Financial access for starting a business: Evidence of internal and external financial sources, and performance of Malaysian SMEs

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Abstract - The main objective of this study is to unearth the impact of internal and external funding sources for starting a business on the performance of SMEs, and to identify the potential of other core variables namely business experience, educational level, and size of firm, which may significantly influence the SMEs’ performance. The data was collected from 484 SMEs via a structured questionnaire and analyzed by using the Structural Equation Modeling (SEM) technique. The study found that the internal and external sources of finance were insignificantly related to the SMEs’ performance, while business experience, level of education, and firm size were positively related to the SMEs’ performance. The findings of this study reveal that finance is not the main source that needs to be taken into account by entrepreneurs, supporting institutions, and policy makers in improving the SMEs’ performance. Further research in this area of study should extend into examining and adding more components that are relevant to a variation of the SMEs’ performance.

Keywords: Financial Access; External Sources; Internal Sources; SME Performance
1. Introduction

Generally, small and medium enterprises (SMEs) have become the strength of many economies all over the world. Despite its increasing importance to the economy and individual entrepreneurs, SMEs struggle with access to finance (Klonowski, 2012). Access to finance is the main avenue for entrepreneurs to get capital. Capital is needed both at the start-up and expansion stages. Moreover, this capital can be obtained internally or externally. Internal sources of finance can be generated from internal resources, such as owner’s saving, family’s money, and retained earnings. In contrast, basic sources of external finance come from banks, individual or institutional investors, venture capital, and the government. A large proportion of external financing for SMEs is, however, mainly originated from internal funds. This means that access to external finance is the most challenging task facing SMEs, especially in the less developed regions (Harvie, Oum, & Narjoko, 2011).

Much has been written about financial constraints and financial access faced by SMEs in the developed and developing countries and most recently, in the emerging economies. Irrespective of economic progress, the issues are common across the globe that SMEs have limited access to external capital due to their own weaknesses and the reluctance of the financial sector to provide credit to this sector (Harvie et al., 2011). Acknowledging this constraint, the Malaysian government has intervened in the financial market by enacting various laws, rules, and regulations, as well as by providing direct support to SMEs (BNM, 2014).

As a result of the heavy government intervention in the financial market, Malaysia has a comprehensive financial landscape that supports SMEs. This includes banking institutions (BIs), leasing and factoring companies, Development Financial Institutions (DFIs), venture capital companies, government funds, and Bank Negara Malaysia (BNM) schemes. Various financiers offer about 80% of the total financing to SMEs; 11% from DFIs; 6% from government funds and schemes; 1.7% from venture capital; and 1% from leasing and factoring (BNM, 2014).

The provision of the various government-related funds and schemes helps SMEs to grow and compete in the market. Nevertheless, the impact of such a support remains unclear until a research from different perspectives is carried out. Therefore, a clear flaw in the Malaysian literature on financial access among SMEs is the missing link between internal and various external financial sources and SME performances. Hence, the main purpose of this study is to identify the impact of internal and external funding sources for starting a business on the performance of SMEs. Besides access to finance, this study is also interested in unearthing the potential of other core variables which may be significantly related to SMEs’ performance namely business experience, educational level, as well as size of firm.

2. Literature Review

2.1. Definition of SMEs Worldwide and in the Malaysian Context

The definition of SMEs includes an extensive range of meanings and measures, differing from country to country and among the sources reporting the statistics of the SME,
although they tend to use the same metrics of measurement such as employment, turnover, and asset base (Blackburn and Jarvis, 2010).

Although there is no specified definition for SMEs, most of the countries usually measure SMEs by the number of full-time employees since this information is easily collected (Ganbold, 2008). As a result, a large number of countries define SMEs as companies that have between 0 and 250 employees (Ayyagari, Demirguc-kunt, & Maksimovic, 2005). Similarly, as agreed by the Asia-Pacific Economic Cooperation (APEC), the definitions of the SMEs are inclined to comprise the number of employees, maximum levels of capital, sales and revenue, assets, and type of industry (APEC, 2010).

In the Malaysian environment, most of the literature assumes that all enterprises that are not included in the large enterprises are included in the SME category (Rosman & Mohd Rosli, 2011), as most of the enterprises worldwide are small and micro sized (APEC, 2010). As a result of this, before the foundation of the National SME Development Council (NSDC) in June 2004, there was no standard definition for SMEs that was catered to the Malaysian environment. Therefore, the number of full-time employees, shareholders’ funds, or annual sales turnover were frequently used as a benchmark of criteria to define SMEs by the agencies (BNM, 2014).

