



**INFLUENCE OF INTERNAL AND EXTERNAL CHALLENGES ON  
FINANCIAL PERFORMANCE OF SMEs IN SAUDI ARABIA MODERATED  
BY BUSINESS SUPPORT**

By

**ALFAQIRI MARYAM YOUSEF N**

**Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia,  
in Fulfilment of the Requirements for the Degree of Master of Science**

**October 2023**

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Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfilment  
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**Chairman : Zariyawati binti Mohd Ashhari, PhD**  
**School : Business and Economics**

The COVID-19 pandemic caused global disruptions, impacting small and medium enterprises (SMEs) severely. SMEs, representing 90% of businesses in Saudi Arabia, are essential to the economy but face challenges, including exclusion from major industries. Post-pandemic, SMEs grew significantly, reaching 892,063 by June 2022, as reported by Monsha'at.

This study explores the effects of internal and external challenges on the financial performance of SMEs in Saudi Arabia, emphasizing the moderating role of business support. It also highlights the importance of human capital investment over technological adoption to drive SME growth.

A quantitative approach was employed, gathering 390 responses from SME owners and managers. Data analysis utilized SPSS and AMOS, applying exploratory factor analysis and structural equation modelling. Using the resource-based view theory, the

study found that both internal and external challenges significantly impact financial performance.

Business support was found to significantly moderate the relationship between internal challenges, such as resource leakage and lack of skilled labor, and SME performance. External factors, including regulatory constraints, further exacerbate difficulties, especially post-COVID-19. The findings underscore the need for enhanced financial and non-financial business support to improve SMEs' performance.

**Keywords:** SMEs, financial performance, COVID-19, internal challenges, external challenges, business support

**SDG:** GOAL 8: Decent Work and Economic Growth

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Master Sains

**PENGARUH CABARAN DALAMAN DAN LUARAN TERHADAP  
PRESTASI KEWANGAN PKS DI ARAB SAUDI: DIMODERASIKAN OLEH  
SOKONGAN PERNIAGAAN**

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Pandemik COVID-19 memberi kesan besar kepada perusahaan kecil dan sederhana (PKS). Di Arab Saudi, PKS, mewakili 90% daripada perniagaan, memainkan peranan penting tetapi menghadapi cabaran seperti pengecualian daripada industri utama. Selepas pandemik, jumlah PKS meningkat kepada 892,063 pada Jun 2022, menurut Monsha'at.

Kajian ini mengkaji kesan cabaran dalaman dan luaran terhadap prestasi kewangan PKS, dengan fokus kepada peranan sokongan perniagaan sebagai moderator. Ia juga menekankan pentingnya pelaburan dalam modal insan berbanding teknologi untuk pertumbuhan PKS.

Pendekatan kuantitatif digunakan dengan 390 soal selidik dikumpulkan daripada pemilik dan pengurus PKS. Analisis data dilakukan menggunakan SPSS dan AMOS melalui analisis faktor penerokaan dan pemodelan persamaan struktur. Berpandukan

teori pandangan berasaskan sumber, kajian ini mendapati cabaran dalaman dan luaran memberi kesan ketara terhadap prestasi kewangan.

Sokongan perniagaan didapati memoderasikan hubungan antara cabaran dalaman, seperti kekurangan pekerja berkemahiran, dan prestasi PKS. Faktor luaran, seperti peraturan, memburukkan lagi cabaran selepas pandemik. Penemuan ini menegaskan perlunya sokongan tambahan, sama ada kewangan atau bukan kewangan, untuk meningkatkan prestasi PKS.

**Kata Kunci:** PKS, prestasi kewangan, COVID-19, cabaran dalaman, cabaran luaran, sokongan perniagaan

**SDG:** MATLAMAT 8: Pekerjaan yang Layak dan Pertumbuhan Ekonomi

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# CHAPTER 1

## INTRODUCTION

### 1.1 Introduction

The first chapter of this thesis begins with the background and rationale of the present study. It provides an overview of the Coronavirus Disease 2019 (COVID-19) pandemic and outlines its impacts on SMEs in Saudi Arabia. The chapter subsequently describes the problem of this study, its objectives, its research question and its significance. The chapter concludes with the organisation of this thesis.

