Bank Financing for Small and Medium-sized Enterprises (SMEs) in Libya

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ABSTRACT

Small and Medium-Sized Enterprises (SMEs) are of increasing importance for all national economies worldwide. Evidence already shows that SMEs are critical in key economic areas, including the distribution of income, the absorption of labour and the alleviation of poverty. As a result, SMEs have been increasingly the focus of policies and strategies that aim at achieving sustainable development goals in both developing and developed countries, regardless of any pre-existing differences in their underlying economic systems. However, despite widespread developments in recent decades, the lack of access to finance remains a formidable obstacle for SME development.

In seeking to diversify its economy and reduce its over-reliance on the large firm-dominated oil sector, Libya has chosen to focus on the role of SMEs to assist in achieving myriad economic and social development objectives. However, as the case in many other developing countries, Libyan SMEs face difficulties obtaining external finance, yet, there has been very little research undertaken to investigate the issues associated with their access to finance. This is particularly the case with bank financing, which as elsewhere, is the most important source of external finance for SMEs.

The purpose of this thesis is to address this deficiency and enhance our understanding of the attendant factors that facilitate or impair SMEs access to bank finance from a demand-side perspective as well as a supply-side perspective. To achieve this aim, we target the population of SMEs in the Libyan city of Benghazi as representatives of the demand side, and Bank Al Tanmeya, one of the main external finance providers for SMEs in Libya, as representative of the supply side. We gather the data using a combination of qualitative and quantitative methods. Data on the demand side are collected through a self-administrated questionnaire, whereas interviews and document analysis are the primary tools used to collect data on the supply side.

On the demand side, the findings reveal that bank finance represents the most important source of external finance for Libyan SMEs, especially during the post start-up stage. We find that SMEs approach banks for finance mainly for the purposes of modernization, expansion, and aiding working capital. In most cases, SMEs see banks as the most appropriate source of finance for the firm’s particular stage of development or because of an existing close relationship with banks and their staff. High interest rates, unreasonable levels of security and bureaucracy are the most cited difficulties
Libyan SMEs experience with bank finance. We also find that many SMEs are discouraged from applying for bank finance because of a lack of collateral, and most importantly, because of interest charges on bank loans due to religious considerations associated with Shariah (Islamic law). We find that Libyan SMEs view Islamic finance as a possible alternative source of finance, and one that they would use if available. In particular, the results indicate a strong preference for the Musharakah mode of finance.

In modelling SMEs accessibility to bank finance, the results of a stepwise logistic regression analysis indicate several factors that act as determinants of bank loan applications approval. These include firm size (in terms of employment), the business sector of operations, the age of the business, and the age and level of education of the owner-manager. In addition, SMEs having Bank Al Tanmeya as a their business partner are more likely to have access to bank finance.

On the supply side, the results reveal that Bank Al Tanmeya’s involvement with SMEs is mainly driven by their perceived profitability. However, the relative information opacity of SMEs and their weak financial infrastructure, as reflected in their lack of reliable collateral, the unavailability and unreliability of financial statement information, along with prevailing economic instability and the centralization of the bank’s organisational structure pose some negative effects on this involvement.

We also find that security/collateral, good business plans, and the profitability of the business are very important when processing SMEs loan applications. The type of the business activity, the applicants’ credit history, and their business experience are also found to be important. Based on assessment of the applicant’s creditworthiness, the central credit committee at the bank’s headquarters almost exclusively makes the final credit decision. Lastly, the results also reveal that to meet the potential increasing demand for Islamic finance products, and in accordance with newly-adopted banking regulations, Bank Al Tanmeya has plans to offer SME clients access to several Islamic finance products, mainly Murabahah, Ijarah, and Musharakah.

This study is the first of its kind in the Libyan context. As such, it contributes significantly to the existing body of literature on SME financing in developing countries generally, and in this case, the Middle East and North Africa particularly. The findings have important implications for policymaking and economic planning in Libya where the transition towards a more market-oriented economy is taking a place in which SMEs have a substantial role to play.
STATEMENT OF ORIGINALITY

This work has not been previously submitted for a degree or diploma in any university. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made within the thesis itself.

Abdulaziz M. A. Abdulsaleh

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DEDICATION

To the soul of my mother, my father, and my sisters and brothers.
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Chapter 1. Introduction

1.1 Background

Worldwide, small and medium-sized enterprises (SMEs) contribute greatly to the economies of all countries. Accordingly, over the past few decades, topics concerning SMEs have dominated the agenda of researchers, practitioners, and policymakers in both developed and developing countries alike. The recognition of the significant economic contributions of SMEs has resulted in increased attention to this sector. This widely growing acknowledgment of the importance of this sector is present in the fields of academia, economic planning, and public policy.

In both developed and developing economies, the SME sector plays a fundamental role in promoting economic prosperity through its significant contributions to income creation, the absorption of labour, and the alleviation of poverty (Roman, 2011; Fatoki, 2011; Qureshi and Herani, 2011; Yesseleva, 2010; Le and Nguyen, 2009; Altman and Sabato, 2005). According to the Organisation of Economic Co-operation and Development (OECD, 2004), SMEs contributed about 70 percent to employment and more than 55 percent to Gross Domestic Product (GDP) in high-income economies. In middle-income economies, the corresponding figures were 95 percent and 70 percent, and in low-income economies the statistics were 70 percent and 60 percent for employment and GDP respectively.

In addition, SMEs create additional exporting opportunities and increase possibilities for generating innovation. Other positive aspects associated with SMEs within an economy include the fostering of entrepreneurship, the opportunity for quick returns on investment towing to their relatively rapid establishment, assisting inter- and intra-regional decentralization, and their ability to act as a countervailing force against the economic power of larger enterprises (Cook, 2001). As a result, many countries, including Japan, Germany, Australia, and the US have been supporting and subsidising the development of SMEs and this has helped to achieve a quantum leap in both economic and social development in these countries.

Based on this ground, SMEs have been the focus of research in a number of areas including financing (e.g. Berger and Udell, 2006; Tucker and Lean, 2003; Van Auken and Neeley, 1996), innovation (e.g. Rammer and Schmiele, 2008; Zhang, Macpherson and Jones, 2006), and management (e.g. Hutchinson and Quintas, 2008; Ghobadian and
Gallear, 1996). A common finding is that access to finance is crucial for SMEs’ survival, growth, and development.

There is no doubt that access to finance is of crucial importance for the ongoing and sustainable growth of this key sector through its role in facilitating the creation of new businesses and nurturing the innovation process as well as promoting the growth and development of existing businesses, which in turn, boost national economic growth. In this context, there is typically a strong positive correlation between overall economic development (as measured by income per capita) and financial development (as measured by the ratio of private credit to GDP), on one hand, and the level of SME financing on the other (Ardic, Mylenko and Saltane, 2012).

As such, a well-functioning financial sector is vital in providing for the financing needs of SMEs. It is well known that while banks are the main providers of external finance to SMEs, bank finance is often not readily accessible for SMEs. In fact, a great deal has been written about SMEs having difficulties accessing finance from banks. Such issues have been proven to be of a global nature existing in both developed and developing economies but more so in the latter. This pattern sees no exception in Libya, a developing country in transition.

In Libya, it is only recently that SMEs have started to attract more attention as a means to restructure the national economy and reduce a traditional over-reliance on the predominately large-firm oil sector. However, access to finance, especially from banks, remains a key challenge for these entities. Given the fact that banks have been almost the sole primary component of the country’s financial system for some time, investigating their interaction, as a finance provider, with SMEs in the Libyan context is particularly important.

1.2 Thesis Context

Excessively reliant on the extraction of oil and gas as well as being burdened by an inefficient public sector, the Libyan economy is arguably one of the least diverse economies in the Middle East and North Africa (MENA) (IMF, 2007). However, fuelled by the transition from a planned economy to a market economy, the recent tendency has been towards encouraging and subsidising the private sector represented mainly by SMEs. As such, this sector has attracted the interest of decision makers in recent years. For example, 2006 saw the establishment of the Employment Fund, followed by the National Program for SMEs in 2007. The year 2010 saw the installation
of the basic legal infrastructure for developing the private sector with 22 new laws fundamentally changing regulations on commerce, customs, income tax, labour, and land registry easing the establishment of SMEs within the Libyan economy. More recently, in 2012, the new Libyan government launched Libya Enterprise. The mission of Libya Enterprise is to create a supportive environment for SMEs throughout the country by promoting entrepreneurial culture and providing business support for start-ups. Consequently, numerous SMEs have been started but many of them disappeared shortly afterwards mainly because of the lack of much needed funding especially from banks.

The existing literature is clearly an important source of information in developing an understanding of bank financing for SMEs. For decades, there have been numerous studies conducted to discuss the availability of bank financing to SME sector. It is interesting to note that the findings from these studies have contributed significantly to the enrichment of the literature on this subject. Unfortunately, however, most of this literature focuses on the US and the UK and other developed countries and very little research specifically concerns the developing world. Cook (2001) noted that the financing of SMEs remains one of the most under-researched areas in developing economies. Libya, as an emerging economy, is no exception.

Ahmad (2015) found that SMEs in Libya face a financing gap. A study by Al-rubaie (2008) argued that because of the absence of effective financial markets and poorly diversified credit structure in the country, SMEs in Libya often find themselves compelled to resort to banks to obtain loans necessary to finance their operations. However, SMEs in Libya remain more reliant on informal sources of finance as they lack basic trust in commercial banks (Samawi et al., 2016). Al-badri (2006) mentioned that the majority of SMEs in Libya are dependent on internal funding sources and only a small percentage can actually access finance from banks. Wahab and Abdesamed (2012) and Saleh (2009) reached a similar conclusion.

The OECD (2014a) report on SME Development Strategy Project for Libya underlined that the creditworthiness of SMEs is a key problem for the Libyan banking sector. The lack of credit information is a major barrier for banks in Libya to disburse loans to SMEs. The report also highlighted that Libyan banks lack the capacity to assess the creditworthiness of SMEs. While some existing SMEs receive some financing from
banks, start-ups remain neglected. In addition, lack of collateral poses additional barrier to SMEs lending and borrowing.

Until the early 2000s, there was no research on SME financing in Libya. Since then there has been a sparse academic literature concerning SMEs access to and demand for finance. However, the focus has been generally on issues relating to the availability of finance for SMEs from formal and informal sources. Among these, only a handful explored the demand by SMEs for bank finance and this was only from the viewpoint of SMEs themselves. As such, previous studies have not sought to offer an overall picture of the status of SMEs access to bank finance from both the demand- and supply-side standpoints.

More specifically, prior studies have not examined the experiences of SMEs’ borrowers and bank loan officers with regard to SMEs demand for and access to bank finance. A study of such experiences is vital to unearth the factors that determine SMEs demand for bank finance and the decisions made by bankers to supply them with credit. No such study has yet been undertaken in Libya, although such an approach is arguably necessary in order to enhance our understanding of factors that underline the accessibility of SMEs to bank finance.

As such, the topic of bank finance for SMEs in Libya provides a unique field of study, especially as it remains largely unexplored. Considering the importance of banks as finance providers for the development of a strong and healthy SME sector, which is central to the transition process currently taking place in the country, an empirical study investigating and querying their role in relation to SMEs financing is called for. The current study incorporates two dimensions of bank finance critical to the success, development, and sustainability of SMEs, namely, the demand and supply of bank finance, with the aim of exploring the prevailing and potential status of bank finance for SMEs in the Libyan context. Consequently, this study seeks to contribute to the knowledge about bank finance for SMEs by examining the experiences of parties that are directly involved in demanding and supplying bank finance for SMEs.

1.3 Thesis Motivation

Numerous extant studies address the access of SMEs to finance, bank finance particularly, as a dynamic factor of an enabling and productive economic environment, especially in developing countries where efficient equity markets and robust regulatory infrastructures are almost absent. In evidence, both the International Finance
Cooperation (IFC) and the World Bank rank economies according to the ease of doing business, which in turn is a reflective of the ease of access to finance. Increasing SMEs’ access to finance will lead to increasing the growth of SMEs which will have a direct effect on GDP growth given increased output, value-added, and profits. A recent World Bank’ report titled Finance for All particularly highlights the relationship between the increased access of SMEs to finance and GDP growth (World Bank, 2008, p. 63):

“...if entry, growth, innovation, equilibrium size, and risk reduction are all helped by access to and use of finance, it is almost inescapable that aggregate economic performance will also be improved by having stronger financial system”.

In this respect, in order to sustain the substantial contributions of SMEs to aggregate economic growth, it is of critical importance to study SME financing generally, and bank finance in particular.

As discussed, there has been much less of the much-needed work in this area in developing countries (Cook, 2001). In developed countries, there is rather more analysis, but these reflect business environments with clear property rights and developed financial markets and regulatory infrastructures. As these are often less robust or almost absent in developing countries, it would be imprudent to generalise their results to the case of developing countries. Therefore, one motivation for this study lies on the lack of research directly related to SME financing in general and in particular bank finance in the developing countries’ context. This is particularly very true in the Libyan context.

Further, given the Libyan government’s strategy for economic diversification, sustainable growth, and capacity-building to contain exogenous shocks from oil prices, as well as with the country’s newly adopted attitude toward the private sector, mainly SMEs, the study is timely conducted. When considering the vulnerability of these businesses, it is particularly important to query and understand the role of the banking sector in catering for their financing needs. This is particularly important in the Libyan context where banks have been the sole ingredient of the country’s financial system, yet, there has been little academic work on the development of SMEs with regard to their access to bank finance. In this regard, the study is motivated by the speculation that a better understanding of the working relationship between banks and SMEs could lead to a better operating paradigm for both entities, which in turn, will have positive effects on the national economy in the longer run.
In addition, to my best knowledge, none has incorporated both the demand and supply sides of bank finance in a single study. This has also motivated the undertaking of this study with the anticipation of offering a fuller understanding of the complex issues associated with bank financing for SMEs in developing countries in transition. The focus on banks as a main source of finance for SMEs departs from previous studies focusing on bank financing for SMEs in the developing country context (e.g. Abor, Agbloyor and Kuipo, 20014; Chong, Lu and Ongena, 2013; Abor and Biekpe, 2007). In this regard, the study comes in response to the call of some researchers (e.g. Feakins, 2004; Tucker and Lean, 2003; Cook, 2001) to explore how formal bank finance interacts with the SME sector in transition economies and the forms of finance offered by banks and used by SMEs in these economies.

The conclusions of some recent studies (e.g. Hajjaji, 2012; Saleh, 2009) which stressed that Libyan SMEs lack of access to finance is worsened by the absence of Islamic finance have provided an extra motivation for the investigation in this study. In fact, this study is also unique in the sense that it is a pioneering exploration of attitudes towards Islamic methods of finance as an alternative source to meet the demands of Libyan SMEs for finance.

A final motivation for this study concerns choosing Libya as the venue for this study. Apart from being the candidate’s home country, the reasons are twofold. First, Libya is a developing country undergoing profound economic change coupled with a political transition, which makes it an interesting content to investigate the interaction between banks and SMEs. Second, because of the uprising that was taking place in the country during 2011, Libya was omitted from a recent study conducted by Rocha et al. (2011) jointly funded by the World Bank and the Union of Arab Banks aimed at investigating the status of bank lending to SMEs in MENA region. This provides an additional motivation to undertake this study to fill this void in the literature.

1.4 Thesis Aim and Objectives

The aim of this thesis is to obtain an informed understanding of the status of bank financing for SMEs in Libya. Accomplishing this aim entails fulfilling the following objectives.

i. Identifying the financing sources used by Libyan SMEs at the start-up stage.

ii. Identifying the funding sources that available to Libyan SMEs during post start-up stages and the position of bank financing.
iii. Investigating what factors determine Libyan SMEs access to bank finance.

iv. Observing factors affecting Bank Al Tanmeya’s (as representative of the supply side) engagement with SMEs.

v. Examining the factors that Bank Al Tanmeya considers when making decisions regarding business loans to SMEs.

vi. Exploring the attitudes of both Bank Al Tanmeya, as representative of Libyan banks, and Libyan SMEs towards the possible implementation of Islamic finance as an alternative funding source.

vii. Determining the constraints faced by SMEs in accessing bank finance and factors perceived by the Bank Al Tanmeya as obstacles to it serving the SME sector.

1.5 Thesis Organisation

The remainder of the thesis is structured into chapters as follows. Chapter 2 Small and Medium-Sized Enterprises Review reviews some general aspects relating to the SME sector. This is because before discussing SME financing, it is important to provide a broad conceptual background for understanding the SMEs sector itself. Therefore, the chapter explains the different approaches usually used to identify what constitutes an SME. In addition, the chapter provides a detailed discussion of the importance of SMEs and their role in the growth and development of national economies worldwide, and to deepen our understanding of the environment in which they operate and the problems and challenges encountered by SMEs are also discussed.

Chapter 3 Financing of Small and Medium-Sized Enterprises deals with the financing behaviour and practices of SMEs. The discussion is initiated by describing some theories that have been suggested to explain SMEs financial behaviour, including the life-cycle paradigm, pecking-order theory, trade-off theory, and asset side theory. Further, the chapter presents the options for raising finance from different sources available to SMEs, including Islamic finance. To gain a better understanding of the context of SME financing, the chapter also highlights the main issues and difficulties facing SMEs when seeking finance.

Chapter 4 Literature Review serves to provide a background for understanding the existing literature in the area of investigation. Thus, it reviews the relevant theoretical and empirical literature relating to bank financing for SMEs from both a demand perspective as well as a supply perspective. In addition, some specific aspects of bank financing for SMEs, which are of particular interest in this study, are also included. In
so doing, the chapter serves as guidance for the methodological choices subsequently employed in the thesis.

Chapter 5 Research Design and Methodology describes and explains the methodology adopted in the thesis in terms of the research design and data collection methods and procedures. In this chapter, and in light of the study’s objectives, we discuss the use of qualitative and quantitative methods as well as the triangulation approach. The chapter also provides a description of the data sources and the different tools used to gather the required data, along with the various stages of the actual data collection process.

Chapter 6 Empirical Results: Questionnaire Analysis presents the quantitative data analysis and reports the empirical findings from the survey questionnaire. The purpose of this chapter is to analyse the data collected on the demand side (SMEs) and discuss the results obtained by applying the techniques explained in the previous chapter. This includes presenting some demographic information on the questionnaire respondents (SMEs and their owner-managers), analysing the respondents’ experiences with bank finance, and exploring the potential use of Islamic finance as an alternative source of finance for Libyan SMEs from the demand side point of view.

Chapter 7 Empirical Results: Interview Analysis provides an analysis of the qualitative data regarding the supply side represented by Bank Al Tanmeya. We obtained the data from a number of interviews conducted at the bank as a part of this thesis. The analysis in this chapter concerns the bank’s engagement and experience with SMEs clients. In addition, we discuss the practices of the bank in financing this sector, and from a supply side perspective, an analysis of insights into Islamic methods of finance and their potential to serve SMEs.

Finally, Chapter 8 Conclusion presents a summary of the thesis and a discussion of the main findings. In addition, the chapter provides a brief discussion of its contributions, implications, and limitations. We conclude the thesis with some suggestions for further research.
Chapter 2. Small and Medium-Sized Enterprises

Review

2.1 Introduction

The definitions of SMEs are many and varied, changing from country to country and between the different sources reporting statistics on SMEs. Some of the commonly used benchmarks are the number of employees, net assets, sales, and investment. However, the most common definitional basis is employment. Nevertheless, even when the number of employees is the adopted criterion, there is variation in defining the upper and lower size limit of the SME’ labour force. This is necessary when separating SMEs from other private enterprises and in identifying their unique characteristics and challenges.

The purpose of this chapter is to provide a general review of SMEs. Section 2.2 discusses definitions of SMEs and explains why they can vary across countries and even within the same country. The following section distinguishes between SMEs and entrepreneurship. Section 2.4 provides a brief review of what differentiates SMEs from larger enterprises. Section 2.5 discusses the importance and role of SMEs in the growth and development of national economies around the globe while Section 2.6 reviews the literature on some problems and challenges encountered by SMEs. Section 2.7 discusses SMEs in the Libyan context. Section 2.8 concludes.