However, the definition of SMEs have been officially reviewed in 2014 and a new definition was authorized at the 14th NSDC Meeting due to many developments in the economy since 2005 such as structural changes, changes in business trends, price inflation, etc. (SME Corporation Malaysia, 2014). They can be summarized as in Table 1.

**Table 1: Definition of SME**

<table>
<thead>
<tr>
<th>Sector Size</th>
<th>Manufacturing, Agro-based Industries, and MRS</th>
<th>Primary Agriculture, Services, and ICT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>Sales turnover &lt; RM300,000 OR full-time employees &lt; 5</td>
<td>Sales turnover &lt; RM300,000 OR full-time employees &lt; 5</td>
</tr>
<tr>
<td></td>
<td>Sales turnover from RM300,000 to &lt; RM15 million OR full-time employees from 5 to &lt; 75</td>
<td>Sales turnover from RM300,000 to &lt; RM3 million OR full-time employees from 5 to &lt; 30</td>
</tr>
<tr>
<td>Small</td>
<td>Sales turnover from RM15 million to &lt; RM50 million OR full-time employees from 75 to &lt; 200</td>
<td>Sales turnover from RM3 million to &lt; RM20 million OR full-time employees from 30 to &lt; 75</td>
</tr>
</tbody>
</table>

Sources: Definitions for Small and Medium Enterprises in Malaysia (approved for adoption by NSDC on 14 July 2013); SME Corporation Malaysia (2014).

**2.2. SMEs’ Performance**

Different firms use different measures of performance. As a multidimensional construct, it has several dimensions such as profitability, image, customer loyalty, product and service innovation (Garg, Joubert, & Pellissier, 2004), survival, success, profit, competitiveness, as well as growth (Wolff & Pett, 2006; Dobbs & Hamilton, 2006). Furthermore, Sohn et al. (2007) added that it includes departmental units such as marketing and manufacturing. Essentially, the concept of performance arises from the Resource-Based View (RBV) theory. The RBV theory states that valuable resources and availability of capabilities could be the main sources of sustainable competitive advantages (Mahoney, 1995). Swanson (1999) defined performance as “the valued productive output of a system in the form of...
goods or services”. He added that performance is an accomplishment and fulfillment. To Lin, Peng and Kao (2008), business performance is the outcome of operations, including the achievement of the firm based on either internal or external objectives. Empirical evidence by Harabi (2007) indicated that the principal factors of firm performance are related to business strategies, location, price, competitor, company liability, market demand, and certain government policies.

Performance of an organization is based on the result from various strategies that are adopted by the organization itself. These measures of performance can be quantitative or qualitative or both. Similarly, firm performance can be measured by non-financial and financial methods (Bagorogoza & Waal, 2010; Ahmad, Ramayah, Wilson, & Kummerow, 2010; Bakar & Ahmad, 2010). Previous researchers have suggested that financial measures should have a link with market-based measures (Dess & Davis, 1984; Hambrick & Mason, 1984; Schendel & Patton, 1978). Meanwhile, non-financial measures include the internal process and the open system. The internal process is measured by the improved coordination of internal processes, better organization of the personnel’s tasks, and increase in product quality. The open system is measured by the increase in customer satisfaction, increase in the skill of adjustment to the changeable needs of the markets, and improved image of the company and its products (Rubio & Aragon, 2009). However, most of the organizations adopt quantitative measurements to evaluate their firm performance.

2.3. Access to Finance

Commonly, a growing number of SMEs need to access a wide range of sources of finance specifically in developed and developing countries (Hussain, Millman, & Matlay, 2006). Numerous prior literatures contend that SMEs struggle with accessing finance (Mason & Kwok, 2010; Guijarro, Garcia, & Auken, 2009; Hughes, 2009; Bruns & Fletcher, 2008; Mason & Harrison, 2004). Access to finance is believed to help a firm to prosper and grow (Butler & Cornaggia, 2009). Bouri et al. (2011) added that increasing the access to financial sources to SMEs in developing countries could expand the economic situations through GDP growth, fostering innovation activity, and macroeconomic sustainability. Numerous prior researches have highlighted that access to finance is one of the triggering factors for fostering a conducive, economic environment (e.g., Isern et al., 2009; Eriksson et al., 2009; Hussain et al., 2006).

