

Effect of Equity on Financial Performance among Small Business Firms in East Africa Countries

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Abstract: Small business firms are an essential force of the financial system and the catalyst of the economic development not only for developed countries but also contribute to the developing countries. This study determined the effect of equity on financial performance among small business firms in East Africa Countries (EAC). The study adopted a panel data research design and cross-sectional survey research design where by secondary data were used. The population applied on the financial records of the 2,868 from 2016/17 - 2018/19 financial years (Annual Data). The sample size of the study was 828 observations from 296 small business firms registered as manufacturing service. Dar es Salaam, Arusha, Mwanza, Mbeya, Morogoro and Dodoma Regions were purposively sampled to be used as research locations of this study. Random sampling procedure was used to select small business firms registered as manufacturing service for all 6 Regions. The data collected from different reliable sources which included the Small Industries Development Organization (SIDO) and Business Registrations and Licensing Agency (BRELA). Results revealed that, the equity had statistically negative influence on the financial performance among small business firms of EAC in terms of Return on Capital Employed (ROCE) and Return on Equity (ROE) with P- Values -0.001 and -0.14 respectively and a significant positive influence on the financial performance of small and business firms of EAC in terms of Return on Assets (ROA) with P- Value 0.001. The study recommends small business firms to consider the essential determinants like size of the business which influence the financial performance among small business firms and minimize liquidation risk.

Keywords: Equity, Financial Performance, Small Business Firms, East Africa Countries, Tanzania

I. INTRODUCTION

Small Business Firms (SBFs) is crucial strength to support economic development for both developed countries and developing countries. Small business firms contribute 70% of jobs on average in East Africa Countries [9]. SBFs enhance the effectiveness of equal distribution of services in nations [7]. Therefore, accepting the enhancement of equity can increase effectiveness of SBFs that is necessary to inform the strategy interaction needed for the expansion and sustainability of the SBFs. Globally, previous studies indicate that equity on financial performance of SBFs have created in various findings. According to [2, 12] revealed that in European Countries there is indirect relationship between equity and financial performance in SBFs which are developed by credit risk. Since SBFs achieve weak presently since a high level of SBFs owners have no information concerning the good source of finance and how equity can influence their financial performance. This has caused various discussions on the educational ground about equity in SBFs since it affects the effectiveness and financial performance of the SBFs [13].

Empirical evidence from Europe Union (EU) revealed that there is a positive association between equity and the financial performance of SBFs [3, 5, 11]. Weak SBFs cause poor financial performance that added questions than reply to practitioners and scholars because the financial performance of SBFs has been decline, as well as Tanzania [7]. Empirical evidence shows that the financial assets are needed for the SBFs development [4]. This is the basis that the SBFs plans of the United Republic of Tanzania (2018) agree to help SBFs access service in financial institutions, support better access of SBFs to the bank financing, and increase original financial organizations for financing SBFs. Additionally, financial performance of SBFs enhancing the competitive economy, which is one of agenda in Tanzania national development vision of 2025 [6]. A suitable equity is crucial not only to maximize return to different firms but also because of the effect on the SBFs financial performance and its capability to achieve a competitive advantage [1]. The real representation of SBFs process in Tanzania is not well been fully addressed in describe the effect of the equity and essential implication on the development of SBFs [10]. Previous studies is a focused on listed and single sectors, such as restaurants, hotel, transport, retail, food industry and wholesale and not service sectors [15]. This study intends to find out the effect of equity on financial performance among small business firms in East Africa Countries (EAC).

II. LITERATURE REVIEWS

According to [8] found that worth financing has more favorable and association result on business financial performance for the SBFs. Previous study showed that equity financing alternative has the effect of the financial performance of micro and small firms. Nevertheless, the study did not observe the ROE and ROCE as measure of financial performance. According to [14] revealed that in United State (US) the SBFs are growing quickly and hence increase profit and increasing assets. They center themselves to give sustain during the process of equity development. Capital formation is very vital for SBFs in creation profitability and attaining financial balance [8].

Previous study in China found that subsistence of indirect association between the increase of assets and goes down profitability of the firms [15]. Empirical evidence revealed that equity to deposit created negative effect on ROA and ROE [8, 13]. According to [11] found that there is positive relationship between expansion of assets in equity, ROA and ROE. The major significant connection existed between the expansion of equity and ROE. Consequently, the profitability of enterprises was indirect influenced by equity in Cambodia since of the both positive and negative on ROA and ROE [12]. Empirical evidence shows that there is positive reliance of short obligation to equity in all acquiring per share, profit for resources, and return on value in India [7]. Away from positive and negative associations consider the improvement of resources is accounted for to meet positive association with return on resources, acquiring per share and return of value. This means that when there is short -term debt, there is goes up the profitability and the capital of the enterprises than the long term debt [4].