2.2 What is an SME?

While there is broad acknowledgement of the role of the SME sector internationally, defining SMEs remains a challenging task. In fact, there is no one generally agreed definition for “small and medium-sized enterprises” applicable in all countries. For instance, the IFC SME Country Indicator examines the formally registered small and medium-sized enterprises in 132 economies, out of which 12 have no exact definition for what constitute an SME, and 26 economies have more than one SME definition in place (Kushnir, 2006). In fact, in some cases there are several definitions used within the same country due to the diverse characteristics of these enterprises in each sector in each economy. Some economies also distinguish between different types of SMEs. For example, China distinguishes between town and village enterprises, while in Singapore the definition of local SMEs differs from that of foreign SMEs (Harvie and Lee, 2002).
Keasey and Watson (1993) argued that SMEs have different functions and are of various natures and types which lead to the situation where no single definition can be universally applicable to all SMEs. The absence of a common and generally accepted definition of SMEs can be ascribed to the diversity and richness of the characteristics of SMEs in addition to the political strategies and economic conditions in each country (OECD, 2004). Curran and Blackburn (2001) indicated that SMEs operate almost in each sector of the economy and, therefore, no standardized definitions apply to them across all sectors. Moreover, Harvie and Lee (2002) added that definitions of SMEs vary widely between countries because each economy and each sector in any country, experience differing phases of social and economic development.

Acknowledging the existence of differences in defining SMEs, Bridge, O’Neill and Cromie (1998) stressed that any definition of SMEs should possess, at least, two of the following. First, the management of the firm is independent and the managers are usually the owners. Second, an individual or a small group provides capital and ownership. Third, the firm mainly operates locally, however, its markets do not have to be local. Finally, when compared with the largest businesses in its industry the number of employees, sales volumes or other size measures must be small.

The dearth of a formal definition of SMEs has resulted in different approaches to be adopted by governments, international organisations and national statistical institutions/bureaus in order to distinguish SMEs from other enterprises. These approaches can be either qualitative approaches or quantitative approaches. The qualitative approach depends on descriptive criteria such as small-scale decentralization and flat organisational hierarchy (Brytting, 1991) whereas in the latter “the quantitative approach” the focus is on quantitative measures such as the number of employees, sales volumes, assets value and the level of investment (Lee and McGuiggan, 2008). In some cases, nonetheless, both measures are combined together. Therefore, it can be said that in general SMEs are companies/entities whose characteristics satisfy certain qualitative criteria and/or do not exceed certain quantitative limits.

2.2.1 The Qualitative Approach

The qualitative methods for defining SMEs tend to focus on particular characteristics of SMEs that are inherent in their nature. According to Intarakumnerd, Chairatana and Tangchitpiboon (2002) the most common qualitative aspects used to define SMEs include its geographical scale or operations, degree of independence, and the type of
management. In fact, some researchers argue that the use qualitative definitions which could better create the premises for harmonization and comparability of financial reporting of SMES is preferable (Buculescu, 2013). Such definitions based on qualitative criteria are also known as economic definitions.

Endorsing the qualitative approach Keasey and Watson (1993) criticised the quantitative-based definitions. They argued that if some firms are classified as small or medium according to their assets or sales turnover measurements in a certain sector, the same firms might be found to be belonging to large firms in another sector if the number of employees was taken as a measure of size. In an effort to prevent such problems and confusion in defining and measuring SMEs, Bolton Committee Report (1971) attempted to produce a qualitative definition for SMEs. The report recommended that three economic criteria are to be met for a firm to be classified as SME: (i) the firm has to have a relatively small market share, (ii) the firm is fully owned or partly owner-managed; and (iii) the firm is independent in the sense of not constituting part of a larger firm.

In line with Bolton Committee Report Keasey and Watson (1993) emphasised that a firm will be considered as SME if it satisfies special qualitative characteristics. They explained that an SME should be legally independent, run and managed by its owner-manager, and has relatively a small share of the market. In the same vein, Trewin (2001) maintained that when defining SMEs some management and organisational characteristics should be taken into account. These characteristics include: independent ownership and operations; close control by owner-managers who also contribute most, if not all, the operating capital; and principal decision-making by the owner-managers.

In addition, the aforementioned report adopted some limits under the quantitative definitions that applied to different sectors of the economy. Three criteria of quantitative nature were employed. These criteria are; turnover, the number of employees, and the number of vehicles used in the firm. As such, retailing, wholesaling, the motor trades, and miscellaneous enterprises were defined by the turnover criterion. Enterprises operating in manufacturing, construction, and mining were defined according to the employment criterion, and transportation enterprises were defined based on the number of owned vehicles.

Other researches such as Wynarczyk (1993) suggested other qualitative approaches to define SMEs. For example, the author stated that uncertainty, innovation, and evolution
are three qualitative criteria that distinguish SMEs from large firms and can be used to define them.

On the other hand, while maintained the key advantage of the qualitative approach in terms of its strong theoretical base Brooksbank (1991) argued that there are many practical problems surrounding its application/implementation as qualitative criteria are not always accessible as is the case for the quantitative information. Then, it can be said that while the economic definition was originally suggested to overcome the deficiencies and problems associated with the quantitative definition, in fact, in practice terms the latter is used more often because it is more practical and arguably less costly.

2.2.2 The Quantitative Approach

According to this approach, which is also known as the “statistical approach” criteria of quantitative nature are used to define SMEs. As such, the size of the firm is determined based on some selected quantitative criteria. In fact, quantitative-based definitions of SMEs are the most popular ones used by researchers as well as policy makers. Work by Senderovitz (2009) concluded that in general all the official definitions of SMEs are quantitative in nature. In addition, Brooksbank (1991) believed that what fundamentally advances the quantitative approach is its practicability since criteria such as the number of employees, sales, and turnover are readily accessible and unambiguous.

The Bolton Committee Report (1971) realized that when defining SMEs the quantitative measures are important and should not be ignored. Hence, the report has suggested quantitative definitions for certain sectors and switched from qualitative approach into quantitative one. The reason behind this can be attributed to the fact that definitions that are based on quantitative measures are believed to be very simple and objective (Curran and Blackburn, 2001).

In general, however, in terms of practice there are no standard criteria based on which SMEs can be defined in statistical terms. Some researchers (e. g. Harvie and Lee, 2002; Curran and Blackburn, 2001; Harper, 1984) identified alternative types of quantitative measures to define SMEs such as: value of capital, turnover, labour intensity, sales volume, production capability, financial turnover, and some technical measures. Nonetheless, traditionally, the number of employees is the most common standard in determining the size of the firm (Ayyagari, Beck and Demirgüç-Kunt, 2007).
Table 2.1 Examples of quantitative criteria used in defining SMEs in some countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Criteria</th>
</tr>
</thead>
</table>
| US       | • Type of activity: manufacture, wholesale, mining, constructions, agriculture etc.  
          | • Number of employees (maximum 500 employees) depending on the type of economic activity.  
          | • Value of sales.                                                         |
| Canada   | • Type of activity: manufacturing or services.                            |
|          | • Number of employees (maximum 500 employees) depending on the type of economic activity. |
| Japan    | • Type of activity: manufacture, constructions, transportation, wholesale, retail sales, services. |
|          | • Number of employees (maximum 300) depending on the type of economic activity.   |
|          | • Capital value.                                                          |

Source: Buculescu (2013).

Hallberg (2000) stressed that countries vary in their definitions of what constitute an SME. He further explained that what is considered as SME in one country may be considered a large enterprise in another if the measure of the number of employees is the one adopted. Therefore, this measure can be criticized if comparison across countries is needed. Yet, the author himself agreed that among all the quantitative measures used to define SMEs the number of workers and the value of assets are the most common measures.

The benchmark of the number of employees for defining SMEs has a number of advantages. First, it makes it simple, to some extent, to compare firms in different sectors and countries. Second, it is a stable yardstick that is not directly affected by some economic factors such as fluctuations in prices, movements in exchange rates, and inflation. Third, generally speaking it is also readily available and accessible. For example, in the study by Pratten (1991) the author preferred to use the number of employees rather than the sales turnover or the value added. The author accounted for his choice by stating that “information about the employment is readily available and that because it may be considered to be less confidential” (p. 3).

Nevertheless, in some cases the process of defining SMEs according to the number of employees can be more complex. For instance, Curran and Blackburn (2001) suggested that when using the number of employees as a measure of the firm size it should be taken into account the number of part-time employees; otherwise, the accuracy of the measure may be affected. They concluded that although this criterion is very simple and easy to use, it should be used carefully.

On the other hand, in some countries the “value of capital” is suggested as a basis for SMEs definition. However, according to Harper (1984) such criterion is even more
complicated. He explained this by stating that in order to accurately assess the value of the firm’s capital a number of factors should be considered and cannot be neglected. One important factor, for example, is the attitude of the owner-manager when asked about the value of his/her firm. Studies showed that the majority of SMEs owner-managers do not like to publicly declare the real value of their firms. Even if they do it will not be accurate because most of them cannot differentiate between their personal property and the capital of their firms.

For all qualitative or quantitative definitions suggested there are many problems leading to a general lack of consensus. Thus, it seems that any definition will, to some extent, be unsatisfactory for all purposes since no single definition can be equally applicable for the great variety of SMEs-related concerns for both researchers and policy makers.

According to Osteryoung and Newman (1993), a definition for SME is important for two main reasons. First, researchers must insure that the item being studied is the same as other researchers use in the field otherwise any cumulative knowledge from any similar research will be lost. Second, government policy makers must have a clear and concise definition for SMEs in order to ensure that any funds spent are correctly allocated. The authors suggested that an SME definition must have three criteria. First, it must be measurable and observable. Second, it must be congruent with the perceptions of the market system. Finally, it must be meaningful. The study concluded that by having a definition of SMEs that is measurable, consistent with the financial markets, and meaningful, the prospect of understanding the operations of these entities should be enhanced and should result in a more effective research and more effective government policy.

The existence of different definitions provided by different countries and organisations sought to facilitate comparability and the internationalization in defining SMEs. As such, it is believed that it is important to know the variety of different definitions for SMEs across different countries and regions. Following are some definitions for SMEs implemented by different countries and international organisations.

2.2.3 Definition of SMEs: International Review

According to the Organisation for Economic Cooperation and Development (OECD, 2004), not only do the characteristics of SMEs reflect the economic patterns of a country but they also mirror the social and cultural dimensions of that country. These unique patterns are noticeably reflected within several definitions of SMEs adopted in
different countries and regions. Whereas the number of employees is referred to as the distinctive criterion for SMEs in some countries, others use other criteria such as invested capital. A combination of a number of different criteria is also common.

Adopted in 2003, and entering into force in 2005, the definition of the European Commission (EC) for SMEs states that a small enterprise is one that has a headcount of less than 50 and a turnover or balance sheet total figures of not more than €10 million. A medium-sized enterprise is defined as the one which has a maximum headcount of 250 and a turnover of no more than €50 million or a balance sheet total statistics of no more than €43 million (European Commission, 2009). It can be observed that while turnover and statistics of balance sheet are part of this definition, the employment size is still the overriding factor (O’Reagan and Ghobadian, 2004).

Table 2.2 European Union definition of SMEs

<table>
<thead>
<tr>
<th>Enterprise category</th>
<th>Headcount of staff</th>
<th>Turnover €</th>
<th>OR</th>
<th>Balance sheet €</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td>≤ 50</td>
<td>≤ 10 million</td>
<td></td>
<td>≤ 10 million</td>
</tr>
<tr>
<td>Medium</td>
<td>≤ 250</td>
<td>≤ 50 million</td>
<td></td>
<td>≤ 43 million</td>
</tr>
</tbody>
</table>


In Australia, there is no one common definition adopted for SMEs (Yesseleva, 2012). Some definitions categorise businesses based on the number of employees as used by Fair Work Australia (FWA) and other surveys of SMEs, or annual revenue as used by the Australian Taxation Office (ATO). In 2001, the Australian Bureau of Statistics (ABS), which has the largest data set on SMEs in Australia, presented a definition that is exclusively based on the number of workers. Accordingly, SMEs are identified as follows; small businesses are those businesses employing 5 or more people but less than 20 people; medium businesses are those employing 20 or more people but fewer than 200 people (Trewin, 2001).

In the abovementioned definition, the ranges of the employment size are based on “headcount” rather than a measure of full-time equivalent persons. In addition, a distinction can also be made between employing and non-employing businesses where employing businesses have an active Income Tax Withholding role. Interestingly, this definition further categorises small business with less than 20 employees into (Trewin, 2001):
• Non-employing businesses: sole proprietorships and partnerships without employees;
• Micro businesses: businesses employing less than 5 people, including non-employing businesses; and
• Other small business: businesses employing 5 or more people, but less than 20 people.

In the UK, in practice terms there is a wide variety of definitions of SMEs in place. A number of these definitions are summarised by Bridge, O’Neill and Cromie (1998) as follows:

➢ The Department of Trade and Industry DTI uses the following definitions:
  • Small enterprises: 0-49 employees.
  • Medium enterprises: 50-249 employees.
➢ For purposes of financing SMEs, Bank of England focuses mainly on those enterprises with up to and including £1 million in turnover annually.
➢ According to the companies act of 1985 a company is small if it at least satisfies two of the following:
  • A turnover of no more than £2.8 million.
  • A balance sheet total of no more than £1.4 million.
  • No workforce more than 50 people.

A medium-sized company should at least satisfy two of the following:

• A turnover of no more than £11.2 million.
• A balance sheet total of no more than £5.6 million.
• No more than 250 employees.

In Japan, the definition implemented by the Small and Medium-sized Enterprise Basic Act and used by Japan’s Ministry of Economy distinguishes between SMEs operating in different economic sectors. The definition classifies SMEs businesses in the retail or services sector as those with less than ¥50 million in capital. For firms in the wholesale sector the figure must be less than ¥100 million. As for firms operating in manufacturing the capital has to be less than ¥300 million. In addition, it restricted by this definition that enterprises in retail must have fewer than 50 employees. For those in services or wholesale the number should be less than 100 employees, and for
manufacturing firms the upper limit of employment is 300 employees (Economist Intelligence Unit, 2010).

Table 2.3 SME definitions in Japan

<table>
<thead>
<tr>
<th>Industry</th>
<th>Capital size ¥</th>
<th>Number of employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>≤ 300 million</td>
<td>≤ 300</td>
</tr>
<tr>
<td>Wholesale</td>
<td>≤ 100 million</td>
<td>≤ 100</td>
</tr>
<tr>
<td>Retail</td>
<td>≤ 50 million</td>
<td>≤ 50</td>
</tr>
<tr>
<td>Services</td>
<td>≤ 50 million</td>
<td>≤ 100</td>
</tr>
</tbody>
</table>

Source: Economist Intelligence Unit (2010).

According to the World Bank definition of SMEs and under similar measures, a firm must meet two of three requirements for employees, assets, or annual sales to be classified as small or medium. These indexes are; up to 50 employees, total assets of up to $3 million, and up to $3 million of total sales annually for a firm to be classified small. As for a medium firm, the indexes are; a maximum of 250 workers, up to $15 million of total assets, and total annual sales of up to $15 million (IFC, 2009).

Table 2.4 World Bank definition of SMEs

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of employees</th>
<th>Assets</th>
<th>Annual sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>&lt; 50</td>
<td>&lt; 3 million</td>
<td>&lt; 3 million</td>
</tr>
<tr>
<td>Wholesale</td>
<td>&lt; 300</td>
<td>&lt; 15 million</td>
<td>&lt; 15 million</td>
</tr>
</tbody>
</table>

Note: Firms must meet at least two of the three characteristics.

Source: IFC (2009).

Unlike the above definitions which have simple and clear classification for SMEs that applies to all industries more complex standards are employed in the United States for each individual industry. The adopted measurements have taken into account industry-specific trends and conditions which are reflected in indicators of economic activities (e.g., employment or revenue) and varying size caps for each business or industry. For example, a congressional committee was presented with 700 definitions of SMEs (Watson and Everett, 1993). In 1992, the Small Business Administration (SBA) used 30 different size standards (e.g., 100 or fewer employees, 500 or fewer employees, 1,000 or fewer employees, $5 million in average annual receipts) when categorizing firms as SMEs (Dilger, 2012). The rationale behind that, according to Kidalov and Snider (2011), is to better reflect differences and fair competition between industries.

In 2008, the SBA initiated a comprehensive review of SMEs size standards. At that time, 41 different size standards were used including: number of employees (7 size standards); average annual receipts in the previous three years (31 size standards);
average assets (one size standard); megawatt hours for electrical power industries (one size standard); and barrel per day refining capacity for petroleum refineries (one size standard).

Currently, the SBA uses two size standards to determine what constitute an SME. These standards are industry-specific size standards and an alternative size standard based on the firm’s maximum tangible net worth and average net income after taxes. The SBA’s industry-specific size standards determine the size for firms in 1,141 industrial classifications and 18 sub-industry activities. These standards are generally based on five measures: number of employees; asset size; average annual receipts in the previous three years; barrel per day refining capacity for petroleum refineries, or megawatt hours for electrical power industries.

Some of the most common adopted size standards (in terms of upper limits) are:

- 500 employees for most manufacturing and mining industries.
- 100 employees for wholesale trade industries.
- $7 million of annual receipts for most retail and service industries.
- $33.5 million of annual receipts for most general & heavy construction industries.
- $14 million of receipts for all special trade contractors.
- $0.75 million of receipts for most agricultural industries.

In the economies of Asia Pacific Economic Cooperation (APEC) the number of employed personnel within the business is the most common criterion used when defining SMEs. Hence, within the region, SMEs are defined as enterprises with less than 100 people, whereby, a micro firm employs less than five employees, a small firm employs between 5 and 19, and a medium sized enterprise employs between 20 and 99 people including self-employed managers (Dababneh and Tukan, 2007).

Similarly, the number of employee is the most common basis for defining SMEs in Middle East and North Africa region (MENA). Most of the countries in the region categorize the size of their SMEs using the number of employees. The criteria of SMEs definitions in some countries in the region are summarised in Table 2.5.
From the table it appears that the definitions for micro and small businesses are almost the same across most of the countries listed. This is due to the fact that these countries are relatively comparable to each other in terms of economic structure, development stage, and demographics. However, within the medium enterprises category UAE has the highest threshold for staff headcount. This is attributable to the high number of large-scale foreign companies that are operating in the country’s dynamic and strong economy.

Elsewhere in the world, in Malaysia, the definition adopted by the National SME Development Council states that SMEs in manufacturing are those having sales turnover not exceeding RM 50 million (RM = Malaysian Ringgit) or full-time workers not exceeding 200 workers. As for SMEs in services and other sectors the cut-off figures are RM 20 million or 75 full-time employees (National SME Development Council, 2013). In Turkey, SMEs definition was revised in 2003 to be parallel to the SME definition of European Union. Accordingly, SME is an enterprise which has between 1 to 249 employees and has annual balance sheet value and receives sales revenues up to 25 million TL (Turkish Lira) (Karabulut, 2013). In South Africa, the most widely framework used to define SMEs is that of The National Small Business Act (Falkena et al., n.d). The act determines the upper limit in terms of the number of employees for small firm as 50 employees and less than R2 million to R25 million (R = South African Rand), depending on industry, for the annual turnover. According to the same framework, the maximum number of employees for medium firms in mining, electricity, manufacturing, and construction sectors is 200, otherwise it has to be 100 with an annual turnover less than R4 million to R50 million, depending upon industry.
2.3 SMEs vs. Entrepreneurship

After reviewing the literature on the different approaches and criteria followed to define SMEs it is worth mentioning that despite the fact that both terms of small and medium-sized enterprises and entrepreneurship have been used interchangeably by researchers and authors, in fact, they are different entities (Darren and Conrad, 2009). Although, SMEs and entrepreneurship tend to accomplish the same goal entailing employment creation, economic growth, development, and economic transformation, however, both concepts differ considerably. Lundström and Stevenson (2005) argued that though the two concepts are related, SMEs and entrepreneurship are not the same.