The International Finance Corporation (IFC) and the World Bank survey found that the ability to get credit is the main criterion for SMEs in doing business. Furthermore, the Global Entrepreneurship Monitor (GEM) defined the availability of financial resources for SMEs in the form of equity and debt as one of the key factors for supporting and boosting entrepreneurial activities (GEM Global Report, 2010). The Investment Climate Surveys of the World Bank depict that having access to finance can improve and develop firm performance. Financial availability not only aids in the growth of companies, market entry, and reducing business risk (Beck, et al., 2008), but it can also enhance entrepreneurial and innovation activities among SMEs (Klapper, Laeven, & Rajan, 2006). Moreover, firms with better access to finance are better able to invest in and exploit growth opportunities (Beck, et al., 2005). In other words, increase in the access to capital would directly improve the aggregate economic performance (World Bank, 2011). Nevertheless, SMEs particularly in developing countries face significant barriers in accessing financial sources. They are restrained by gaps in the financial system, for instance, not meeting the collateral requirements (Schans, 2013; Madiche & Nkamnebe 2010), high costs of administration...
(Chaya & Suhb, 2008), lack of experience in dealing with financial intermediaries (Rudjito, 2010), etc.

2.4. Internal and External Sources and SMEs’ Performance

There are two types of sources of finance namely internal (informal financing) and external (formal financing) sources, which may influence SMEs’ performance. Internal sources (also known as informal finance) as defined by Ayyagari et al. (2010) are everything other than bank financing. They clarify that informal financing comes from pawnbrokers, moneylenders, or informal banks, which are not legally registered. To Straub (2005) internal financing includes loans seconded from family members, non-profit organizations, moneylenders, rotating savings, and credit associations. These financiers use self-enforcing contracts without formal legal procedures and use coercion or violence to ensure that the borrower meets the loan repayment obligation. Moreover, informal or internal financing could also be in the form of bank loans which the firm has taken before it has become a legal or registered firm (new SME). For example, it would include an entrepreneur taking a personal loan to finance the start-up costs of his new business (Reynolds, 2011). Reynolds (2011) added other sources of informal financing, which include personal savings, personal and family loans from friends, employers, colleagues, credit card loans, etc. Similarly, as reiterated by the previous researcher, the main internal financing comes from personal savings and borrowings from family and friends (see OSMEP, 2012; Sharifah Mariam et al., 2009).

Several previous works indicate that access to internal finance could promise a better business performance. Among them is the study by Ayyagari et al. (2010) which concluded that informal sources of finance could facilitate the growth of small firms better than the formal sources and may play the same role as angel finance or investors in the financing and creation of fast-growing start-ups in developing countries. Prior to that, the specialist literature stated that the finance gap that exists could be overcome via accessing the informal sources of finance by SMEs, which may also influence their performance (Mason and Harrison, 1993). Essentially, dependency of SMEs on informal networks of finance constrains the firms from expanding their operation in the economy (Hussain, et al., 2006). As supported by Reynolds (2011), the data from the Panel Study of Entrepreneurial Dynamic (PSED) shows that new entrepreneurs prefer to use internal sources of financing such as from family and friends rather than external sources. This result holds the pecking order theory as they prefer to seek financing from the internal sources first, before moving to debt and equity. Hence, given the importance of internal financing in business performance, particularly for SMEs, the first hypothesis can be stated as follows:

\[ H_1: \text{SMEs with higher access to internal financing for starting a business will outperform those that have less or no access.} \]

The second type of sources of finance is external financing which is sometimes interchangeably used as formal financing. The external sources of financing could include any source that is derived fundamentally from outside the firm (Ayyagari et al., 2010). In contrast, Reynolds (2011) noted that firms get their formal financial sources after they are legally registered. The sources could be in the form of additional team equity, asset-backed loans, lease, working capital loans, team member’s personal loans, venture capital, firm loans, government agency loans, and any other loans or debts. Besides that, SMEs can get
their financing from financial institutions (FIs) which serve as the formal sources of finance. The types of formal financing offered by FIs are based on several lending technologies. A lending technology includes the combination of the main information, loan contract agreement, procedures or policies as well as monitoring strategies (Berger & Udell, 2006).