### 1.2 Background of the Study

The COVID-19 pandemic is a global health crisis caused by the spread of the SARS-CoV-2 virus. It was first identified in Wuhan, China, in December 2019 and quickly spread throughout the world (Thukral, 2021). Due to its severity, the World Health Organisation (WHO) identified the COVID-19 outbreak as a public health emergency of international concern in March 2020 (World Health Organisation, 2021). Many never anticipated that this global pandemic would still be ravaging the world after more than one and a half years. However, it has caused the world's greatest disaster, affecting social, economic and cultural values, especially the high rate of death victims. The cumulative number of confirmed cases worldwide had reached 678.4 million by the end of 2022, while the cumulative death toll had reached 6.8 million (World Health Organisation, 2023).

The COVID-19 pandemic hit every sector across the globe, with the negative impact on the global economy being geometrically increasing. The impacts of COVID-19 on

Small and Medium Enterprises (SMEs) are of particular concern as they constitute 90% of businesses worldwide (Sonobe et al., 2021). The pandemic created immediate and significant changes to how SMEs conduct business around the world. The spread of COVID-19 has had a great impact on the global economy and brought severe challenges to the survival of SMEs. SMEs around the world have been abruptly confronted with changes in consumption patterns, demands, product distribution and consumer behaviour, as many SMEs have lost access to their front-line customers and raw materials.

Lockdowns and movement restrictions policies set by governments around the world to contain the pandemic prevented key personnel and staff from working, resulting in job losses and a significant decrease in demand.

The impact is being felt not only by individual firms but also within national economies around the globe. According to Kasradze, COVID-19 caused significant global trade and travel disruptions, particularly across borders (Kasradze et al., 2021). The closure or slowdown of trade by major exporters such as China, the European Union and the United States severely impacted the supply chain. These disruptions have posed major challenges to SMEs, affecting their ability to operate and function effectively in the global economy. A research report on the countermeasures and suggestions on the impacts of the COVID-19 pandemic on SMEs issued by the China Association for Small and Medium Enterprises pointed out that a significant number of SMEs in China are experiencing financial difficulties due to the pandemic. Nearly 67.69% of SMEs have reported a decrease in business income, while 21.61% are facing challenges in repaying loans and debts on time, leading to increased pressure

on their operating funds. Additionally, 86.22% of SMEs in China have reported being unable to sustain their operations due to insufficient funds (Ma, Liu, and Gao, 2021).

A survey conducted by the National Federation of Independent Business (NFIB) on 700 companies with less than 360 employees revealed that more than 75% of SMEs in the United States have been severely affected by the COVID-19 pandemic (OECD, 2020). Rapid lockdowns and travel restrictions in the United States brought the economy to stand still, with people applying for unemployment benefits soaring to nearly 22 million for the first time since the great depression. In addition, the market shrinkage and economic damage caused by the pandemic in Britain, France, Japan and other countries are also extremely serious (Hurley et al., 2021). Statistics have shown that in the first quarter of 2020, the Gross Domestic Product (GDP) of France fell by 5.3% compared to the previous quarter. Japan's first-quarter GDP declined by 3.4% over the previous year, while Brazil's first-quarter GDP fell by 0.3% year-on-year. Meanwhile, the UK's first-quarter GDP also decreased by 1.6% compared to the same period last year, amounting to \$703.3 billion (Ma, Liu and Gao, 2021). A survey conducted by McKinsey in August 2020 of SMEs in the UK revealed that nearly 80% of the surveyed companies had declined in their operating income during the pandemic (Dimson and Sharma, 2021). In short, millions of Small and Medium Enterprises around the world face an existential threat.

There is also a degree of long-term uncertainty about what happens to SMEs in the post-COVID-19 era. In March 2020, the International Monetary Fund (IMF) declared that the world had entered a recession due to the COVID-19 pandemic and that the

length and depth of the recession were reliant on two things: containing the virus and having an effective coordinated response to the crisis (IMF, 2022).