As is the case for SMEs there are variable definitions to the concept of entrepreneurship. However, there are some generic elements that can be found in almost every definition. The most important among these elements are, according to Zindiye (2008), entrepreneurs are risk takers, business opportunity, innovation, and creativity.

For example, Cronje, Du Toit and Motlatla (2004: p. 40) define entrepreneurship as:

“Entrepreneurship is the process of mobilising and risking resources (land, capital, human resources) to utilise a business opportunity or introduce an innovation in such a way that the needs of society for products and services are satisfied, jobs are created and the owner of the venture profits from it. This process includes new as well as existing ventures, but the emphasis is usually on new products or services, and new businesses”.

Another definition by Rwigema and Venter (2004: p. 6) states that:

“Entrepreneurship is the process of conceptualising, organising, launching and through innovation nurturing a business opportunity into a potentially high growth venture in a complex, unstable environment”.

Carland et al. (1984) emphasised that innovation is an important factor distinguishes entrepreneurs from SMEs owners. Interestingly, their study was concluded by proposing two conceptualizations; one for distinguishing entrepreneurs from SMEs owner/managers and the second for differentiating entrepreneurial ventures from SMEs. The definitions proposed can, according to the authors, guide studies concerning SMEs and entrepreneurship. The definitions suggested are as follows (Carland et al., 1984: p. 358):

“Small business venture: A small business venture is any business that is independently owned and operated, not dominant in its field, and does not engage in any new marketing or innovative practices”. 
“Entrepreneurial venture: An entrepreneurial venture is one that engages in at least one of categories of behaviour that is, the principal goals of an entrepreneurial venture are profitability and growth and the business is characterized by innovative strategic practices”.

“Small business owner: A small business owner is an individual who establishes and manages a business for the principal purpose of furthering personal goals. The business must be the primary source of income and will consume the majority of one’s time and resources. The owner perceives the business as an extension of his or her personality, intricately bound with family needs and desires”.

“Entrepreneur: An entrepreneur is an individual who establishes and manages a business for the principal purposes of profit and growth. The entrepreneur is characterized principally by innovative behaviour and will employ strategic management practices in the business”.

Hisrich and Drnovsek (2002) believed that entrepreneurship results in either creating or enhancing of value which usually associated with risk and rewards not just for entrepreneurs but also for customers as well. Collins, Smith and Hannon (2006) agreed with this adding that entrepreneurship is not confined to SMEs as it takes place in all sectors and in all firms irrespective of their size. Lucky and Olusegun (2012) argued that entrepreneurship is a process that leads to creation of SMEs while SMEs are just firms or business ventures that are being managed by individuals. Specifically, the conclusion reached by Lucky and Olusegun (2012) is that SMEs are firms and not entrepreneurship whereas entrepreneurship is a process and not SMEs.

2.4 SMEs vs. Large Companies

A decent amount of literature deals with differences between SMEs and large companies. It is reported that, in general, comparing with large companies SMEs have nimble and flexible organisation structure with highly centralized decisions making (Carrier, 1994), minimal planning process (Atkins and Lowe, 1997), and management practices (Gray and Mabey, 2005). Similarly, some general characteristics of SMEs that differentiate them from large companies are listed by Raymond and St-Pierre (2005). Characteristics relating to SMEs environment include greater uncertainty and more reliance on business partners. In terms of strategy and decision-making, SMEs decision-making process is reactive, short term, and more focused on material rather than the flow of information as in large companies. From a structure perspective, SMEs has more simplicity and are poorer in resources.

Large enterprises usually tend to be managed by skilled professional people who are charged with hierarchical authority. In addition, administrative roles within large
corporations are also divided up according to the company’s operational functions (traditionally: production, sales, financing, marketing, etc.). On the other hand, SMEs are frequently administered by personal or direct management. The concept of personal or direct management in SMEs refers to persons who usually own and operate the undertaking and do not receive remuneration in the form of a salary for the services they render to the SMEs.

Managerial models and approaches used in large companies cannot be applied to SMEs. Many researchers have been analysing and studying management styles and ownership in SMEs to decide on the SMEs’ distinctive characteristics and what makes SMEs different compared to larger companies. According to Beaver and Prince (2004) management and ownership cannot be separated from each other in SMEs which is not the case in large companies where managing and controlling the firm are usually separated from ownership.

In the same vein, the Bolton Report (1971) indicated that SMEs are usually managed and controlled by the owner-manager who is, in most cases, the founder of the firm and, in some cases, if more than one person is involved it will be family members. However, according to the report, in large companies management is separated from ownership as the latter is distributed between many shareholders. This leads to these owner(s)-managed firms to be more flexible, more creative, and, more importantly, more innovative.

Moreover, managerial styles employed in SMEs are believed to be different from those adopted in the sector of large companies (Beaver and Prince, 2004). The Bolton Report (1971) attributed that to the fact that many SMEs owner-managers lack high educational qualifications; instead they usually have skills qualifications. Although in many cases large companies are the outcome of successful SMEs that had grown, the managerial style in large companies are rigid, bureaucratic, strict, and very formal. On the other hand, managerial styles in SMEs sector are described as intuitive, informal, and far more flexible (Beaver and Prince, 2004). Beaver and Prince (2004) argued that different managerial styles exist in SMEs are due to the different characteristics and entrepreneurial skills of their owner-managers which are, in turn, affected by the firm’s motives and plans, its age, and the firm’s operating surroundings.

Curran and Blackburn (2001) argued that unlike large firms, SMEs are controlled by the market and not the opposite. Consequently, these firms are unable to control their
surroundings and their performance is entirely dependent on the quality of the management and the so-called market power. As for large companies, Wynarczyk (1993) argued that they are less dependent on the quality of the existing management because it is powerful enough to take immediate actions and adjust itself. As a result, the authors added, large companies are able to change their position by takeover or merge with another company operating in the same sector or industry.

Cronje, Du Toit and Motlatla (2004, p. 492) observed some important characteristics by which SMEs can be distinguished. These characteristics are as follows:

- SMEs are generally more labour intensive than larger businesses;
- On average, SMEs generate more direct, and possibly also more indirect, employment opportunities per unit of invested capital. In service industries the capital invested per employment opportunity is even less;
- SMEs are an instrument for utilizing the talents, energy, and entrepreneurship of individuals who cannot reach their full potential in large organisations;
- Smaller businesses often flourish by rendering services to a small or restricted market which larger businesses do not find attractive;
- SMEs are a breeding ground for entrepreneurial talent and a testing ground for new industries;
- SMEs make a contribution to the competitiveness of the economy; and
- SMEs create social stability since they cause less damage to the physical environment than larger factories, stimulate personal savings, increase prosperity in rural areas, and enhance the population’s general level of economic participation.

Likewise, Elasrag (2010) listed some qualitative characteristics unique to SMEs as they are inherent in their nature. These characteristics include:

- Management and ownership are rarely separate;
- Project’s equity is not publicly traded;
- Personal security of the owners is required to secure debt acquisition and repayment;
- Personal objectives of the owners guide and influence business decisions directly;
• The level and number of formal contractual relations are kept at a minimum level;

• Control over business operations and decisions reside with one or two persons who are usually family members.

For policy development and implementation, the United Nations Industrial Development Organisation (UNIDO) stressed the significance of firm classification. Therefore, countries are advised to consider some indicators that might be used in order to differentiate between SMEs and large companies. In the table below the main qualitative indicators recommended by the international organisation are summarised.

**Table 2.6 UNIDO qualitative indicators to distinguish SMEs from large companies**

<table>
<thead>
<tr>
<th>Category</th>
<th>SMEs</th>
<th>Large companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management</td>
<td>Proprietor entrepreneurship</td>
<td>Manager entrepreneurship</td>
</tr>
<tr>
<td></td>
<td>Functions linked to personalites</td>
<td>Division of labour by matters</td>
</tr>
<tr>
<td>Personnel</td>
<td>Lack of university graduates</td>
<td>Dominance of university graduates</td>
</tr>
<tr>
<td></td>
<td>All-round Knowledge</td>
<td>Specialization</td>
</tr>
<tr>
<td>Organisation</td>
<td>Highly personalized contacts</td>
<td>Highly formalized communication</td>
</tr>
<tr>
<td>Sales</td>
<td>Competitive position not defined and uncertain</td>
<td>Strong competitive position</td>
</tr>
<tr>
<td>Buyer’s Relationships</td>
<td>Unstable</td>
<td>Based on long-term contracts</td>
</tr>
<tr>
<td>Production</td>
<td>Labour intensive</td>
<td>Capital intensive, economies of scale</td>
</tr>
<tr>
<td>Research Development</td>
<td>Following the market, intuitive approach</td>
<td>Institutionalized</td>
</tr>
<tr>
<td>Finance</td>
<td>Role of family funds, self financing</td>
<td>Diversified ownership structure, access to anonymous capital market</td>
</tr>
</tbody>
</table>

Source: Dababneh and Tukan (2007).

With respect to financing of SMEs, which will be the focus of the next chapter, a general observation is that in a normally functioning financial market some of the differences between SMEs and larger companies such as higher interest rates or less favourable terms of debt financing is reflected (OECD, n. d.). In addition, as they have access to a broad range of external funds including; bonds, equity, and loans large companies usually comply with higher requirements of disclosure to a greater extent than SMEs. Subsequently, in order to compensate for the higher costs of information collection, the smaller volume of external financing and the greater risk of failure, financial institutions and other external funding providers tend to charge higher interest rates to SMEs.
Another difference is that lending to SMEs is more likely to be based on collateral than is the case for loans to large companies (OECD, n. d.). This may result in a situation where lending decision is based on access to collateral rather than on the expected return. As such, since many SMEs usually lack collateral they are subjected to more credit rationing compared to larger companies.

2.5 The Role and Importance of SMEs

Almost in all countries, developed and developing as well as those in transition, the significant contributions to the socio-economic made by SMEs have been widely recognized. Their positive effects can be supported numerically in a number of areas including; generation and distribution of income (Beck, Demirgüç-Kunt and Levine, 2005; Kuratko, 2005), absorption of labour and curbing unemployment (Abor and Biekpe, 2007; Daniels, 1999; Glancey, 1998) and alleviation of poverty (Green, Kirkpatrick and Murinde, 2006; Taussig, 2005; Gebremariam, Gebremedhin and Jackson, 2004; Hallberg, 2000).

Moreover, some industries particularly in the sector of services have been predominated by SMEs. Computer software, marketing, and human resources development are cases in point (OECD, 2000). As a result, SMEs have been the focus of policies and programs that aim to achieve sustainable development goals in advanced and emerging economies as well as developing ones regardless of any differences in the economic systems adopted in those countries.

Since the 1970s, SMEs have been widely researched primarily as a job creation tool. Tolentino (1995) attributed the potential economic and social benefits of SMEs to their ability to: (i) create jobs at low cost of capital; (ii) positively contribute to the Gross Domestic Product (GDP); (iii) create opportunities for employing appropriate technology; (iv) improve forward and backward links between different sectors; (v) provide support to large-scale enterprises; (vi) expand a pool of skilled and semi-skilled workers; (vii) provide an opportunity to expand the entrepreneurial base; (viii) provide the required flexibility to adapt to market failures; (ix) enter into market niches which are not profitable for larger enterprises; (x) contribute to development policies that are more oriented towards decentralisation and rural development; and (xi) support governments’ efforts to alleviate the negative aftermath of structural adjustment programs.
It has been acknowledged that SMEs have enabled large number of people to engage in the economic and social mainstream of society (Korcsmáros, Takacs and Dowers, 2003). By providing job opportunities for millions of people particularly in rural areas SMEs have had the potential to promote economic growth and prosperity as well as reducing the income inequality gap. By so doing, SMEs have become the key to achieve high development levels and increasing the growth rate of many economies worldwide.

Many studies conducted in different parts of the world have documented the dual crucial role of SMEs in employment creation and generating of income. For example, Ayyagari, Beck and Demirgüç-Kunt (2003) conducted a rich detailed study aiming at investigating the relation between SMEs sector and both growth and poverty alleviation by using a broad cross-country data base. They found that in high-income countries enterprises with less than 250 workers contributed about 70 percent to employment and more than 55 percent to GDP, while in the group of low-income countries, contributions made by such projects was approximately 30 percent in job creation and 15 percent to GDP. With regard to the middle-income countries, however, the figures were 55 percent, 35 percent for employment and GDP respectively.

In the United States, in 1995, just over 99 percent of all employers in the private sector was represented by SMEs (OECD, 2000). In 1997, this figure expanded by 5 percent, while the increase in the number of total employer firms was 2.2 percent. In addition, Audretsch (2000) analysed of the differences between the static role of SMEs and their dynamic role in the American economy during a five-year period of time 1990-1995 in terms of employment taking in consideration the emergence of new firms (births) the exit of others (deaths), and the rise of labour force in existing firms (expansions) as well as any reductions (contractions). His results showed that of approximately 13 percent increase in the employment rate the share of SMEs was considerably greater than that of large corporations. He also found that firms with less than twenty employees provided nearly one-third of the jobs created by new firms. He added that employment resulted from the start-ups of new SMEs over the given period soared by 144.69 percent.

A later paper by Edmiston (2007) reported that from 1990 to 2003, small firms (less than 20 employees) accounted for 80 percent of the net new jobs created in the US economy. Medium firms (20 to 499 employees) accounted for 13.2 percent of the net new jobs, while large firms (500 or more employees) accounted only for 7.3 percent. As for their contribution to the creation of wealth in the country, Kuratko (2005) reported
that of up to $440 million saved by SMEs in 1987 above 75 percent of those funds collected in the USA.

Likewise, Canadian SMEs have been participating significantly in the local economic progress. According to Ravi (2011) in 2009, more than 99 percent of the existing business establishments in the Canadian economy were SMEs. These firms have employed 64 percent of private sector employees in the country. Canadian SMEs contribution to the GDP had increased from 26 percent in the year 2000 to nearly 30 percent during 2008.

Likewise, in the European Union (EU) SMEs have been the main source of employment creation over the last decades. In 2005, there were almost 20 million enterprises active within the European member states the overwhelming majority of these (99.8 percent) were SMEs with less than 250 employees (Schmiemann, 2008). Spence and Perrini (2009) referred to the fact that of the six million new job opportunities generated between 1998 and 2004 in the EU-27 countries, five million were created by SMEs.

In Spain, in the nineties an average of 38.5 percent of the new employment opportunities were created by SMEs (less than 200 employees) compared with only 13 percent existed in large firms (more than 200) (Trouve et al., 2001). Additionally, Trouve et al. (2001) demonstrated that recently established enterprises account on average for a 15 percent higher proportion of total job creation than other enterprises. Another example is that of the German SMEs segment which is the employer of about 72.6 percent of the labour force in Germany (Kadiri, 2012).

Since Bolton Report was published in 1971, SMEs have been the target of nationwide development policies in the UK. Consequently, numerous schemes and national programs have been implemented in order to improve the economy performance. It is estimated that there were 3.7 million active businesses in UK, of these, small businesses accounted for over 99 percent and a further 25,000 were of medium size (Chen et al., 2006). The figures indicate that these businesses employ over ten million people, a figure that amounts to over 40 per cent of private sector employment, and they collectively turn over £1,287 billion, accounting for over 40 per cent of the private sector total (Hann, 2012). In the neighbouring country of Ireland, similarly, 98 percent of all employment opportunities attributed to firms having less than 50 workers (Carey and Flynn, 2005).
Emerged mainly as a result of the privatization process as well as restructuring and downsizing of large state-owned enterprises SOEs, SMEs sector in Eastern European countries seems to be smaller and younger than its counterparts in the most advanced economies in the continent. Nevertheless, it is the most vibrant sector which has been credited to assist these economies to prosper. Collecting data from 15 countries composing a sample of 97,107 firms, Klapper, Sarria-Allende and Sulla (2002) studied the behaviour of SMEs in the private sector in the region. They found that SMEs were responsible for generating more than 50 percent of gross employment opportunities. They also noted some stark differences between countries in the sample in terms of the number of firms and the participation of these firms in total employment. For example, 71 percent of the total employment in the Estonian economy was attributed to SMEs sector whereas the figure was only 8 percent in Russia. The explanation given by the authors was that this may be due to either differences in the size of population and the level of development across countries or a bias in the data since the sample confined to the formal sector excluding the informal one which may be larger in some countries.

The salient example that can be cited to emphasise the crucial role and speedy development of SMEs is that of Asia-Pacific economies. Numbering hundreds of thousands and constituting more than 90 percent of all non-agriculture firms SMEs in the region hire a substantial portion of the domestic workforce ranging from 75 percent to more than 90 percent and responsible for 30 percent of direct exports and 10 percent of foreign direct investment (Wattanapruttipaisan, 2003). In Singapore, for instance, SMEs account for more than 90 percent of all enterprises in manufacturing, commercial, and services sectors providing half of the employment opportunities in the country and contributing about a third of the total value-added. In Taiwan, nearly 98 percent of the total enterprises are SMEs with a share equals to 70 percent of the total employment making 48 percent of total exports for the country’s economy (Shariff and Peou, 2008). As in (Tambunan, 2007) irrespective of the agricultural sector, Indonesian SMEs dominate about 90 percent of all establishment firms contributing the same percentage to the total employment.

In Australia, at the end of June 2011 SMEs comprised 99.7 percent of all trading businesses in the country (Clark et al., 2012). They contributed 57.1 percent to the GDP and 70 percent to private sector employment (Clark et al., 2012). In the same vein, in China and Japan SMEs have had the greatest contribution to the economic prosperity undergoing in both nations. In China, over the period of time 1978-1996
SMEs were the employer of nearly 230 million of the local force labour (Shi and Li, 2006) and contributed up to 58.5 percent of GDP, 50 percent of tax revenues. Chen (2006) gave more detailed figures. He cited that of all registered corporations the percentage presented by SMEs exceeded 99 percent at the end of 2001 when they were the largest employment opportunities provider with 85 percent in the industrial sectors, 90 percent in the retailing industry, and over 65 percent in the construction industry. In Japan, approximately 78 percent of the total jobs provided in the country are generated by SMEs (Korcsmáros, Takacs and Dowers, 2003). Moreover, in Tokyo alone 99.5 percent of all factories have less than 300 employees employing around 74 percent of the capital city’s workforce (Kadiri, 2012).

Studies based on the Latin American and the Caribbean context showed similar trend. Henon (2010) reported that SMEs in the region are estimated to be accounted for providing 20 percent to 40 percent, depending on the country, of all jobs and 30 percent to 50 percent of GDP and that more than 90 percent of the firms operating in the manufacturing sector are SMEs. In Ecuador, for example, firms hiring a number of employees that does not exceed 50 accounted for 99 percent of all firms in the economy and 55 percent of employment (Hallberg, 2000). In Brazil, the largest national economy in the region, the average share of SMEs in the total employment throughout the country is approximately 60 percent ranging from 13 percent in the state of Alagoas to 100 percent in Roraima state (Cravo, Gourlay and Becker, 2012). Another example comes from Trinidad and Tobago where SMEs are responsible for up to 57 percent of the employment opportunities in the country (Peres and Stumpo, 2000).

Due to number of reasons such as, political instability, high levels of corruption, and illiteracy it is not surprising that African economies do not attract foreign investors and multinational corporations. As a result, the role of local SMEs as a catalyst for diversify, strengthen, and modernise the national economies in the continent has increasingly arisen. According to Paiko and Adefila (2012), the number of employees hired by non-agricultural SMEs in Africa is estimated to constitute nearly 61 percent of the domestic workforce.