External capital to the SME is derived from three main sources namely banks, venture capital, and the government. Among them, commercial banks are conventionally the main source of financing for SMEs and can meet up to 80 percent of their capital requirements (Bruns and Fletcher, 2008). Meanwhile, alternative financial sources that are available include venture capital, which concerns with investing capital in a project in which there is a substantial element of risk, typically in a new or expanding business. Venture capital, however, only offers less than 10 percent of financing to SMEs (Oakey, 2007). The banking institution is still the most vital entity for starting a business in many countries (Mason and Harrison, 1993).

There are several evidences that link the relationship between external financing and performance of the firm. For instance, the study by Cull and Xu (2005) provided evidence that access to bank loans for private firms was significantly and positively related to firm growth. The result suggested that Chinese firms were more likely to reinvest their profits when they have better access to bank loans thus showing that the firms are growing larger. Meanwhile, Ayyagari et al. (2010) found that bank financing has a high impact on growth of firms. Nevertheless, they noted that the growth of firms relies heavily on alternative financing conduits despite the formal financing. Additionally, they reported that firms that received government help in accessing finance have no significant advantage in the firms’ performance. In fact, they do not grow as fast as firms that have not received any government assistance. Other than that, there is significant positive proof that finances have a favorable impact on starting a business, which then directly leads to economic growth. As proven by Stam and Garnsey (2008), the impact of a start-up capital has a positive relationship on the growth performance of businesses. Likewise, the study by Aghion, Fally, and Scarpetta (2007) proved that SMEs are heavily dependent on external financial sources on greater growth of financial development. Previous evidences show that access to finance brings greater productivity within an economy. For instance, the study in US depicted that financial access gives a positive significant change to agricultural crop yields. The states that have a high access to finance relatively increase their production levels (Butler & Cornaggia, 2009). From these arguments, the relationship between external financing and firm performance can be stated as:

$$H_2:$$ SMEs with a higher percentage of access to external financing for business start-up will perform better than those that have less or no access to external financing.

### 2.5. Business Experience, Educational Level, Size of Firm, and SMEs’ Performance

As mentioned before, besides access to finance, this study also intends to unearth the potential of other core variables, which may be significantly related to SMEs’ performance namely business experience, educational level, and size of firm. Generally, business experience could be translated as an individual’s prior knowledge about doing business and entrepreneurship. Business experiences can be acquired from many sources, such as prior education, family business, business acquisition, previous working experience, as well as past engagement experience with other businesses (Dyke, Fischer, & Rueber,
1992). A prior study by Strober (1990) debated about the Human Capital theory, which explains that performance of a firm is heavily affected by business experience (Van & Rocco, 2004). An early study by Fischer et al. (1993) contends that the more drawn out the experience of an entrepreneur is, the higher the rate of development and benefits of a business endeavor. Likewise, experience is believed to be a vital factor in deciding a firm’s achievement (Moha Asri, 1997). Presently, according to Schans (2013), plans to grow are correlated with business experience, which means with less experience, there will likely be lesser growth. As found in numerous literatures (see Somik & Mengistae, 2006; Harada, 2003), individual business experience is positively and significantly correlated with performance depending on the suitability and similarity of one’s past experience to the type of current business. Hence, the link between personal business experience and performance of the firm can be specified as:

\[ H_3: \text{Individual business experience is positively linked to the SMEs' performance.} \]

Rationally, individuals with a higher educational level have comparatively more enthusiasm and they seem able in managing their own business which directly enhances their business growth (see Mengistae, 2006; Cooper, 1995). A lot of previous works defend that a higher level of entrepreneurial education could influence a higher performance (refer Nichter & Goldmark, 2009; Fairlie & Robb, 2007; Mengistae, 2006). In line with the Human Capital theory, these studies conclude that the entrepreneur’s educational level is an important factor that could affect the business development (see Van & Rocco, 2004; Hewlett, 2002). More than that, the study conducted by Okapra (2011) in Nigeria revealed that the lack of education, and not poor management, financial support, lack of training, lack of experience, corruption, insufficient profits, poor infrastructure, as well as low demand for product and services, is one of the limitations which hamper small businesses from sustainability and growth. To Rudmann (2008), higher education has a positive effect on business development. The current educational and training establishments are sufficient to teach and develop entrepreneurial development. Hence, he suggested that innovative education is necessary.