### 1.2.1 Overview of the Small and Medium Enterprises (SMEs) Sector in Saudi Arabia

Across the globe, Small and medium-sized enterprises are recognised as powerful drivers of economic activity. According to Aboradi, they represent 90% of businesses and more than 50% of employment worldwide (Aboradi et al., 2018). Each country has its definition of what constitutes an SME. For instance, the European Union defines SMEs by the annual sales turnover, number of employees, annual balance sheet or the size of shareholders' funds. In the United Arab Emirates (UAE) and the Kingdom of Saudi Arabia, SMEs are considered businesses that employ less than 250 people and have less than 200 million Riyadh in annual revenue (Alharbi, 2022). However, the most adopted definition of SME in Saudi Arabia is shown in the table below:

**Table 1.1 : Definition of SMEs Adopted in Saudi Arabia**

<b>Enterprise Category</b>	<b>Number of employees</b>	<b>Annual revenue</b>
<b>Micro</b>	1-2	Less than USD 27,000
<b>Small</b>	3-49	USD 27,00-1.3 million
<b>Medium</b>	50-200	USD 1.3 – 13.3 million

(Source: developed for this study)

According to the Saudi Arabian General Investment Authority, SMEs account for approximately 99% of all businesses in the country and employ over 70% of the private sector workforce. Around 70% of SMEs in the Kingdom of Saudi Arabia are in the trade and construction sectors, followed by around 10% in manufacturing

(Martin Jaouni, 2022). Statistics showed that the SME sector contributes to around 30% of the Gross Domestic Product (GDP) in the Kingdom of Saudi Arabia.

The Saudi Arabia SME sector, which has been put in line with goals outlined in Vision 2030, continues to diversify Saudi Arabia's economy, which has been dependent on oil for several decades. Furthermore, the number of SMEs under Vision 2030 grew from 447,000 in 2015 to 614,000 in 2020 (Narayanan, 2023).

Small and Medium Sized enterprises (SMEs) play a host of tasks and functions, which are critical contributors to the modern economies of most countries (Bagale et al., 2021). It is the main reason why Saudi Arabia has put on several strategies to make strides to ensure the growth of SMEs. The government seeks to support SMEs by improving the economic environment and seeking ways to increase its contribution to GDP, diversify sources of income, as well as expand the production base to meet government goals and functions. The Saudi Arabian government has been actively supporting the growth of SMEs in the country through several initiatives and programs, including the establishment of the Small and Medium Sized Enterprises General Authority (Monshaat) in 2015, which was formed to promote the development of SMEs and provide them with financial and non-financial support.

Even during the COVID-19 pandemic, when SME operations all over the world were disrupted, the Saudi Arabian government offered support that has been instrumental in helping SMEs get back on their feet. These support measures are part of an effort to increase the contribution of the SME sector to the GDP. Saudi Arabia has a goal to raise the contributions to 35% of GDP by 2030 (Nova, 2022). In addition, Saudi

Arabia has implemented regulatory reforms to make it easier for SMEs to conduct their business. The latest survey on Saudi Arabian SMEs established that the government has reduced the time and cost of starting a business and simplified the process of obtaining permits and licenses. Despite these efforts, SMEs continue to face many internal and external challenges that not only threaten their growth but also their existence. Nevertheless, with continued support, the government believes that this policy can help support the growth of SMEs in the country.

### **1.2.2 The Impacts of COVID-19 on SMEs in Saudi Arabia**

The COVID-19 pandemic spread rapidly across the world, including Saudi Arabia, leaving a significant impact on SMEs in Saudi Arabia. SMEs in the country have faced internal and external challenges, including reduced demand, personnel, markets, supply chain disruptions, as well as policy and cash flow issues.

According to Nurunnabi, the operating income fell sharply, operating costs rose significantly, while operating profits shrank for many SMEs operating in Saudi Arabia (Nurunnabi et al., 2020). Sources of funds to finance SMEs' operations were also affected severely by the pandemic, which greatly impacted the financial status of SMEs.

