

## SMEs Capital Budgeting Practices: A Review Article

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### Abstract

*This study aims to conduct a comprehensive systematic review of the existing literature on capital budgeting practices (CBP) in Small and Medium-Sized Enterprises (SMEs). By analyzing 130 academic publications from 1964 to 2024, we seek to identify key trends, gaps, and emerging themes in this field. Our analysis reveals a substantial body of research focusing on CBP in larger corporations but highlights a significant dearth of studies specifically examining SMEs, particularly in developing economies. Despite the value of existing research, the current review underscores the need for further exploration of CBP within SMEs. A critical area of inquiry is to understand how SMEs' CBP differs from those employed by large firms and the underlying reasons for these discrepancies. By revealing the unique challenges and opportunities faced by SMEs, this study contributes to the knowledge pertaining to the development of more effective financial management strategies tailored to their specific needs.*

**Keywords:** *Capital Budgeting Practices, Capital Budgeting Techniques, Systematic Literature Review, SMEs, Emerging Markets.*

### Introduction

The emergence of new small businesses signifies entrepreneurial activity and serves as the foundation for economic growth. However, their long-term prosperity relies on securing capital for both operational expenses and long-term investments (World Bank, 2016). Capital budgeting, the process of allocating a firm's limited financial resources, particularly capital, to maximize shareholder value, plays a crucial role in these decisions concerning long-term projects and expenditures (Sureka, R. et al, 2023).

In recent years, access to external financing has improved for small and medium-sized enterprises (SMEs). Recognizing SMEs' significant contribution to national economies, governments have implemented policies to alleviate their financing constraints (Fatoki & Smit, 2011). Given the intensifying global competition and expanding international market opportunities, SMEs must prioritize resource efficiency to maintain a competitive edge. Effective financial management, particularly capital budgeting, is critical for their survival and growth. By strategically allocating their finite capital resources, SMEs can enhance their operational efficiency and ultimately ensure their long-term viability.

Nonetheless, there is compelling evidence to suggest that SMEs exhibit capital budgeting practices (CBPs) distinct from those employed by larger firms, with significant room for improvement (Garcia-Martinez, L.J. et al. 2023). Notably, capital budgeting decisions by SMEs should not be held to a lesser standard; they operate within environments characterized by similar levels of uncertainty and may undertake projects of comparable scale. However, for nascent ventures and small businesses with inherently limited resources, sound decision-making is paramount, as errors are often costly and arduous to rectify (Bort, J. et al, 2024).

Research suggests that SMEs rarely utilize a structured capital budgeting process, and their decisions are frequently influenced by subjective factors, often conducted hastily and with minimal analysis or delayed altogether (Alam & Alam, 2022). These practices contribute to suboptimal project outcomes and significant opportunity costs. As uncertainty pervades across all markets, the ability to make methodical and well-analyzed decisions becomes increasingly crucial for firms of all sizes (Koot, M. et al., 2021). A recent study by Sureka et al. (2022) corroborates this observation, highlighting a significant bias toward large firms in

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CBPs research. Their analysis revealed that roughly 69% of the studies examined CBPs within this context. Conversely, there is a dearth of research specifically exploring CBPs employed by SMEs.

This highlights a critical research gap: the exploration of CBPs within SMEs and the development of strategies to enhance these practices (Mansoor et al., 2020). Moreover, while the few extant research has predominantly focused on the selection of capital budgeting techniques (CBTs) by SMEs, a critical gap exists in the exploration of the full capital budgeting practice. Capital budgeting encompasses a four-stage process: identification, development, selection, and post-audit review. The current body of literature largely overlooks the application of these remaining three stages within SMEs and focuses only on the selection stage. This gap is particularly concerning given the established role of SMEs in economic growth, further compounded by documented challenges they face in securing investment capital. Furthermore, no studies were identified that delve into the "process" and "factors" influencing CBP decisions within SMEs.

Therefore, the current study seeks to comprehensively examine and analyze the extant literature pertaining to CBPs of SMEs. Through a critical review of prior research, the authors aim to shed light on the current state of knowledge regarding SMEs CBPs. Furthermore, this review provides a comprehensive assessment that identifies knowledge gaps, offering valuable insights for practitioners involved in capital budgeting within SMEs. Additionally, it serves as the initial phase of a comprehensive project funded by the Ministry of Higher Education, Research, and Innovation - Oman (MOHERI) designed to explore the CBPs employed by Omani SMEs.

The rest of the paper is structured as follows. Section 2 presents the paper's methodology. Section 3 describes the results and presents the findings, while Section 4 concludes the paper.