In addition, the entrepreneur with an education is able to be flexible with current changes in terms of technology adoption, for instance, producing new products, employing specified technical knowledge, adopting flexible operations, and engaging in new production processes (Nichter & Goldmark, 2009). However, Moha Asri (1997) contends that individual business experience is a more important factor for growing the business compared to education. Thus, the next hypothesis is formulated as:

\[ H_4: \text{The higher the entrepreneur’s level of education, the higher the SMEs’ performance.} \]

Thirdly, it is the size of the firm. Size of firm is normally presented by two measurements including the number of employees and market structure namely monopoly, oligopoly, or monopolistic competition. This study, however, refers to the number of full-time employees instead of market structure as the firms’ size measurement. A large firm with a higher number of employees is believed to show more growth compared to a small business (Birley and Westhead, 1990). Beck, Demirguc-Kunt, Laeven, and Maksimovic (2006) noted that small firms in both developed and developing countries have lesser access to external finance which constrains them in their operation and growth potential. Babatunde and Olaniran (2009) identified three levels of determinants of firms’ performance. They concluded that firm size is one of the factors that affect the firms.
Numerous findings suggest that firm size is also a factor that reflects on firm growth besides sector activities and management experiences (see Baldwin, 2005). As discussed by Ayyagari et al. (2010), after controlling the firm size, the smallest quintile of firms does report growth in their productivity when using financial sources.

\[ H_5: \text{Firm size is positively related to the SMEs’ performance}. \]

3. Research Methods

3.1. Measurement of the Variables

To test the stated hypotheses and to ensure validity and reliability of the measurement, this study used the scales adopted in literatures and modified them according to the study’s purposes. The dependent variable for this study is SMEs’ performance. These measures of performance can be quantitative or qualitative or both. However, most of the organisations adopt the quantitative measurement to evaluate their firm performance. Moreover, the measures of firm performance could be financial and non-financial (Bakar & Ahmad, 2010; Ahmad, Ramayah, Wilson, & Kummerow, 2010; Bagorogoza & Waal, 2010). Performance measurement for this study uses the financial technique. Items used are based on a modified version from the studies of Ar and Baki (2011) and Voola and O’Cass (2010). SMEs’ performance is represented by 10 items such as market share, sales, customer satisfaction, product quality, profitability, growth, productivity, number of employees, number of new customer, and overall performance. All items are fixed on a five-point of Likert-type scale ranging from 1 (significantly lower), 3 (unchanged), to 5 (significantly higher).

Independent variables for this study are internal and external financial sources. Both are measured by the percentage of access to finance either from external or internal sources for starting a business (see SME Annual Report, 2012; Beck et al., 2004). Many studies forewarn the potentially strong influence of some variables, including business experience, level of education, and size of firm on various performance indicators. According to the literature, they can present higher effects on the firms’ performance (Randoy & Goel, 2003; Wynarczyk & Watson, 2005; Rahman et al., 2011). However, since the interest of this study is on determining the effect of external and internal funding for starting a business and SMEs’ performance, these three variables are treated as the controls in the model. Measurement for business experience is according to the number of years the sample has engaged in managing a business. Meanwhile, the educational level is measured by the respondent’s highest level of formal education. The number of full-time employees defines the size of the firm in business.

3.2. Sample Selection

The empirical analysis in this study is in accordance to primary data. Primary data for this study was collected through printed questionnaires, distributed directly by the researcher and enumerators. The questionnaire design was constructed based on previous studies as discussed. The questionnaire was translated into Malay in order to be used in the Malaysian environment. Of the 600 printed questionnaires, 500 usable questionnaires were returned, but only 484 of them were completed enough to be used in the structural analysis. The response rate indicates 80.67 per cent (484 of 600) after about 3 months of conducting
the actual survey. Purposive sampling was applied for the sample selection. The selection procedures for unit analysis in picking the samples included: 1) must be an SME (have less than 200 full-time employees); 2) owner or manager of the business; and 3) has operated the business for 3 years and above.

A summary of samples in this study are shown in Table 2. It shows that a majority of the respondents are male (66.5%). The majority of participants are aged between 30 and 39 years old (37.5%) and 40-49 years old (35.3%). Moreover, most of them are married (87.8%). In terms of their educational level, over half of the entrepreneurs have finished their secondary school education at 66.9%, followed by completed tertiary education (31.2%), and attended primary school (1.9%). Meanwhile, the highest number of samples is from Johor, Malaysia (22.7%).

