

**FINANCIAL BEHAVIOR OF SMES DURING ECONOMIC CRISES: CHALLENGES
AND POLICY IMPLICATIONS FOR EMERGING MARKETS**

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Abstract

Due to limited financial resources and limited access to external financing, small and medium-sized enterprises (SMEs) are excessively vulnerable during economic crises, despite their crucial role in economic development and employment generation [7]. This study investigates the financial behavior and resilience strategies of SMEs facing various economic shocks, combining global theoretical perspectives with a focused analysis of Uzbekistan and the broader Central Asian region.

The results suggest that SMEs adjust their financial strategies according to the nature of the crisis. During a financial crisis, firms typically adhere to the Pecking Order Theory, drawing on internal financing, postponing investments, and lowering leverage to preserve liquidity [4]. In operational crises such as the COVID-19 pandemic, the reduction of internal funds forces SMEs to borrow to survive, consistent with a modified “Risk Theory” [4]. At the same time, geopolitical shocks stimulate flexible restructuring, resource reallocation, and innovation, according to the Resource-Based View [1]. Empirical evidence suggests that SMEs initially implement defensive strategies, primarily cost-cutting, investment deferral, and cash flow preservation—rather than immediate innovation. Government support can play a crucial role in improving firm survival, but if it is poorly targeted, it during major systematic shocks [5].

The case of Uzbekistan reveals ongoing structural challenges, such as limited access to credit, the dominance of state-owned companies, regional variations, and widespread informality [6]. Overall, the thesis concludes that building SME resilience needs balanced policy actions to encourage digital transformation, enhance financial inclusion, and promote sustainable economic growth.

Keywords: Small and Medium-Sized Enterprises (SMEs), financial behavior, economic crisis, capital structure, financial resilience, credit constraints, informal economy, digital transformation, Uzbekistan.

Introduction

Small and medium-sized businesses (SME's) are the foundation of today's economy and make up most of the total number of businesses and a significant percentage of global employment [7]. While SMEs are critical to global economies, they continue to be susceptible to all the structural weaknesses mentioned above, especially during times of economic downturns. In addition, due to their limited financial assets, lack of ability to obtain financing (both internally as well as externally), and their reliance on financial institutions for many of their financing needs, SMEs have a much higher level of vulnerability to disruptions in liquidity and demand than do large enterprises [8].

The impact of economic crises on small and medium-sized enterprises (SMEs) varies by type of crisis. Financial crises are primarily caused by conditions in the credit market, resulting in tighter credit standards and less liquidity. In these types of environments, SMEs typically preserve cash, reduce leverage, and delay capital expenditures. Conversely, operational crises such as the pandemic had an immediate impact on revenue for many SMEs, requiring firms to access capital via debt to survive. Conversely, geopolitical shocks such as trade disruptions or regional conflicts require SMEs to reallocate resources and restructure supply-chains rapidly [1]. These differences demonstrate that financial behavior of SMEs is not consistent across crises and is based upon their type.

The institutional environment greatly impacts the resilience of an organization. A stronger financial system leads to an improved ability of SMEs to have access to a wider range of financing sources, as well as a greater level of legal protection. Various factors in emerging markets can place strains on SMEs, including limited credit availability, high collateral requirements and significant amounts of informal businesses, all of which increase the vulnerability of SMEs and restrict the ability of SMEs to recover post-systemic shock [6].

The case of Uzbekistan demonstrates how despite recent rapid economic growth due to ongoing economic reform, structural issues continue to hamper SME growth. The limitations of SMEs to access capital; the high concentration of state-owned enterprises within major economic sectors [3]; significant regional disparities; the high level of informality in the economy, continue to create difficulties for SMEs to be able to grow. Although recent reforms and efforts to promote financial inclusion through greater use of digital financial services have occurred, there are still very substantial gaps in accessing the various forms of financial services in most rural areas [2].

This study will analyze how SMEs have behaved financially and have survived various economic crises through both theoretical and empirical perspectives from emerging market economies and particularly the in-depth case of Uzbekistan. This research shows that crisis typologies and institutional levels of development affect how SMEs will financially respond to a crisis. To strengthen SME resilience, policymakers need to implement an equal measure of policies to improve financial inclusion, encourage digital transformation of SMEs, and reduce structural distortion in the market.

