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Business Financing for Malaysian SMEs: What are the Banks' Determining Factors?

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This paper presents the findings of a qualitative study on what constitute the 'success factors' that determine the evaluation and approval by commercial banks in Malaysia for the business financing applications by the small and medium enterprises (SMEs). It has been acknowledged that the SMEs play an important role in the Malaysian economy. In 2004, there were 690,000 establishments representing 92 percent of total establishments in Malaysia. SMEs provided about 30 percent of the total employment in the country. However, among some of the pertinent problems and challenges faced by the SMEs concerns business financing. In fact, the non-availability of finance has been the most frequently cited problem encountered by the Small and Medium Enterprises (SMEs) in developing countries such as Malaysia. Acknowledging that the lack of access to financing facilities is currently one of the most important challenges faced by Malaysian SMEs, this paper explore and re-evaluates the criteria and processing procedures of banks that give out financing to the SMEs. From this qualitative study which utilised the convergent interview techniques on the top commercial banks in Malaysia, it was found that there were 15 main factors which were categorised as financial and non-financial factors which were deemed to be important in order for the banks to approve the SMEs business financing applications.

Field of Research: Business financing, Malaysian SMEs, Banks

1. Introduction

The significant role of the Small and Medium Enterprises (SMEs) in the economic development of Malaysia have been well documented. SMEs is the engine for entrepreneurial development which in turn generate a diverse spectra of economic activities, employment opportunities and also making immense contributions to trade and exports of the country. In its efforts to enhance the performance and contributions of the SMEs sector, the Malaysian government has designed and put in place various strategic plans. These are the Second Industrial Plan (IMP2) which ended in 2005, which was then followed by the Third Industrial Plan (IMP3) for the period 2006-2020, which in the long term coinciding with the country's aspiration for developed country status by 2020 (MITI, 2005). However, SMEs in many countries, including Malaysia

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face a myriad of challenges and constraints. The study by Wan (2003) highlighted some pertinent challenges facing SMEs in a globalised environment such as the lack of financing, low productivity, lack of managerial capabilities, poor access to management and technology and stringent regulatory requirements. In the case of Malaysia, various studies and reports which include the APEC Survey (1994), the SMI Development Plan 2001-2005 (SMIDEC, 2002), Ting (2004), the UPS Survey (2005) have highlighted that SMEs have somewhat similar challenges. These challenges include the lack of access to loans, limited adoption of technology, lack of human resources, competition from multinational companies and globalization. Acknowledging that the lack of access to financing facilities is currently one of the most important challenges faced by Malaysian SMEs, this paper explore and re-evaluates the criteria and processing procedures of banks that give out financing to the SMEs.

2. Background to the Study

Bank lending has played an important role as the major source of funds and liquidity for the private sector in Malaysia (Public Bank Economic Review, 2002). As the main mobilization of funds in the economy, the banking sector was able to support the increasing lending requirements to business activities. Reflecting that, Bank Negara Malaysia (2004) stated that demand for new financing by businesses was higher in 2004. Loan applications received from businesses were increased by 20 percent in 2004, a turnaround from the decline of 7.7percent in 2003. The increase was driven by higher applications received from the manufacturing, construction and the wholesale and retail trade sectors, amounting to RM76.2 billion. In tandem with higher loan applications, new loans approved to businesses were increased by 9.8 percent to RM84.9 billion, accounting for 48.9 percent of total new loans approved by the banking system. Nearly 51 percent or RM43.2 billion of new loans approved to businesses were channelled to the construction, manufacturing and the wholesale and retail trade sectors.

Banks lending objective is to improve the private sector business activity to enhance their contribution to economic growth. One of the key sectors identified for further development in many economies is the SMEs sector because of its importance to the development of local entrepreneurial capabilities and industry linkages and their high multiplier effects on economic (Rajandram, 2004).

Studies carried out by Udell (2004) using the data in the United States, found that nearly half of small business (SMEs) financing comes from externally provided debt. Realizing that, SMEs continued to receive strong support from the banking sector. In 2004, the banking system approved RM31.6 billion of new loans to more than 92,000 SME accounts which shown a significant increase of 21.9% from 2003. Loan disbursements grew strongly by 15.3% to RM100.4 billion, while outstanding loans to SMEs expanded by 7.7% to RM88.3 billion (Bank Negara Malaysia, 2004).

Banks also are more stringent and cautious in approving the financing for SMEs, as they do not consider them as attractive and profitable undertakings (Hossain, 1998; Bhattacharya, 2000; and Sia, 2003). A study by Hall and Fang (2004) also found that the lending to SMEs generally more risky than larger firms. Therefore, it has been found that most of the financial institution and non-financial institution required collateral in the form of land or buildings. The value of the real-estate security is usually set at twice the amount of loan (Bhattacharya, 2000), which many enterprises fail to provide as collateral. SMEs also regarded as high risk borrowers because of their low capitalization, insufficient assets, and high mortality rates (Sia, 2003) and consequently, they are not offered any attractive deals in terms of loans and interest rate. Thus, this research is aimed at investigating the factors that are evaluated by banks providing business financing to SMEs.

3. Literature Review

A study by the World Resources Institute (2009) showed that in most countries, SMEs have difficulty in securing financing because they do not have the necessary systems in place to provide transparent information to investors or lenders. In addition, they cannot provide the high collateral requirements that banks require for the higher risk. These financial conditions are similarly found in Malaysia whereby SMEs like in most other developing countries typically operate in a much less supportive environment whereby opportunities to tap into formal commercial lenders are much fewer than developed economies. With regard to debt financing, SMEs are often considered too large for microfinance institutions and too small for the commercial lenders besides from being lacking the collateral requirements of banks. The World Resources Institute also posits that for the large majority of local banks, SMEs finance is regarded as unattractive business as their perception is characterised by high risk and transaction costs. This perception may have resulted from the mismatch between the bank’s requirement and the accounting and management practices common among SMEs as well as the lack of suitable credit scoring mechanism for the SMEs (Wendel and Harvey 2006). Financing for sustainable SMEs, the hurdles are even higher. Commercial lenders are often more reluctant to support businesses in the rural areas where many sustainable SMEs are located and also in the relatively new product sectors such in the emerging green technology product areas.

