.

Lack of management involvement/readiness and family involvement: family-owned businesses share their skills, competences, and ideas among the family members and do not consider input and suggestions from the managers and employees. Family involvement in firms documented a positive and significant towards the performance of the family-owned businesses. However, literature documented that family involvement in the innovation process adversely affects the performance of the firm.

2.2.3 Technology related barriers

Technical barriers may originate from predominant standards, e.g. in telecommunications, or arise due to changes in technology (Freeman, 1994). Risk of technology obsolescence, destruction of a firm's competences with the change of technology, and dangers from picking the wrong technology, are major considerations in some fields of high technology (Starbuck, 1996). Other technical obstacles are due to the scale of capital requirements for entering a particular new technology field and scale of experience effects (technological entry barriers). Societal factors may form important innovation barriers (Shane, Venkataraman, & MacMillan, 1995). Norms and values of a society and attitudes towards science, socio-economic change and entrepreneurship determine the innovation climate (Piatier, 1984).

Limited access to technology: In developed economies access to technology is easy for SMEs and because it's cheaper and readily available in the market. However, in developing nations it's hard for SMEs to get access to the latest technology. SMEs in developing nations like Pakistan have limited access to new technology and particularly family-owned SMEs have limited access or no access to technology because they prefer to work in a traditional way. *Limited access to machinery:* Similarly, like limited access to technology SMEs in developing countries mostly working on outdated machines or hand-made products because with the passage of time they didn't get them-self familiar with technology and the latest machines. Due to a lack of supportive laws and regulatory framework and economic conditions in developing nations SMEs are unable to import the latest machines. *Limited access to technical equipment:* Access to technology and the latest machines provide access to technical equipment. Technical equipment facilitates SMEs to produce at a large scale with quality to achieve the market demand. Family-owned SMEs get limited or no access to technical equipment.

2.2.4 System support

Lack of central system support: effective strategic planning and management required a central system support. The formal organizational system has central systems support but as far as family-owned SMEs concern there is no formal system and flow of information. Centralization of control and powers indicates a positive and significant impact on the innovation in the case of newly developed ventures while, indicate a negative relationship with innovation in the case of older firms (Koberg, Uhlenbruck, & Sarason, 1996). Problems with internal mechanisms affect the process of information dissemination which ultimately hampers the innovation process. *No formal communication channels:* Lack of formal organizational structure obstacles includes inadequate communication channels or flows. It also includes a lack of inter-departmental or inter-functional integration. For example, the collaboration between production or marketing departments is vital especially for process innovation and product innovation.

2.3 External Factors

2.3.1 Market-related barriers

A few factors related to the market hampering the innovation process in family-owned businesses. One type of market-related factors includes insufficient appropriability "*Firms ability to capture rents or profits from created innovation*" (Teece, 1986). Family-owned SMEs are not able to capture rents or profits from created innovation due to the size of firms. Large or multinational organizations spend a huge amount of investments in research & development and process innovation and capture profits or rents from the innovation process. The intensity and nature of competition affect the firms' strategy or profits and indirectly affect the process of innovation or barriers to innovation.

Competition fairness: developed economies or technically developed economies produce on a large scale at a lower cost. SMEs from developing economies are unable to compete with SMEs from developed economies or even with large organizations. The nature and intensity of competition in the market are high so it is hard for family-owned SMEs to invest a huge amount of research & development to compete with large scale organizations or SMEs from developed economies. *No protection from foreign competition:* SMEs are considered asking with respect to their local markets because local markets are captured and controlled by the national SMEs. However, financial integration and trade, free agreements and the concept of internationalization allow large-scale firms or SMEs from developed economies to entre markets of developing nations. Laws and regulatory frameworks do not provide any protection to local SMEs from foreign competitors.
Competition from regional countries: with the emergence of trade free agreements and integration of financial markets regional markets are emerging and the intensity of competition is getting high. In Asian region china, Japan and other technically advanced economies producing at large scale and domestic family-owned SMEs are unable to compete with limited access to technology, machines, and technical equipment while the managers/owners lack the required level of qualification and technical skills. *Short-termism:* Another market-related barrier to innovation is 'short-termism'. With limited resources and access to resources SMEs trying to generate good profits in the short-term which affects the firms' innovation process. Family-owned SMEs focus on the strategic performance as compare to financial performance, however, the survival of family-owned businesses is based on the availability of the financial resource, so SMEs try to generate financial resources from the system to ensure the survival of firms.

