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Determinants of Credit Facility Provision among Small Retailers in Malaysia: The Bankers' Perspective

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This study examines the determinants of credit facilities provision among the small retailers in Malaysia. Specifically, this study examines as to why many small retailers are facing difficulties in obtaining credit facilities from the banks. Using a qualitative approach on bank officers located in Selangor, Malaysia, this study shows that there are three main determinants to credit facilities to the small retailers. The three main determinants are attitude of the small retailers, credit policy of the banks and the quality of financial reports and documents. Within the attitude of small retailers, this study shows that poor repayment capability, poor personal credit rating and good attitude of the small retailers can become a hindrance to obtaining credit facilities from the banks. This study also shows that within the credit policy of the banks, the need for security and collateral, and also sufficient funds in the bank account of the small retailers also influence the bank officers' decision in approving the credit facilities. Finally, the banks would require the small retailers to provide proper financial statements and complete documents when submitting for credit facilities application. The findings of this study indicate that the provision of credit facilities can be obtained if the small retailers know what are the criteria in getting their application approved. This study recommends that the relevant parties such as the professional accountants and the universities to play role in offering free consultancy work related to preparation of financial statements. In addition, the banks can also assist the small retailers in documentations for easy access to credit facility.

Key words: *Credit facility, financial reporting, small retailers, Malaysia.*

Introduction

The Small and Medium Enterprises (SMEs) is one of the industries that drive the development of any economy and even more so to the development of the developing countries. The economic boom in the Asean countries attributed by the SMEs have seen the employment of many people and of consequence, lifted the people out of poverty to become middle class people (Tanzer, 2005; Gbandi & Amissah, 2014). Malaysia is not an exception to this scenario as the statistics show that the SMEs had contributed RM435.1 billion in 2017 to the Malaysian economy with a real gross domestic product growth of 7.2% compared to 2016 5.2%, resulting in its contribution to the country's GDP rising to 37.1% in 2017 compared to 2016 36.6%. The SMEs are expected to play a greater role in becoming a key driver of growth for a country, particularly for the developing country such as Malaysia. This is aligned with the Ninth Malaysia Plan (2006-2010) that had underlined the principal SME policy, which is the development of a competitive, innovative and technologically strong SME sector that would contribute to the domestic economy and compete globally (Jaafar, Selamat, Ismail & Hamzah, 2011).

One of the key players within the SMEs is the small retailers. Small retailers are those that have annual sales turnover from RM300,000 but less than RM3 million and full-time employees from 5 to 30. The Malaysian government treats small retailers as a major priority of the economy development and the government has provided a large budget for the small retailer to grow and sustain in the business world. The number of small retailers in Malaysia has increased over the years which are more than 50,000 small retailers registered in Malaysia (SMECorp, 2016). The small retailers have evolved to become one of the income generators for the country (Mittal and Batra, 2004).

Despite the increasing numbers and significance of SMEs to the economic growth, recent studies have shown that 60% of the SMEs fail within the first five years of operation (Boachie-Mensah and Marfo-Yiadom, 2005; Aduzzaman, 2016). One may pose a question on why this scenario exists. Among the reasons why such scenario exists are lack of access to credit facility, limited adoption of technology, lack of human resources, competition from MNCs and globalisation (Ting, 2004; Jaafar et al, 2011). Sarapaivanich (2003) argued that misuse and untimely, poorly recorded and inaccurate accounting information. Of consequence, this leads the SMEs to assess their financial situation inaccurately and make poor financial decisions. In the worst case, SMEs might fail and perhaps bankrupt at the end (Stice, Stice, Albrecht, Skousen & Swain, 1999). Another possible reason is the shortage of capital due to number of reasons such as lack of access to credit facility from the banks (Gamage 2000). However, there is yet a study that has conducted to examine the credit facility provision of the banks using a Malaysian setting.

This study aims to examine the credit facility provision by the banks for the small retailers. Specifically, this study examines the reasons as to why the small retailers fail to obtain credit facility from the banks. Using sample in the area of Kuala Selangor, the findings in this study would assist the government and other related parties including the banks and the accounting profession in understanding the determinants of credit facility provision among small retailers. The remainder of this paper is structured as follows. The next section, Section 2 provides the literature review. Section 3 outlines the research design. The results of the data analyses and discussions are shown in Section 4. The last section, Section 5 concludes this study.