Various studies have shown that a majority of SMEs indicated inadequate working capital and lack of access to commercial lending as their major problems and it is also crucial issues to many of them (MITI 1990; Chee 1986; Diah 1985). Shahadan et al (1990) also identified the inability of SMEs to raise capital and limited access to institutional credit as the two typical problems of SMEs. Hassan (1992) pointed that SMEs are not able to gain access and utilize available funding due to interrelated factors such as inadequate collateral and lack of performance record to convince the financial institutions into providing them with the loans. Other studies in developed countries like United States of America and United Kingdom also suggested that SMEs operating in these countries faced financial problems. Broom & Longenecker (1975) indicated that one problem of major significance to many small businesses is lack of capital and credit. Most bankers associate loans to SMEs with low returns and high risk. Thus, SMEs businesses are not only having problems in obtaining bank finance, but they also claim that the costs are too high. Lee (1998) in his study stated that the bankers who appeared to view any small business loan application as a potential portfolio of non-performing loans. This viewpoint may be attributed to what the bankers perceived as inefficiency in small loan processing and biases in assessing credit worthiness of small business customers. Furthermore, previous studies have found out that SMEs were deprived of funds due to the lack of understanding on the part of bankers and the SMEs owners (Rosli Mahmood, 2000; Deakins & Hussain, 1994; Wyant & Hatch, 1990).

From the above discussion, it can be seen that while the availability of finance is unquestionably important, their accessibility is even more crucial. As defined by Tagoe (2005), accessibility to finance means getting adequate and affordable financing over a suitable timescale. In this study, the accessibility of finance is focussed on lending by banks in Malaysia. The study investigated on the factors that banks look for when they evaluate and consider financing to the SMEs in Malaysia.

3.1 Factors Evaluated by Banks in Conventional Business Financing

Before banks make a decision to provide a loan, they have to evaluate the imperfect information about prospective borrowers to determine if they are creditworthy. The information provided to the banks must be sufficient to make a credit decision. From a review of the literature, *12 success factors* have been identified as the pertinent factors that banks take into account when evaluating the applications for business financing by SMEs. By combining academic literature and those from the banking practitioners, the 12 factors considered as important determining factors are tabulated in table 1.

Table 1: Determining Factors in Evaluating Business Financing

No.	The success factors	A	B	C	D	E	F	G	Total	Selected for this study
1	Financial statement (audited)	√	√						**2**	√
2	Sources of repayment		√	√		√			**3**	√
3	Purpose			√	√				**2**	√
4	Business ability/product				√				**1**	√
5	Knowledge				√				**1**	√
6	Third–party opinion				√				**1**	√
7	Size of business				√				**1**	√
8	Capacity					√	√	√	**3**	√
9	Character			√		√	√	√	**4**	√
10	Economic condition					√	√	√	**3**	√
11	Collateral					√	√	√	**4**	√
12	Capital						√	√	**2**	√
	Total	**1**	**2**	**3**	**5**	**5**	**5**	**5**		**12**

Key to table:
A – Peter S. Rose * (1999)
B – Harry P. Guenther *(1999)
C – Bala Shanmugam*, Craig Turton, and George Hempel (1992)
D – Aidan Berry**, Sue Faulkner*, Mark Hughes* and Robin Jarvis** (1993)
E – Edward W. Reed ** and Edward K. Gill* (1989)
F –Shamsudin Ismail**, Shamsher Mohamad** and Annuar Mohd Nasir**(1988)
G – Arthur G. Pulis, III (1991)
Note: * - Academician
** - Practitioner

The first factor considered by banks when evaluating the business loan is the *audited financial statement* (item 1 in table 1). The financial statement used is the audited financial statement for the incorporate company because this financial statement contain both qualitative information (e.g. the auditors' report and chairman's statement), and quantitative information (e.g. balance sheet) of the business (Berry et al, (1993). For sole proprietor and Partnership Company 3 years' unaudited accounts are required. Analysis of financial statement typically includes four key areas: liquidity, profitability, gearing and operational performance and usually banks will use the last three, four, or five years audited financial statement (Rose, 1999). Information from balance sheets and income statements is typically supplemented for financial ratio analysis. The ratios commonly used by the bankers are; operating efficiency, coverage ratio, liquidity ratio, profitability ratio, and leverage ratio. The cash flow is referred to as the sources and uses of income.

The second factor is *repayment* (item 2 in table 1) which is often considered as the first line of defence. This factor allows the banker to know the source of income for the repayment. This factor is important in order to evaluate the ability of owners to earn a sufficient amount to repay the loan.

The third factor is *purpose* of the loan (item 3 in table 1). The purpose of the loan is a significant variable in the lending decision because the loan is raised will be influential in assessing the potential risk involved in the lending decision (Berry et al, 1993). An understanding of the loan's intended use helps the analyst to understand whether the loan request is reasonable and acceptable.

The fourth factor is *business risk/product* (item 4 in table 1). For some businesses, by their nature, are likely to be riskier than others. In finance theory this type of risk is normally referred to as business risk. Business risk is reflected through the volatility of profits (Berry et al, 1993). The business risk also can relate with the product produced by the business, because once the business produce a product which is cannot enter into the market or the business produce a product which is cannot expand it will make a business is risk. The business ability also is referring to the ability of applicant to generate enough cash, in the form of cash flow, to repay the loan. Generally, the borrowers have only three sources to draw upon to repay their loan: cash flow generate from sales or income, the sale or liquidity of assets or fund raised by issuing debt or equity securities.

The fifth factor in business financing is *knowledge* (item 5 in table 1). Knowledge refers to the information gather by the bankers in the applicant's business. This knowledge will greatly help a banker in assessing the risk associated with a lending proposal. This knowledge can be derived through past records and bank's own internal records.

The sixth factor is the *third-party opinion* (row 6 in table 1). Third-party opinion is the information acquired by asking the other parties involved with the applicant's business such as supplier, customers, others bankers, and etc. In particular, if the third party has previously been a source of good introductions presumably the banker will have greater confidence in this third-party's opinion and introductions.