According to [9] observed that the financial performance of SBFs in developing Countries has negative effects with equity. Therefore can cause a different doughty concerning the contribution of equity to the improvement of SBFs. Empirical evidence revealed that there is subsistence of boosting the equity on SBFs financial performance [2, 5, 9]. Consequently, there is combination of results on the effect and contribution of equity to the SBFs financial performance. Previous studies shows that at least 75% of the SBFs used equity in financing their businesses [2]. Empirical evidence shows that the equity of SBFs in Tanzania is greatly financed by own equity due to the problems of access to financial leverage from the financial institutions. Opposing to this circumstance in Tanzania, the empirical evidence shows that SBFs in Uganda and Kenya protected more financial leverage for financing their businesses contrasted to Tanzania [2, 6, 9].

III. RESEARCH METHODOLOGY

The study adopted quantitative research approach since involved equity and financial performance from a Dar es Salaam, Arusha, Mwanza, Mbeya, Morogoro and Dodoma Regions. This study adopted panel data research design and cross - sectional survey research design where by secondary data were used. The population applied on the financial records of the 2,868 small business firms registered as manufacturing service from 2016/17 - 2018/19 financial years (Annual Data). The sample size of the study was 828 observations from 296 small business firms registered as manufacturing service; Yamanne (1967) formula was used to calculate the sample size of the study. Dar es Salaam, Arusha, Mwanza, Mbeya, Morogoro and Dodoma Regions were purposively sampled to be used as research locations of this study. Random sampling procedure was used to select sample size of small business firms registered as manufacturing service for all 6 Regions. the reason for selecting 6 regions as study areas is due to the fact that the 6 regions has many businesses opportunities and large growing regions of Tanzania in term of population compared to other regions in Tanzania. The data collected from various reliable sources which included the Small Industries Development Organization (SIDO) and Business Registrations and Licensing Agency (BRELA).

Econometric Model Development: Multiple Linear Regression Model (MLRM) was used to determine the effect of equity on financial performance among small business firms in EAC. The reason of choosing the multiple linear regression model is due to the reality that the dependent variable of the study is *“continuous in nature”* therefore, the multiple linear regression model is appropriate for this study. The equations of the study shown as follows:

$$ROE = \beta_0 + \beta_1 X_1 + \beta_{ln} X_{ln} + \varepsilon \dots \dots \dots (i)$$

Whereby, $ROE =$ Return on Equity, $X_1 =$ Equity, $X_{ln} =$ Controllable Variable (Size of the Business), $\varepsilon =$ ErrorTerm, $\beta_0 =$ Constant term

$$ROCE = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_{ln} X_{ln} + \varepsilon \dots \dots \dots (ii)$$

Whereby, $ROCE =$ Return on Capital Employed, $X_1 =$ Equity, $X_{ln} =$ Controllable Variable (Size of the Business), $\varepsilon =$ ErrorTerm, $\beta_0 =$ Constant term

$$ROA = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_{ln} X_{ln} + \varepsilon \dots \dots \dots (iii)$$

Whereby, $ROA =$ Return on Assets, $X_1 =$ Equity, $X_{ln} =$ Controllable Variable (Size of the Business), $\varepsilon =$ ErrorTerm, $\beta_0 =$ Constant term

IV. RESULTS AND DISCUSSION

The parameter tests like multicollinearity test through Variance Inflation Factor (VIF), Hausman test, and Breusch, and Pagan Lagrangian multiplier for selection of fixed or random effect model to use. in conclusion, regression analysis was done to show the effects of independent variables on dependent variable. Was carrying out to find the results of the study

A. Effect of Equity on Financial performance of SBFs in Term of ROE Multicollinearity

Table 1 explains the result for the multicollinearity test which was used to evaluate whether the independent variables integrated in the model influence one another [9]. The result portrayed that the independent variable influence one another since the mean variance inflation factor VIF 4.14 was greater than 2. The rule of thumb is that if the variance inflation factor is greater than 10, the model is

suffering with multicollinearity problem since the mean variance inflation factor VIF was less than 10. This implies that the model did not suffer with multicollinearity problem [3].