Literature Review

Small and Medium Enterprises

The definition of SMEs differs with jurisdiction and there is no consensus on the real definition of Small and Medium scale enterprises (SMEs) as the terms, 'Small' and 'Medium' are relative and they differ from industry to industry and country to country (Ezeagba, 2017; Kamaruzzaman & Ghani, 2019). In Malaysia, the Small and Medium Industries Development Cooperation (SMIDEC) defines a SME as a small and medium size business which can be grouped into three sizes namely, micro, small or medium. The size of a SME in Malaysia is determined by the number of its employees and its annual sales turnover (SMECorp, 2016). It is divided into two main categories namely, manufacturing, and services and other sectors. For manufacturing, small-sized SME is defined as those that have annual sales turnover of more than RM300,000 but less than RM15 million and have full-time employees ranging from 5 to 75 employees. On the other hand, medium-sized SMEs are those that have an annual sales turnover from RM15 million but not exceeding RM50 million with full-time employees of more than 75 but not exceeding 200 employees.

For SMEs under the services and other sectors, small-sized SMEs are those that have annual sales turnover from RM300,000 but less than RM3 million and full-time employees from 5 to 30, whilst for medium-sized SMEs, the sales turnover must be from RM3 million but not exceeding RM20 million and have full-time employees from 30 to 75 employees. Small retailers are classified under the services and other services industry (SMECorp, 2016).

Small Retailers and Credit Facility Provision

SMEs are often set up using two forms of financing namely, the internal source and the external source (Ogujuiba, Ohuche & Adenuga, 2004, Jaafar et al., 2011, Gbandi & Amissah, 2014). These two forms of financing are fundamental to the agility of the SMEs (Aruwa, 2004). The internal source of financing can come from friends, relatives and cooperatives (Gbandi & Amissah, 2014) whilst the external source of financing comes from the formal finance institutions such as commercial banks, microfinance banks and international development agencies (Gbandi & Amissah, 2014). These external sources would provide many types of credit facility such as bank loan, revolving credit and bank overdrafts to companies in order for them to operate their business. Since a critical element in the development of the SMEs is access to finance, particularly in credit facility, it is important to examine this issue.

A group of studies have examined the provision of credit facility to SMEs. These studies conducted provision of credit facilities in various dimensions. One of the dimensions is the challenges faced by the SMEs in obtaining capital to finance their operations (Ogujuiba et al. 2004, Kauffmann, 2005). For example: Ogujuiba et al (2004) found that many SMEs in Nigeria failed to continue their business due to their failure to obtain financing. Similar findings were also reported in the World Bank Report (2001). The report reported that 39% of the small size SMEs and 37% of the medium size SMEs are having financial constraints due to inability to obtain financing from the banks. Although studies have shown that commercial banks and development banks are the most popular source of finance for the SMES (Jaffar et al, 2011), often the SMEs faced difficulty to obtain loans (Aruwa, 2004; Gbandi & Amissah, 2014). Carsberg, Page, Sindall and Waring (1985) and Deakins and Husain (1994) suggested the reason for the SMEs not being able to obtain loan is due to the SMES failing to provide financial reports to the banks.

Several studies have shown that financing is a greater obstacle for the MSEs as compared to the large companies particularly in the developing countries. These studies suggested that access to finance can adversely affect the growth of the MSEs as opposed to the larger companies (Beck, Demirgoc-Kunt & Maksimovic, 2005; Gichuki, Njery & Tirimba, 2014). These studies suggested that assessing credit is a major obstacle to SMEs and often the banks would demand for the SMEs to provide collateral of which affect their access to credit facility. For example: Ackah and Vuvor (2011) noted that although the government policy in Ghana have substantially increased the banks' lending to the SMEs however, the limited access to credit, high interest rates and prohibitive collateral requirements still pose significant constraints to the SMEs. This behaviour is common among the banks which consequently, force the SMEs to limit their investments to retained earnings and thus, affecting their agility (Gichuki et al, 2014).

Another reason as to why the SMEs fail to obtain credit facility could be attributed to the lack of information about their business (Ackah & Vuvor, 2011). The SMEs often have a vast of information about the potential of their business. However, the owner of the SMES often having difficulty to articulate and provide detailed information to the banks that lead to failure in obtaining credit facility. In addition, the SMEs may tend to become restrictive in providing detailed information about the business as required by the banks as they are afraid that the information about their business maybe leak to their competitors (Winborg & Landstrom, 2000; Ackah & Vuvor, 2011).