The seventh factor is the *size of business* (item 7 in table 1). The size of the applicant's business will be extremely influential in a lending decision because it will effect on the banker's perception of risk. In terms of liquidations small firms go into liquidation than larger counterparts.

The eighth factor is *capacity* (item 8 in table 1). Capacity is defined as the legal status of the borrower to enter into contract (Reed & Gill, 1989), whether a borrower has the authority to borrow on behalf of his firm or business because if the borrower lacks such as authority, banks may find difficult to collect their loans. Capacity may also refer to the repayment capability of the borrower (Shamsudin et al, 1988), which is measured by the expected cash flow of the borrower's business.

The ninth factor is *character* (item 9 in table 1). Character assessment is performed to determine the willingness and desire of borrowers to repay the debt (Shamsudin et al, 1988). The borrower's attitude such as honesty, integrity, industry and morality are considered in character assessment.

The tenth factor is *economic condition* (item 10 in table 1). Bankers need to know how changes in competitive economic conditions, technology, and the demand for products and distributions methods affect the borrower's business. Economic conditions affect the ability of the borrower to repay financial obligations but are beyond the control of the borrower and the lender.

The eleventh factor is *collateral* (item 11 in table 1). Collateral refers to any asset which the borrower may have to charge or pledge as security against the loan. The range of assets can be pledged to the bank as security. The collateral is important because it is used to reduce the credit risk.

The twelfth factor considered by banks in business financing is *capital* (item 12 in table 1). Capital represents the borrower's money that he puts into a project. It indicates the financial worth of the borrower and also reflects the accumulated wealth of the borrower and to some degree as an indication of past success.

3.2 Factors Evaluated by Banks in SMEs Business Financing

After having identified the factors that are used by banks used in evaluating conventional business financing, the factors that are used by the banks in evaluating SMEs lending are then explored. Investigations showed that the bankers have traditionally taken their knowledge of the borrowers and their business market and combined this knowledge with limited financial information provided by borrowers to make lending decisions. According to Justas (1982), the success of the small business depends on the management skills and expertise of the owner. Thus, the premise of this research will explore the success factors in getting business financing for SMEs based on the reconciling of the six pertinent literature references (Rose 1999; Guenther 1999; Shanmugam, Turton, and Hempel 1992; Berry, Faulkner, Hughes and Jarvis 1993; Reed and Gill 1989; Shamsudin Ismail, Shamsher Mohamad and Annuar Mohd Nasir 1988; Pulis III 1991), as shown in table 2. From the reconciling and synthesis of the literature, an additional of 7 factors (apart from the original 12 factors) were identified in conventional business financing to be included as a success factors in getting the business financing for SMEs (these 12 factors which have been discussed earlier as success factors for the conventional business financing).

Table 2: Success Factors for SMEs Business Financing

No.	The success factors	A	B	C	D	E	F	G	Total	Selected for this study
1	Financial statement	√	√		√				3	√
2	Sources of repayment	√							1	√
3	Purpose	√		√					2	√
4	Business ability/product	√	√		√	√			4	√
5	Knowledge	√							1	√
6	Third–party opinion	√							1	√
7	Size of business	√							1	√
8	Capacity	√							1	√
9	Character	√	√		√	√		√	5	√
10	Economic condition	√							4	√
11	Collateral	√	√	√	√	√	√		6	√
12	Capital	√							1	√
13	**Competence management**			√		√		√	**3**	√
14	**Financial projection**						√		**1**	√
15	**Geographical risk**							√	**1**	√
16	**Market involved**				√				**1**	√
17	**Industry risk**							√	**1**	√
18	**Experience/track record**				√			√	**2**	√
19	**Strategic planning**				√		√		**2**	√
	Total	12	4	3	7	4	3	5		19

Key to table:
A – Success factors for business from literature.
B – Len Fertuck (1982)
C –Sunday I Owualah (1988)
D – Jankowichz, A.D and Hisrich, R.D (1987)
E – Larry Wynant and James Hatch (1991)
F – Howard E Van Auken, and Richard B Carter (1989)
G – Review of bank lending practice (2003)

The first factor is *competence management* (item 13 in table 2). It usually refers to the management skills of the SME to manage the business. In reality the success or failure of business is depend upon the skills of the management team. Hence, banks must have the confidence that the firm has good management skills before a loan is granted.

The second factor is the *financial projection* (item 14 in table 2), or also known as a pro forma financial statement. Pro forma financial statement is a projected statement based on the forecast. The forecast is important to develop internal budgets for the functional department of the business. The lenders seek this financial statement because they want to make sure that the applicant's business will generate enough profit to pay back both the principal and interest on the loan.

The third factor is *geographical risk* (item 15 in table 2). Geographical risk is the geographical location of SMEs. Some banks limit their exposure to residential property in certain areas because the value and marketability of residential property differs substantially between urban centres and small rural areas.

The fourth factor included is *market involved* (item 16 in table 2). The market involved means how far the products that produce by the borrower can establish and also can compete with others product in the markets.

The fifth factor is the *industry risk* (item 17 in table 2). Risk is a term that is based on the uncertainty of future outcomes. Banks place great emphasis on conditions in the industry and the applicant’s competitive position and relative stability. Industry risk also look at the trends of industry including technological changes, new process, and changes in customer demands.

The sixth factor is the *trading experience* or track record (item 18 in table 2). Track record is the past experience of the borrower’s business and it is concerned with relevant past experience such as the number of years spent in the industry, other commercial experience, training etc. The past track records have been used by the bankers to assist them in doing the judgment on the forecast information. The past tract record could include the assessment of the management’s ability to meet their objectives, to manage staff and to manage their finance.