The pandemic has had a relatively large negative impact on the market, which, on the other hand, affected the performance of SMEs in Saudi Arabia. The pandemic severely influenced the market supply, market demand and commodity prices. The decrease in supply caused by COVID-19 in Saudi Arabia was mainly due to the uncertain supply of products, transportation channels and slow logistic speed. Due to difficulties in the

supply chain and low demand in the market caused by the pandemic in Saudi Arabia, SMEs performed poorly (Marmore Team, 2021). Furthermore, the pandemic largely affected personnel mobility in SMEs and reduced working hours. SMEs in Saudi Arabia lost a large number of employees due to hard economic times caused by the COVID-19 pandemic, which has exacerbated the decline in the labour market, causing direct and indirect disruptions to various departments within small and medium-sized enterprises (SMEs). As a result, the number of employees in SMEs has been negatively impacted, impeding the recovery of the production and processing service chain and hindering the overall economic recovery of these businesses (Alhawal et al., 2020).

The COVID-19 pandemic outbreak caused many SMEs in The Kingdom of Saudi Arabia (KSA) to close, leading to unprecedented disruption of commerce in most industry sectors. Saudi Arabia (SA) has suffered two shocks from the spread of COVID-19. Government policy has responded to these two developments. The main measures taken by The Kingdom of Saudi Arabia government are as follows:

- i. On March 20, 2020, it announced a private sector support plan of 70 billion riyals (18.7 billion US dollars, or 2.7% of GDP): postponing the payment of government taxes, fees and other fees to provide liquidity to the private sector besides increasing available funds through the National Development Fund.
- ii. The Kingdom of Saudi Arabia Monetary Authority lowered its policy interest rate twice in March 2020, reducing repo interest rates by 1.25 points and 0.5% to 1%, respectively.

### 1.3 Problem Statement

The COVID-19 pandemic significantly impacted social activities as well as political and economic consequences worldwide. Its spread led to a massive shutdown of businesses. The pandemic also caused huge disruptions among SMEs in Saudi Arabia, mass layoffs, financial crises, low sales, employee health concerns and loss of consumer confidence (Monshaat, 2020). The businesses affected more by the COVID-19 pandemic are explicitly small and medium enterprises (SMEs). This effect forced SMEs to change their business models and adapt to this changing environment, where the service industry of SMEs has taken the most hit.

Internal and external challenges facing by the SMEs in Saudi Arabia include the forced shutdown of businesses. Internal challenges faced by Saudi Arabia are related to external challenges. An example of an external challenge is regulation by the government, which implemented the movement control order (MCO) in Saudi due to COVID-19, which aims to reduce the spread of COVID-19. People were asked to stay home, shops and businesses were requested to remain temporarily closed, as well as operations and construction projects were paused.

Many SMEs were unprepared for remote work, which resulted in decreased productivity. Hence, it affected them as they faced internal challenges in business operations. The temporarily closed operation affected the sales of the business. SMEs also tried online sales or marketing, but it was difficult to transition to online sales as limited support is available from online vendors (Mohammad, 2020). Thus, it disrupted the supply chain and reduced demand, which led to cash flow problems.

Consequently, SMEs struggled to pay bills, repay their loans and even stay in business due to a lack of proper cash flow.

SME businesses across Saudi Arabia were shut down due to insufficient working capital and a lack of sales. Mass layoffs, financial crises, lower supply and demand, employee health issues and a decline in customer confidence were among the significant disruptions brought on by the pandemic in Saudi Arabia's SMEs. Small and medium-sized businesses (SMEs), which often have constrained resources, few staff and restricted cash flow, were especially susceptible to the pandemic's detrimental effects. For instance, many SMEs face serious financial challenges.

To reduce the difficulty of SMEs impacted by COVID-19, several actions were taken by the government of the Kingdom of Saudi Arabia. The loan guarantee program provides low interest to fund development projects in the health, tourism, real estate and education sectors with a more significant economic impact to ensure their sustainability (Project Support Fund, 2020). Furthermore, the Saudi Arabian government announced a private-sector financing support program worth approximately 50 billion riyals (13.3 million US dollars). It is a private sector stimulus plan for SMEs to provide funds for financing and strengthen business operations to ensure that SMEs can sustain and continuously contribute to Saudi's economy. Hence, it is crucial to identify the impact of COVID-19 on SMEs' performance in considering the business support from the government of Saudi Arabia.

## **1.4 Research Objective**

This research aims to understand the impact of COVID-19 among SMEs in Saudi Arabia. Hence, the specific objectives are as below:

- i. To examine the relationship between SMEs' internal challenges and financial performance.
- ii. To examine the relationship between SMEs' external challenges and financial performance.
- iii. To examine the moderating effect of business support relationship among SMEs' challenges (internal and external) and financial performance.