A body of the literature has also suggested that the lack of qualified staff in the SMEs deter them to obtain credit facilities from the banks. Banks often would require financial reports from the SMEs (Osoro & Muturi, 2013). However, the lack of capacity of the SMEs' staff lead to the failure of the SMEs to provide financial reports of high quality which is an important criterion to access credit facilities from the banks. The lack of the capacity of the SMEs' staff is because hiring experienced staffs are considered expensive for the SMEs (Adigwe, 2012). In addition, the banks often face difficulty in obtaining information to assess the risk of new unproven ventures or earnings prospects and the fact that the probability for new small ventures is considered to be high (Ackar & Vuvor, 2011). Of consequence, the banks face with uncertainty on the agility of the SMEs as lack of information on the SMEs' financial conditions (Ackar & Vuvor, 2011).

Research Design

Participants

The bank officers located in Selangor, Malaysia have been chosen as the participants in this study. Specifically, the bank officers are chosen as they are the ones who are in charge of approving credit facilities to the small retailers. In addition, this study chooses banks located in Selangor, Malaysia because most of the SMEs are located in Selangor and hence, most applications for credit facilities are done in the banks located in Selangor, Malaysia.

This study approached three bank officers to assist in achieving the research objectives of this study. The first bank officer is known as Mr A, who are working in a commercial bank located in Klang, Selangor whilst the second bank officer, Mr B is also working in a commercial bank located in Shah Alam, Selangor. The third bank officer is Mr C, who is working in a cooperative bank. All the bank officers have more than 10 years of related work experience. Therefore, the bank officers were deemed suitable to provide their perspective on the determinants of credit facility provision to the small retailers.

Research Instrument and Data Collection

This study relies on the qualitative approach and hence, interview using semi-structured questionnaire is designed. The interviews were held on a semi-structured survey basis in order to have a problem-focused approach, thereby allowing more personalized discussion to be conducted with the survey. The use of face to face interview allows the researchers to obtain view points of the interviewees with some flexibility to adjust and explain the questions (Curran & Blackburn, 2001). In addition, the interviewees have the opportunity to explain their thoughts and highlight area of interest and expertise (Horton, Macve & Struyven, 2004).

The questionnaire was developed on the basis of this study of which was later discussed and refined in a discussion with a panel of academics experienced in conducting qualitative research and banking. It consists of two sections, namely personal questions about the participants and on the determinants of credit facility provision practice by the banks for the small retailers.

The participants were approached during office hours. An appointment was set beforehand with the bank officers to meet for the interview. Questions were posed to the bankers and it took about an hour to two hours for each interview. Upon completion of the data collection, the interviews were recorded and subsequently transcribed. The text results were then structured and categorized according to major themes, followed by a specific coding, which was subsequently used to structure and guide the data evaluation process.

Findings

The coding analysis that results in a category system provides three main themes namely, attitude of small retailers, credit policy of the banks and financial reporting quality of the small retailers.

Attitude of Small Retailers

The participants interviewed shared the view that one of the determinants to the difficulty in obtaining credit provision is attributed by the attitude of the small retailers. Under this theme, the study shows that attitude of small retailers can influence the bank officers' decision to provide credit facilities. One of the attitudes that the bank officers would look into is on the bad credit score. Bad credit score refers to an individual's poor history in settling his debt on time and likelihood to default payment. Often, the banks would observe at the borrowing history of the small retailers and determined whether the small retailers have had a bad history of loan default and if yes, this would affect the banks in providing credit facilities to the small retailers. As noted by bank officer, Mr A:

> *When the company apply for a loan, Banks will also look at the company's borrowing history, and they calculated the business credit scores. The Bank want to see the history of borrowing and repaying loans. The company or directors may face difficulties of securing the loan if they have defaulted the loans repayment in the past. The Central Credit Reference Information System (CCRIS) report will be able to track*

> *whether you have made the minimum payment or the full payment, or if you have late or overdue payments. The CCRIS can even track your outstanding balance for the month, so even a small amount that is left unpaid for several months may not be favourable for you.*

In addition, the banks would also look at the personal credit score of the small retailers. Personal credit score refers to a statistical number that evaluates an individual's creditworthiness often based on credit history. Mr B provided his opinion.

> *One of the most common reasons to decline a loan is if the borrowers considers your credit score to be "too low." The magic number will vary depending on the borrowers and the circumstances. Sometimes, the director or the owner personal loan also become a factor for the business loan to be approved, even if your company has been doing well. If you are unable to manage your personal loan and unable to service properly, the logic is, how reliable is it if you pay for a business loan?*

Mr C, the bank officer from the co-operative bank noted that:

> *Normally banks will ask for personal guarantor by the directors for a business loan application. Your personal record of bankruptcy, summonses or litigation cases against directors or owners is also an important factor for a loan application to be approved. So, directors' personal records should be good. Even though it happened in the past. All of these records can be easily traced by banks through credit reporting agencies such as CTOS Data Systems Sdn Bhd (private limited) and RAM Credit Information (private limited). Past loan refusals are taken into accounts by the Bank. So, make sure all necessary documents or applications are done properly to minimize any unnecessary rejections.*