2.3.2 Law and regulatory barriers

Law and regulatory barriers or short-term government policies are considered frequent sources of barriers to innovation (Piatier, 1984; Pol et al., 1999). Many policies laws and regulations directly or indirectly affect the innovation process. Pakistan is ranked 136 out of 191 in ease of doing business and 120 out of 137 in the global entrepreneurship index similarly, literature documented that the business environment in Pakistan is not supportive for newcomers and even the law and regulatory environment is quite complex and difficult process to get started. The regulatory environment of Pakistan is not suitable for the micro and small firms and preventing them from the government support and resources they are entitled to.

Complicated procedures of starting a business: There are different multiple independent departments are working and SMEs or micro-level firms supposed to get them registered with respective departments. All the departments have their own different processes and procedures to complete the registration process. *Complicated & time-consuming public procurement procedures:* Managers/Owners of family-owned SMEs have a lower level or no qualification, but they possess a limited or lower level of technical knowledge moreover, public procurement procedures are quite complicated and time consuming for them. However, they consider is time-consuming and complicated and they work as un-registered businesses and ultimately, they unable to get support from the government or even face problems in access to finance from formal channels. *Absence of effective legal protection:* The government of Pakistan started a dedicated program under the title of Small and Medium Enterprises Development Authority (SMEDA) to support SMEs in Pakistan. However, the legal environment does not provide any legal protection to SMEs and even SMEDA is unable to provide any legal protection to SMEs in Pakistan.

2.3.3 Economic related barriers

Low economic growth rate: South-Asian region is making a higher level of growth as compared to Pakistan and similarly, they are placed higher in rank in ease of doing business and global entrepreneurship index. This indicates that these countries are moving much fast as compare to Pakistan. *Relative high inflation rate:* High level of inflation rate reduce the purchasing power of people and ultimately affect the economic performance and economic growth of the country. Higher levels of inflation hamper the financial performance of SMEs and ultimately affect the innovation process.

Relatively high-interest rate: Higher the level of interest also affects the performance of SMEs and ultimately economic growth. The higher level of interest rate is considered as a restraining factor in new startups and the provision of loans is associated with the higher interest rates. This ultimately affects the innovation process of SMEs. *Exchange rate fluctuations:* Pakistan exports a few products from textile, cement, marble, leather, sports goods, cutlery, and surgical instrument sectors. Each sector contributes a significant portion of the total exports of Pakistan. Fluctuation in the exchange rate affects the financial performance of SMEs and economic growth which ultimately affects the innovation process of SMEs.

2.3.3.1 Access to finance

Lending infrastructure: lending infrastructure for SMEs is still not developed much since the inception of microfinance banks in 2002. Microfinance banks required collaterals or security for the loans. Microfinance banks charge a higher interest rate which affects the performance of SMEs and the innovation process of SMEs affected by the higher interest rate or due to lending infrastructure. *Lending technology & credit:* Microfinance banks in Pakistan using outdated financial technology and lending procedures. Microfinance institutes need to introduce new and effective tools and channels to regularize the landings and credit to SMEs in Pakistan. Lending technology will facilitate the SMEs in getting the loans and credit from microfinance institutions.

