

# Review of: "Determinants of Internal Financing: Small and Medium Enterprises in Pakistan"

Tong Jiao<sup>1</sup>

<sup>1</sup> The Robert Gordon University

**Potential competing interests:** No potential competing interests to declare.

## General comments:

1. The author should try to find a native speaker to proofread this draft as there are many language problems. Due to the time constraints, I won't be able to correct each of them.
2. The writing could be more concise and structured; there are a lot of repetitions.
3. Make sure that proper citations will be given to information obtained from other sources. Here is just an example. In paragraph 2 on page 3, the statistics on SMEs' access to external finance are obviously obtained from other sources, but no citation was given.

## Abstract:

1. The structure of the abstract could be improved. The author could first briefly explain the dilemma between using retained earnings for investment and using earnings to pay dividends to shareholders. Then, he/she can describe the sample and estimation methods. Next, move on to the main empirical findings. Finally, discuss the implications of the findings, e.g., do they support/reject certain predictions from corporate finance theories.
2. The description of the sample is not clear. For example, are the sample firms listed firms? If not, where/how did the author manage to get private companies' data?
3. The "PLS" techniques should be rephrased as "panel data" techniques.

## Section 1:

1. This section could be titled "Introduction."
2. The first three paragraphs could be merged and then shortened. Yes, it is important to let readers know the importance of SMEs in the economy, particularly in emerging markets. However, this is obviously not the focus of this article. The author should control the word count on background information.
3. Similarly, paragraphs 4-5 could be merged and then shortened. The writing should focus on explaining that SMEs face the challenges of getting external finance.
4. In the "Introduction," the author should briefly talk about the key findings and contributions of this article.
5. The last paragraph has some language issues. For example, it is not clear to me what "factors of internal equities" mean.

**Section 2:**

1. The section title could be titled as “Literature Review.”
2. The literature lacks focus. It should focus on, as indicated by the title of this article, the relationship between firm size and the use of internal equity/retained earnings as the main source of finance. There is very little discussion about this relationship in the first two paragraphs; the author merely mentioned some old capital structure theories and some of the implications from these theories on firms’ use of debt financing.
3. Need to include more up-to-date literature; most of the studies mentioned here are more than 30 years old.
4. The writing could be more concise and better structured.
5. There are some language problems. For example, the term “factors of enhancement in internal equities” is confusing. Is it the same as “determinants of internal financing”?
6. More empirical studies could have been reviewed to identify the gap in the empirical literature to justify the aim of this study.

**Section 3:**

1. The title could be titled as “Research Methodology.”
2. The equations should be properly labelled. E.g., Eq. 1, Eq. 2 .....
3. The definition for  $SURPLUS_t$  is problematic. The correct way to calculate retained earnings (RE) should be:  $RE_t = RE_{t-1} + \text{net earnings}_t - \text{dividend}_t$ . The author’s definition double-counts the  $RE_{t-1}$  and inflates the accumulated internal financial resources (i.e., the so-called “internal equities”) that could potentially be used for investment.
4. Need to explain further why the size of a firm (TOTAST), internal equities (SURPLUS), and payment of bonus shares (BNUS) are jointly determined.
5. Figure 1 is not informative. The connections between the items included in the figure are not always clear.
6. The author needs to justify the regression models on page 6 and page 7. With reference to relevant literature, explain why independent variables affect the dependent variables (i.e., construct research hypotheses). For example, model 2) contains a variable measuring the intangible assets; the author needs to explain why the value of intangible assets might be correlated to the amount of bonus shares/stock dividend. In addition, some of the variables included in these models should be scaled to avoid heteroskedasticity, e.g., intangible assets and fixed assets could be scaled by total assets. The result from the Breusch–Pagan test shows the regression models suffer from heteroskedasticity.
7. The writing could be more concise and better structured. For example, in paragraph 3 on page 7, there is no need to redefine some of the regression variables such as SURPLUS, BNUS, TOTAST because they have already been defined before.
8. The writing of paragraph 4 on page 7 lacks clarity. For example, the author wrote that “the positive effects of total assets (TOTAST) and paid-up capital (PAIDUP) imply that large-size companies are more likely to expand their business through internal financing”. This explanation of expected results is inappropriate as PAIDUP and TOTAST are both independent variables and TOTAST measures company size. Similarly, the author indicated that the annual amortisation of intangible assets may decrease earnings; therefore, INTNGBL is included as an independent variable

in equation 1. However, the annual depreciation charge on tangible fixed assets will have the same impact on earnings. Why FXDAST is included in equation 2 not equation 1.

9. On page 8, there are still some repetitions of definitions for variables e.g., DVDND RTNR and INTNGBLE. Also, SMEs is introduced as a measure of company size. Why another proxy for company size is required here given that TOTAST is also a proxy for size? Furthermore, ICT, SRV, INFLCPI, DCPS, CRPTN, and LAW are not defined in writing; nor are they included in the three models shown on page 8. Why are they needed, and what are the expected coefficients on these variables?
10. What is the purpose of presenting the equations at the beginning of page 9?
11. More detailed sample description and selection criteria could have been provided (paragraph 1 & 2 on page 9). For example, where did the author get the annual reports of sample companies? (E.g., from company websites or from the stock exchange). What are the rules for dropping outliers from the sample? In addition, the author did not explain where he gets the data for the 116 SMEs included in his sample and how they are selected. Finally, it is not clear how the author fixed the data problems mentioned towards the end of paragraph 2 on page 9 (e.g., current assets + fixed assets > total assets).
12. More statistics could be presented in table 2 (e.g., N, number of observations). Also, some of the variables presented here are not discussed in the methodology or included in the regression models, e.g., current assets, payables, and leverage ratio. Also, tables that contain statistical results should be self-contained (i.e., the definitions of all the variables and brief descriptions of the statistical methods used should be provided at the bottom of each table). Table 3 should be moved to the earlier part of the methodology where the author defined all the variables, e.g., page 8 or 9. Also, before running the regression, the author could produce a correlation matrix first so that potential multicollinearity could be identified.
13. The presentation of the regression output is unprofessional. The author needs to check how published journal articles (those with decent rankings) present the regression output.
14. The regression results are dubious. For example, the cross-section numbers reported in the tables are much lower than the number of firms described in table 1 ( $398+116 = 514$ ). Also, in the methodology, the author indicates that SURPLUS and BNUS and PAYOUT are determined jointly. Therefore, the three equations using them as dependent variables should be run as simultaneous equations. But the results presented by the author suggest that each of the three models was run separately. Furthermore, the regression models that are actually run by the author are different from those discussed in the methodology. For example, the leverage ratio and the interaction variables between SME, ICT, and SRV dummies were not mentioned in the methodology.
15. The interpretation of the regression results is poor. Little effort to discuss the economic and statistical significance of the results; and, no attempt to interpret the results in the context of theories and the results obtained by previous empirical studies.

## Section 5

1. This section should be titled "Conclusion."
2. The structure of this section is inappropriate. It is not clear what the intended purpose is for writing the first three

paragraphs. In the conclusion, the author should first summarise the key findings of the study, then discuss their academic, practical, and policy implications, and finally discuss the potential limitations of the study and directions for future research. Although the author mentioned a few limitations, they are either superficial (e.g., only used data from Pakistan) or not well-articulated (e.g., why the dataset cannot reveal the effects of fiscal policy and Covid-19?). The last two sentences of this section are difficult to comprehend.

**References:**

1. Some references listed in the final reference list are not cited in the main body of this article; some references cited in the main body of the article are not listed in the final reference list. The author should check whether he/she has correctly followed the citation style required by the publisher (e.g., Harvard style).