Table 1: Test for Multicollinearity (Variance Inflation Factor)

Variable	VIF	1/VIF
Business Size	5.84	0.171315
Equity	2.43	0.411166
Mean VIF	4.14	

Source: STATA, 2021

Hausman Test for choosing between fixed effect and random effect model before employing the fixed effect model or the random effect model, the hausman test for fixed versus random effect model was done to know which model is appropriate for estimating the impact of equity on performance SMEs when the measure of performance was return on equity (ROE). The P- Value > 0.05 random effect model was used as suitable gauge to evaluate the equity on financial performance by ROE.

Table 2: Assortment between Fixed Effect Model and Random Effect Model

Variable	Coefficient		Difference	Standard Error
	b	B	b-B	sqrt(diag(V_b-V_B))
	Fixed	Random		S.E.
Equity	-0.154084	-0.1397227	-0.0143613	0.0481391
Business size	-1.763673	-4.41076	2.647087	5.256864

$$\chi^2(5) = (b-B)'[(V_b-V_B)^{-1}](b-B) = 3.13$$

$$\text{Prob} > \chi^2 = 0.6799$$

Source: STATA, 2021

B. Breusch and Pagan Lagrangian Multiplier Test for Fixed Effects

Because the P-Value is 0.0001 from Table 3 was less than 0.05. This implies that the null hypothesis was rejected and the alternative hypothesis was accepted. Thus, there is significance difference across units (i.e. there is panel effect). Since P- Value < 0.05, the fixed effect model is suitable for determining the effect of equity on the financial performance of SBFs by ROE in East Africa community and not the ordinary regression analysis.

Table 3: Breusch and Pagan Lagrangian Multiplier Test for Random Effects

Variable	Var	Sd= sqrt(Var)
ROE	5.90065	2.429125
Equity	4.770106	2.184057
Size of the Business	0.7579847	0.8706232

$$\text{Test: Var}(u) = 0$$

$$\chi^2(01) = 14.67$$

$$\text{Prob} > \chi^2 = 0.0001$$

$$\text{ROE} [id, t] = Xb + u [id] + e [id, t]$$

Source: STATA, 2021

C. Effects of Equity on the Financial Performance of SBFs in Terms of ROA

Hausman Test for Selection between Fixed Effect and Random Effect Model Before employing the fixed effect model or the random effect model, the Hausman test for fixed versus random effect model was done to know which model is appropriate for estimating the impact of equity on performance SMEs when the measure of performance was return on assets (ROA). The result in Table 4 indicates that the fixed effect model was employed since the P- Value < 0.05.

Table 4: Assortment between Fixed Effect Model and Random Effect Model

Variable	Coefficient		Difference		Standard Error
	b	B	b-B		sqrt(diag (V_b-V_B))
	Fixed	Random			S.E.
Equity	0.1448222	0.2058408	-0.0610186		0.0164827
Business size	-14.39962	-10.92401	-3.475607		1.770428

$$\text{chi2 (5)} = (\text{b-B})'[(\text{V}_b - \text{V}_B)^{-1}] (\text{b-B}) = 18.44$$

$$\text{Prob} > \text{chi2} = 0.0024$$

Source: STATA, 2021

D. Breusch and Pagan Lagrangian Multiplier Test for Fixed Effects

Because the P-Value (0.0001) in Table 5 was less than 0.05. This implies that the null hypothesis was rejected and the alternative hypothesis was accepted. Thus, there is significant difference across units (i.e. there is panel effect). Because the P- Value < 0.05, fixed effect model is fitting for determining the effect of equity on the financial performance of SBFs by ROA in East Africa community and not the ordinal regression analysis.

Table 5: Breusch and Pagan Lagrangian Multiplier Test for Fixed Effects

Variable	Var	Sd= sqrt (Var)
ROA	5.189855	2.278125
Equity	0.7271315	0.8527201
Size of the Business	0.4878505	0.698463

$$\text{Test: Var (u)} = 0$$

$$\text{chibar2 (01)} = 125.18$$

$$\text{Prob} > \text{chibar2} = 0.0000$$

$$\text{ROE [id, t]} = \text{Xb} + \text{u [id]} + \text{e [id, t]}$$

Source: STATA, 2021

E. Impact of Equity on the Performance of SMEs in Terms of ROCE

Hausman Test for Selection between Fixed Effect and Random Effect Model Before employing the fixed effect model or the random effect model, the Hausman test for fixed versus random effect model was performed to know which model is appropriate for estimating the impact of equity on performance of SMEs when the measure of performance was return on capital employed (ROCE). The results in Table 6 show that the fixed effect model was employed since the P- Value <0.05.