Mr A, then provided his view on the reason why the banks would refuse providing credit facilities to the small retailers. He noted that:

> *Banks are unlikely to give you a business loan and may reduce the loan margin if they see that you personally already have financial commitments that entail a considerable amount to be paid monthly such as credit cards, car loans, study loans and personal loans. All your monthly commitments are traceable via the Central Credit Reference Information System (CCRIS) report. Even study loans like PTPTN is also captured.*

Surprisingly, upon further discussion with the bank officers, this study shows that good attitude of the small retailers can also a reason for the bankers not to provide credit facilities. The bank officers provided their opinion that an individual with no previous records with the banks provide doubts to the bank officers on whether the individual would not default payment. As noted by Mr B:

> *Some people do not like to have credit cards due to the fear that they may overspend or some just simply prefer to spend what they have in their bank accounts. While being cautious with your spending is good, having no credit facilities means having no past repayment records and the banks will not be able to know whether you are a good "paymaster" or not. Therefore, it may be beneficial to have one or two credit facilities such as credit cards. But, of course, it is important to spend and repay on time before the due date — this is important to show that you are a good paymaster. This will also help you and to increase the banker's confidence to lend you the money.*

In sum, this study finds that attitude of the small retailers can influence the banks' decision to provide or not to provide credit facilities to the small retailers. Having bad attitudes would deter the ability of the small retailers to obtain credit facilities. However, in the case whether the small traders have no history of using the banks' credit facilities, such attitude although considered good, can also become a hindrance towards provision of credit facilities.

Credit Policy of the Banks

Another determinant to the provision of credit facilities is on the credit policy of the banks. One of the credit policies imposed by the banks is repayment capacity of the small retailers. Repayment capacity refers to the individual's ability to repay debt from his regular income. In this study, it shows that banks would often look at the repayment capacity of the small retailer before making decisions. As noted by Mr B:

> *In processing the loan applications from any business including small retailers, we (bankers) want see the ability of the borrowers to make the minimum monthly payments before we approve the loan application. We calculate the debt to income ratio or debt service ratio (DSR) to see whether the company can handle the minimum payments. The debt service ratio (DSR) is calculated based on the applicant's total loan commitment against the total income. Higher DSR gives indication to more debt and a higher chance of getting the loan to be rejected.*

In addition, Mr B also noted that:

> *We will compare how much the average earnings every month to how much the company spend on debt repayment, that is for minimum payments. If in our opinion and calculations, the company does not have extra or enough cash to pay for a new loan, it is likely that the loan application will be rejected.*

This study also shows that having not enough security or collateral on the loan can also become a hindrance of provision of credit facilities to the small retailers. Often, banks would impose the small retailers to provide sufficient security or collateral before approving their credit facilities. Mr C provided his opinion on this matter:

> *Sometimes, banks also will evaluate the value of the collateral provided by the borrowers. Collateral may be in the form of buildings, land, machinery, fixed deposits and so on. If there is insufficient collateral value, it is possible that the application was not approved. We will also look at the security provided whether it is already being charged or not. We will ensure that the assets are allowed for second charge. If there is a restriction for the second charge, we have to reject the loan.*

In addition, the small retailers not having strong cash flow also become a hindrance for not getting credit facilities. It is common that when the small retailers want to apply for credit facilities, they need to provide evidence that their cash flow is strong. However, it is common for the small retailers not to prepare cash flow statement or budgeted cash flow which leads to banks not to approve credit facilities to the small retailers. Mr A opined:

> *Cash flow is one of the first things bankers look at when deciding whether to approve a small business loan. They will assess the financial projections and business plan whether your business potentially having a healthy cash flow. They want to know that you have enough cash flow to not only cover your business expenses, but also pay back the loan. And it will be very good if the business still has an excess cash after all that payments for business expansion. Poor cash flow management is a major cause of business failure. That is why your loan application was rejected. By using suitable system such as accounting software enables you to easily generate cash flow reports and projections - then, monitor your cash flow.*

Another credit policy of the banks before approving credit facilities to the small retailers is that they would check whether the small retailers to have sufficient funds in their bank account. As noted by Mr C:

> *What the banks normally do is to review your financial projections and business plan to make sure you're not underestimating the amount of capital you need. It sounds weird, but often, the more money you ask for, the more likely you are to obtain a bank loan. Sometimes, your business prospect is good and promising but the loan amount that you applied for was too small and does not reflect your business prospects. For banks, the cost of servicing small loans is not worth it, especially when you apply*