## Methodology

### *Search Criteria*

To ensure a comprehensive review encompassing the utilization of Capital Budgeting Practices by SMEs, a systematic search strategy was employed. This strategy involved the identification of relevant academic literature published from the 1960s to the present day. The selection criteria for inclusion were as follows: (a) a systematic literature review (SLR) related to CBP, (b) studies investigating CBP of either SMEs only or both large firms and SMEs, and (C) the availability of full text.

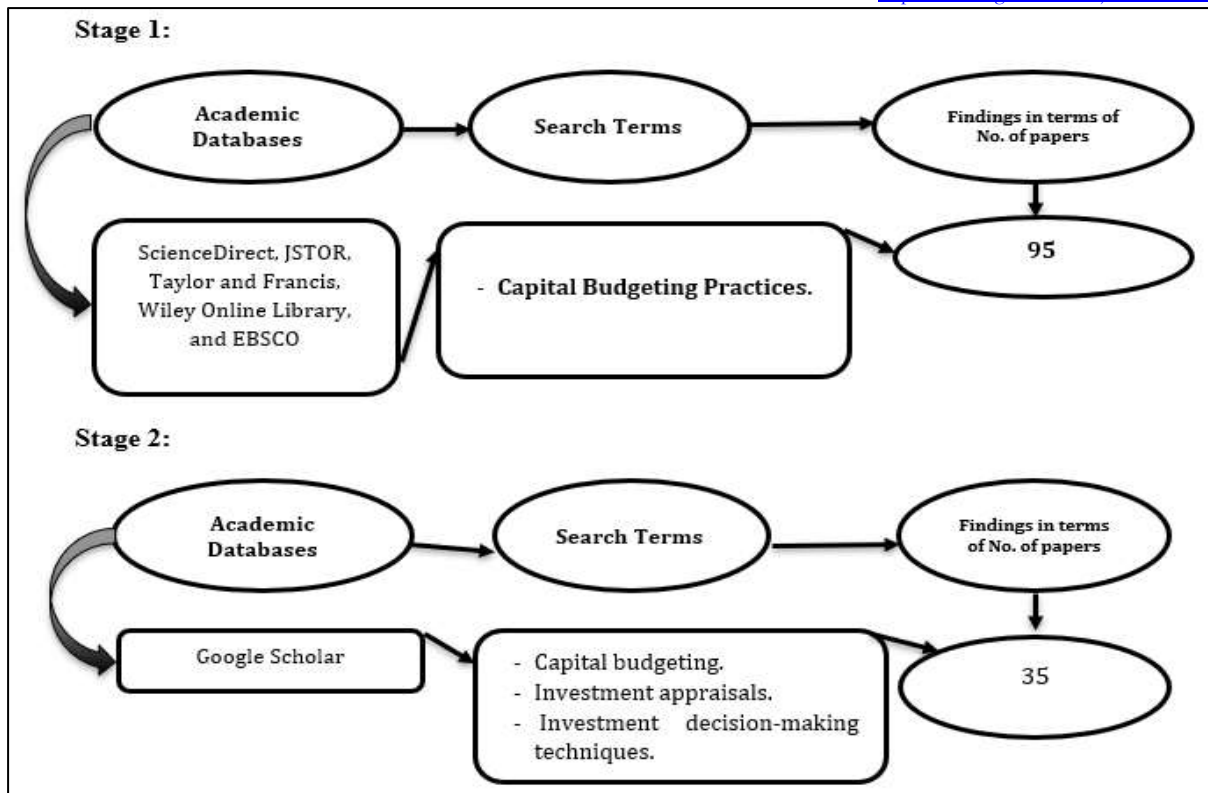
### *Data Collection*

To trace the evolution of CBPs within SMEs, a two-stage search strategy was implemented. The first stage employed a traditional string search technique across a comprehensive selection of academic databases, including ScienceDirect, JSTOR, Taylor and Francis, Wiley Online Library, and EBSCO. Recognizing the prevalence of research on CBP, the search term utilized is capital budgeting practices.

## The Results and Findings

The initial screening process involved reviewing abstracts for the presence of the previously mentioned search term. Full-text articles were retrieved for studies that did not explicitly mention the target population in the abstract to ensure comprehensiveness. Finally, the retrieved articles were assessed for the inclusion of empirical data on SME-specific CBP, resulting in a total of 95 identified papers.

To ensure a more exhaustive search and potentially capture studies not indexed within the aforementioned databases, a snowballing technique was employed in the second stage. This technique involved utilizing Google Scholar and replicating the original search strings with general terms such as capital budgeting, investment appraisals, and investment decision-making techniques. This process yielded an additional 35 papers, bringing the cumulative total to 130 identified papers.