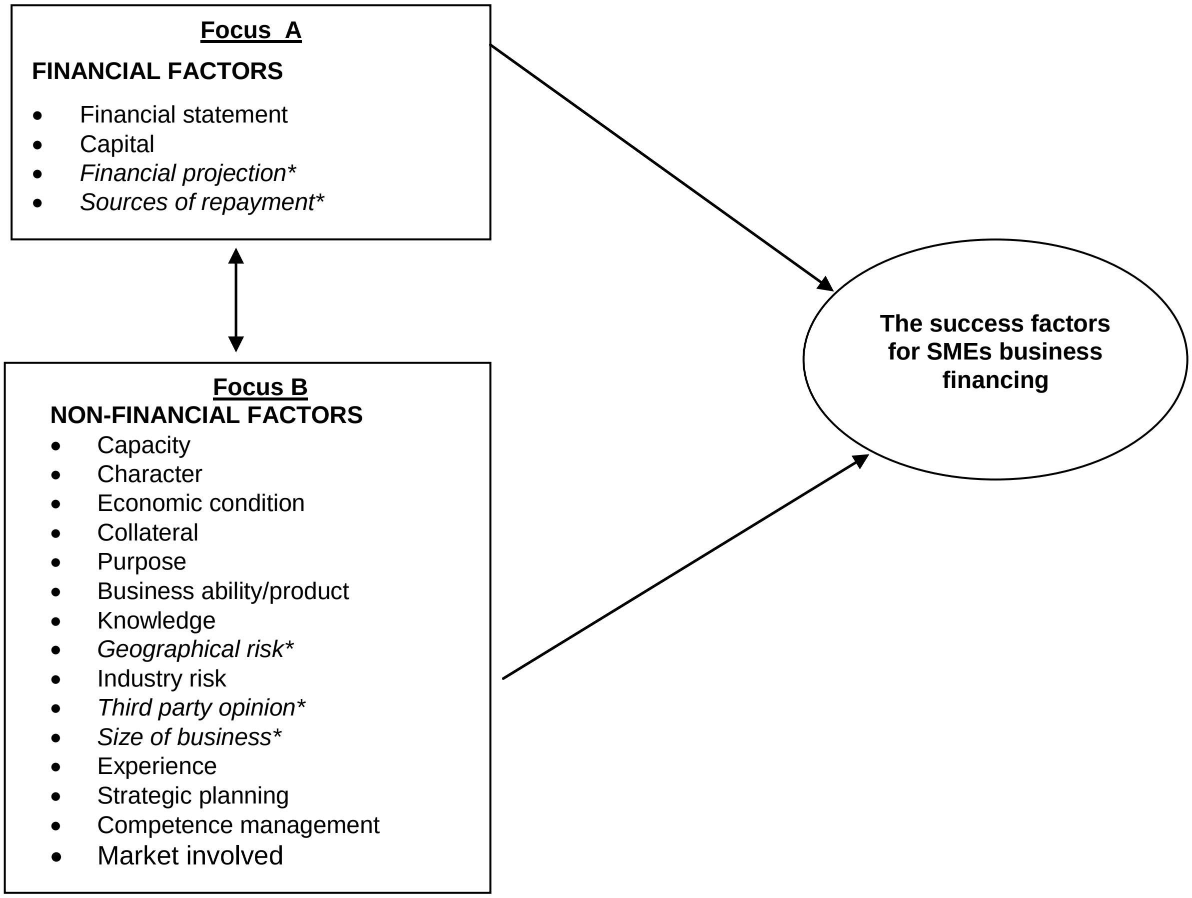
The seventh factor is *planning* (item 19 in table 2). This factor is a systematic process that takes from some current state to some future desire state. Business planning usually relates and takes into account the perspectives of strategic planning. Strategic planning is a long-term plan for a business and involves establishing an overall plan for the business. Strategic planning concern with establishing company priorities and also it’s allocates resources and takes the steps necessary to meet the strategic goals.

Having explained and discussed the significance and importance of all the factors evaluated by banks in both categories of conventional business financing and SMEs business financing factors, the research model will utilise the above 19 factors as the criteria by banks in Malaysia to evaluate the SMEs financing application by the commercial banks. The next step of this investigation will seek to verify with the commercial banks in Malaysia to validate if these are the so-called *‘success factors’ when they, the bankers* evaluate and decide whether a financing application by the SMEs will be successful.

4. Methodology and Conceptual Framework

Figure 1 shows that two categories have been identified as the success factors which determine the provision of SMEs financing in Malaysia. These factors can be subdivided into two categories; a) the ‘financial factors’ and b) the ‘non-financial factors’. Both these categories will be used as the basis for this study about the success factors for SMEs financing.

Figure 1: The Success Factors for SMEs Business Financing



From a review of the published literature and synthesising these with the above discussion about the success factors for conventional business financing and SMEs financing, four financial factors can be identified, namely - the financial statement, sources of repayment, capital, and financial projection.

Under the 'non-financial factors' category, 15 factors were identified. These namely - capacity, character, economic condition, collateral, purpose, knowledge, business ability, geographical risk, industry risk, third party opinion, size of business, experience, strategic planning, competence management, and market involved.

With reference to figure 1, the arrow that connects the 'financial factors' and 'non-financial factors', showed that each element under the both groups are related with each other and also built a strong relationship. This relationship will determine the success factors for SMEs financing.