Table 2: Profile of Entrepreneur

<table>
<thead>
<tr>
<th>Variables</th>
<th>Frequency (n=484)</th>
<th>Percentage (100.0%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td>322</td>
<td>66.5</td>
</tr>
<tr>
<td>Female</td>
<td>162</td>
<td>33.5</td>
</tr>
<tr>
<td>Age</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20-29 years old</td>
<td>52</td>
<td>10.7</td>
</tr>
<tr>
<td>30-39 years old</td>
<td>180</td>
<td>37.2</td>
</tr>
<tr>
<td>40-49 years old</td>
<td>171</td>
<td>35.3</td>
</tr>
<tr>
<td>50-59 years old</td>
<td>69</td>
<td>14.3</td>
</tr>
<tr>
<td>60 years old and above</td>
<td>12</td>
<td>2.5</td>
</tr>
<tr>
<td>Marital Status</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Married</td>
<td>425</td>
<td>87.8</td>
</tr>
<tr>
<td>Single father/ mother</td>
<td>15</td>
<td>3.1</td>
</tr>
<tr>
<td>Unmarried</td>
<td>44</td>
<td>9.1</td>
</tr>
<tr>
<td>Highest Education Level</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary School</td>
<td>9</td>
<td>1.9</td>
</tr>
<tr>
<td>Secondary School</td>
<td>324</td>
<td>66.9</td>
</tr>
<tr>
<td>Tertiary education</td>
<td>151</td>
<td>31.2</td>
</tr>
<tr>
<td>State</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Johor</td>
<td>110</td>
<td>22.7</td>
</tr>
<tr>
<td>Kedah</td>
<td>1</td>
<td>0.2</td>
</tr>
<tr>
<td>Kelantan</td>
<td>61</td>
<td>12.6</td>
</tr>
<tr>
<td>Negeri Sembilan</td>
<td>51</td>
<td>10.5</td>
</tr>
<tr>
<td>Pahang</td>
<td>49</td>
<td>10.1</td>
</tr>
<tr>
<td>Perak</td>
<td>94</td>
<td>19.4</td>
</tr>
<tr>
<td>Perlis</td>
<td>5</td>
<td>1.0</td>
</tr>
<tr>
<td>Penang</td>
<td>59</td>
<td>12.2</td>
</tr>
<tr>
<td>Sarawak</td>
<td>54</td>
<td>11.2</td>
</tr>
</tbody>
</table>

Source: Based on the data survey.

4. Findings

This study used the Structural Equation Modeling (SEM) with AMOS 18.0 and Statistical Program for the Social Sciences (SPSS) 16.0 for Windows software packages to analyze the data. SEM is known as a family of statistical models that enlightens the connections among multiple variables. Hence, the initial step is to test the measurement model in order to certify the validity and reliability of the scales.
The establishment of the scale’s unidimensionality starts by checking the factorial structure of each of the concept that needs to be measured. This study followed the suggestion by Hair et al. (2007) in which the goodness-of-fit used contains at least one index from each of the following category namely: (1) Absolute fit - Chi-square ($X^2$), Root Mean Square Error of Approximation (RMSEA) and Goodness of Fit Index (GFI); (2) Incremental fit - Adjusted Goodness of Fit Index (AGFI), Comparative Fit Index (CFI), Tucker Lewis Index (TLI) and Normed Fit Index (NFI); and (3) parsimonious fit - Chisq/df ($X^2$/df).

There are several actions or options that have to be taken to better fit the data facing an unfit situation as mentioned by Hair et al. (2006, p.795) such as: (1) Path estimate by dropping the low loadings with loadings below 0.50 and ideally 0.70; (2) Standardized residuals by detecting a potentially unacceptable degree of error in the same construct and by recreating the covariance arrow between these two items; (3) Modification of indices by dropping the items that show high modification indices; and (4) Specification search - an empirical trial-and-error approach using model diagnostics.

Therefore, after considering the selected options as suggested, all the results of the selected fitness indices were achieved. This resulted in, $X^2=356.8$, df= 79, $X^2$/df=4.517, NFI= 0.926, TLI=0.922, CFI= 0.941 and RMSEA= 0.085, which met the model fitness requirement ($X^2$ > 0.05, $X^2$/df= < 5.0, NFI= > 0.90, TLI= >0.90, CFI= > 0.90 and RMSEA= 0.05 to 0.10). Finally, all the items were retained from the model and accepted for further analysis.