In Nigeria, the second largest economy in Africa, SMEs account approximately for 85 percent of the total firms in the economy (Ayinde and Olawale, 2011) contributing nearly 30 percent to 50 percent to income in rural areas (Okpara and Wynn, 2007). These firms are responsible for make a living for up to 60 percent of farm businesses
employees (Lucky and Olusegun, 2012) and roughly 70 percent of employees in the industrial sector (Inyang and Enuoh, 2009). In addition, in their comparison of the ability of both SMEs and large enterprises in terms of jobs creation in the Nigerian context Sands, Dogon-Daji and Abdullahi (2006) concluded that large firms are lagging behind SMEs which have a relatively better status as employment creators.

Elsewhere in the continent, the Ghanaian SMEs account for 70 percent of the total employment opportunities generated in the country (Paiko and Adefila, 2012). In other parts of Africa, Wolf (2001) provided evidence suggesting that SMEs operating mainly in rural areas absorbing more than 50 percent of all employed labour force in all of the three countries canvassed by his survey namely; Kenya, Tanzania, and South Africa. In another example from the northern part of the continent, SMEs represent a large portion as 90 percent of all enterprises operating in the Egyptian private sector in trade, service, and manufacturing sectors numbering 2.48 million enterprises accomplishing an annual growth rate of 4.6 percent and engaging about 6.43 million people (Elkabbani and Kalhoefer, 2011).

Apart of their advantageous position in terms of employment and re-distribution of income, SMEs also stand ahead of large companies in terms of flexibility and absorption of economic shocks. Characterised by dynamism and flexibility, SMEs have better ability to quickly adapt to any fluctuations in the demand as well as the supply side. What disadvantages large enterprises in this regard is that their bureaucratic structures so they are incompatible with the degree of flexibility usually needed to undertake risky activities. In addition, Korcsmáros, Takacs and Dowers (2003) argue that during recessions job losses rate is usually lower in SMEs probably due to, they explain, the greater flexibility in the wages.

An example showing the role of SMEs as potential vehicle for recovery from recession comes from China. Over the period from 1998 to 2003, of approximately 19 million employees laid-off from Chinese state-owned enterprises the vast majority were re-employed by SMEs (Chen, 2006). A similar example comes from the USA. Between 1979 and 1995 while the fortune 500 companies experienced job loses up to four million jobs, SMEs were responsible for creating more than 24 million jobs in the economy as the birth rate of these firms soared to nearly 200 percent during that period (Freear, Sohl and Wetzel, 1997).
In the same vein, Rousseau (1999) argues that in the age of the knowledge-based economy characterised by changing consumers’ preferences and market conditions, unlike large firms, SMEs flexibility allows them to remain competitive. He states that (Rousseau, 1999, p. 6):

“In the new economy, size does not give the same economic advantage to firms as in the past. The increase in competition brought by the reduction of trade barriers and the emergence of new countries require additional flexibility and responsiveness from firms that must compete with more efficient producers in other countries. Large firms may have difficulty adapting to this increasing pressure for change and improvements to products because of the legacy of uncompetitive products, investments and employees. SMEs, however, appear to have the ability to respond more quickly than large firms to changes in market conditions”.

In short, since recently as two decades SMEs have been receiving more attention as they have the potential to accelerate the economic growth in addition to their social benefits. As a result, SMEs sector has been a key component of the economies of advanced, emerging, and developing countries occupying most of the national socio-economic agenda and strategies. The interest in the crucial role of this segment in the development process has also attracted researchers in academia. Consequently, numerous studies have been conducting throughout the world in order to stress the importance of this sector for individuals and for the society as a whole. The most highlighting aspects of that role are reducing unemployment, poverty alleviation, and absorption of economic shocks.

First, whilst large companies undergo downsizing and disbanding processes which lead to huge numbers of workers facing redundancy, SMEs create countless number of employment opportunities in all sectors; trade, export, services, and manufacturing. Moreover, SMEs play a pivotal role during recessions as the new employer of redundant employees.

Second, existing mainly in remote and rural areas and regions where the majority of the population are poor SMEs have been the main source of income for a large number of people helping them satisfactorily meet their basic needs contributing to achieve the national development plans goals in terms of social cohesion and economic prosperity.

Third, due to their simple structure and their close relationships with suppliers and customers SMEs can adapt and respond to any changes in economic and markets conditions in a more flexible and less bureaucratic manner than large firms. For these reasons, SMEs are believed to be more innovative and lucrative investment.
2.6 Problems and Difficulties Facing SMEs

Despite the critical importance of SMEs that has been discussed earlier in this chapter they continue to experience significant problems and constraints which lead to their contributions to fall short of expectations. According to Coad (2007), the growth of SMEs is a particularly unpredictable phenomenon. Entry rates of new firms are high; nonetheless, a large number of new entrants firms can be expected to disappear within a few years. Bartelsman, Scarpetta and Schivardi (2005) analysed the post-entry performance of new firms in seven OECD countries. They found that about 20-40 percent of entering firms fail within the first two years while only about 40-50 percent survives beyond the seventh year. According to the authors, one of the reasons they do not survive is that they face several obstacles and challenges over time.

The difficulties SMEs encounter are not identical to those faced by large firms. Although each country’ economy is different from others it has been recognized that SMEs, in general, are confronted by the same problems. It is documented that most of these problems are said to be due to the characteristics of SMEs as being very risky and have high levels of uncertainty or to those of their owner-managers and their attitude towards remain independence. Problems and difficulties facing SMEs can be managerial, financial, and technological. SMEs also face problems relating the regulatory environment and marketing.

Among these problems and difficulties the availability and cost of capital is the most common and the most important. Finance is essential for SMEs to grow, expand, and prosper. As such, not surprisingly, the lack of access to finance can cripple SMEs growth prospects.

Unlike large companies which are able to raise finance from many different sources, SMEs rely much more heavily on debt financing especially loans from banks for their short-term and long-term needs and have little or no access to other sources of funding. Kihimbo, Ayako and Omoka (2012) argued that because of SMEs inability to pledge the required collateral financial institutions, especially banks, view these firms as very high in risk. Therefore, in most cases, they are unwilling to finance them, or alternatively, SMEs will need to pay significantly higher interest rates than large enterprises on loans of the same type and maturity. In addition, in such cases, the tendency of asymmetry information to exist between SMEs’ owner-managers and the potential external investors or lenders is a major contributing factor to this problem.
The difficulties SMEs face can be considered internal if they are caused by the owner-managers themselves. The over involvement of SMEs’ owner-managers and their lack of financial and managerial knowledge can disadvantage their firms. This situation makes SMEs weak and unattractive to deal with not only from the point of view of finance providers but also from those of both raw materials suppliers as well as services providers. As a result, many SMEs may have to decrease their volume of production or reduce its quality because of lack in supply of raw materials (Tambunan, 2000) which, in turn, may affect their market share. Bruch and Hiemenz (1984) argued that supply of raw materials for SMEs is often unstable in quantity, quality, and price because of lack of infrastructure in transportation and communication more relevant to SMEs especially in the early stages of their lifecycle.

In addition, the literature on SMEs argues that owner-managers’ managerial weaknesses contribute to frequent business failure. Such weaknesses have been identified in a number of key areas such as; strategic planning (Wang, Walker and Redmond, 2007), marketing (Percy, Visvanathan and Watson, 2010), human resources management (Bacon et al., 1996), use of information technology (Kiveu and Ofafa, 2013), and business networking (Franco and Haase, 2010).

Regulation requirements imposed by governments have an important impact as a constraint on SMEs. Such a problem creates more barriers for SMEs in start-up stage and the following early growth stages. Regulatory and procedural requirements entail business costs which must be incurred by potential entrants including initial financial outlay. It is argued that such regulatory requirements can become prohibitive in terms of costs and this might deter potential entrepreneurs or drive them to the informal sector (Djankov et al., 2002). Consequently, this can impede SMEs’ ability to grow and positively contribute to the economy. A study by Desai, Gompers and Lerner (2003) found a negative correlation between firm entry and the number of start-up procedures. Furthermore, Klapper, Laeven and Rajan (2004) reached a conclusion that entry regulation requirements hamper firm entry even more in industries with naturally high rate of entry.

Lee (2001) believes that SMEs with high levels of technological sophistication can be expected to grow rapidly. However, the level of technological capabilities represents a real growth challenge for SMEs especially in developing countries. In spite of the global technological advancements, SMEs are still hindered by their lack of
technological implementation (Arinaitwe, 2006). Without technology, SMEs will find it difficult to compete or grow. In a similar vein, it was found that inability to adopt technology impede SMEs from fully reaching their potential (Romijn, 2001).

SMEs also encounter important challenges in the area of marketing. Research by Smit (as cited in Cant, 2012) showed that many SMEs failed because of lack of understanding of the relevance and importance of marketing for their businesses. The study by Brink, Cant and Ligthelm (2003) identified some marketing issues which impact on the survival and growth of SMEs. These issues include poor location, insufficient marketing, inability to conduct marketing research, poor products or service, misreading the market, poor service, and misreading customer trends and needs.

There are more problems facing firms in SMEs sector include; the lack of technology, the lack of skilled workers, production functions, inadequate infrastructure, and the problems in the export market relating to the lack of information about international trading practices. Each one of these problems has a relation with the previous problems in one way or another.

2.7 Overview of SMEs in Libya

it is only recently that SMEs have started to be seen as the potential growth engines for Libya’s private sector development in order to alleviate oil and hydrocarbon dependency, kick-starts the growth, and helps in the re-building the national economy. In 2002, a budget of LD 195 million (LD = Libyan Dinars) was earmarked in the framework of monies in support of SMEs (UNECA, 2008). Furthermore, in 2010, the basic legal infrastructure for developing the private sector was adopted with 22 new laws changing fundamentally commerce, customs, income tax, stock market, labour, communication, and land registry easing the establishment of more SMEs within the local economy.

More recently, in 2012, the Libyan government launched the Libya Enterprise to promote entrepreneurial culture and provides business support for start-ups in Libya. The mission of Libya Enterprise is to develop entrepreneurship and innovation culture throughout the country and create a supportive environment for SMEs. Libya Enterprise currently runs eight incubators and enterprise centres nationwide (Gunto and Alias, 2013).
Libyan SME sector is dominated by the production of food products, wood products, and metal for construction. Some SMEs also engage in the production of clothing, ceramics and bricks, grain milling and press, and publication goods (Castel et al., 2010). There is also scope expand activities in the glass and leather goods industries, fisheries, and tourism.

It is expected that SMEs will complement the activities of large companies through integration into the mainstream of industrial development. Most SMEs of manufacturing activities in Libya are concentrated in the North Western; Misratah, Al-Jfara and Tripoli (approximately 46 percent), and North Eastern regions (around 36 percent) (Castel et al., 2010). About 80 percent of SMEs in Libya are privately owned and run by individuals while only 16 percent are established in the form of small corporations and 3 percent are family-owned.

The official definition of SMEs in Libya, set by the General People’s Committee in 2006, has integrated two quantitative parameters namely; the number of employees and the amount of invested capital. Accordingly, small businesses have been officially defined as enterprises employ up to 25 employees with an invested capital of maximum LD 2.5 million, whilst enterprises with a labour size between 25 to 50 workers and have an invested capital above LD 2.5 million but not exceeding LD 5 million are considered medium enterprises.

<table>
<thead>
<tr>
<th>Firm size</th>
<th>Number of employees</th>
<th>Amount of capital invested LD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td>≤ 25</td>
<td>≤ 2.5 million</td>
</tr>
<tr>
<td>Medium</td>
<td>≤ 50</td>
<td>≤ 5 million</td>
</tr>
</tbody>
</table>

Source: General People’s Committee (2006).

The Bolton Committee (1971) suggested three ways to measure the role and importance of SMEs to any national economy; their share in the total number of firms, their share of output, and their share of employment. In Libya, although it is reported that more than 80 percent of all enterprises in the Libyan private sector belong to SME segment (Braun and Jones, 2011) the exact size of the sector is still unknown. While 180,000 private enterprises are officially registered with the Libyan tax authorities it is believed that there are many productive enterprises operating in the informal sector where it is inefficient, risky, and difficult to achieve scale (Porter and Yergin, 2006).
According to UNECA (2008) Libyan SMEs are operating primarily in commerce (72.9 percent), followed by services (13.1 percent), and industry (13.1 percent) employing some 1,146,543 people primarily in commerce and services (95.4 percent). This means that SMEs employ 93.8 percent of the total number of salaried employees in the country (UNECA, 2008). Porter and Yergin (2006) stated that most SMEs in Libya have conducted their business outside the formal economy to avoid taxation and other fiscal and regulatory considerations. As for the contribution of this sector to the GDP of the country, it is only 4 percent (UNECA, 2008).

The Government and foreign investors focus primarily on oil and gas sectors. Such focus has not led to the enhancement of the rest of the Libyan economy. Although Libyan SMEs represent a significant portion of Libyan firms they have relatively low value-added (Elmansori and Arthur, 2014). In fact, SMEs in Libya face a number of problems and challenges which are generally similar to those faced by their counterparts elsewhere in the developing countries.

SMEs in Libya are beset with several problems concerning the inadequacy of financing, low performance of organisational structures, and the inefficiency of the management models adopted. SMEs development in Libya also faces serious constraints in relation to lack of managerial, financial, marketing, and technical expertise. Another challenge to the development of a thriving SMEs sector is the limited presence and influence of a culture of entrepreneurship within the population. The incentive and legal framework and the institutional coordination are reported to the emergence of a sustainable SMEs sector.

In addition, Libyan SMEs rely heavily on foreign workers as they struggle finding Libyan workers with the adequate skills and willingness to work in the private sector (since the public sector often offers higher salaries and compensation packages) (OECD, 2014b). Moreover, Porter and Yergin (2006) revealed that in over two-thirds of SMEs in Libya less than half of the employees have received sufficient vocational training in their field of work.

If these problems are addressed and the role of SMEs in the problem-solving process is recognised this will have positive benefits for the development of the national economy at large. All of this is demonstrative of the need to apply a national policy in support of SMEs; an agency dedicated to offer the support necessary with regard to administration, financing, and organisation.
2.8 Concluding Remarks

The role played by SMEs in the economy has been proved to be the catalyst in the development process in most nations. However, because each country has reached a particular stage of development and each country has its own social, political, and cultural background there is no consensus on SMEs definition nor is there a single uniformly accepted definition that can be applied worldwide. Definitions of SMEs differ from one country to another and even from one institution to another in the same country according to the approach adopted whether it is of quantitative or qualitative nature though the most commonly used yardstick is the number of employees. In practice, however, a mix of both qualitative and quantitative criteria is frequently used.

Due to their flexibility in absorbing labour, widely spread distribution, innovative capacity, and profitability the importance of SMEs in the socio-economic development is well documented. Almost in all countries SMEs have the share of lion in terms of the number of firms in the economy. They greatly contribute to the economic and social development in areas such as creation of employment, more equitable distribution of income, and hence poverty alleviation. SMEs have some general characteristics distinguishing them from large companies; yet, they offer complimentary services to the large companies and act as the seedbed for the development of entrepreneurial skills.

SMEs face many difficulties hampering their growth. These problems can be related to external and internal factors. Regarding external factors, there are a number of obstacles constraining their growth such as the availability and cost of capital and government regulations. In terms of internal factors, there are also important constrains hindering their growth, for instance, poor management and financial competences, shortage of skilled labour and raw materials, gaps in information and knowledge.

In the Libyan context, SMEs have been recently receiving more attention due to their vital role in the current transformation of the national economy. As a result, a number of initiatives and national programs have been launched in order to promote entrepreneurial culture and provide the suitable environment for a thriving SMEs sector. However, the value added, contribution, growth, and performance of SMEs has been considerably low. The reason is that Libyan private sector in general and SMEs in particular lack business expertise and face problems of economies of scale and poor managerial, financial, and marketing capabilities not to mention the problem of financing.
Chapter 3. Financing of Small and Medium-Sized Enterprises

3.1 Introduction

Over the past few decades, the topic of SMEs has dominated the agenda of researchers and policymakers in both developed and developing countries. This widely growing acknowledgment of the paramount importance of this field is reflected in academia, economic planning, and public policies.

In order to fulfil their role, SMEs must have secure access to a range of financial resources. Therefore, query and understand the financial system to help SMEs solving their financial problems is the key to achieve sustainable development goals. Hence, this has provided a fertile area of study and investigations for both academicians and practitioners. As a result, a large literature has emerged focusing on what has become known as the SMEs financing gap with the hope to gain better understanding of the topic of SMEs financing.

Financing has continued to be one of the key challenges that keep confronting SMEs. The accessibility to funds and the cost of raising them have remained issues limiting the in-capitalisation requirements leading to premature collapse of enterprises. The unique features of SMEs could generate a different set of financial problems or cause SMEs to look at the same set of financial problems in a different manner. As a result, different financial decisions, financial arrangements, institutions, and practices may change.

The issues of finance availability and costs matter for most SMEs for two reasons. First, SMEs are more finance-constrained than large enterprises because they typically do not have access to the public debt and/or equity markets. Second, SMEs are more vulnerable to information problems as they tend to be more informationally opaque.

The purpose of this chapter is to review the literature on the financing sources of SMEs and the difficulties encountered by them in raising finance. The reminder of the chapter is organised as follows. The next section briefly discusses the financing behaviour and practices of SMEs. Section 3.3 reviews the practical and theoretical literature on sources of finance from which SMEs can channel funding and Section 3.4 discusses the difficulties faced by SMEs in raising finance, including equity and debt gaps. Section
3.5 provides an overview of SME financing in Libya. The final section provides some concluding remarks.

3.2 Financing Behaviour of SMEs

The availability of finance has been highlighted as a major factor for the development and growth of SMEs. In fact, access to finance for SMEs is essential not only for boosting start-up businesses but also for the expansion and internalization of existing businesses (Osano and Languitone, 2016). Many researchers (e.g. Yeeseleva, 2010; Cook, 2001) have documented the importance of financial capital for SMEs survival and success. 

Financing methods employed by SMEs vary from initial internal sources such as owner-managers’ personal savings and retained profits (Quaye and Sarbah, 2014; Wu, Song and Zeng, 2008) to informal outside sources including financial assistance from family and friends (Abouzeedan, 2003), trade credit, venture capital, and angel financiers (He and baker, 2007) and thence to formal external sources represented by financial intermediaries such as banks, financial institutions, and securities markets (Chittenden, Hall and Hutchinson, 1996).

The wide realisation of the substantial contribution of SMEs to national economies has resulted in a large increase in academic literature relating to SME financing. As such, many studies and academic work were dedicated to examine how SMEs owner-managers select financing sources for their firms and if the sources selected follow a consistent pattern. Different patterns/theories were suggested most famously; the life-cycle paradigm, the pecking order theory, the trade-off theory, and the asset side theory.

3.2.1 Life-Cycle Paradigm

In the early years of their existence SMEs encounter three phases of development; (i) seed stage, (ii) start-up stage, and (iii) expansion stage. The first stage is where the invention or the business idea becomes operationally feasible. In the start-up stage the production and hiring of personnel take place. The expansion stage pertains to the growth and development of the business after initial market acceptance of the product or service.

According to the financial growth cycle paradigm proposed by Berger and Udell (1998) financial needs and the financing options available for SMEs change throughout the
various phases of a firm’s lifecycle. In other words, at different stages of the firm’s growth cycle, different financing strategies are required.

In general, because of the unique features of SMEs during the start-up phase such as informational opacity (Berger and Udell, 1998; Schmid, 2001), the lack of trading history (Cassar, 2004; Fraser, 2004), and the high risk of failure (Huyghebaert and Van de Gucht, 2007) SMEs in this stage depend heavily on insider funding sources.

<table>
<thead>
<tr>
<th>Firm size</th>
<th>Firm age</th>
<th>Information availability</th>
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Figure 3.1 Firm continuum and sources of finance

As SMEs advance through their business lifecycle they begin to gradually adjust their capital structure (La Rocca, La Rocca and Cariola, 2011). During subsequent stages as SMEs mature they start to establish a track record in addition to the ability to provide collateral. This serves to improve their creditworthiness and thereby attracts the attention of investors who would willingly inject money into the business. Consequently, firms begin substituting internal with external financing sources such as venture capitalists, trade credit, and bank loans. In more advanced stages when SMEs become more informationally transparent they may develop access to securitised debt and publicly listed equity markets (Berger and Udell, 1998).