> *from a major bank. For them, it is not worth it to entertain your loan application because interest income to be generated from your loan is just too small.*

Unavailability of track records can also a hindrance for the banks to approve credit facilities to the small retailers particularly when they have just set up their business. Mr B provided his view:

> *If your business is relatively new, you may not have built up enough of a business performance and credit history to qualify for a small business loan. Of course, it's possible to have a very successful business and solid financial, even if you haven't been operating very long. Some Banks require you much more time in business than others in order to evaluate and grant you the loan.*

Mr A supported Mr B's opinion and provided his view in relation to new and risky industry. He noted that:

> *Sometimes, the industries where you are in just simply considered "risky" by certain banks. For example, food business such as restaurant is quite risky business to venture in because they have a high failure rate. In this situation, you need to have more creative and promising in presenting your business proposal. Also, venturing into a totally new business or industry is also considered a risky due to the banks have no background knowledge on it. There is no industry performance for them to compare with.*

In sum, credit policy of the banks can influence the bank officers' decision to provide or not to provide credit facilities to the bank retailers. The banks would look into few aspects of the small retailers such as payment capacity of the small retailers and whether the small retailers can provide some security or collateral when applying for credit facility. In addition, ensuring that the small retailers and the experience and type of industry are also part of the credit policy of the banks.

Quality of Financial Records and Documents

The last theme in this study that derived from the coding analysis is the quality of financial records and documents. Quality of financial records and documents often refer to the completeness of the record keeping of the small retailers. The small retailers can provide documents on information related to financial transaction as and when required. In addition, the small retailers provide the full set of financial statement represented by the statement of profit and loss, statement of financial statement and statement of cash flow. As noted by Mr A:

> *It is important to submit the correct documents to be evaluated especially those related to income and cash flows. Among the supporting documents most banks will ask for are a business plan, three to five years of business and personal tax returns, business bank account statements, financial statement/projections for the business, and your personal and business credit reports. They may also want to see legal documents related to your business such as rental, licenses, permits, and corporate documents. There are also other documents that can help to support a loan application such as a job contract in hand. That will add confident of the bank to lend you money.*

Mr B supported Mr A's opinion as he emphasized the need for the small retailers to have complete documents when applying for credit facilities from the banks. Mr B provided his opinion:

> *You need to make sure that the application form is filled up correctly and necessary documents required are attached completely. Sadly, one of the most common reasons small business loan applications are denied is that the applicant didn't complete the application correctly or didn't provide all the necessary backup information. Submission of complete document with promising business proposal are extremely important. Beside the past records of financial statements, the bank also looking for pro-forma balance sheet, income statement and cash flows.*

In sum, it is imperative that when applying for credit facilities, the bank officers would check the quality of the financial reports, particularly on whether the small retailers have submitted along with their application, the full set of financial statements. In addition, the small retailers are also required to submit all relevant documents related to their company such as company profile.

Conclusion

This study examines the determinants the credit facilities provision by the banks to the small retailers. Using qualitative analysis, the coding analysis identifies three main themes namely, the attitude of the small retailers, the credit policy of the banks and the quality of the financial reports and documents of the small retailers. With regards to the attitude of the small retailers, this study shows that the bank officers would look into the payment capacity as well as the personal credit score of the small retailers before approving the credit facilities to the small retailers. However, having good attitude does not guarantee that the banks would provide credit facilities to the small retailers due to uncertainty. Secondly, the banks would also would determine whether credit facilities should be given by referring to their credit policy such as whether the small retailers could provide security or collateral on the credit facilities. In addition, the banks would also ensure that the small retailers do have sufficient funds in their banks before approving the credit facilities. Finally, the banks would ensure that the small retailers have complete set of financial statements and documents when submitting application for credit facilities.

This study is not without limitations. First, this study relied on qualitative research by conducting interviews with the bank officers located in Selangor. Specifically, this study only relied on three bank officers. Although the researchers believe that the number of participants is sufficient to achieve the research objectives of this study, increasing the number of participants would perhaps provide a more robust finding. Secondly, this study focuses on the credit facilities provided by the banks. There are other financial institutions that also provide such facilities to the small retailers such as TEKUN, PUNB and TERAJU. However, these financial institutions are not included in this study. Future study may take these financial institutions in examining the determinants of credit facilities provision.

The findings in this study provide some understanding to the government and other related parties on the determinants of credit facilities provision to the small retailers. The government other related parties could provide awareness courses to the small retailers on how to obtain credit facilities and what are the documents needed in applying for credit provision. They can also provide courses relating to preparation of financial statements.

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