Understanding these dynamic relationships will not only be important for individual firms' ability to survive over time, but also for the ability of emerging economies to achieve long term sustainable economic growth and macroeconomic stability.

Literature Review

Small and Medium Enterprises (SMEs) continue to demonstrate world-wide economic development through their combined corporate presence (over 99% of all companies) and employment opportunities these companies provide (95% of the global workforce) [7]. SMEs also tend to experience heightened levels of vulnerability during periods of economic crisis compared to larger corporations because SMEs tend to have limited financial resources, limited access to formal credit, small cash reserves, and reduced capacity for taking advantage of economies of scale [8]. Past events (such as the 2008 Global Financial Crisis, the COVID-19 pandemic, and other economic shocks) have shown that SMEs have been among the first to experience liquid cash shortages, revenue losses, and higher chances of bankruptcy. SMEs tend to exhibit defensive financial behaviors (e.g., retaining cash, limiting expenses, and deferring investments) to survive through periods of economic instability.

Theories regarding the financial behavior of SMEs under crisis conditions can be grouped into three categories.

Pecking Order Theory indicates that an SME will rely primarily on its own capital for financing, then borrow money and lastly, use equity as a source of funds [4]. Therefore, during a crisis, an SME will typically decrease their leverage and rely on internal funds to keep their business going.

Trade-off Theory states that the decision for a company to either incur debt or to use retained earnings is based on balancing out the tax benefits of using debt versus the potential costs of going bankrupt due to excess debt obligations [4]. In times of operational or liquidity crises, SMEs may incur debt to keep their businesses operating even though the costs of going bankrupt will increase as they incur debt. Resource-Based View (RBV) identifies the strategic management of internal and external resources as the means for developing resiliency and competitive advantage [1]. SMEs that effectively can leverage innovation using government assistance are more likely to survive through the crisis, demonstrating that financing alone cannot guarantee long-term survival.

SME financial behavior is influenced by the type of economic crisis they are experiencing. In an economic crisis (e.g. the GFC of 2008) they will typically respond by de-leveraging, using their own internal funds, delaying their investment and mitigating against credit constraints [4]. Conversely, during operational crises (e.g. COVID-19) they will often resort to survival-type borrowing, carry out rapid cash burns and significantly reduce costs. Geopolitical crises (e.g. regional conflict, trade disruption) will result in SMEs needing to restructure their supply-chains and pivoting markets or redeploying their resources in a strategic manner [1]. All crisis types will lead to SMEs using a defensive financial response immediately by focusing on liquidity and risk management, while in the longer term they may adopt an innovation, digitalization or strategic diversification approach.

Government support and an institutional framework are necessary to support SMEs resilience through times of crisis [5]. Programs that include emergency liquidity assistance, subsidized lending, and technical assistance dramatically increase the number of companies that can continue operations and to prevent company bankruptcies. Conversely, poorly targeted interventions can lead to long term debt accumulation or the existence of unproductive "zombie" companies, which will limit the potential for increased productivity growth [5].

SMEs in emerging markets have additional structural challenges. For example, in Uzbekistan, access to formal credit is limited, state owned enterprises dominate the economy [3], there is a high degree of informality and there are wide disparities between regions of the country [6]; all of these factors are having a negative impact on SME development. In addition, women led businesses are disproportionately impacted by the lack of financing while digital transformation is uneven. International financial institutions (IFIs) and/or government programs have attempted to alleviate these challenges by offering targeted financing options, credit guarantees and modernization support; however, there are still significant gaps in coverage and effectiveness.

Even though there has been significant amount of worldwide research on the financial behaviors of small and medium enterprises (SMEs) during crisis situations, we can see from the literature that there are still considerable knowledge gaps in this area, especially for transitional countries like Uzbekistan. There is limited understanding of how different types of crises impact the financial decisions of SMEs in developing markets; moreover, limited research has been conducted into the joint effect that informality, digital adoption and structural barriers to resilience have. Additionally, there is limited research on how this affects regional differences, as well as the effectiveness of institutional support. This thesis intends to address these two gaps to develop a comprehensive understanding of SME financial behaviors and resilience in Uzbekistan to provide guidance for both policy makers and practitioners in developing institutional interventions.