Table 6 : Assortment between Fixed Effect and Random Effect Model

Variable	Coefficient		Difference		Standard error
	b	B	b-B		sqrt(diag(V_b-V_B))
	Fixed	Random			S.E.
Long term loan	-0.0503698	-0.0497371	-0.0006326		0.0041361
Business size	-3.993848	-2.818602	-1.175247		0.4313532

$$\text{Chi2 (5)} = (\text{b-B})'[(\text{V}_b - \text{V}_B)^{-1}] (\text{b-B}) = 62.79 ; \text{Prob} > \text{chi2} = 0.0000$$

Source: STATA, 2021

F. Breusch and Pagan Lagrangian Multiplier Test for Fixed Effects

Since the P-value (0.0001) in Table 7 was less than 0.05. This implies that the null hypothesis was rejected and the alternative hypothesis was accepted. Thus, there is a significant difference across the units (i.e. there is panel effect). Since $p < 0.05$, there is fixed effect model and the model is appropriate for assessing the impact of equity on the performance of SMEs (ROCE) in Tanzania and not the ordinal regression analysis.

Table 7: Breusch and Pagan Lagrangian Multiplier Test for Fixed Effects

Variable	Var	Sd= sqrt(Var)
ROCE	0.723367	0.8505099
E	0.1333956	0.3652336
U	0.5453439	0.738474

Test: Var (u) = 0; chibar2 (01) = 488.48; Prob> chibar2 = 0.0001

ROE [id, t] = Xb + u [id] + e [id, t]

Source: STATA, Output (2020)

G. Regression Analysis for Random Effect and Fixed Effect Model

Random Effect Model on Financial performance of SBFs in Term of ROE Random effect model was used to determine the effect of equity on the financial performance by ROE of SBFs in East Africa Community. Result in Table 8 shows that independent variables included in the model were good performance in term of ROE of SBFs. 7.1% of deviation of financial performance ROE of SBFs for overall were explained by the independent variable included in the model. Results further showed that indicated variable included in the model collectively had a significant influence on the financial performance in term of ROE of SMEs (P - Value < 0.001). The forecaster variable (business size) did not significantly influence financial performance in term of ROE for SBFs in the study area while the forecaster variable significantly influenced financial performance in term of ROE for SBFs. Equity statistically significance (P - Value < 0.001 and had a negative influence on financial performance in term of ROE for SBFs with regression coefficient of -0.14. This implies that each percentage increase in equity decreases the performance (ROE) of SMEs by 0.14 percentages. This implies that own capital has adverse effect on the financial performance of SBFs. The results agree with [15] those who found out that equity creates negative impact on ROA ROE. Nevertheless, these findings differ from [4, 8] who found that equity financing has more positive effect on financial performance for the business.

Table 8: Regression Results (Random Effect Model)

ROE	Coef.	St. Err.	T-value	P-value	[95% Conf Interval]	Sig
Equity	-.14	.029	-4.78	0	-.197 - .082	***
Business Size	-4.411	3.413	-1.29	.196	-11.101 2.28	
Constant	9.161	5.719	1.60	.109	-2.049 20.37	
Mean dependent var		1.339	SD dependent var		2.429	
Overall r-squared		0.071	Number of obs		808.000	
Chi-square		53.160	Prob> chi2		0.000	
R-squared within		0.028	R-squared between		0.126	

*** P- Value <.01, ** P- Value<.05, * P- Value<.1 Note the robust standard errors estimate were obtained in order to deal with heteroskedasticity and autocorrelation.

Source: STATA, 2021

H. Fixed Effect Model on Financial Performance of SBFs In Term of ROA.

Fixed effect model was used to determine the influence of long-term debt on the financial performance in ROA of SBFs in Tanzania. The result in Table 9 shows that explanatory variable included in the model were good financial performance in ROA of SBFs. 44.2% of deviations of financial performance in ROA of SBFs were explained by the independent variable included in the model. These results further showed that independent variable included in the model collectively had a significant influence on the financial performance in ROA of (F = 85.804, P- Value < 0.001). The forecaster variable (size of the business) did not significantly influenced financial performance in ROA of SBFs in the study areas while the forecaster variable significantly influenced financial performance in ROA of SBFs. Equity statistically significance (P- Value < 0.001) and had a positive influence on financial performance in ROA