A number of empirical studies including (e.g. Briozzo and Vigier, 2009; Kimhi, 1997) used the lifecycle model as their chosen approach to understand the financial behaviour of SMEs. In line with these studies, La Rocca et al. (2011) found that the financial behaviour of SMEs could be, to a large extent, attributed to the lifecycle pattern which was found consistent over time and quite similar across different industries and institutional contexts. In addition, in their study of small businesses financing using a sample of 60 SMEs across three cities in China Wu et al. (2008) found evidence supporting the business life cycle model.

However, other studies critique this model and claimed that it does not offer a complete picture of SME financial behaviour. For example, Berger and Udell (1998) themselves concede that the lifecycle paradigm is not applicable to all SMEs operating in different industries implying that firm size, age, and information availability, which are intended to constitute the backbone of this particular paradigm, are not perfectly correlated. Gregory et al. (2005) partially agreed with the model stating that SME financing cannot be standardized. Moreover, according to their results and contrary to the growth lifecycle model suggestion that the financial needs and options of SMEs lie on some size/age/information continuum, only firm size was found to be a significant predictor of capital structure decisions in SMEs.

3.2.2 Pecking Order Theory

The SME financing pattern explained by Berger and Udell (1998) seems to be contrasting with the hypotheses given under the pecking order theory. The pecking order theory developed by Myers (1984) and Myers and Majluf (1984) emerged as a result of asymmetric information present in financial markets wherein insiders (firms managers) have superior information about the firm’s prospects than outsiders.
The theory suggests that the capital structure decisions of a firm are a function of its age. As postulated by this theory, internal sources of funding are prioritised while the use of external sources is delayed until the internal sources are exhausted. As such, when seeking funds a firm prefers internal equity to external debt, short-term debt to long-term debt, and external debt to external equity. Therefore, the order of financing preference for a firm should follow internal equity, issuing debt, and then issuing equity (Cassar and Holmes, 2003).

The literature on SMEs provides demand-side and supply-side reasons to justify the preference order suggested by this theory (Lucey and Mac an Bhaird, 2006). Demand-side justifications are based on the well-established fact that SMEs owner-managers are usually unwilling to lose control of their business. As such, to meet the financing needs of their firms owner-managers will try to follow a pecking order of, first, their own personal savings and retained earnings; second, short-term borrowings; third, longer-term debt, and, least preferred of all, from the introduction of new equity investors. As for the supply-side explanation, it is noticeable in the restrictions that exist when SMEs cannot obtain the debt financing they require at market interest rates resulting in underinvestment problem.

Consistent with pecking order theory and contrary to the lifecycle model Gregory et al. (2005) argued that older firms should be less reliant on external financing. They attributed this to the fact that because older firms have more opportunities to accumulate retained earnings and more internal funds are available to finance their operations. Hall, Hutchinson and Michaelas (2000) reached a similar conclusion. Work by Sanchez-Vidal and Martín-Ugedo (2005) on Spanish SMEs supports the pecking order theory.

Other studies such as Baeyens and Manigart (2005), Daskalakis and Psillaki (2008), Mac an Bhaird and Lucey (2010), Mac an Bahird (2010) reported results supporting the existence of pecking order priorities in the context of SME financing patterns. For example, the paper by Mac an Bahird (2010) examining the pecking order theory and its relation to SME financing concluded that SMEs are generally funded in a manner that is consistent with the pecking order theory.

The capital structures literature reports that SMEs face extreme versions of pecking order theory described as a “modified” by Ang (1991) and as a “constrained” by Holmes and Kent (1991). In the former, in order of preference owner-managers contributions is probably second to funds generated internally ahead of external debt.
The explanation given by Ang (1991) is that the large asymmetry of information and the agency costs perceived by outsiders in addition to the high cost of transaction would make the cost of outside funds greater than the returns from alternative investment opportunities. In the latter, “the constrained version” the financing preferences of owner-managers are constrained by two factors (Holmes and Kent, 1991). First, SMEs usually do not have the option of issuing additional equity to the public; and second, owner-managers are strongly adverse to any dilution of their ownership and control of their firms.

3.2.3 Trade-Off Theory

The term trade-off theory is used by different authors to describe a family of related theories. The standard version of the hypothesis of this theory emerged out of the debate of the well-known Modigliani and Miller theorem when income tax was added to their original proposition. The essence of this theory is that by evaluating various costs and benefits of alternative leverage plans an interior solution can be obtained when marginal costs and marginal benefits are balanced (Frank and Goyal, 2008).

The trade-off theory focuses on taxes and bankruptcy costs. According to the standard trade-off theory, taxes and bankruptcy account for the firm use of debt. As such, when firms seek finance for their operations they “trading-off” the costs and benefits of debt. Myers (1984) explained that by stating that a firm that follows the trade-off theory sets a target debt-to-value ratio and then gradually moves towards the target. The target is determined by balancing debt tax shields against costs of bankruptcy. As stated by Seifert and Gonenc (2008) the trade-off theory arrives at balancing the benefits of debt (tax and reduction of free cash flow problems) with the costs of debt (bankruptcy and agency costs between stockholders and bondholders).

A number of studies investigated the applicability of the trade-off theory to SME. The study by López-Gracia and Sogorb-Mira (2008) concluded that both the pecking order theory and the trade-off theory help to explain SME financial behaviour. However, according to them, greater trust should be placed in the trade-off approach. Their results also revealed that debt tax shields seem to play an important role in determining SMEs sources of finance. The results of Cassar and Holmes (2003) also support static trade-off theory in Australian SMEs.

However, against this theory, some research indicates that SMEs are not as profitable as larger firms so they have less use for debt tax shields (Michaelas, Chittenden and
Poutziouris, 1999). Likewise, Day, Stoll and Whaley (1985) argued since SMEs are generally less capital-intensive the debt tax shield is of lesser value for these firms. In addition, Bartholdy and Mateus (2008) found that tax rates do not significantly influence the level of debt in SMEs.

**3.2.4 Asset Side Theory**

Arguing that both the Pecking Order theory and the Trade-off theory overlook the point that the asset side of the balance sheet primarily determines the financing source for an additional unit of money, Bartholdy and Mateus (2008) introduced the asset side theory in an attempt to detect what determines the main sources of financing used by SMEs. Their theory argues that due to asymmetric information and the solution to this problem for different providers of funding (primarily banks and other firms in the form of trade credits) the marginal costs of each funding source are a function of the use of the funds. Therefore, the composition of the asset side or the intended use of funds determines the source of the funds and, more generally, the capital structure. In particular, purchases of goods and services are financed by trade credits, investments in fixed assets are financed by long-term loans from banks and other debtors, and other parts of working capital are funded by short-term bank loans.

Bartholdy and Mateus (2008) tested this theory on a panel data set of Portuguese SMEs. According to their results, the hypotheses of the pecking order theory and the traditional trade-off theory were rejected. In addition, they found that the composition of the asset side is an important determinant of the type of financing sought and used by SMEs. That is to say, the marginal cost of the financing source is a function of the use of funds. This suggestion was partially confirmed by the significant positive relationship between asset structure (the ratio of fixed to total assets) and long-term debt found in the study by Mac an Bhaird and Lucey (2014). Similarly, it was found that SMEs are more likely to seek some external debt if they have more tangible assets that can serve as collateral (Fourati and Affes, 2013).

Despite the effort that has been made to theorize the financial behaviour of SMEs which has resulted in the different financing patterns followed by SMEs, it seems that different theories suggest different approaches. However, regardless of what theory or pattern is followed when seeking finance SMEs in general have a range of options to cater for their financing needs. The next section presents a review of the general literature on SMEs sources of finance.
3.3 Sources of SME Finance

Access to finance is of crucial importance for the ongoing and sustainable growth of SMEs. At every stage of their development, SMEs need finance for their operations. In general, there are four occasions where SMEs need to raise finance (Bates and Hally, 1982). First, SMEs need finance for start-up capital to help establishing the business. Second, finance is needed for expansion. That is for purchasing buildings or machinery or for working capital purposes. In some cases, the finance might be used to taking over another existing business. The third occasion is when the finance is needed for innovation. This can be an independent occasion or sometimes it coincides with the first or the second occasion. Finally, SMEs might seek finance to adjust their existing financial structure by, for example, changing in the proportion of equity to debt or by substituting long-term debt with short-term debt or vice versa.

SMEs have a number of options for raising finance. For example, according to Oncioiu (2012), funding for SMEs may be made by calling the internal sources (equity capital) and/or external funding sources. Some advantages of internal financing sources include preserving the independence and financial autonomy since it creates no additional binding (interest, guarantees), maintaining borrowing capacity, and being a reliable mean of financial support of the enterprise’s needs. Nonetheless, they also bear some drawbacks because the owner-managers have less funds to invest in other more profitable activities than the activity which generated the financial overflow (alternative cost). On the other hand, external financing is necessary if SMEs do not have sufficient internal resources to cover the investments necessary for their planned activities. External financing sources of SMEs include; loans, grants, and capital market instruments. The needed borrowing is obtained by the analysis of the evolution indicators of costs that are generated by the enterprise development. This need should be determined from the planning stage of development.

Baldwin, Gellaty and Gaudreault (2002) studied the use of different financing sources and instruments by Canadian SMEs. The authors classified five financial instruments and four groups of funding sources. The financing instruments identified were; retained earnings, share capital, short-term debt, long-term debt, and other. As for the funding sources, they included; internal sources, financial institutions, and innovative sources (e.g., venture capital and public markets).
3.3.1 Equity Financing

Due to moral hazard and problems with information opacity typically being more severe during the initial stages of SME development internal equity financing, as best represented by owner-manager personal savings, is critical in these early stages (seed financing and start-up). Subsequently, in later stages, in order to develop and grow SMEs tend to reduce their dependence on these sources and start seeking alternative channels for raising capital. Internally generated profits and venture capital exemplify just two of the other equity options SMEs seek to expand as they grow.

In general, “…equity capital is that capital invested in the firm without a specific repayment date, where the supplier of the equity capital is effectively investing in the business” (Ou and Haynes, 2006, p. 156). Equity capital can be raised either internally or externally. Internal equity is funds obtained from the current owner-manager(s), family and friends, or from the retained earnings within the firm. External equity, however, is the capital acquired from external channels other than the existing partners and their relatives.

As mentioned above, equity financing is preferred over debt as a mode of financing for new and young SMEs as they undergo a typical cash shortage and are generally unable to secure loans with collateral during the founding phase. The advantages of equity financing in this regard are twofold (Ou and Haynes, 2006). First, unlike debt, equity offers long-term financing with minimum cash outflow in the form of interest. Second, it helps to enhance the new/young firm’s creditability by indicating that the firm has the approval of sophisticated financial professionals.

Ou and Haynes (2006) determined two situations when SMEs pursue financing from equity capital sources in order to meet expansion needs. First, when SMEs face financial distress coupled with a lack of alternative sources of finance. Second, when cash outflows exceed the cash inflows generated from regular sources. The authors attributed this attitude adopted by SMEs in these two particular cases to the reluctance of regular lenders to lend to the firm because of uncertainty about future growth opportunities. As a result, these firms are usually classified as high risk. Inconsistent with this, Schäfer, Werwatz and Zimmermann (2004) found that risky SMEs are more likely to receive equity financing. Another study by Ueda (2004) supports this finding.

Other arguments suggest that some SMEs owner-managers may choose not to use equity in order to avoid any undesirable changes in the ownership of their firms (Reid,
1996). Other entrepreneurs, nevertheless, may choose to source funding from external equity in order to share the risk with less risk-averse investors. However, the valid judgement of the importance of the external equity for SMEs according to Berger and Udell (1998) should be based on the eventual success of firms that receives it and not on the quantity that the firm utilises.

Stanworth and Gray (1991) argued that the financial needs of firms with high rapid growth rate such as technology-based firms are likely beyond what can be internally generated by the firm (self-financing resources). To fill this gap, these firms are more likely to pursue external sources of finance particularly equity finance. Consequently, there has been significant development with regard to the supply of equity finance targeting SMEs. Examples include the creation of secondary stock markets and the emergence of the venture capital industry.

I. Venture Capital

Venture capitalists are financial intermediaries. Venture capital is that form of financing in which investors’ capital is redeployed and invested directly in portfolio companies (Metrick and Yasuda, 2010) which for the most part are young or start-up firms (Potter and Porto, 2007). Further, venture capitalists decide the timing and type of investment in addition to their role in monitoring, screening, and contracting (Gorman and Sahlman, 1989). Moreover, by performing these functions venture capitalists virtually participate in strategic planning and decision making in the firm. The venture capital market includes a variety of organisations including public corporations, small business investment corporations, and private limited partnerships (Barry, 1994).

Compared to other more conventional financing sources venture capital displays some particular characteristics. To start with, investments employing venture capital often involve high levels of asymmetry information and uncertainty as well as higher intangible assets (Gompers, 1995). In addition, Hellmann (1998) explained that the situation in which a company has a sufficiently large incentive for active monitoring takes place only when the venture capitalist has a concentrated stake invested. Monitoring in such cases may include spending more time in the company and regular meetings with the managers (Hellmann and Puri, 2000). Finally, venture capitalists can provide the firm with strategic access to technology experts, legal and accounting advisors, new suppliers and clients as well as strategic partners (Cumming and Johan, 2010).
As above, venture capital investment is uniformly associated with high risk and uncertainty. For example, when providing external finance to firms venture capitalists encounter a significant adverse selection problem and moral hazard issues (Smolarski and Kut, 2011; Fenn, Liang and Prowse, 1997). Another problem that may arise is the agency problem (Berger and Udell, 1998). This occurs in the relationship between the venture capitalist and the entrepreneur when the latter lacks sufficient information or skills to make optimal production decisions. This problem might also be combined as information about the project is imperfect and revealed over time (Bergemann and Hege, 1998). In order to alleviate these problems and reduce uncertainty particular mechanisms can be implemented. In this context, Gompers (1995) highlighted three control strategies. These strategies are:

(i) The use of convertible securities;
(ii) The syndication of investment; and
(iii) The staging of capital infusions.

According to Cumming (2006), most venture capital transactions include convertible securities. Bascha and Walz (2001) asserted that unlike traditional debt and/or equity instruments convertible securities have the ability to mitigate the agency problem effects by leaving the owner-manager with some control during the investment period. In addition, Barry (1994) argued that as the price of conversion is a function of performance the venture capitalist has a better chance to recover the investment if the venture is not successful. Other studies show other motivations for employing convertible debt with examples include reducing the risk-shifting incentives of the entrepreneur (Green, 1984), resolving problems arising with debt financing (Dewatripont, Legros and Matthews, 2003), and gaining indirect equity financing when issuing traditional equity is unattractive (Stien, 1992).

Syndication is a common form of venture capital risk alleviation and refers to two or more venture capitalists sharing in a single financing round. This mechanism is used in order to decrease problems associated with adverse selection through the participation of a co-investor sharing the risk (Smolarski and Kut, 2011). Cumming (2006) reached a broadly similar conclusion stating that venture capital syndication significantly mitigates adverse selection problems. Additionally, Lerner (1994) suggested that adverse selection problem can be efficiently mitigated in the presence of high information asymmetry in venture capital financing by implementing the syndication
strategy. It was also found that syndication reduces the opportunistic behaviour of entrepreneurs (Wright and Lockett, 2003).

Another strategy of venture capital is staged financing. As the term suggests venture capital staging refers to that mode of financing in which venture capitalists invest in stages in order to maintain the project under control. Gompers (1995) provided evidence indicating that staged investment enables venture capitalist to gather more information allowing him/her to monitor the firm prior to any refinancing decisions are made. As such, the venture capitalist has the option of abandoning the project if and when any unattractive information regarding the investment emerges (Cherif and Elouaer, 2008). Wang and Zhou’s (2004) results showed that the staging financing plays a crucial role in controlling moral hazard. Therefore, it is an effective mechanism in controlling agency problems.

Not only do venture capitalists provide an alternative source of funding for SMEs they also help resolving many informational problems plaguing SMEs. They are critical in helping some firms to be born in the first place (Mollica and Zingales, 2008). However, the supply of venture capital appears to be relatively inflexible, at least in the short-term, as it requires years of experience to develop the necessary skills (Kortum and Lerner, 2000).

II. Business Angels

Unlike other external sources, business angel finance is not intermediated. It is instead an informal market for direct finance. Angels are highly selective wealthy individuals with long business experience who invest directly in high growth SMEs with which they have had no previous relationship (Ramadani, 2009; Madill, Haines and Riding, 2005). This form of investment is usually based on an equity contract typically common stock. Though angels by definition are individuals they sometimes coordinate their investment in small investment groups (Prowse, 1998).

According to Harrison and Mason (1992) there are three features that make angel financing an appropriate option for SMEs. First, angels are more active in the early stages of enterprises life cycle (seed and start-up) closing the so-called “equity gap” by forming a “bridge” between internal financing sources and outside investors. Second, by having lower rates of rejection and being a more patient form of capital with longer exit horizons angel financiers tend to be more obliging to the needs of SMEs’ owner-managers. In a survey by Brettel (2003) German entrepreneurs ranked business angels
as the most desirable funding providers. Finally, unlike venture capitalists angel investors prefer to invest in their local economies where the majority of SMEs operate.

Angel investors are a crucial source of financing for many SMEs especially start-ups. According to Morrissette (2007), the amount of capital that angels provide is estimated to be eleven times that provided by venture capitalists. Data collected by Shane (2012) from different surveys conducted between 2001 and 2003 show that between 140,000 and more than 260,000 angels injected investments between $12.7 and $36 billion into between 50,000 to 57,000 ventures each year. In Germany, for example, a study by Stedler and Peters (2003) estimated the total capital assets for each business angel in the country at €2.5million to €5 million distributed across a portfolio of between 1 and 5 firms all in start-up stage.

The extent to which angels are involved in the firms in which they invest is debatable. Barry (1994) claimed that angels are not active investors. Yet, studies show opposing results (e.g. Harding and Cowling, 2006; Landström, 1993). In terms of benefits, Lumme, Mason and Suomi (1998) concluded that the performance of investee firms can be improved as a result of the skills, knowledge, and expertise of angel investors.

In other research, Mason and Harrison (1996) questioned a sample of 20 dyads regarding the role played by business angels apart from their financial stake. The respondents reported that non-financial contributions made by angels included assistance with management functions, finance and accounting functions, strategic advice, financial advice, general administration, networking, and marketing. Further, 50 percent of the entrepreneurs rated these contributions of angels as either helpful or extremely helpful.

Worldwide, based on quantitative analysis angel financing dominates venture capital financing in terms of both the number of firms utilizing it and the financial value of investment (Fairchild, 2011). However, as a source of financing, business angels have two main limitations (Wall, 2007). First, few angels are prepared to inject additional money into a firm to enable it to grow and be a real competitor in its market. Second, most angel investors do not have neither the skills nor the interest in investing in a firm after it has access to other external sources of finance including public equity markets.
3.3.2 Debt Financing

It is well known that capital structure decisions, in SMEs as in large firms, relate to the use of either equity or debt or both. However, Berger and Udell (1998) believe that in the case of SMEs this is partially incorrect because information opacity is more severe in SMEs. Issuing additional equity to satisfy the firm’s financial needs would then lead to a dilution in ownership and control. Therefore, in order to keep full ownership and control of their businesses SMEs’ owner-managers may prefer to seek debt financing rather than external equity (Berger and Udell, 1998).

Three significant differences between debt financing for SMEs and that of large firms are identified in the literature (Wu, Hedges and Zhang, 2007). First, unlike managers of large firms who usually have the choice of broader range of debt financing resources SMEs tend to be more attached to commercial lenders especially institutional lenders as a source of short-term debt financing that can be renewed for long-term debt. Second, as information asymmetry problems are more acute in SMEs long-term lending relationships are important for SMEs in order to deal with the resultant agency problems along with the other three conventional mechanisms; signalling, monitoring, and bonding (the provision of guarantee or collateral). Third, in concentrated owner-managed SMEs and contrary to what the agency theory suggests it is not clear whether debt can lower the agency costs that result from information asymmetry arising due to different motives of owners and managers.