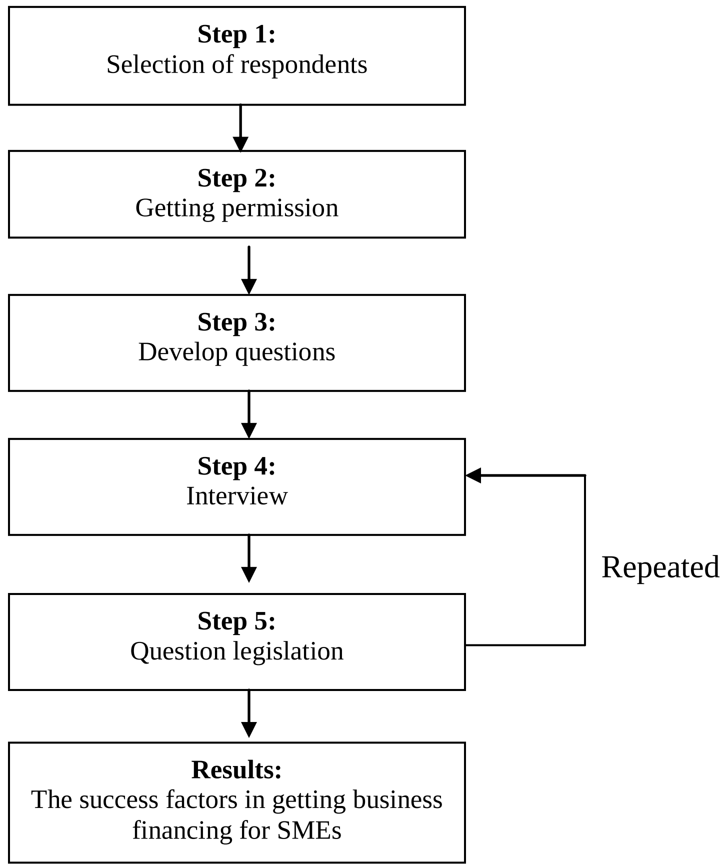
4.1 Qualitative Method

The research methodology use in this study is a qualitative method. Qualitative research methodologies were used for this research for three reasons. The first reason is related to the objectives of the research. This research seeks to explore the little-researched area of what are the successes factors in getting the business financing for SMEs? That is, this research is theory building rather than theory testing. Qualitative methods address theory building rather than the theory testing that is used by quantitative methods. In the early stage of theory development like this research, where phenomenon are not known, qualitative research methods could be used because prematurely used quantitative research methods can lead to inconclusive findings.

Interview data is a major source of information for many qualitative researchers (Carson et al, 2001). Interviews can be categorized as highly structured or highly unstructured, these two points being the poles of a continuum (Sekaran et al, 2001). The range from unstructured interviews designed to discover in-depth insights and understanding, and more structured interviewing focusing on a technique called *convergent interviewing*, an approach particularly useful in business research (Carson et al, 2001).

For this study, the convergent interview is used in the collection of data. According to Carson et al. (2001), the convergent interview is a methodology that allows a relatively structured approach to sort out what needs to be done in a research project in the early stages. It also a technique for collecting, analyzing and interpreting qualitative information about people’s attitudes, beliefs, knowledge and opinions through the use of a limited number of interviews with experts that converge on the most important issues within a topic area.

Figure 2: Steps in Conducting Convergent Interviews



Source: Adapted from Mohd Harif, MAA 2001, 'Financial planning in the establishment of a new franchise system in Malaysia: An action research study', Doctor of Philosophy Thesis, Faculty of Business and Commerce, University of Southern Queensland Toowoomba, Australia.

Figure 2 shows the five steps to conduct convergent interview in the process of collecting the information or data about the success factors in getting the business financing for SMEs. Each step is consequence, but at the step four and five, it must be repeated to each different respondent.

4.2 Sampling and Data Collection

All the information required for this study was derived from primary data and these were gathered during the process of conducting convergent interviews. All the ten major banks in Malaysia were selected for the purpose of this research because there are the largest and important group of financial institutions in Malaysia. Moreover, for most local businesses, banks are often the major source of credit (Rose, 1999). However, out of the ten major banks in Malaysia, researcher only managed to conduct interviews with only seven banks. These seven banks were most appropriate as they are actively involved in lending to SMEs in Malaysia. The seven banks selected are: Alliance Bank Malaysia Bhd, Bumiputra-Commerce Bank Bhd, EON Bank Bhd, Malayan Banking Bhd, Public Bank Bhd, RHB Bank Bhd, Malayan Banking Bhd (Maybank), and SME Bank.

4.3 Method of Data Interpretation

The procedure used for analyzing and interpreting the convergent interview data is discussed. Firstly, after each individual interview, the taped interview was listened to in order to clarify and expand the key issues into summary notes. Each interview was transcribed within a day of the interview. Secondly, a progressive interpretation report was written by comparing the summary notes of the first two interviews. This progressive report was then compared to each subsequent interview's summary notes and added to, and/or modified according to new issues that emerged after each interview.

4.3.1 Cross Case Analysis

The cross-case analysis methodology was used in interpretation data for this study. This method entailed making an in-depth analysis with each respondent for considering the success factors in getting the business financing for SMEs. The findings in this study was gathered from the similarity existed in the analysis have been done with each respondents (Denzin, 1983). The cross-case analysis enabled the comparison of different cases against predefined categories (i.e. commitment process drivers and the assumptions identified in commitment model analysis).

This method have been chosen because the cross case analysis enables the comparison of multiple cases in many divergent ways, which would not be possible within a single case analysis. The case comparison can be made against predefined categories, in search of similarities and differences, or by classifying the data according to data sources. This method also will give more accurate result due to increase in the generalization (Denzin 1983; Miles & Huberman 1994). Additionally, this anlysis can increase the understanding and explanation (Glaser & Strauss 1967; Glaser & Strauss 1970) about the issues studied (Denzin 1983). This is because, when presented with many different situations, the researcher would be able to obtain a clearer picture and in-depth views about the event or matter being investigated. The researcher will then be in a position to predict the probability of the event or finding will happening or not.

5. Discussion and Findings

In the convergent interview, the probe questions were developed, so that an assessment could be made of the framework of the success factors in getting business financing for SMEs. The study tended to confirm the conceptual framework developed. Table 3 constitute all the questions and also answers gathered from the convergent interview.

The first question asked of each interviewee (Question 1) was a broad and general question developed is to establish rapport, as shown in table 3. The question probes the respondent to tell the interviewer the story of their experiences in banking sector and also their experience in SMEs industry. This question was asked is to know about the interviewee experience in banking and SMEs sector, how long they involved in credit. Respond from the respondent shown that most of the respondents are involved in credit since their first start working in banking sector. So, most of the credit officer started their job in credit area since they enter in banking sector which shown that they have a lot of experience in credit. From the seven respondents only two (row 1 in table 3) did not tell about their experience in banking sector because of the time is limited and maybe they think that is not too important for them to answer it.

Questions 2 were asked "how your bank defined SMEs industry?" This question was built in order to know whether exist the differences between the commercial bank at Malaysia in define the SMEs sector. The definition of SMEs is not consistent across the process of interview with the bank. But for the purposed of this study, we have not attempted to apply a rigid criterion to define SMEs.