4.1. Structural Model and Discussion

The value of means, standard deviations, and correlations for this study are depicted in Table 4. As shown in Table 4, most of the businesses have operated in the industry for more than 10 years (mean, 13.52) and owners have on average an educational certificate from a secondary school (mean educational level, 3.6880). Nevertheless, the size of firm is quite small (mean firm size, 13.21). Judging from the mean values of internal sources (mean 71.08), a large portion of the entrepreneurs used internal sources at about 71.08% as the source to start-up their business. On the other hand, the mean value of external sources (mean 28.35) indicates that not many of the entrepreneurs access the external sources at approximately 28.35% to start-up their business. This study is aligned with the argument by Stouder (2002) which showed that new entrepreneurs prefer to use internal sources of financing such as from family and friends rather than external sources. For the purpose of frequency analysis, scales 1 to 2 were regarded as low, scale 3 as moderate, and scales 4 to 5 as a high level. Equally important, the performance of the SMEs (mean 3.78) was quite high as well while the standard deviation values of variables ranged between 0.65 and 26.7 in general. The Standard Deviation (SD) is a measure of how spread out are the numbers. It shows that the variation or dispersion for the study is between 0.65 and 26.7 from the mean.

The correlation coefficients, which describe the significance and strength of the relationship among the constructs, are well reflected in Table 3. As shown in this table, the correlations for independent variables range from 0.061 to 0.569. The value of the correlations between the independent variables indicates no problem with multicollinearity, since it does not exceed 0.80 (Kennedy, 2003). As a result, it can be concluded that the multicollinearity assumption is not present in this study.
Table 3: The means, standard deviations, and correlations

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>SD</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Business Experience</td>
<td>13.52</td>
<td>6.819</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Educational Level</td>
<td>3.6880</td>
<td>1.11631</td>
<td>-0.061</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Firm Size</td>
<td>13.21</td>
<td>9.972</td>
<td>0.115*</td>
<td>0.194**</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Internal Sources</td>
<td>71.08</td>
<td>26.748</td>
<td>-0.090</td>
<td>-0.074</td>
<td>-0.275**</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. External Sources</td>
<td>28.35</td>
<td>26.281</td>
<td>-0.026</td>
<td>0.084</td>
<td>0.298**</td>
<td>-0.569**</td>
<td></td>
</tr>
<tr>
<td>6. Business Performance</td>
<td>3.7789</td>
<td>0.65397</td>
<td>-0.063</td>
<td>0.314**</td>
<td>0.358**</td>
<td>-0.348**</td>
<td>0.352**</td>
</tr>
</tbody>
</table>

Notes: Correlation test used Pearson correlation, ** Correlation is significant at the 0.01 level (2-tailed), * Correlation is significant at the 0.05 level (2-tailed). Source: Based on the data survey.

After conducting the measurement model and fitting the selected indices, all the variables in the measurement model were transformed into the structural model, where all the covariance arrows were replaced with one-way arrows, indicating the causal relationship among the variables. The structural model result for the study is shown in Table 4.

Table 4: SEM results of the structural paths

<table>
<thead>
<tr>
<th>Path</th>
<th>Estimate</th>
<th>P</th>
</tr>
</thead>
<tbody>
<tr>
<td>SMEs Performance &lt;--- Internal Sources</td>
<td>-0.005</td>
<td>0.147</td>
</tr>
<tr>
<td>SMEs Performance &lt;--- External Sources</td>
<td>0.002</td>
<td>0.602</td>
</tr>
<tr>
<td>SMEs Performance &lt;--- Business Experience</td>
<td>0.009</td>
<td>0.027</td>
</tr>
<tr>
<td>SMEs Performance &lt;--- Educational Level</td>
<td>0.150</td>
<td>***</td>
</tr>
<tr>
<td>SMEs Performance &lt;--- Firm Size</td>
<td>0.017</td>
<td>***</td>
</tr>
</tbody>
</table>

Note: *** significant at 0.001 level (2-tailed). Source: Output based on Structural Model.