Choosing between short and long-term debt is important when seeking additional finance. Short-term debt decisions are influenced by the benefits and disadvantages associated with its use (García-Teruel and Martínez-Solano, 2007). Jun and Jen (2003) summarised short-term debt advantages as a funding source. These advantages include (i) zero interest rate in some cases such as in the case of trade credit; (ii) in comparison to long-term loans short-term debt has generally lower nominal interest rates; (iii) it is easy to adapt according to the firm’s financial needs; and (iv) lower costs of flotation than those of long-term loans. In addition, from the lender’s point of view, short-term debt is an efficient way to deal with asymmetry information problems as firms have to repay the debt and any associated charges over a shorter constant period (Myers, 1977). However, the main drawback of short-term debt is the higher level of risk. Hence, financially weak firms would prefer long-term debt as they perceive short-term debt benefits do not abolish its additional risks (García-Teruel and Martínez-Solano, 2007).
In such cases Long-term debt may then be better choice for the firm as it could have a positive impact on investment and performance (World Bank, 2015).

1. Trade Credit

One of the most important sources of external financing for SMEs is trade credit. Berger and Udell (2006) estimated that one-third of the total debt of SMEs in the US in 1998 was represented by trade credit. According to García-Teruel and Martínez-Solano (2010) trade credit is a delay in the payment for goods or services after they have been delivered or provided as a result of an agreement between the supplier and the firm. Therefore, for the firm this is a source of financing appears in the balance sheet under current liabilities (accounts payable) whereas for the supplier it is an investment in accounts receivables.

The rationale behind the widespread use of trade credit among SMEs has been a source of argument in the literature. This attitude can be ascribed to either a transaction motive or a financing motive. The transaction motive suggests the better ability for both parties (the seller and the buyer) to predict their cash needs in the short-term. As such, cash management transaction costs can be economized (Ferris, 1981). The financing motive is that SMEs resort to trade credit when alternative sources of finance are unavailable or more expensive (Arslan and Umutlu, 2009).

Fatoki and Odeyemi (2010) argued that trade credit is preferred by new and young SMEs when the risk of default is high during the early years of operations. Moreover, in relation to financial motives firms with easier access to credit market can act as a financial intermediaries and offer funding for firms that face difficulties in accessing external financing (Rodriguez-Rodriguez, 2006; Demirgüç-Kunt and Maksimovic, 2001).

The role of trade credit as a source of finance for SMEs is even more important in countries with less developed banking and financial systems where asymmetric information problems are more pronounced. In China, for example, Allen, Qian and Qian (2005) attributed the accelerating growing of the country’s economy rather than formal external finance to alternative sources foremost of which is trade credit. Supporting this, Yano and Shiraishi (2012) investigated the efficiency of trade credit as an alternative channel for funding rural SMEs in China using firm-level micro data over the period from 1999 to 2005. They concluded that offering more trade credit to SMEs
can assist these firms in their post-entry survival and thereby strengthening their opportunity to thrive.

Another example comes from Russia where the financial and banking system is also typically considered less developed. Employing data from a survey of 352 Russian firms in 1995 Cook (1999) emphasised the unique positive role of non-financial firms namely trade credit suppliers in addressing problems with information asymmetry. The author explained two ways through which trade credit can surmount capital market imperfections. First, as trade credit suppliers have more information on their partners’ businesses trade credit can mitigate the problem of information asymmetry enabling them to evaluate and control the credit risk of their buyers. Second, by using trade credit SMEs can demonstrate their creditworthiness to banks and, consequently, banks will be more willing to lend to them.

Some researchers (e.g. Wilson and Summers, 2002) argued that trade credit can be a costly financing source if the buyer delays the payment beyond the specified date in the agreement. Nevertheless, Berger and Udell (2006) believe that in spite of some drawbacks trade credit remains a crucial financing source for most SMEs especially the young firms. They further explain that trade credit has the ability to provide the desired cushion during credit crunches, contractions of monetary policy, or other shocks that may make other funding suppliers unwilling to provide funding to SMEs.

II. Non-Bank Financial Institution Debt

According to Berger and Udell (1998) funding provided by financial institutions is the main category of debt for SMEs. These institutions include banking systems and other financial institutions. However, as finance institutions tend to differ from banks in their lending policies possibly in part because of regulatory differences (Berger and Udell, 1998) and following Ayyagari et al. (2007) who separate bank finance from other non-bank financial institutions funding, the focus in this section will be on non-bank financial institutions as the role of banks will be discussed in greater details in the next chapter.

In spite of the important and unique role played by non-bank financial institutions including credit unions, pension funds, finance houses, investment trust companies, finance companies, and insurance companies in meeting the financial needs of SMEs the market for non-bank debt has been largely ignored in the finance literature (Arena, 2011; Cheng and Degryse, 2010). Nonetheless, some researchers have attempted to
investigate this role. For example, Atieno (2001) investigated and assessed the role of such institutions in facilitating the access to credit by SMEs in rural Kenya. The author attributed the dominant position of these institutions as funding providers to SMEs to the fact that their procedures for loan applications are shorter than those of commercial banks. Another advantage makes this financing source favourable to SMEs, the author added, is longer loan maturity periods.

Non-bank debt offers a channel for SMEs to raise funding in both developing and developed nations. In Zimbabwe, for instance, loans granted by non-bank financial institutions account for nearly 30 percent of total debt and were ranked second in order of importance by domestic SMEs (Aryeetey, 1998). A more recent study conducted by the Federation of Small Businesses found that 15,000 financial institutions in the US competed to lend to SMEs of which half were non-bank lenders in the form of credit unions (Goff and Nasiripour, 2012). Also in the US, an earlier study by Denis and Mihov (2003) targeted a sample of 1,560 new debt issuers firms during 1995-96 found that of total amount of debt of $350 billion raised by the firms in the sample non-bank debt was responsible for almost $40 billion.

Johnson (1997) explained that while banks prefer short-term debt as their liabilities are also short-term non-bank financial institutions such as insurance companies are generally in favour of long-term loans as they have long-term liabilities. However, the author believes that non-bank financial institutions can act as a financial intermediate between banks and public debt. In other work, Aryeetey (1998) suggested that in order to encourage banks to cooperate with non-bank financial institutions special incentives could be beneficial.

In general, the main advantage that encourages SMEs to use more debt than other external sources of finance in their capital structure is the tax shield benefit (Fosberg, 2004). In addition, when seeking external funding SME owner-managers tend to limit the use of equity in order to maintain control of their firms (Cressy and Olofsson, 1997; Hutchinson, 1995). However, Abor (2008b) found that SMEs with many shareholders (group-owned SMEs) may choose to utilize low debt levels to avoid bankruptcy and the agency costs accompanied with debt financing.

3.3.3 Government Assistance and Initiatives

In both developed and developing countries governments have recognized that the SME sector faces constrained access to external financing which may negatively affect its
crucial role in achieving development goals. As such, many governmental initiatives and programs have been implemented to ensure SMEs have easier access to finance. Credit guarantee loans, factoring programs, and subsidised fees are typical examples of such programs.

According to Mensah (2004, p. 3), “… government official schemes are those introduced by government either alone or with the support of donor agencies to increase the flow of financing to SMEs”. It has been argued that such schemes have the capability to ease the access of SMEs to additional credit (Boocock and Shariff, 2005; Levitski, 1997). However, Riding, Madill and Haines (2007) maintain that government schemes aimed at assisting access to finance for SMEs can be effective only under well-specified conditions.

In addition, as SMEs are subjected to credit rationing due to their size and information asymmetry Zecchini and Ventura (2009) suggested that in order to be effective such schemes should aim at lowering the degree of discrimination against SME borrowers in terms of lending costs and unmet demand. Moreover, as for SMEs operating in the export sector, Albaum (1983) recommended that it should be taken into account that not all firms are at the same phase of export development, thus, a set of programs targeting firms at different stages of export development is essential.

Credit guarantee schemes and other government assistance programs represent a key policy tool to address SME financing gap. It is estimated that there are more than 2250 guarantee schemes in over 100 countries worldwide (Green, 2003). In addition, Pombo (2010) (cited in OECD, 2013) reported that with a few country exceptions in Asia, Northern and Eastern Europe, and Central America some forms of credit guarantee services exists in most regions of the world.

On the basis of their design and operation two significantly different concepts of SME financing schemes can be observed (Oncioiu, 2012):

- Financing schemes based on governmental economic policies: these schemes aim to achieve certain economic and social objectives by targeting with priority some certain categories of firms. Adherents of this approach are the Japanese SMEs who are currently preferentially financed through a variety of public schemes which develop strongly and with great potential for job creation.
- Financing schemes focused on market requirements: the aim of this type is to provide financial resources under the same or very close conditions to the
market conditions. The main concern is to avoid causing distortions in market competition which might advantage certain categories of firms. These schemes, which forecast modest subsidies to SME financing costs, have a less sensitive role in stimulating them.

One example of governmental assistance programs in industrialized countries is that of Small Business Financing Program in Canada. Under this program, the Canadian government may guarantee up to 85 percent of loans less than $C250,000. During the financial year 2005-06 this program enabled SMEs to attain more than 10,000 loans with total value exceeded $C1 billion (Klyuev, 2008). Another example is the Small Firms Loan Guarantee Scheme in the UK aims at facilitating SME access to finance by providing guarantees for SME loans. Over the period 1998-99, approximately 45,000 loans to SMEs were guaranteed with a value of £189 million (OECD, 2000).

In developing countries, different pictures emerge. In Croatia, the government implemented the National SME Loan Scheme jointly with eight local commercial banks in 2000. The program aimed at increasing the supply of finance targeting SMEs and decreasing the cost of borrowing. However, contrary to expectations the program suffered from a low rate of loan approvals with only 5 percent and 29 percent of applicants approved in the first two years; 2000 and 2001 respectively (Cziráky, Tišma and Pisarović, 2005). Cziráky et al. (2005) attributed this to the inconsistency in lending criteria employed by the banks involved in the program.

Other examples that positively illustrate the role these programs include the Kilimanjaro Cooperative Bank Scheme targeting rural SMEs in the region of Kilimanjaro in Northern Tanzania. In his evaluation of this program, Satta (2006) concluded that in terms of loan productivity the Kilimanjaro Cooperative Bank Scheme outperformed all other schemes from Asia, Latin and Central America, and the Middle East with 500 active borrowers for each credit officer and an efficiency ratio of 30 percent.

Three major reasons rationalize government intervention on behalf of SMEs in finance markets namely, credit market failure, price distortions, and dynamic externalities (Bechri, Najah and Nugent, 2001). Nonetheless, government direct intervention to enhance SME access to finance may also lead to undesirable consequences (OECD, 2004). Some indirect mechanisms and policies can help achieving these programs’ objectives. The role of tax legislation is a case in point. In addition, it is assumed that in order to be effective SME financing scheme should meet two principal criteria (Mensah,
First, provide SMEs with their financial needs. Second, they should be sustainable.

3.3.4 Islamic Finance for SMEs

As recently as the 1970s, Islamic finance has arisen as a new trend with promising potential in the field of finance. The rapid growth of Islamic finance is not confined to Islamic countries as it also has spread to non-Muslim countries that have sizeable Muslim populations including the US, the UK, and Australia. According to McKenzie (2011), since the mid of 1990s the financial assets of the Islamic finance industry had grown from USD 150 billion to around USD 1041 billion in 2009. The author further asserts that this industry is expected to sustain a growth rate of 10 to 15 percent per annum over a number of upcoming years.

It is argued in the Islamic financing literature that many of the elements of microfinance are in accordance with the broader objectives of Islamic finance. In this context, Obidullah and Lattif (2008) believe in the possibility of a “successful marriage” between the two disciplines. They support their belief by clarifying some aspects which these two disciplines have in common. According to authors, both Islamic finance and microfinance advocate entrepreneurship as well as risk sharing between the financier and the entrepreneur. Also, both disciplines prioritize developmental and social goals by encouraging the participation of the poor in the economic activities.

Additionally, Segrado (2005, p. 5) lists a number of principles that Islamic finance shares with microfinance including:

- Prohibition of all forms of economic activity which are morally or socially injurious.
- Egalitarian approach (no restriction to any category of clientele).
- Focus on the well-being of the community as a whole, concentrating on the poor.
- Aim at social justice.
- Advocacy of entrepreneurship.
- Advocacy for financial inclusion through partnership finance.
- Participatory approach.
- Risk sharing.
In comparison with conventional methods of financing and by considering the participatory nature of Islamic financing that encourages the client loyalty Islamic financing methods are believed to have greater suitability and support for SMEs. This can be attributed to the ongoing dialogue between the two parties (the financier and the entrepreneur) which, in essence, improves the decision-making process. As a result, a superior outcome of the business decision-making can be expected as the two parties working together rather than working in isolation each.

Elasrag (2011) emphasises that unlike conventional interest-based finance which advantages the financier Islamic finance offers unique financing techniques for SMEs that ensure justice for both parties in the contract. In the same vein, Ibrahim (2003) argues that Islamic financing methods are better suited in satisfying the financial needs of SMEs. The focus in Islamic financing and investment, he explains, is on the transaction itself instead of the creditworthiness of the partner. As such, entrepreneurs are granted funding without an obligation on them to provide strict securities or collateral which SMEs often lack. He adds that because profit and loss sharing is pivotal in Islamic finance any securities or collateral demanded by the financier is not against the risk of loss, it is rather against possible fraud or repayment evasion.

A salient example of Islamic finance system that can be cited is that of Sudan where the entire financial system has been officially converted into an Islamic financial system. According to Ibrahim (2003), the Sudanese Islamic Bank, opened in 1994, provided financing for up to 500 SMEs by the end of its first year in operation. These enterprises were financed through Musharakah, Mudarabah, and Murabahah with a percentage of 17, 6 and 74 respectively. In 1993, Faisal Islamic Bank of Sudan was established. During the fiscal year of 1993-94 the number of SMEs financed by the bank was 1,400 of which 100 percent was financed by Murabahah. The Agricultural Bank of Sudan and Islamic Co-operative Development Bank are examples of other financial institutions offer Islamic finance to SMEs in Sudan.

Since the Islamic financing methods are typically provided by banks the methods that are applicable for financing SMEs are discussed in the next chapter concerning bank finance for SMEs.

### 3.4 Difficulties Facing SMEs in Raising Finance

The difficulties facing SMEs in raising finance has been long a subject for research. It is largely argued in the literature that the growth of SMEs is hindered by limited access to
finance sources. Clarifying this, Binks, Ennew and Reed (1993) explain that the smaller the firm the larger the proportionate increase in the capital base needed to meet this increase in demand, but the lower its capacity to attract finance through loans or equity. As such, this resultant demand will lead SMEs to essentially go externally in seek of additional funding. Bearing in mind the limited resources of finance available to them, this means that SMEs will confront some difficulties and problems.

As a result, a “financing gap” for SMEs may exist as they grow. Ray and Hutchinson (1983) identified two dimensions of the existence of financing gap. If the marginal return on the investment exceeds their marginal cost of capital a financing gap would exist. In addition, a financing gap would exist if the cost of money to small concerns, defined as the risk less rate of interest plus allowances for differentials in risk and loan administration cost, exceeds the money to large concerns. Hence, due to this excessive cost SMEs would not be able to invest and grow.

Worldwide, it is estimated that the gap for formal and informal SMEs has been revised upwards from $3.2 to 3.9 trillion globally; of which $2.1 to 2.6 trillion is in emerging economies (IFC, 2013). Adding formal microenterprises with the formal SMEs population the gap for the 100 million-plus formal SME sector alone could be as high as $1.7 trillion. For formal SMEs, a total value gap for credit is estimated at $1.5 to 1.8 trillion; of which $0.9 to 1.1 trillion is from emerging markets. Another $0.5 to 0.6 trillion represents the credit gap for the estimated 60 to 70 million formal microenterprises in emerging markets (IFC, 2013).

Some studies have outlined the fact that the essential reasons behind SMEs lack of access to finance can be traced back to their irregular characteristics in addition to the fact that SMEs experiencing financing gaps that attributed to market imperfections witnessed on the supply side. In most cases, SMEs undergo financing gaps because of a combination of reasons originating from both the supply and demand sides. Three main obstacles that may prevent SMEs from obtaining adequate financing have been identified in the literature. These obstacles are (Zavatta, 2008): (i) the existence of market informational asymmetries between SMEs and lenders or outside investors; (ii) the intrinsic higher risk associated with small-scale activities; and (iii) the existence of sizeable transactions costs in handling SME financing.

As SMEs owner-managers typically have better information on their businesses that cannot be easily accessed or cannot be accessed at all by potential investors
informational asymmetry always exists in SME financing transactions. This situation will lead to two problems. First, the investor might be unable to adequately distinguish between “high quality” and “low quality” projects. In such cases, cost variables (i.e. interest rates) may not work well as a screening device because high interests may lead to an excessively risky portfolio (the adverse selection problem). Second, once funding has been supplied the investors may not be able to judge whether the firm is using the funding in an appropriate way (the moral hazard problem). Under such conditions, outside financiers tend to adopt a very cautious attitude towards SMEs. Subsequently, they choose to either reduce the amount of financing sought or refuse it altogether.

The difficulties faced by SMEs in accessing finance can be also attributed to their high risk profile. SMEs are regarded as risky enterprises for a number of reasons. First, the problem of inadequate accounting systems in SMEs undermines the accessibility and reliability of information regarding profitability and capacity of repayment. Second, in comparison with larger companies SMEs face a more uncertain competitive environment. SMEs experience more variable rates of return and higher rates of failure. Third, SMEs are comparatively less equipped in terms of both human and capital resources to withstand economic adversities.

Regardless of their risk profile, the management of SME financing is an expensive business. The cost of assessing a loan application or of conducting a due diligence exercise in view of a possible equity investment is, to a large extent, independent from the size of the financing under consideration. For all practical purposes, the following costs are fixed: (i) administrative costs; (ii) legal fees; and (ii) costs related to the information attainment. In the case of smaller investments it is more difficult to recover these costs. Similar considerations apply to the costs that external financiers must incur after disbursement when conducting field inspections or attending board meetings.

In addition, a fourth problem which is usually cited in the literature is the lack of collateral that typically characterizes SMEs (Zavatta, 2008). In the case of debt financing SMEs’ lack of collateral is possibly the most widely cited obstacle faced by SMEs in accessing finance. The amount of collateral required in relation to the size of the loan is a measure frequently adopted to empirically assess the severity of the financing gap. In most cases, the lender may consider the collateral insufficient simply because the owners-managers tend to use resources from the company for personal or
other purposes. As a result, finance providers may prefer to inject their money in other businesses that provide more security for their investments.

3.4.1 Equity Gap

In the context of SME financial development the financing gap relating to the lack of equity finance is the most obvious one. A number of studies highlighted the existence of an equity gap in SMEs (e.g. Gualandri and Venturelli, 2008; Mason and Harrison, 2003). The equity gap is often quantified “as a set of boundaries relating to the amount of equity finance sought in which potentially viable and profitable businesses are unable to raise the finance they need” (BIS, 2012, p. 10).

Mason and Harrison (2003) explain that equity gap emerges between the funding provided by venture capitalists and that supplied by business angels. They further add the equity gap is evident in two particular cases. First, stages of development such as start-up and early-stage ventures as most of the investments of venture capitalists are found in the expansion stage. Second, the equity gap can be also observed for firms requiring small amount of investment since venture capitalists tend to invest in fewer but larger deals rather than more small-scale deals.