Table 3: Data From the Interviews

Questions	Bank 1	Bank 2	Bank 3	Bank 4	Bank 5	Bank 6	Bank 7
1. Can you tell about your experiance in banking and also in SMEs sector?	-start in loan at MIDF in 2001 -2004 enter RHB also in loan	**	-1993 start in credit at Kuan Yik Bank -2001 resign, enter EON bank Group also in commercial credit until now.	**	-5 yrs experiance in SME bank and just 3 yrs transfer to Kedah branch	-14 yrs	- 10 yrs in credit
2.How does your bank defined the SME industry?	-Employee <150	-networth or shareholders' fund <10m	Small - Employee< 50 - sales turnover < 10m Medium - employee 51-150 -sales turnover 10-25m	-Employee < 250 -Sales turnover<25m	**Manufacturing** # medium -sales turnover >10m -employee 51-150 (full time) # small -sales turnover 0.25m -10m -employee 5-50 (full time) # micro -sales turnover <0.25m employee < 5 (full time) **services** # medium -sales turnover 1m-5m -employee 20-50 (full time) # small -sales turnover 0.2m -1m -employee 5-19 (full time) # micro -sales turnover < .2m employee < 5 (full time)	**Manufacturing** -sales between 0.25m – 25m -employee <150 **agriculture/ construction/ services** -sales between 0.2m – 5m -employess <50	-paid-up capital <RM5 million.
3.Can you explain about the process of giving financing to this sector?	-application form - once qualify required doc. - evaluation	**	-marketing -request basic document=audited acc (co sdn bhd), unaudited acc.3 yrs.(partnership), bank statement 6 mth, -disscuss abt collateral	-application -request document -interview borrower	Depend on the customer whether 1) walk-in 2) by email 3)by letter or call 1st:interview to see whether the customer is qualify or not 2nd once qualify require to submit working paper or business plan	Clasify the borrower –the business must operation at least 2 yrs. -required doc - interview and site visit	-marketing i) officer go to search the borower ii) existing customer-enhance the facilities iii) walk-in suctomer -request basic doc
4. Can you justify what are the factors that your bank looked for before giving the credit to SME business.	-management -capability dlm business. - industry -financial -product	-5C's-capital characeter capacity condition collateral - industry -produk -financial statement	- financial account (networth) - loan track record -conduct of current account - industry risk -integrity of borrower -scriss report	-financial statement 3 yrs -networth/capital -character -purpose -track record -guarantor /collateral -business plan	Look at 2 criteria 1)starting business - proposal -market - management -financial -knowledge of borrower 2) old business - past record - mgmt acc. - market -purpose of the loan - financial statement	-Already have business to look their financial -purpose of the loan -capacity to repay -character -condition -collateral -knowledge of borrower -business	- vaibality of business -management -conduct of current account -security/ collateral -track record -market -financial statement
5. From all of these factors, which factors are the success factors in getting the business financing for SMEs.	-operation dr segi management, produk, scriss -financial -market of business	-Character of borrower -produk -opportunity in market -industry -conduct of current account.	- financial account (networth) - loan track record -conduct of current account - industry of business	-financial statement 3 yrs -networth/capital -purpose -track record -business plan	- market involve -financial / past record - management	-character - capacity to repay -business plan -business ability cashflow	-management -track record -vaibality of business -market
6. What are the actual factors that will make the loan application from SMEs be rejected by your bank?	-industry -availability of business -management -produk	-ratio yg rendah dr industry -industry -business/product -poor financial statement	- poor conduct of current account -poor financial statement -request not justify -exposure=amt given against collateral	-poor track record -poor financial statement	Because of 5Cs - character - capital -condition -capacity -collateral	-financial -business itself -capacity to repay	-Capability of repayment -poor management

* Question arising from the previous interview
** Questions that were not anwsered

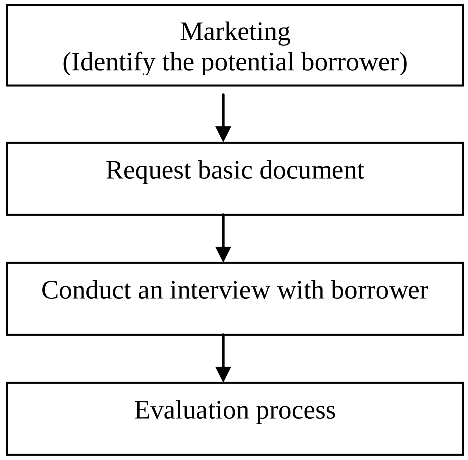
From the reconciliation of the answers given by the respondents, the researcher found that most of banks classified the SMEs based on the employees and annual sales turnover (row 2 in table 3). The average number of employees used by these banks (respondent 1, 3, 4, and 5 in table 4.1) to consider as SMEs business is less than 50 employees for small business and less than 150 employees for medium enterprise, while, the average amount annual sales turnover is less than RM10 million for small business and less than RM25 million for medium enterprise. Thus, this definition is aligning with the SMEs definition used in Malaysia.

Respondent 2 (Bank 2 in table 3) didn't used an employees and annual sales turnover to define SMEs but used a net worth or shareholders fund. The average amount shareholders fund is less than RM10 million, no differences for small or medium enterprise. Thus, this definition closely suited with the SMEs definition used in Malaysia. Respondent 7 (Bank 7 - column 8 in table 3) mentioned their bank used a paid-up capital in define the business is SMEs or not. The amount of paid-up capital for classify SMEs is less than RM5 million.

In question 3 the respondent was asked "how the process of giving the financing to the SMEs sector?" From this question, we can know how these banks process the SMEs loan application, what are the steps before getting the financing and what the customer must do to apply the business financing from these banks. From the seven respondents, only one didn't answer this question (Bank 2 in row 2, column 3 in table 3). The answer from the six respondents is quite similar. That is all the banks used the same process in providing the financing to the customer. Thus, it will support the research issues.