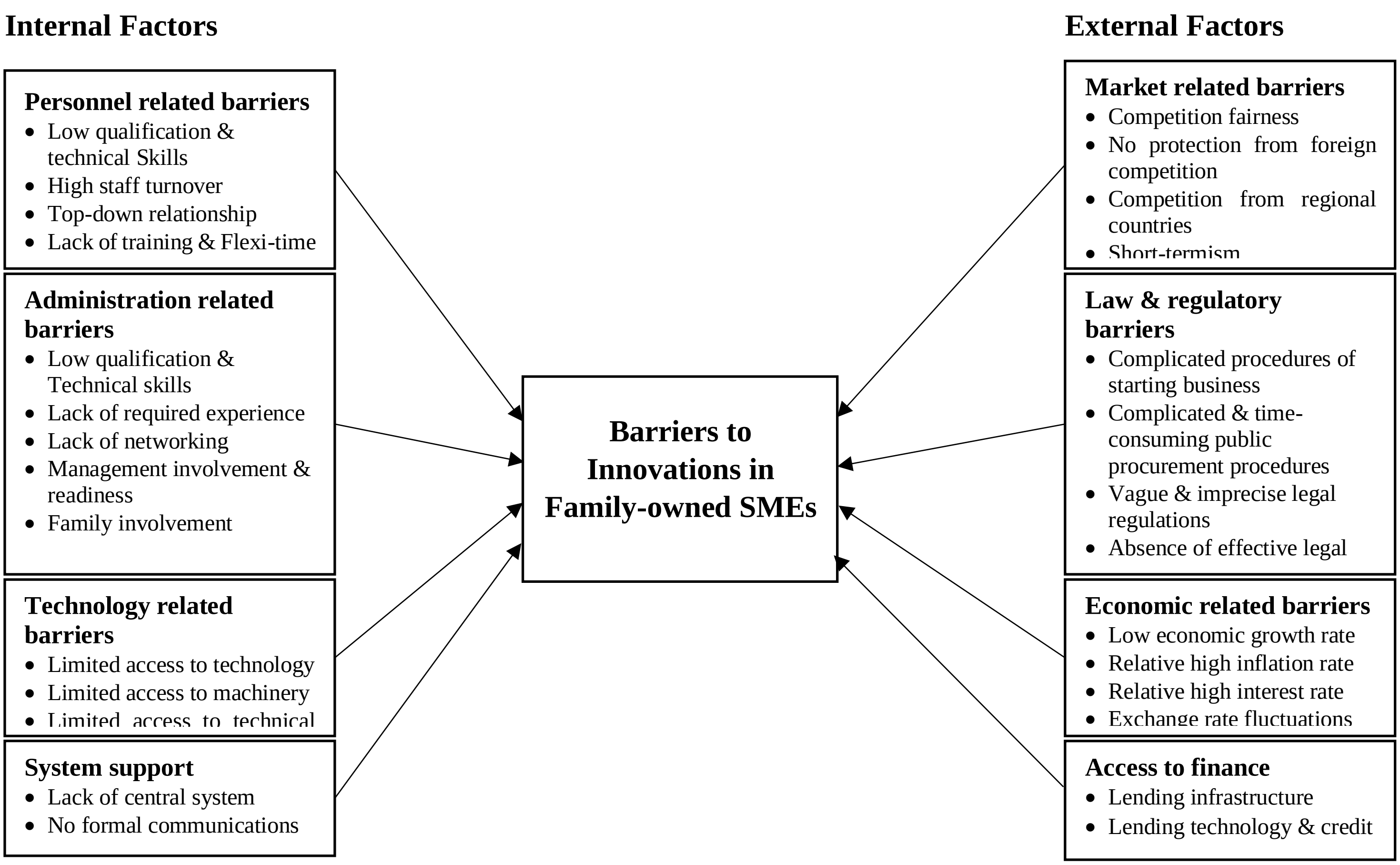

Figure 1: *Barriers to Innovation in Family-owned SMEs*

This paper discusses the possible internal and external barriers to innovation in family-owned SMEs. Internal factors categorized based on the firm's characteristics, culture and nature of the business include personnel-related factors, administration related factors, technology-related factors and system support while, external factors categorized based on the market-related factors, economic growth, law & regulatory framework and access to finance. The current study discusses the comprehensive framework based on the barrier to innovation in family-owned SMEs. This comprehensive framework provides the guidelines to the family-owned SMEs working in Pakistan as well as to regulatory authorities to define and upgrade their policies. This study provides the conceptual framework based on the barriers to innovation in family-owned SMEs in figure-1. These internal and external factors have a significant relationship with each other. This relationship can be unidimensional or feedback relationship illustration in figure 2. Figure-2 indicates the internal factors also indicate a significant relationship with other internal factors, similarly external factors also indicate a significant relationship among the external factors. Moreover, some of the internal factors indicate a relationship with external factors similarly some external factors indicate a significant relationship with internal factors. Future research study needs to test the underpinning framework empirically. This study also indicates that internal factors have a feedback relationship among each dimension of internal factors and also indicate an impact on the external factors. Similarly, external factors affect the dimension of internal factors.