As can be seen in the definition of equity gap illustrated in the above paragraph it is assumed that equity gap does exist mainly due to insufficient funds being made available by finance suppliers. In other words, the supply side of the equation is the one blamed for the existence of equity gap. In this context, some key supply-side reasons for the existence of an equity gap as reported by Murray (2007) can be summarised as follows:

- High costs: Investments involve high costs for investors; not only is the actual invested amount a sunk cost which sometimes cannot be recovered but also the high costs of transaction in terms of finding right investments and creating the appropriate contracts for them; the monitoring costs post-investment also to be added.

- Asymmetry of information: This is especially widespread in technology and innovative businesses where technologies might not be yet proven and their acceptance in the market is yet to be realised which results in high risk for investors.

- Few opportunities for economies of scale: Every proposal needs to be evaluated on its own individual merit and thus there is little room for economies of scale.
• Unproven entrepreneurs: Entrepreneurs without previous business experience pose an additional risk to investors and may increase the monitoring costs post-investment.

• Low liquidity/lack of exit options: Investors in small unquoted businesses have very limited opportunities to exit their investments and to gain their return which in turn increases the risk of investing in small young firms.

However, in recent years there has been an established argument that blaming only the supply side for the existence of the equity gap does not offer a full picture of the situation. That is to say, there is also a demand-side dimension to blame. For example, Mason and Harrison (2001) argued that the fact that many investors complained about the limited amount of high-quality investment proposals can be introduced as a demand-side issue. They also presented the notion of investment readiness the lack of which leads to the inability of SMEs’ owner-managers to raise finance. This readiness for investment according to Mason and Harrison (2001) involves:

• Owner-managers’ attitudes towards equity: As they are unwilling to relinquish some of their ownership and/or unwilling to obtain external interference in their businesses, many SMEs’ owner-managers prefer to avoid equity.

• Poor presentation of entrepreneurs’ proposals: This refers to both written and oral presentation of the proposed business opportunities, for instance, through low quality and incoherent presentations or poorly presented business plans.

• Investability of the proposed business: This can refer to an incapable management team, insufficiently large potential target market, or insufficient potential return in relation to the risk posed by the opportunity.

Even though there are strong reasons suggesting that the existence of equity gap might be due to either the supply-side or the demand-side Mason and Harrison (2003) concluded that the equity gap most likely occurs because of a combination of reasons that relate to both supply side and demand side.

3.4.2 Debt Gap

Along with equity, debt finance represents a principal source of funds for SMEs. While equity capital is, in most cases, the only capital that can be provided by the owner-manager at the initial development stages debt finance is usually sought at later stages when SMEs become attractive to outside financiers in order to aid expansion. Loans and
overdrafts are the most common forms of debt finance. However, access to debt finance is thought to be restricted.

A large literature has emerged on debt gaps among SMEs. The results of the study by Deakins et al. (2008) support the argument that SMEs face finance debt gaps. The literature on the nature and existence of debt gap argues that credit availability to SMEs is affected by the existence of informational asymmetries as well as by some reputational effects.

Stiglitz and Weiss (1981) mentioned that as a result of imperfect information many sound SMEs propositions will have no sufficient credit available. Examples of such proposals include new and technology-based propositions for which market intelligence will be limited and asymmetric information is more acute. Another example is that of manufacturing or technology-based firms whose owner-managers might be reluctant to provide full information about their businesses because of concerns that disclosure may make it easier for others to exploit (Shane and Cable, 2002).

North, Baldock and Ekanem (2010) indicated that there are also some categories of SMEs owner-managers that will face debt gap because of their lack of a track records in the case of newly established businesses and difficulties of providing the necessary collateral in the case of manufacturing SMEs as well as because of risks associated with projects involving product and market diversification. Furthermore, there may be asymmetries arising from location as well as sector. For instance, owners of SMEs in rural settings may face difficulties with access to bank finance (OECD, 2008).

Reputational effects arise when SMEs with viable business propositions are prevented from raising the finance they need by their own experiences or others’. Some SMEs’ owner-managers may choose not to apply for debt finance because they are discouraged from applying. Deakins et al. (2008) explain that by stating that some entrepreneurs may not pursue debt finance if there are perceived issues. They would either think that they would be rejected so there is no point in applying or that can be due to a perception that they do not think that they have the information or good credit history that it is usually required by lenders.

The study by Deakins et al. (2008) concluded by identifying a number of categories of SMEs’ owner-mangers that are more likely to experience debt gap due informational issues or reputational effects. These categories are:
Younger SMEs and younger entrepreneurs with limited trading records and security.

Female and ethnic minority entrepreneurs (from reputational effects).

Fast growth firms especially in manufacturing and technology-related sectors.

Out of the “norm” situations where SMEs owners have unusual business propositions; such as high growth proposals from SME owners in rural environments.

3.5 An Overview of SME Financing in Libya

As stated earlier in this chapter, in addition to the personal wealth of the owner-manager(s) SMEs can obtain finance for their operations from various sources including: venture capital, business angels, trade credit, non-bank financial institutions, bank finance, and government assistance schemes. Unfortunately for SMEs in Libya, not all these sources are available or readily accessible. Equity markets scarcely exist and debt markets are crude. Furthermore, venture capital availability is almost completely absent. In this context, Eltaweel and Bown (2013) concluded that the absence of venture capital institutions contributes to the equity gap encountering Libyan SMEs. In addition, The Global Competitiveness Report 2008-2009 ranked Libya 133 in financial market sophistication and 131 in financing through equity market. The same survey ranked Libya 115 from 134 countries in the availability of venture capital finance (Porter and Schwab, 2008). Moreover, more advanced financing options which are more suited to SMEs such as leasing and factoring do not exist.

Informal sources of finance appear to be the most common and the most used among SMEs in Libya (Samawi et al., 2016). The vast majority of Libyan SMEs use internal funding sources in the form of personal savings and funds from family and friends to start and operate their businesses at the initial stages (Eltaweel, 2012; Porter and Yergin, 2006). Trade credit from suppliers seems to be a popular source during the expansion stage (Eltaweel, 2012). When it comes to institutional external sources, however, despite some constraints bank loans are the main source of finance (OECD, 2014b).

Other sources of finance and guarantee mechanisms are still underdeveloped if not fully absent. There is no official active credit guarantee scheme targeting SMEs in Libya. In 2008 under the supervision of the Ministry of Economy a Libyan fund for credit guarantees was implemented. The fund drew up agreements with commercial banks to facilitate SMEs access to finance. For instance, the fund guaranteed up to 40 percent of
loans provided by Jumhuriah Bank. There is no clear indication of the effectiveness of the scheme. Furthermore, the scheme does not cover all banks and it is not an independent entity.

At present, five regional investment funds are to be established nationwide in Tripoli, Benghazi, Misrata, Sabha, and Zawiya. These funds will be capitalised with USD 200 million each and will provide equity of up to 25 percent of project capital while the rest of the credit would be guaranteed. Only start-ups will be targeted excluding existing firms. The funds are not yet operational and remain subject to the allocation of financing by the Ministry of Planning.

The difficulty of funding SMEs’ growth is a universal problem. However, the issue is particularly manifest in Libya. Historically, the state owned enterprises dominate the Libyan economic landscape. These organisations were high up on the political pecking order. As such, owner-managers of SMEs feel that they are discriminated against by a lack of access to external funding. The World Bank’s (2011) Investment Climate Assessment notes that more than 50 percent of Libyan SMEs surveyed perceive access to finance as a major or very severe constraint.

A number of difficulties and constraints in the raising of external finance by SMEs have been highlighted by Eltaweel (2012). These difficulties include the lack of business planning and financial management skills, cultural factors, the absence of some institutional sources of funding and financial information, restrictions on bank lending, and aspects of government policy. While some of these difficulties are common to SME finance in many parts of the world others, however, can be considered as specific to the Libyan context.

3.6 Concluding Remarks

The role of finance has been viewed as a critical element for the development of SMEs. It is well documented in the literature that access to finance is crucial not only for business formation but also for their survival and expansion. Worldwide, the availability of finance for SMEs has been a topic of significant research interest to academics and an issue of great importance to policy makers.

There are a number of theories explain how SMEs select among various methods of finance. The life-cycle paradigm views firms through a financial growth cycle in which different capital sources are sought at different points in that cycle. Consequently,
smaller/younger/more opaque firms are more likely to rely on internal finance, trade credit or angel finance. As they grow, firms will have access to intermediated finance on the equity side (e.g. venture capital) and on the debt side (e.g. banks and finance companies). In more advanced stages as the firm grows public equity and debt markets might be accessible. The pecking order theory claims that the cheapest source of finance in terms of cost is used first then when exhausted the firm moves to the second cheapest and so on until it ends up seeking external equity.

The trade-off theory is used to explain the choice between debt and equity and the structure of debt. Accordingly, marginal financing costs are the factor drives financing decisions. As a result, firms choose financing such that marginal costs of the funding sources are equal and in balance whereby the tax-related benefits of debt are offset by costs of financial distress. The asset side theory argues that the use of funds (i.e. a firm’s asset side) matters for the ideal source of finance. In this theory, the composition of the liability side of the balance sheet is influenced by the composition of the asset side in terms of the different types of debt used to finance the firm or that the use of the funds is important in deciding the type of financing available.

Most of the literature reports that the main sources of financing that are available for SMEs include equity in the form of personal savings and internally generated cash, venture capital, and business angels. In terms of debt, SMEs can obtain fund through trade credit from suppliers and long or short-term credits form banks or other institutions. SMEs can also source funding from government assistance schemes and programs designed to help these firms to grow and expand. More recently, the re-emergence of Islamic finance has provided SMEs with an additional source from which they can obtain the finance they need theoretically at more favourable terms.

However, a number of obstacles that may prevent SMEs’ owner-managers from obtaining adequate financing have been identified. These obstacles are attributed mainly to issues related to the existence of informational asymmetries between SMEs and lenders or other finance providers, the high risk involving in investing in SMEs, and the issue of high transaction costs. SMEs failure to offer collateral to secure external finance in the case of debt finance is another problem. The existence of such issues has led SMEs to face financing gaps in terms of equity finance as well as debt finance.

In Libya, the majority of SMEs are heavily reliant on internal funding sources as other sources of external finance remains scarce. This is attributable to the inadequate
financial infrastructure and the low levels of financial intermediation in the country. There is no market for venture capital and the leasing sector has not been developed. Implemented credit guarantee schemes do not seem to have made a significant contribution to expanding SMEs access to finance and do not yet reach a significant number of more constrained firms. Factors affecting the accessibility of Libyan SMEs to finance include lack of planning and regulatory support, bureaucracy, and owner-managers’ poor management skills.
Chapter 4. Literature Review

4.1 Introduction

Worldwide, the role of SMEs in the growth of economies which fosters market diversification, promotes innovation, and, more importantly, greatly reducing unemployment rates is beyond dispute. Notwithstanding, capital accessibility considered to be the most critical element for this sector’s success in accomplishing this role. At the core of this is a growing interest in the access to financial resources available to SMEs particularly bank finance.

A large body of the literature has documented that banks are the main capital provider for SMEs in both developed and developing countries (e.g. Karadag, 2015; Grunert and Norden, 2012; Adair, Ammous and Fhima, 2010; Vera and Onji, 2010; Viducic, Viducic and Boras, 2010; Le and Nguyen, 2009; Ono and Uesugi, 2009; Zhou, 2009; OECD, 2006; Ayadi, 2005; Carey and Flynn, 2005; Lund and Wright, 1999; Berger and Udell, 1995; Cole and Wolken 1995). De Bettignies and Brander (2007) assumed that bank loans are available for SMEs on a competitive and fair basis.

In order to optimize their capital structure, Moro, Grimm and Grassi (2010) suggested that SMEs should only focus on bank financing. Keasey and McGuinness (1990) argued that despite the fact that bank financing is more expensive in comparison to other sources of finance it generates a higher rate of return for SMEs. They further concluded that bank finance can help SMEs accomplish better performance levels than other financing sources can do. They argue that SMEs employ the funds more efficiently when they are monitored by, and questionable to banks. In the same vein, Aqel (1998) listed some advantages that the banking system has as a finance supplier to SMEs:

- Proficiency and ability in both management and financial expertise.
- Most banks have a wide distribution of branches in all regions of the country.
- The proficiency of auditing and adopting international standards of accounting.
- Stability of banks’ financial resources and their ability to offer a variety of services.

Although it is often argued that knowledge of banking literature plays a less critical role in the operations of a bank (Sinkey, 1998) it is still interesting and important to review it. Therefore, the purpose of this chapter is to provide a review the existing literature related to practices, experiences, and other aspects of banks financing for SMEs.
Following this introduction is a brief discussion of the involvement of banks with SME sector in terms of motives and hindrances. Techniques and strategies employed by banks to lend to SMEs are then presented. The chapter then proceeds to review the literature on SME lending criteria and bank credit decision making. The following section discusses the determinants of SMEs access to bank finance in terms of SMEs characteristics and those of their owner-managers. Obstacles encountered by SMEs in accessing bank finance and reasons for rejecting their finance applications will be respectively the focus of the two subsequent sections. Next, some non-lending products and services provided by banks to SMEs are highlighted. The financing models for SMEs offered by Islamic banks are then introduced. Following is a brief overview of banks and SMEs finance in Libya. Concluding remarks are made in the final section.

4.2 Banks Involvement with SMEs

From the banks’ perspective, SMEs represent a strategic profitable part of bank business. This can be evidenced by the sign that more recently SME market has being served by a wide range of banks, not just smaller banks with relationship-based models (IFC, 2010). In this regard, De la Torre, Martinez-Pería and Schmukler (2008) describe the engagement between SMEs and banks as integral. They explain that banks do not only provide the necessary capital for entrepreneurs to establish new SMEs or expand the existing ones they also offer a variety of services and financial products.

The findings of Beck, Demirgüç-Kunt and Martinez-Pería (2008) have highlighted a number of factors perceived by banks as drivers to finance SMEs. The most important factor is the great potential of profitability associated with the involvement with SMEs as banks perceive this sector as unsaturated with good prospects. Another factor is the possibility to seek SMEs clients through their relations with their large clients. Intense competition in other markets such as the large business and retail customers is an additional reason cited for banks moving “downstream” to serve SMEs.

A more recent study by Narita et al. (2013) reported similar results. The study included 100 banks located in 21 countries in Latin America and the Caribbean. The results indicated that the vast majority of the banks predict continuing loan portfolio expansion in the SME sector considering this sector to be strategic to their business. In addition, most of the banks report having an active financing policy for SMEs. The participated banks also considered SMEs as a dynamic segment and agents for national economy
growth. They attributed their interest and involvement with this segment to its increased profitability and accelerated growth.

On the other hand, however, it is argued that banks are, in general, reluctant to lend to SMEs for a number of reasons. First and foremost is the information asymmetry characterises SMEs which arises from SMEs’ lack of financial information resulting from the difference in information available to SMEs’ owner-managers compared to bankers. Second is the high cost of lending to SMEs including monitoring cost, bonding cost, and residual loss (Ekpu, 2015; Petersen, 1994; Landström, 1992). Accompanied with these two reasons is the high risk involved in lending to SMEs which may lead to adverse selection problems occur when banks cannot readily verify whether SMEs have access to qualitative projects or moral hazards happen when funds granted to SMEs diverted for alternative projects.

A study by Sudin and Shanmugam (1994) found that because of problems related to the character factor bankers face greater difficulties when dealing with SMEs clients. The authors ascribed this to SMEs’ owner-managers lack of knowledge in accounting and insufficient information in the loan application with no proper business plan. Likewise, the study of BizClim (2011) examined the weak interest of banks in funding SMEs. The participants illustrated this weak interest as a constraint extensively indicating that in many countries banks are interested in the “high end” mainly large corporations on the one hand, and short-term working capital and consumer finance on the other. The study concluded that investment in lending to SMEs is, more often than not, not a priority as banks find lending to SMEs cumbersome, costly, and a higher risk business.

Beck, Demirgüç-Kunt and Martinez-Pería (2008) reported some differences in factors impeding engagement of banks with SMEs across countries. The authors analysed the effects of some factors related to information, legal, contractual, macroeconomic environments as well as the competition in SME sector on bank financing to SMEs in a number of developed and developing countries. Their findings showed that in developed countries the intense competition in SME sector was cited as the top obstacle hindering banks from serving this sector. Other obstacles rated by banks in developed countries were lack of adequate demand by SMEs, regulations, and macroeconomic factors. On the other hand, in less developed countries the most important consideration was given to the state of macro-economy. Competition in the SMEs market and
regulations were also ranked as main obstacles while, surprisingly, contractual and legal environments came fourth in ranking.

4.3 Bank Lending to SMEs

Banks play an essential role in financing SMEs as these businesses have more difficulty accessing equity capital markets. Bank loans refer to specified sums under specified terms/conditions made available to individuals and entrepreneurs to start, grow or sustain their firms’ activities. However, banks provide finance for SMEs can be uncertain task considering asymmetric information effects. Therefore, a successful strategy for financing SMEs is that one guarantees tailored financial products to meet the specific SMEs needs whilst, in the same time, can deal and cope with the pre-mentioned problems and risks.

The literature categorises lending techniques adopted by banks to serve SMEs into four main distinct lending categories namely, financial statement lending, asset-based lending (based on the provision of collateral and its quality), credit-scoring lending (based on statistical techniques), and relationship lending.

Berger and Udell (2006) define a lending technology as a unique combination of primary information source, screening and underwriting policies/procedures, loan contract structure, and monitoring strategies/mechanisms. They agreed with the above classification describing the categorization of lending techniques into two types; transactions lending that is based primarily on “hard” quantitative data and relationship lending, which is based significantly on “soft” qualitative information as an oversimplified and flawed. They added that while financial statement lending targeting transparent borrowers other transactions techniques are all focused on opaque borrowers. Next, each one of the major lending techniques used for SME lending is briefly described.

4.3.1 Financial Statement Lending

In this technique, the focus is primarily on the strength of the borrower’s financial statements through evaluating the information in these statements. Two requirements based on hard information are essential in this technique. First, the borrower firm must have certified audited financial statements prepared by a reputable accounting firm according to widely accepted accounting standards such as GAAP. Second, the financial ratios calculated from these statements must reflect a strong financial condition. The
expected future cash flows of the firm to be perceived as the primary source of repayment. The decision resulted from the analysis of these financial statements and terms of the contract might reflect a variety of different elements such as collateral and personal guarantees. Thus, unlike other lending techniques this is likely to be, as argued by Berger and Udell (2006), best suited for relatively transparent firms.

4.3.2 Asset-Based Lending

This technique is apparently the most secured form of lending to SMEs. Under such transactions financial institutions especially banks base their decision to lend to SMEs on the quality of the firm’s assets to be pledged as collateral (the primary source of repayment). The collateral in this case may be accounts receivable and inventory. In order to ensure that the liquidation value of the collateral should always exceeds the credit exposure the value of collateral is evaluated daily in the case of accounts receivable and for inventory it is typically weekly or monthly (Udell, 2004).

The use of collateral is a common feature of all other lending techniques adopted by banks to lend to SMEs. However, the pledging of accounts receivable and inventory is regarded as a secondary source of repayment in cases of financial statement lending, relationship lending, and credit scoring. In contrast, in asset-based lending the extension of credit is primarily based on the value of the collateral rather than the overall creditworthiness of the firm.

4.3.3 Credit Scoring Lending

Based mainly on “hard” quantitative information credit scoring is a lending technology used by financial institutions especially banks to evaluate informationally opaque loan applicants. Unlike the information in relationship lending which need long time to be acquired, the hard data required by credit scoring are readily gathered usually from consumer credit bureaus and commercial credit bureaus. The use of credit scoring method is based on attaching certain statistical weights to the expected future loan performance and the borrowers’ history given that the creditworthiness of the owner-manager and that of the firm are closely related. The assumption here is that ultimately the credit analysis involved in credit scoring determines that the personal credit history of SMEs’ owner-manager is highly predictive of the loan repayment (Berger, Frame and Miller, 2002).
It is evidenced in the literature that credit scoring method increases the credit availability for SMEs. Berger, Frame and Miller (2002) concluded that implementing credit scoring leads to an increase in the supply of credit to SMEs. Additionally, Frame, Srinivasan and Woosley (2001) found that for the banks included in their sample the portfolio share of SMEs increased by 8.4 percent as a result of adopting credit scoring technology. Moreover, according to Berger and Frame (2007, p. 19) this increase can be split into; (1) increasing the quantity of credit extended; (2) increasing lending to relatively opaque risky borrowers; (3) increasing lending within low-income areas; (4) lending over greater distances; and (5) increasing loan maturity.