The conclusion we can deduce from the findings given by the respondents is that there are normally four steps in loan processing as shown in figure 3. The first step is to identify the borrower which mean the bank do a marketing to find potential borrower. Respondent 7 (Bank 7 - in row 3, column 8 in table 3) stated that the marketing is done whether the officer will go out to search a potential borrower or the bank enhances the facility of existing customers or walk-in customers. The findings from respondent 5 also support this statement given by respondent 7. The second step after they classify the potential borrowers, the bankers will request basic documents such as 3 years financial statement, bank statement and also for respondent 5 they will request a business plan. Then, the bankers will arrange an interview with the potential borrower to know better about the customer. The final step is making an evaluation with the information gathered from the borrowers in order to determine whether that customer is eligible or not for financing.

Figure 3: Steps in Loans Processing For SMEs Financing



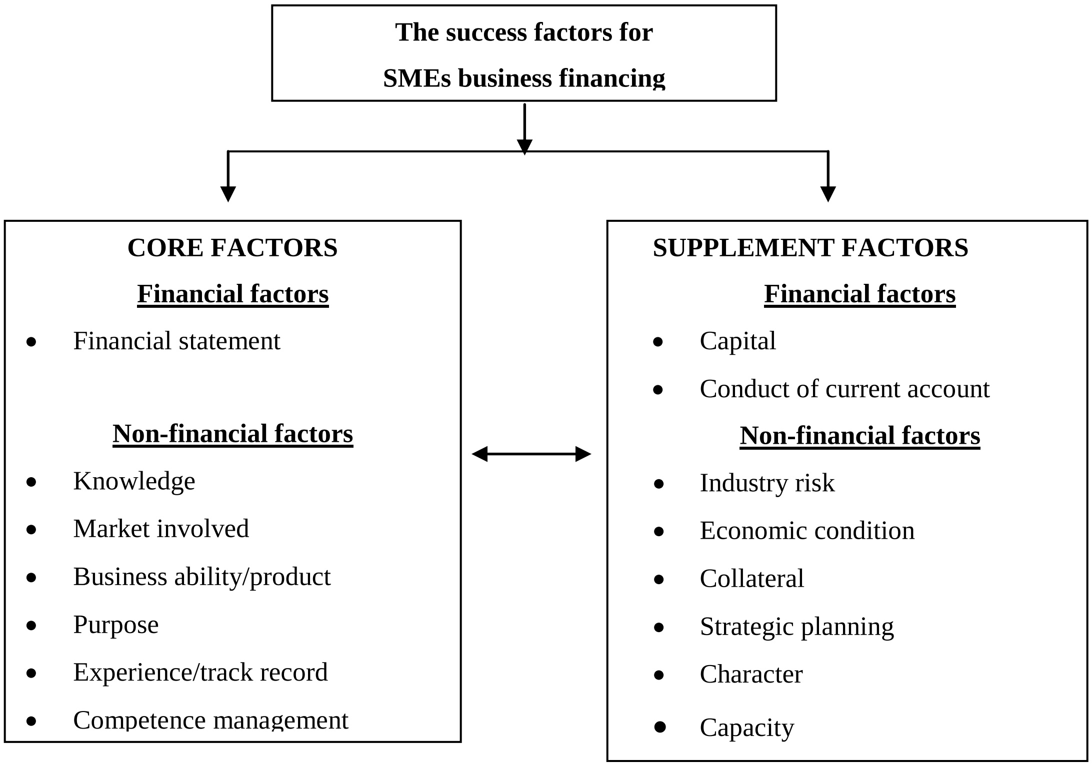
Question 4 was asked in order to probe and identify the factors are looking by banks in giving the financing to entrepreneur who involved in the SMEs sector. This question was built is to answer the main research problems of this research. Table 4 provides the summary of the analysis of the factors which are considered by banks in providing the business financing for SMEs.

In summary, of the 19 factors listed based on literature used by the banks in providing the business financing for SMEs, only 15 factors were identified from the reconciling of the convergent interview as factors used by the banks in getting business financing for SMEs including 1 new factor. All these 15 factors are; financial statement, purpose, business ability, knowledge, capacity, character, economic condition, collateral, capital, competence management, market involved, industry risk, experience, strategic planning, and *conduct of current account*. In addition, 5 factors which are sources of repayment, third-party opinion, size of business, financial projection and market involved are not considered by the respondents as a factor used by the banks in providing the business financing for SMEs.

The next question (no. 5), “from these all factors which factors is considered as a success factor in getting business financing for SMEs?” was built to reaffirm the answers to question no. 4.

By reconciling from the results from the convergent interviews with the seven respondents, we found only 7 apart of 15 factors considered by the bank as a success factors in getting the business financing for SMEs. These 7 factors then categorized as ‘core factors’. Besides that, the other 8 factors have been listed as ‘supplement factors’. Then all these factors also have been categorized as ‘financial factors’ and “non-financial factors”, as shown in figure 4.

Figure 4: The Success Factors for SMEs Business Financing



Question 6 was asked in order to identify what were the factors that will cause the application from SMEs to be rejected by the banks. This question was asked to specifically identify the exact reasons why bankers rejected the financing application. The answers to this question may also be used by the applicant as a guideline in future when they want to apply the business financing. A review of the answers given by all the seven respondents found that poor presentation in financial statement becomes one of the factors for the banks to reject the application of business financing. The respondent which mentioned it are respondents 2, 3, 4, and respondent 6. They mentioned, if the financial statement submitted by the applicant does not present a good performance of the business, then it will make the evaluation process difficult, because the SME could not achieve the targeted business performance. This in turn will result in the bankers having no confidence with the capability of the business to repay back the financing. The other factor is *business* itself will affect the application of financing. Respondents 1, 2.and 6 agreed with this factor because when banks do an evaluation at the business to identify whether the businesses have the ability to generate income with the product and services provided by them. If banks not satisfied and they think that the business cannot go on, they will reject the application outright.

Then, the other factor is a *capacity* to repay the loan. Three of respondents namely respondent 5, 6, and 7 agreed that the capacity of repayment is important in financing.