of SBFs with regression coefficient of 0.145. This implies that each percentage increase in equity increase the financial performance in ROA of SBFs by 0.147 percentages. Thus, equity financing has more positive effects as the owners of SBFs contribute and monitor funds denoted for their business. The findings concur with those of [9] who found out that equity financing has more positive effect on business performance for the business and organization. Furthermore, the findings are reliable with [17] who found out that, in most developed countries, the SBFs sector is growing faster and make more profit because of their assets growth through equity financing. Size of the business statistically ($P - Value < 0.05$) influenced the financial performance in ROA of SBFs and had a coefficient of -2.86 implying that, for each percent increase in size of the financial performance in ROA of SBFs decreased by 2.86%. Business size statistically significance ($P - Value < 0.001$) and had a negative influence on financial performance in ROA of SBFs with regression coefficient of -14.4. This implies that each percentage increase in business size decrease the financial performance in ROA of SBFs by 14.4 %.

Table 9: Regression Results (Fixed Effect Model)

ROA	Coef.	St.Err.	T-value	P-value	[95% Conf	Interval]	Sig
Equity	0.145	.022	6.61	0	.102	.188	***
Business Size	-14.4	2.426	-5.94	0	-19.165	-9.634	***
Constant	18.203	4.644	3.92	0	9.08	27.326	***
Mean dependent var		1.836	SD dependent var			2.278	
R-squared		0.442	Number of obs			823.000	
F-test		85.804	Prob> F			0.000	
Akaike crit. (AIC)		1741.567	Bayesian crit. (BIC)			1769.844	

*** $p < .01$, ** $p < .05$, * $p < .1$ Note the robust standard errors estimate were obtained in order to deal with heteroskedasticity and autocorrelation.

Source: STATA, 2021

I. Fixed Effect Model on Financial Performance Of SBFs in Term Of ROCE

Fixed effect model was used to determine the effect of equity on the performance in ROCE of SBFs in East Africa Community. Result in Table 10 show that explanatory variable included in the model were good financial performance in ROCE of SBFs. 12.9% of deviations of financial performance in ROCE of SBFs was discussed by the independent variable included in the model. The results further showed that independent variable included in the model collectively had a significant influence on the financial performance in ROCE of (F = 16.038, P - Value < 0.001). The forecaster variable (size of business) did not significantly influence financial performance in ROCE of SBFs in the study area. On the other hand, the forecaster variable significantly influenced financial performance in ROCE of SBFs. Equity statistically significance (P- Value < 0.001) and had a negative influence on financial performance in ROCE of SBFs with regression coefficient of -0.05. This implies that each percentage increase in equity decreases the financial performance in ROCE of SBFs by 0.05 %. This implies that a negative correlation exists between equity and SBFs financial performance. The findings are consistent with [13] who found that equity negatively impacted the return on equity. Nevertheless, the findings are contrary to [9] who found out that there was a positive relationship among growth in assets, growth in equity and ROA and ROE. Business size was statistically significant (P- Value < 0.001) and had a negative influence on financial performance in ROCE of SBFs with regression coefficient of -3.994. This implies that each percentage increase in business size increases the financial performance in ROCE of SBFs by 3.994%.

Table 10: Regression Results (Fixed Effect Model)

ROCE	Coef.	St.Err.	T- value	P- Value	[95% Conf	Interval]	Sig
Equity	-.05	.009	-5.37	0	-.069	-.032	***
Business Size	-3.994	1.039	-3.84	0	-6.035	-1.953	***
Constant	-.545	1.989	-0.27	.784	-4.452	3.363	
Mean dependent var		1.223	SD dependent var			0.851	
R-squared		0.129	Number of obs			823.000	
F-test		16.038	Prob> F			0.000	
Akaike crit. (AIC)		345.933	Bayesian crit. (BIC)			374.211	

*** P- Value <.01, ** P- Value <.05, * p<.1. Note the robust standard errors estimates were obtained in order to deal with heteroskedasticity and autocorrelation.

Source: STATA, 2021

CONCLUSION

Findings indicates that equity had statistically negative influence on the financial performance among small business firms of EAC in terms of ROCE and ROE stick a significant positive influence on the financial performance of small and business firms of EAC in terms of ROA. These findings supported by different scholars who wind up by said that the equity had statistically negative influence on the financial performance among small business firms [3, 6, 13]. The study recommends small business firms to consider the essential determinant like size of the business, which influence the financial performance SBFs and minimize liquidation risk.

The researcher suggests that the future researchers to expand the trend of years, this study were limited due to 3 years involved in the study which is very small. Also to expand the study area in order to get the best picture of the results.

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