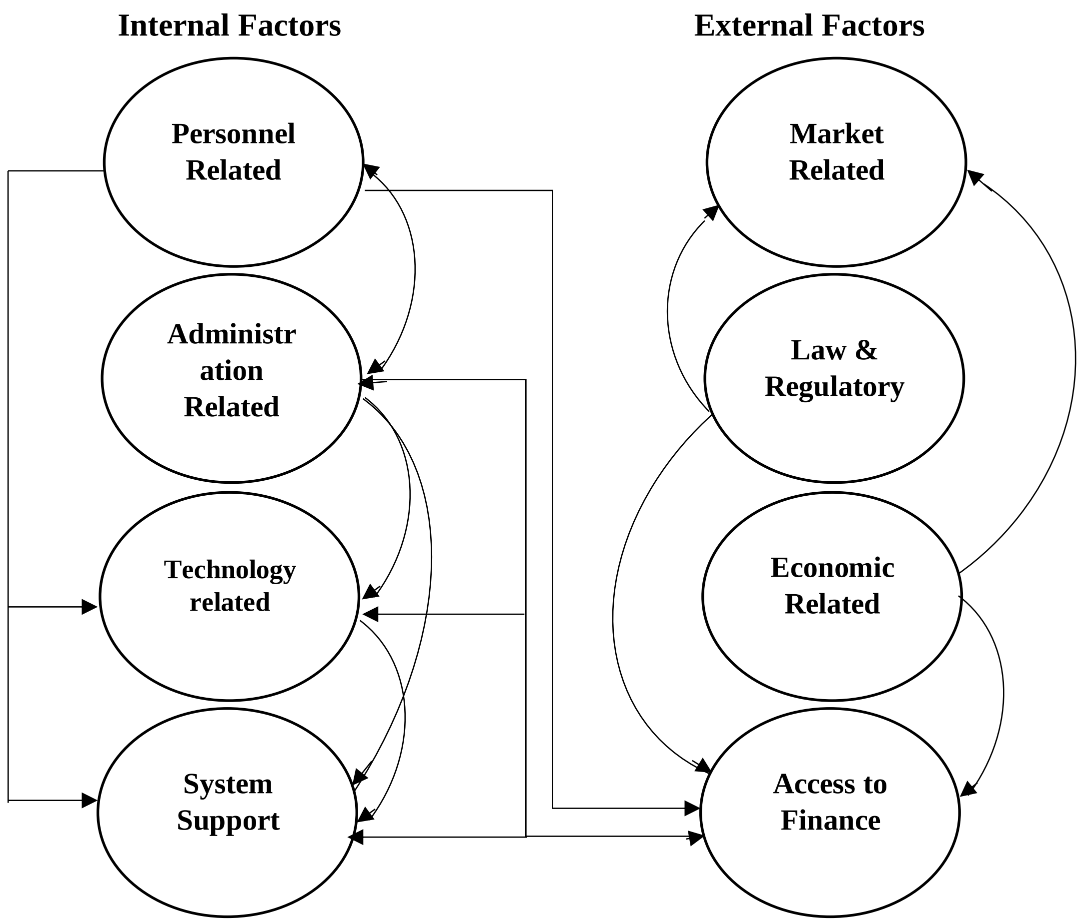

Figure 2: *Inter-relationship among the internal and external barriers to innovation*

Conclusion

Till, to date, a total of 3.2 million businesses were registered in Pakistan and approximately 90% of businesses were registered as SMEs owned & operated by the families, contribute 40% of total GDP of Pakistan, 80% of non-agriculture employment and total exports of Pakistan is $ 24.7 billion. Family-owned SMEs of Pakistan are contributing a significant portion in total exports of Pakistan and economic growth. However, over the period of last two-decade contribution of family-owned businesses in total exports of Pakistan is declining and only 30% businesses survive in first-generation, 13% to 15% businesses survive in second-generation and only 3% to 5% businesses survive in the third generation. Family-owned businesses lacking in innovation and ultimately leads to failure. The current, study provides a comprehensive framework on barriers to innovation in family-owned businesses. Barriers to innovation categorized into internal and external factors; internal factors were based on *personnel-related, administration relation, technology-related and system support*. External factors include; *market-related, law & regulatory related, economic-related and access to finance*. The current study covers the barriers to innovation faced by family-owned businesses internally and externally. Internal and external factors further sub-categorized for a better understanding of barriers to innovation so, regulatory authorities and family-owned SMEs should take appropriate action for sustainable growth. Future research should be considered to test the framework empirically in different cultures and industries to enhance the framework. This framework is recommended to test in the South-Asian region because the basic dynamics of South-Asian markets are similar as compared to other regional markets.

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