Hence, in the evaluation process if the bankers not satisfied with the capacity of applicant to repay the loan, the application will be rejected by the banks. The *management* was also one of the factors that will cause the financing to be rejected by the banks. These were supported by the findings from respondents 1 and 7. If the bankers can identify poor management of the SMEs, they will not provide the financing. This is because the management team is seen to be the important backbone of the SME in determining the success or failure of business.

Two of the respondents (respondents 1 and 2) mentioned the other factor that caused rejection of financing is the type of *industry.* This happen because the banks is not keen to finance certain industrial sector. For example nowadays most of the banks are not interested to finance the property development industry because this sector is high risk. So, if the banker found the applicant is involved in the risky industry, they will reject the application. The other two respondents which is (respondents 3 and 5) mentioned that the *collateral* criterion becomes one of the factors the financing maybe reject by the banks because sometimes bank will request the borrower to prepare a suitable security for financing, so if the borrower failed, they can’t provide the financing.

From the convergent interviews, one respondent considered the purpose, experience/track record, conduct of current account, character, capital and economic condition as the factors that will caused the financing to be rejected. Respondent 3 cited the *purpose* of the loan because sometimes the purpose of loan stated by applicant does not justify their business. That is the reason why the financing application was rejected. Respondent 4 reported that the *experience* of owner have a big impact in application of financing whereas respondent 3 stated that the poorly conducted *current accounts* will caused the application to be rejected by the bank because it showed that the applicant does not know how to manage and use the facilities provide by the banks. Respondent 5 considered *character, capacity, and economic condition* to be factors that caused a financing application to be rejected. That is because character will influence the business, if the bank found the applicant character is not good they will also not want to take a risk by giving the financing to that person. The *capacity* factor in turn is used by the bank to identify whether the borrower has also put their own money into the business or all of that came from the bank.

Table 4: The Factors Considered by Banks for SMEs Business Financing

No.	The success factors (cited in literature)	A	B	C	D	E	F	G	Total
1	Financial statement	√	√	√	√	√	√	√	7
2	Sources of repayment	x	x	x	x	x	x	x	0
3	Purpose	x	x	x	√	√	√	x	3
4	Business ability/product	√	√	x	x	x	√	√	4
5	Knowledge	x	x	x	x	√	√	x	2
6	Third-party opinion	x	x	x	x	x	x	x	0
7	Size of business	x	x	x	x	x	X	x	0
8	Capacity	x	√	x	x	x	√	x	2
9	Character	√	√	√	√	x	√	x	5
10	Economic condition	x	√	x	x	x	√	x	2
11	Collateral	x	√	x	√	x	√	√	4
12	Capital	x	√	x	√	x	x	x	2
13	Competence management	√	x	x	x	√	x	√	3
14	Financial projection	x	x	x	x	x	x	x	0
15	Geographical risk	x	x	x	x	x	x	x	0
16	Market involved	√	√	x	x	√	x	√	4
17	Industry risk	√	√	√	x	x	x	x	3
18	Experience/track record	x	x	√	√	√	x	√	4
19	Strategic planning	x	x	x	√	√	√	x	3
20	*Conduct of current account (new contribute)*	√	√	√	x	x	x	√	4

Key to table:
A – Respondent 1
B – Respondent 2
C – Respondent 3
D – Respondent 4
E – Respondent 5
F – Respondent 6
G – Respondent 7
x – Factors not used by the banks
√ - Factors used by the banks

Based on the conversations conducted during the convergent interviews with the respondents, 12 factors have been considered by the banks to reject the business financing application. All these 12 factors are; poor financial statement, inability of business, less confident in capacity to repay, poor management, high risk industry, lack of collateral, purpose is not justify, no experience, poor conduct of current account, bad character, lack of capital and bad economic condition. In addition, this research has also analyzed the findings from the convergent interview. From the analysis and as illustrated in figure 4, only 15 factors were considered as *success factors* in getting the business financing for SMEs in Malaysia. Out of these 15 factors, 7 factors were identified and categorised under the *core fact*ors based on the number of responses by the respondents during the convergent interviews. The remaining 8 factors were categorised under the *supplement factors* based on the number of response by the respondents during the convergent interview.

6. Conclusion and Limitations

To answer the research problem "what are the banks' determining (or success factors) factors in getting the business financing for SMEs" two models are proposed. In the first model, all the 15 factors used by the banks in evaluating the provision of financing for SMEs in Malaysia are listed as shown in table 4. To provide in-depth findings from this research, model 2 has been designed to list the success factors for SMEs business financing that can be used by entrepreneur in getting the business financing, as shown in figure 4. This model listed the 15 success factors comprised of 3 factors as 'financial factors' and 12 factors as 'non-financial factors'. Moreover, the factors were categorized into two categories: core and supplement factors. From the 15 factor listed, 7 factors were included in core factor and others 8 factors were included in supplement factor. This research finding could be used to other place that have the same settings as this research used, that is, may be could be applied to all developing might as well to developed countries.

From these research findings, some main implications or inputs could be made use of for stakeholders who are directly and indirectly involved in the provision of business financing for SMEs in Malaysia. These stakeholders will include the government and its related agencies that oversee the designing and implementation of SMEs development policies, the banks and other financial institutions and the SMEs owners themselves. The first implication of this research is for the policy makers to provide more pragmatic guidelines to the relevant stakeholders when evaluating the applications based on *success factors* identified from this study. This will serve to further improve the SMEs business financing machinery and will further enhance the development of SMEs in Malaysia. Another implication from this research is the need for the SMEs themselves to understand what bankers look for when they submit their applications for business financing of their SMEs. This will assist in improving their 'success rate of getting their loans approved.

Among some of the limitations of this research is the inability of the researchers in getting all the ten top banks to participate in this study. Nevertheless, the sample of 7 banks out of the 10 constitutes a healthy seventy percent sampling rate. The other limitation is the sometimes difficult situations whereby the bankers who are governed by the strict banking act which prohibits the divulging freely or provision of banking information especially with regard to operational and evaluating criteria used in the business financing applications. However, through the use of qualitative interview techniques which permitted the use of the researchers' skill and probing techniques, the information required from the bankers were ably teased out by them.

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