Methodology

The goal of this research was to understand SME behavior and how SMEs react financially to crises. To achieve this goal, we employed qualitative and analytical research methodology in a systematic way to synthesize evidence from three fundamental sources: Academic Literature; Institutional and Regulatory Publications; and International Financial Reports or Policy Reports.

Analyses were performed on periodicals produced between 2008-2025 to provide information on the global financial crisis, the current pandemic, and other global shocks that affect SMEs and their operation. Foundational studies produced prior to 2008 were included in our analysis where they provided important theoretical underpinnings, such as Pecking Order Theory, Trade-off Theory [4], and Resource Based Theories [1].

A case study on Uzbekistan provided an example of how SMEs operate within an emerging market environment; using national statistics, central bank reports [2], and government policy reports [3,6] to evaluate performance constraints and ability to overcome the financial constraints imposed by crises through their resilience mechanism and structural obstacles that impact their long-term performance. Methodologically, this evaluation framework systematically provided a concise and structured method of evaluating SME behavior throughout different crisis types while maintaining relevance to current institutional and policy contexts.

Results

Based on the systematic review of academic literature, institutional reports, and the specific case study of Uzbekistan's economy, the research identified several key findings regarding the financial behavior of Small and Medium-Sized Enterprises (SMEs) during crises and the structural factors influencing their resilience.

1. Variable Financial Strategies According to Crisis Typology

The analysis indicates that SMEs do not react uniformly to all economic shocks. Their financial decision-making is strictly dictated by the nature of the crisis. Table 1 summarizes the observed shifts in SME financial behavior across different crisis typologies.

Table 1: SME financial strategies and theoretical alignments by crisis typology

Crisis Typology	Key Market Characteristics	Primary SME Financial Strategy	Dominant Theoretical Framework
Financial Crisis (e.g., 2008 GFC)	Tightening credit markets, liquidity shortages, high interest rates.	Cash hoarding, strict deleveraging, indefinite delay of capital expenditures.	Pecking Order Theory (Preference for internal funds)
Operational Crisis (e.g., COVID-19)	Severe revenue disruption, halted operations, fixed-cost pressures.	"Survival borrowing," rapid cost-cutting, reliance on emergency government subsidies.	Trade-off Theory (Accepting bankruptcy risk for short-term viability)

Geopolitical Shock (e.g., Trade wars)	Supply-chain disruptions, raw material volatility, closed export markets.	Rapid resource reallocation, supply-chain restructuring, market diversification.	Resource-Based View (Strategic flexibility and resource management)
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- **During Financial Crises:** Firms primarily adhere to the *Pecking Order Theory* [4]. Facing tightening credit markets, SMEs demonstrated a strong preference for internal financing, reducing their leverage to build defensive buffers against credit constraints.

- **During Operational Crises:** Severe disruptions forced SMEs to deviate from traditional pecking order behavior. Driven by an immediate need to cover fixed costs, firms engaged in "survival borrowing," aligning with a modified *Trade-off Theory* [4].

- **During Geopolitical Shocks:** Consistent with the *Resource-Based View (RBV)* [1]. Geopolitical crises demanded structural adaptability rather than just financial defensiveness.

2. Structural Barriers in Emerging Markets: The Case of Uzbekistan

The case study of Uzbekistan highlights that while global crisis dynamics apply, SMEs in emerging markets face compounded vulnerabilities due to local institutional environments. Figure 1 illustrates the compounding effect of these barriers on SME growth and survival.

The analysis revealed four primary structural bottlenecks, detailed in Table 2, which severely restrict the financial resilience of Uzbek SMEs.

Table 2: Key structural bottlenecks affecting SME resilience in Uzbekistan

Structural Barrier	Description in the Context of Uzbekistan	Impact on SME Crisis Resilience
Credit Constraints	High collateral requirements (often 120-150% of loan value) and elevated interest rates [2].	Restricts access to affordable liquidity during sudden economic shocks.
SOE Dominance	Heavy concentration of State-Owned Enterprises in key economic sectors.	Creates a "crowding-out" effect [3], leaving SMEs with thinner profit margins and weaker financial buffers.
Informal Economy	A significant portion of micro and small enterprises operate informally [6].	Excludes businesses from formal government relief programs (e.g., tax deferrals, subsidized lending).
Regional Disparities	Uneven distribution of digital infrastructure and banking services outside Tashkent [6].	Limits the agility of rural SMEs, making them overly dependent on traditional, slower banking methods.