According to Table 5, the study found that Hypothesis 1 is not supported. In particular, the hypothesis ‘SMEs with higher access to internal financing for starting a business will outperform those that have less or no access,’ was not significant in this study. Similarly, Hypothesis 2 is also not supported by this study. In particular, the hypothesis ‘SMEs with a higher percentage of access to external financing to start-up a business will perform better than those that have less or no access to external financing’, was insignificant. Otherwise, the study found that all the hypotheses for the control variables are fully supported. This means hypothesis 3, which stated that individual business experience is positively related to the SMEs’ performance (r = 0.009, p = 0.05), is supported. In other words, the regression weight of entrepreneur’s experience in the prediction of SMEs’ performance was significantly different from zero. Then, hypothesis 4 is supported as the higher the entrepreneur’s level of education, the higher the SMEs’ performance (r = 0.150, p = 0.001). In other words, the regression weight for the educational level in the prediction of SMEs’ performance is significantly different from zero at the 0.001 level (two-tailed). Similarly, the study supports hypothesis 5 which stated that the firm size is positively significant in being translated into SMEs’ performance. In other words, the regression weight for the size of firm in the prediction of SMEs’ performance is significantly different from zero at the 0.001 level (two-tailed).

Surprisingly, the internal and external sources of finance to start-up a business were not translated into changes in the SMEs’ performance. This finding is totally dissimilar to the common belief of Barney (1986) in the RBV theory, which explains that valuable resources and capabilities available are sources for effective business performance (Mahoney, 1995; Peteraf, 1993). Moreover, access to finance is also believed to allow
enterprises to attempt profitable ventures to grow their organizations and to secure the most recent advances, while guaranteeing their sustainability and that of the country in general.

Even Arogundade (2010), Babatunde and Olaniran (2009), and Bulan and Yan (2009) contended that growing firms have a greater need for external financing. Besides that, empirical evidence by Padachi (2006) also showed that finance is one of the external factors that can lead to larger investment and higher growth. Equally important, the lack of access to finances not only leads to slow growth performance but it could also be the root to consistent poverty traps and income inequality (Claessens & Tzioumis, 2006). The question here is that why doesn’t the high percentage of access to internal and external finance for start-up businesses translate into superior SME performance. This argument, however, is more suitable in the Western areas that are more advantaged in terms of business size and better access to financial sources. However, the firm size in this study includes small businesses as their average number of full-time employees is only about 13 (refer Table 4). Therefore, the financial factor is not seen as being an important element due to the small size of the firm.

Hence, financial facilities offered by banking institutions are not able to assist small firms in a developing country, such as Malaysia, to close and reduce the capital gap and to boost the performance of the firm. This finding aligns with numerous previous works. As expected, all the control variables namely business experience, educational level, as well as firm size were positively significant in this study in line with many previous researchers (Pelham, 2000). As an effort to bond the knowledge gaps in business, the personal interview with entrepreneurs identified that less experienced and educated entrepreneurs had to work harder with higher engagement compared to those who are more experienced and educated. This perhaps answers why the business growth of the former was better than the latter. Large firms are believed to show more performance compared to small businesses (Birley & Westhead, 1990; Bracker & Pearson, 1986) as revealed in this study. Additionally, according to Schans (2013), plans to grow are correlated with firms that have fewer employees and these firms are more likely to have little growth.

5. Conclusion

This study aimed to provide empirical evidence regarding the impact of internal and external funding sources to start-up a business on the performance of SMEs. Besides access to finance, this study was also interested to unearth the potential of other core variables which may be significantly related to SMEs’ performance namely business experience, educational level, and size of firm. By using self-administered questionnaires, 484 samples were collected through the non-probability sampling technique. The key findings of the study highlighted that internal and external sources of finance are insignificantly related to SMEs’ performance. Meanwhile, business experience, level of education as well as size of firm are positively related to high performance of SMEs. To conclude, the findings of this study reveal that financial access is not the main source that needs to be taken into account by entrepreneurs, supporting institutions, and policy makers in improving the SMEs’ performance. Therefore, even though access to finance is seen as an important variable in assisting SME businesses (Colman, 2006), depending on this variable alone is not enough.
This study also has its pros and cons. The current research is limited to close-ended questions. This study restricted the respondents from giving their own responses, comments, additional input, and information due to the set-questions survey method and fixed format. Thus, future research may modify the questions by using a mixed format, enabling the respondents to provide additional input and comment. In terms of variables, this study was limited to internal and external sources of finance for start-up businesses. Therefore, future research could extend this study by examining and identifying the impact of these two types of sources from different views, for instance, on business expansion. Moreover, future works could add more components or other relevant core variables that could influence the variation of SMEs’ performance.

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