## **1.5 Research Question**

The research questions were developed from research objectives to examine their interrelation among the variables of the research study as follows: -

- 1) Is there any the relationship between internal challenges and SMEs' financial performance?
- 2) Is there any the relationship between external challenges and SMEs' financial performance?
  - 3a) How does business support affect the relationship between SMEs' internal challenges and financial performance?
  - 3b) How does business support affect the relationship between SMEs' external challenges and financial performance?

## **1.6 Significance of Study**

The COVID-19 pandemic has caused unprecedented impacts economy on worldwide, and SMEs in Saudi Arabia are no exception. The findings of this thesis may be valuable to the following interest groups.

1. The study findings will contribute to the SME literature by explaining the impacts of the COVID-19 Pandemic, specifically enriching the empirical evidence from the Kingdom of Saudi Arabia. It will help fill the gap in the current knowledge and provide a better understanding of the challenges and opportunities faced by SMEs during the pandemic.
2. The study findings will help SMEs in Saudi Arabia understand the challenges and opportunities presented by the pandemic by helping them identify strategies that can be used to survive and thrive in the current environment. The study will provide valuable information that SMEs can use to make informed business decisions.
3. The Saudi Arabian government can learn innovative approaches to resolving the internal and external issues faced by SMEs in financial performance and contribute to the government's objective of SMEs contributing 20% to 30% of GDP. This research study will benefit the Kingdom of Saudi Arabia government's Vision 2030 objectives for SMEs and SME management in addressing issues coming from internal or external obstacles.
4. The study findings will provide insights to be used in policy decisions and actions aimed at supporting SMEs in Saudi Arabia during and after the pandemic. Policymakers can use the findings to design appropriate interventions to mitigate the negative impacts of the pandemic on SMEs.

## **1.7 Definitions**

SMEs: Small and Medium Enterprises are characterised by the number of employees and annual income they generate. Businesses with 1-5 employees and 0-3 million SR annual revenues are classified as micro businesses; small businesses with 6-49 employees and 3-40 million SR annual revenues are classified as small enterprises, whereas medium businesses with 50-249 employees and 40-200 million SR annual revenues are classified as medium enterprises.

Internal challenges: They are constraints and barrier factors within the SMEs. According to Naradda Gamage et al. (2020), they refer to the difficulties and obstacles facing a business within its organisation or operations.

External challenges: According to Adam and Alarifi (Adam et al., 2021), external challenges refer to the difficulties and obstacles that an SME faces outside its organisation or operations. These challenges arise from various factors, including government regulations and policies, economic downturns and limited financing options.

Business support: Refers to a range of services, resources and support provided to businesses to help them succeed, grow and overcome challenges (Johnsonv et al., 2020).

## **1.8 Thesis Organisation**

This thesis has five main chapters, each of which logically discusses different topics. The first chapter, the introduction, presents the background and rationale of the study problem statement as the rationale for the study. It also consists of primary guidelines like the problem statement, research objectives, questions, significance of the study and definition of terms. The second chapter discusses the thesis as a comprehensive review of the relevant literature on theory and variables relating to SMEs and the COVID-19 pandemic. The literature review concludes with a theoretical framework based on the literature. The third chapter presents the research methodology, including research methods, strategy, research technique, method of data collection, research design, questionnaire design, analysis type, statistical tools for analysis, pilot study

and procedure to collect data from respondents. Chapter 4 presents the findings of this study based on the research questions and the objectives of this study. The final chapter draws the conclusion and recommendations. It provides a summary of the key findings, a response to the research questions, a conclusion of the thesis, its implications, limitations and suggestions for future research.

## **1.9 Chapter Summary**

This chapter is divided into several distinct sections. The first section discussed the background and the rationale of the study relating to the impacts of the COVID-19 pandemic on SMEs. The second section outlined the research problem / the gap addressed in this thesis, dealing with external and internal challenges to SMEs' financial performance. Research objectives and research questions make up the third division in this thesis. The fourth section discussed the significance of this study and the contributions of research findings. The last section highlighted the definitions of terms and concepts used in this study.

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