**Figure 1.** The Two Stages of Search Strategy Illustration

The review revealed that since the early 1960s, several researchers have investigated how theoretical capital budgeting practices are actually implemented by firms. The findings of these studies were later examined by researchers such as Haka (2007), Burns and Walker (2009), Mukherjee and Rahahlen (2011), Sarwary, Z. (2019), and Sureka et al. 2022 to look at the overall pattern of capital budgeting practices by summarizing past survey findings. It is worth noting that the three later studies explored the pattern of CBPs only in developed markets, particularly the US market, and any such pattern in emerging markets has not yet been discovered.

Nonetheless, this review synthesizes research on capital budgeting practices in both developed and emerging economies. We identify a critical gap in the literature by highlighting the disparity between these two contexts. Given the extensive body of knowledge surrounding each stage of capital budgeting, this section summarizes the findings of the latest comprehensive review studies CBP, namely: (Sarwary, Z. 2019 & Sureka et al. 2022).

Sarwary, Z. (2019) employed SLR to investigate Capital Budgeting Techniques (CBT) utilized by SMEs. The review encompassed 26 academic publications spanning the 1964-2017 period. The analysis focused on three key areas: (1) the prevalence of specific CBTs across firm sizes and geographic locations; (2) factors influencing the selection of CBTs by SMEs; and (3) methodological approaches employed in prior research. A Strengths, Weaknesses, Opportunities, and Threats (SWOT) analysis was conducted to synthesize the findings, unveil limitations in existing literature, and identify potential avenues for future research that could advance the field of SME capital budgeting.

Their review underscores the necessity of expanding upon existing models and theoretical frameworks to sustain the field's current eclectic theoretical orientation. Furthermore, the analysis reveals a dominance of descriptive research methodologies. This highlights a potential gap in the field, as limited attention has been given to utilizing qualitative approaches. According to Sarwary, Z. (2019), qualitative research methods could prove valuable in exploring the nuances of trade-offs inherent in the selection of various capital budgeting techniques (CBTs) by SMEs. Nonetheless, their review comprehensively examined the selection

stage (stage three) of CBPs, encompassing methods for evaluating proposed investment projects, and it acknowledges the importance of further research into the remaining stages of the CBP.

The above meticulous review of the extant literature revealed a lacuna in research regarding the CBP of SMEs. This gap is underscored by other scholars in the field (Sureka et al., 2022), who advocate for further investigation into the specific CBP employed by SMEs. Their call to action emphasizes the need to understand how these practices differ from those utilized by large firms, and the underlying reasons for such discrepancies.

Sureka et al. (2022) also employed a systematic literature review (SLR) to synthesize and critically evaluate existing research on CBP. Their comprehensive review, encompassing 185 articles identified through rigorous search and selection procedures, explores the application of CB theories, contexts, characteristics, and methodologies. By triangulating SLR with the bibliometric method, the authors provided a meticulous and holistic overview of the field. Furthermore, the study developed a conceptual framework that elucidates the antecedents, moderators, and outcomes of CB research. Grounded in detailed content analysis, the study proposes 11 actionable future research directions to propel advancements in this domain, of which the need to understand how SMEs CBP differ from those utilized by large firms, and the underlying reasons for such discrepancies.

## Conclusion

Capital budgeting decisions are pivotal determinants of long-term organizational performance and survival across firm sizes (Batra & Verma, 2017). This study systematically synthesizes the extant literature on capital budgeting practices to identify knowledge gaps and inform future research. A particular focus is on the under-researched area of small and medium-sized enterprises (SMEs) to understand the unique capital budgeting challenges and practices within this context.

A systematic literature review (SLR) was conducted to comprehensively map the research landscape. The findings reveal a substantial body of research on capital budgeting, primarily concentrated on larger firms. While acknowledging the valuable contributions of existing studies, this review highlights the paucity of research specifically examining SME capital budgeting practices, particularly in emerging markets.

The implications of this study are twofold. First, it provides a foundational overview of the capital budgeting literature for researchers, practitioners, and policymakers. Second, it identifies critical research avenues to bridge the theory-practice gap, such as exploring the specific capital budgeting practices of SMEs, the factors influencing their adoption, and the impact of these practices on firm performance.

While this SLR offers a robust foundation for future research, certain limitations must be acknowledged. The scope of the review was constrained by the database used, and alternative methodologies could be explored in subsequent studies. Nevertheless, this study constitutes a significant contribution to the field by providing a comprehensive synthesis of capital budgeting research and laying the groundwork for further investigation into SME capital budgeting practices. The findings will inform the subsequent phase of the authors' research project, funded by the Omani Ministry of Higher Education, Research, and Innovation, which will delve deeper into the capital budgeting practices of Omani SMEs.

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