3. The Dynamics of Government Intervention and Long-Term Resilience

The synthesis of institutional reports shows a complex relationship between government assistance and the survival of small- and medium-sized enterprises (SMEs) through the lens of long-term resilience. In the short term (i.e., 1-6 months), the provision of emergency liquidity injections and credit guarantee schemes prevented the mass failure of SMEs.

However, poor targeting or prolonged blanket subsidies can lead to market-dynamics distortions in the long run, often resulting in the accumulation of long-term debt for SMEs and the continuation of unproductive so-called "zombie firms" [5] at the expense of overall economic recovery. In contrast, evidence shows that requiring SMEs to undergo digital transformation and formalization to qualify for conditional government assistance will yield the greatest rates of productivity and sustained growth in the post-crisis period.

Challenges and Limitations

Structural rigidities combined with a lack of readily available capital restrict the availability of financing to SMEs in developing nations. Although there have been reforms in borrowing conditions and accessibility of funds to SMEs, these businesses continue to face many systemic barriers, such as high collateral requirements and flight-to-quality behavior exhibited by commercial banks during periods of crisis [8], all of which result in a high degree of credit rationing. Furthermore, despite the absence of a sufficient financial track record as a signal to potential lenders regarding their ability to repay debt, SMEs encounter further friction in accessing external funding due to the asymmetrical information that exists between lenders and borrowers.

Most SME activities are conducted in an informal manner, leaving SMEs with very little opportunity to access financial products [6] and services from traditional banks. Although the existence of informal activity provides short-term flexibility for SMEs, it can become a substantial limitation when systems are challenged by a crisis (i.e., informal businesses are not eligible for government assistance packages, tax relief, or formal restructuring programs).

The transition to digital financial services (DFS) has not occurred at an even rate across the globe; as a result, many rural SMEs do not possess the requisite digital infrastructure or the digital literacy necessary to participate in e-commerce or adopt e-commerce payment methods, thereby limiting their ability to withstand operational challenges/impacts, such as the COVID-19 pandemic.

Discussion and Implications for Emerging Markets (Uzbekistan)

By creating a transition from the current reactive approach towards future-focused digital transformation, SMEs in Uzbekistan can build greater resilience. Furthermore, State-Owned Enterprises (SOEs) continue to dominate many markets in Uzbekistan and frequently "crowd out" the private sector from obtaining access to traditional forms of financing (i.e., debt and equity) [3]. Therefore, policymakers should concentrate their efforts providing an equal playing field through credit guarantee programs as well as other mechanisms designed to assist in the process of formalizing businesses such as SME transitional programs or non-traditional financing mechanisms (e.g., invoice factoring).

Digital financial products and services can provide SMEs that currently do not use banks access to financial services through the bridging of the gap created by a lack of access to traditional banking systems; however, adequate consumer protection laws and data privacy regulation must be in place prior to offering digital finance products. The Central Bank of Uzbekistan should establish regulatory sandbox programs for testing innovative finance models (e.g., P2P lending and supply chain financing) [2] designed to have a positive impact on SMEs during times of geopolitical and economic instability.

Conclusion

Due to their limited financial buffers and high sensitivity to market fluctuations, SMEs remain the most vulnerable segment during economic crises. This research confirms that

financial behavior varies by crisis type: financial crises trigger a retreat to internal funds (Pecking Order Theory) [4], while operational crises necessitate survival-driven debt.

However, resilience is not solely a matter of liquidity; it requires structural agility, digital adoption, and supportive institutional frameworks. In emerging markets like Uzbekistan, the sustainable growth of SMEs depends on reducing informality [6], enhancing financial inclusion, and ensuring that government interventions are targeted to avoid the creation of unproductive "zombie firms" [5]. When implemented with appropriate structural reforms, SMEs can transition from being victims of economic shocks to becoming the primary drivers of macroeconomic stability.

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