4.3.4 Relationship Lending

Relationship lending is a powerful mechanism used to reduce problems related to opaqueness in SMEs. Under relationship lending “soft” information is gathered by a financial institution (usually small local bank) through continuous contact with SMEs in the provision of financial services (Berger and Udell, 1998). The information will be then used to evaluate the creditworthiness of the entrepreneur as a part of the loan process to ensure that the potential loan will be repaid. The strength of the relationship lending measured by its duration or the breadth of the relationship or whether the bank is the exclusive provider of financial services (Berger, Goulding and Rice, 2014). It was found that strong relationships are associated with better credit availability e.g. higher loan application acceptance rate, or fewer collateral requirements (Moro and Fink, 2013; Bharath et al., 2011; Petersen and Rajan, 1994).

Although the role of agents such as suppliers and customers involved in relationship lending in gathering information might add extra costs to banks Berger and Udell (1998) report some benefits of relationship lending to banks. This includes; lower cost of credit, protection against credit crunches, and the provision of implicit interest rate or credit risk insurance. Moreover, Hernández-Cánovas and Martínez-Solano (2010) found that in order to increase credit supply for SMEs trust-based relationship lending is more effective than the establishment of longer or more concentrated bank-borrower relationship.

While some lending techniques such as asset-based lending and credit scoring lending depend on a strong lending infrastructure, a weak lending infrastructure may foster the use of other techniques and approaches such as factoring and leasing (Berger and Udell, 2006). Such techniques are developed by banks to promote SMEs access to finance.
Factoring and leasing are very suitable tools to provide working capital to SMEs given the fact that there is no collateral required. This is because in both cases the underlying assets accounts receivable or fixed assets respectively are transferred to be owned by the “lender” rather than being pledged as collateral.

4.3.5 Factoring

Factoring is a transaction technique employing hard information to lend to opaque SMEs. It is a method to raise short-term finance whereby clients’ account receivables are purchased by a specialized firm or a bank for a pre-agreed fee plus interest (Soufani, 2002). Consequently, the buyer takes the responsibility to control and manage a debtor portfolio of a firm. In simple words, factoring is the process resulting in exchanging the account receivable of a firm for cash.

Vasilescu (2010) maintains that factoring provides SMEs expedient access to finance regardless of the company’s credit rating with no added guarantees and also offers an access to unrestricted funds that could be invested immediately. As SMEs usually lack the sufficient collateral to obtain finance, using accounts receivable as collateral, that is factoring, to raise finance is a significant decision to increase SMEs’ liquidity (Soufani, 2002). It was found that factoring as an alternative source of finance can play a crucial role in alleviating SME financing gaps (Soufani, 2001).

4.3.6 Leasing

Involving either borrowing or using resources without having to own them, leasing is a very common method of financing for SMEs based on hard information (Deelen et al., 2003). Leasing involves the purchase of fixed assets by a “lender” known as a “lessor” usually a bank then simultaneously enters into a rental contract with the “lessee” “the borrower” under which the payment schedule is specified (Berger and Udell, 2006). In this contract, certain conditions are to be stated. These conditions contain, amongst others, the length of the term, amount and timing of payments, and any end-of-lease conditions or restrictions (Nakusera, Kadhikwa and Mushendami, 2008).

In the case of leasing, depending on the type of business in which SMEs are operating, a number of different options are available for SMEs. These options, in most cases, include an operational lease, financial lease, and full maintenance leasing. More specifically, the leasing contract gives the “lessee” one option between; returning the asset and signing a new lease for more updated asset, exercising a purchase option and
buying the asset or renewing or extending the lease (Nakusera, Kadhiwka and Mushendami 2008).

4.4 Bank Credit to SMEs

Previous studies on bank lending practices for SMEs, which focus on the supply-side, are relatively rare (Stevenson and Pond, 2016; Deakins, Whittam and Wyper, 2010). However, the focus in this section is on two of the key aspects of bank lending decisions to SMEs. More specifically, this section presents a review literature on bank lending decisions to SMEs in relation to lending criteria and very briefly on the credit decision making.

4.4.1 Lending Criteria

Before make a decision to lend to SMEs banks have to evaluate the information about prospective borrowers to determine their creditworthiness. Traditionally, the approach for this is based on the experience and skills of bankers in applying basic lending principles. Bankers conventionally take their knowledge of the borrowers and their business market and combine this knowledge with limited financial information provided by borrowers to make lending decisions. As the precise lending principles into specific assessment criteria vary between banks a number of studies were conducted to determine the relative importance of these criteria. The most common criteria reported in the academic and practice literature are briefly discussed below.

Fletcher (1995) examined the criteria used by Scottish bank managers to lend to SMEs by interviewing a sample of bank managers. The respondents were asked about the process of decision-making and how lending decisions to SMEs are made. The study concluded by identifying the importance of different criteria that employed by bankers in Scotland when considering funding SMEs. These criteria are presented in Table 4.1.

It seems that the management capabilities of owner-managers are the most important factor. This is followed by the location and the source of repayment. Gearing and the use of chartered accountants are ranked next in importance. Interestingly, the qualifications of owner-managers and their experience were found less important.
Table 4.1 Criteria used or sought by Scottish bankers

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management capabilities</td>
<td>76</td>
</tr>
<tr>
<td>Location</td>
<td>58</td>
</tr>
<tr>
<td>Forecast balance sheet and profit and loss</td>
<td>47</td>
</tr>
<tr>
<td>Gearing</td>
<td>45</td>
</tr>
<tr>
<td>Employing a chartered accountant</td>
<td>42</td>
</tr>
<tr>
<td>Motivation of directors</td>
<td>32</td>
</tr>
<tr>
<td>Role of IT consultant</td>
<td>24</td>
</tr>
<tr>
<td>Industry sector</td>
<td>29</td>
</tr>
<tr>
<td>Small business experience</td>
<td>21</td>
</tr>
<tr>
<td>Qualifications</td>
<td>16</td>
</tr>
<tr>
<td>Sources of finance/grants</td>
<td>53</td>
</tr>
<tr>
<td>Connection with bank</td>
<td>29</td>
</tr>
</tbody>
</table>


A more recent Scottish-based study was undertaken by North et al. (2008) with the aim to provide detailed insight into supply-side processes relating to SMEs bank finance. To accomplish this aim face-to-face interviews with eight bank managers at different seniority levels in three of the four major Scottish commercial banks were conducted. There was a consistent agreement among the interviewees that some criteria such as the owner-manager’s knowledge of the business, the personal relationship between the owner-manager and the bank manager, previous trading history, authorised accounts, profitability, and the track record are very important. However, there was some variation in the importance attached to some personal factors such as age, gender, and experience of the owner-manager. The availability of security was considered of secondary importance.

The authors attributed the variations between the bankers in the importance attached to different criteria to differences in their seniority as well as to different internal processes within the participating banks. They concluded their study by summarising the important lending criteria as follows:

- The management track record of the management team.
- The personal relationship with the local bank manager.
- Location of the business.
• The financial history of the firm including the trading accounts for the last three years.
• Business sector, particularly if some sectors are “out of favour”.
• Existing SMEs clients should have easier access to bank finance than new ones.
• Security is perceived as a secondary factor; however, it is a factor that could be important for “high risk” lending situations with some SMEs.

In the US the principles of lending comprise of what is known as “5Cs” namely; character, capacity, capital, collateral, and condition (Sinkey, 1998; Jankowicz and Hisrich, 1987). Character is related to desirable ethical matters such as honesty, integrity, and trustworthiness. Character refers to the borrower’s willingness and determination to meet a loan obligation. The character of the borrower might be assessed based on his/her past experience, his/her conduct during the interview, and how he/she paid previous obligations. In addition, suppliers, customers, creditors, and business contracts can provide valuable insights into the character of a prospective borrower (Ruth, 2004). Shanmugam, Hempel and Turton (1992) mentioned that successful bank lending can be ascribed to good assessment of the borrower’s character. More interestingly, the results of the study by Wilson et al. (2006) showed that loan officers placed more emphasis on the character of the business owner compared with other factors such as collateral and capitalisation.

Capacity is the second “C” in the lending criteria. Capacity should indicate the ability of the borrower to generate enough cash to satisfy all obligations and also refers to the ability to manage cash. In simple words, it is the ability of the borrower to repay the loan. The main purpose of the assessment of capacity is to determine whether a borrower is creditworthy. For the banker, capacity is very critical as it is an indication of the loan repayment. The study by Haron et al. (2012) found that capacity as an indication of sufficient cash flow to service the obligations is among the factors that loan officers take into account when evaluating SMEs loan applications.

In general, analysis of capacity must include four criteria. First, every loan must have a primary source and an alternative source of repayments. Second, it must consider the quality and reliability of cash flow. Third, analysis of cash flow should combine reviews of financial information for prior periods and predictions for future periods. The final requirement is how to measure the key needed ratio for sound lending. In its most basic
form, cash flow is defined as earnings before interest, taxes, depreciation, and amortization.

The third “C” is capital. Capital represents the funds retained in the firm to provide a cushion against any unexpected losses. Another important consideration for bankers is the amount of capital reserves which owner-managers are willing to inject into the business if necessary (Ruth, 2004). The assessment of capital involves determining how much the bank can get if the business is liquidated or went bankrupt. When assessing the capital a special consideration should be given to the applicant’s ownership in the firm in relation to the loan requested (Dorfman, 1991). This could ensure the banker that the borrower with a significant stake in business would be a prudent user of the loan money.

The fourth “C” is the one refers to collateral. Collateral is the asset/s to be pledged by the borrower to secure a bank loan. Collateral can be in the form of inventory, accounts receivable, machinery, equipment, or real estate. From the theoretical point of view, there are two interpretations on the use of collateral when lending to SMEs. These interpretations arising from ex post and ex ante information asymmetries between SMEs and banks (Berger et al., 2011; Berger, Frame and Ioannidou, 2011). According to the ex post theory, borrowers have to provide collateral as a buffer against default risk which arises from moral hazard, costly monitoring or difficulties in enforcing contracts. Ex post theory of collateral predicts a higher incidence of collateral for riskier borrowers and that collateral provides incentives to monitor such borrowers (Longhofer and Santos, 2000).

Ex ante theory starts with the assumption that lenders cannot fully observe the riskiness of borrowers. Accordingly, the incidence of collateral is expected to increase with the ex ante information gap between borrowers and lenders. This gap then may be reduced by less risky borrowers by pledging more collateral as an incentive to signal their superiority. As such, Ex ante theory assumes that that banks would rely less on collateral if they have better information about borrowers.

Collateral is not a substitute for character and capacity and is only one of the five “Cs” of credit. Haron et al. (2013) concluded that for credit officers collateral which is a more “objective and tangible measurement” is more important than management/character which is a more “subjective and intangible measurement”. However, Ruin (1998) emphasised that if a banker, for any reason, is not convinced of
the ability of the applicant to repay the loan the availability of collateral on its own should not justify approving the loan application.

The last “C” is conditions. Conditions refer to the environment in which the borrower’s firm operates. The assessment of condition should include factors that may affect the probability of the borrower to repay the loan. According to Rad, Wahlberg and Öhman (2013) information on financial condition presented in budgets, balance sheets, income statements, and cash flow statements as well as any future projections are assumed to be relevant to the loan assessment procedures. The focus of the assessment is on the borrower’s vulnerability to changing conditions and his/her ability to cope with them (Sinkey, 1998).

Not only do conditions refer to those related to the borrower but also to bank-related conditions. Some examples of the changes in the borrower’s business environment include; changes in demand, supply of raw materials, prevailing technology, suppliers, customers, labour regulatory, and local employment conditions. The bank-related conditions can be exemplified by any changes in interest rates, credit risk, liquidity risk, the bank’s credit policy, and changes in trends in lending industry.

In addition, other researchers have attempted to enrich the existing literature on SME lending criteria. For example, two more “Cs” referring to competition and costumer relationship were added by White (1990). Moreover, an earlier work by Cooper (1975) suggested four “Ps” to be used in the lending assessment process. The four Ps stand for; people, purpose, protection, and payment. People indicates the assessment of the character of the borrower. Purpose involves a judgment of the benefits of the borrower’s business. Protection refers to the detailed analysis of financial information as well as attaining security, while payment is about examining the firm’s future cash flows as a source of repayment.

In developing countries, Harif, Hoe and Zali (2011) conducted a study to answer the question what aspects Malaysian bankers consider when evaluating SMEs finance applications. Interestingly, 15 factors were identified comprised of 3 factors as financial factors and 12 factors as non-financial factors. These factors were further categorized into core factors (7 factors) and supplementary factors (8 factors). Examples of the criteria found in addition to the traditional 5C’s include; financial statements, strategic planning, industry analysis, and competence management.
In the African context, in order to understand the decision-making process in granting loans to SMEs in Ghana Agyapong, Agyapong and Darfor (2011) investigated the criteria used by local bankers in assessing SMEs loan applications. Their results indicated that when deciding on whether to accept or reject SMEs loan applications bankers rank highly criteria such as purpose of loan, repayment of previous loans, type of business, and collateral availability. However, other criteria such as CVs of clients and gearing were less important.

4.4.2 Credit Decision Making

The credit decision represents a critical bank function. The expected profitability of credit engagements of banks and potential borrowers is central to the credit decision. As such, the accuracy of credit decisions has significant impact on the overall profitability of banks (Ammann, 2013). Regardless of whatever lending criteria are adopted the final result of the evaluation process is to provide a measure of the applicant’s creditworthiness. Safi and Lin (2014) identified creditworthiness as “the probability associated with both the ability and the willingness of a trade participant to fulfil its trade obligations”. In simple words, the applicants who are creditworthy pay all their obligations as agreed in the credit terms/conditions and those who are not do not. Therefore, creditworthiness implies the applicant’s ability and willingness to repay the loan.

Generally speaking, bankers would examine the owner-manager’s characteristics, the firm’s characteristics, evaluate their creditworthiness, and decide to approve or to reject the loan application. It is reported in the literature that when lending to SMEs banks may adopt either of the following methods (Berry et al., 1993):

- **Going-Concern Approach**: the focus in this approach is on the future earnings as evidence of repayment ability of the firm. This approach requires more analytical skills, more information, and monitoring which may be costly to administer.

- **Gone-Concern Approach**: also known as liquidation approach. It more interested in the net value of the borrower’s assets. As such, the emphasis of this approach is on the past and present financial situation rather than future predictions.
4.5 Determinants of Accessing Bank Finance

On the demand side, the literature reports on SMEs access to finance and how it is determined by firm- and owner-managers-specific characteristics. In this section, the effects of such characteristics on SMEs access to external finance, particularly loans from banks, are discussed.

4.5.1 SMEs Characteristics

In general, the characteristics of SMEs affect their financial decisions. In this context, the literature has identified several characteristics peculiarly related to SMEs as factors influencing their financial behaviour. These include, but not limited to, firm size and age, ownership type and legal form, geographical location, industry sector, and asset structure.

I. Firm Size

Size is one of the variables that have been traditionally considered in financial decisions and the capital structure choices. For example, firm size is used as a proxy of both the theory of optimal capital structure and the pecking order theory. Although there is no consensus amongst researchers about the criteria that should be employed to measure the size of the firm the notion that firm size has an effect on SMEs activities and their potential to expand appears to receive general agreement. A firm’s size tends to have an influence on the firm’s financial decisions. This influence can be strongly observed in the decision making process about whether one particular sort of finance or another should be chosen and utilized (Cassar, 2004).

Academic literature has proven that size does matter in access to finance. Cassar (2004) Studied firms financing and capital structure using a sample consisted of 292 Australian firms. He concluded that the “larger” SMEs are the more they rely on long-term debt especially from banks. The study by Daskalakis et al. (2014) examined the financial decisions of European SMEs with the objective of investigating whether capital structure decisions are different for firms belonging to different size groups. Using the new SMEs definition of the European Commission the authors separated the sample into sub-samples of micro, small, and medium firms. Their results showed that SMEs’ debt ratio positively related to size for all size-groups. This is in line with conclusion of Li, Karim and Munir (2016) that firm size seems to be particularly important in explaining leverage ratios.
The extent to which firm size can impact leverage decisions and capital structure for each of the SME categories was measured by Mateev, Poutziouris, and Ivanov (2013). They found that medium-sized firms are mainly dependent on long-term bank loans as their preferred method of external financing, while short-term loans and trade credit are the main source of external financing for both micro and small firms.

From a supply side perspective, El Kalak and Hudson (2016) mentioned that banks and other financial institutions have recently started to realize that different credit risk models should adopted when dealing with SMEs than those used for large firms. This is because the small size of SMEs implies a high operational risk associated with their activities, and subsequently greater possibility of bankruptcy.

II. Firm Age

The age of a firm is another important factor in the study of SMEs’ financing decisions (Serrasqueiro and Nunes, 2012). Harvie, Narjoko and Oum (2013) explain that a firm’s age could act for or against the demand for finance. They further explain that the demand of funds of younger firms with growth potential is likely to be higher. However, the supply of finance for such firms may be limited due to a lack of collateral and track records. On the other hand, more established firms with an ongoing track records and a strong client-borrower relationship might find it easier to access to finance.

Dong and Men (2014) found that age is negatively related to financial constraints. They concluded that when it comes to external finance younger SMEs consistently encounter severe financing constraints and, as a result, they are heavily reliant on internal financing sources. Dong, Worthington and Higgs (2011) examined the finance-seeking behaviour in Australian SMEs. Their findings suggest that firm age can explain equity-seeking behaviour of Australian SMEs. They also found that SME age has negative relation with external debt-seeking and it is negatively associated with finance rejection rates.

In the eyes of banks and other creditors older firms are seen to be more creditworthy (McGuinness and Hogan, 2016). As younger firms are usually characterised by informational opacity as a consequence of not having an established track record this may lead to the reluctance of banks to lend to them. According to Klapper (2002), younger enterprises (less than four years of age) are more reliant on informal financing and far less on bank financing. This is supported by Quartey (2003) who found a
significant positive effect of SMEs age on the ability to access external finance including bank finance. In addition, Fatoki and Asah (2011) observed that SMEs established more than five years have a far better chance to be successful in their credit applications from banks compared with SMEs established for less than five years.

III. Ownership Type and Legal Form

The lack of separation between the firm and its owner-manager may affect the financing preferences of SMEs (Petty and Bygrave, 1993). A positive relationship was found between SMEs leverage and the type of organisational structure (Coleman and Cohn, 2000). Abor (2008a) identified the form of business as one of the factors explaining the capital structure decisions of Ghanaian SMEs. In the same vein, Abor and Biekpe (2009) concluded that ownership structure and the type of firm have a significant impact on SMEs using of bootstrap financing. In this context, Van Auken and Neeley (1996, p. 247) state that;

“Owners launching firms organised as either a sole proprietorship or non-construction/manufacturing firms should be prepared to use more bootstrap financing than other firms. Owners of these types of firms should be prepared to develop a financial plan that incorporates the use of greater variety of financing alternatives than owners of firms organised other than a sole proprietorship non-construction/manufacturing firms. As such, a sole proprietorship of non-construction/manufacturing firms should recognize the potential for the associated greater number of constraints and difficulties in raising start-up capital”.

Using data from Chinese SMEs Mok, Yeung and Xu (2008) examined the effects of SMEs ownership on their access to bank loans. Their findings support the hypothesis that SMEs ownership matters in bank lending. Examining the existence of a similar relationship in a European setting, Van der Zwan (2014) employed data extracted from SMEs’ Access to Finance Survey 2011. His findings revealed that SMEs with a multiple ownership structure have higher probabilities of receiving the requested bank loan than SMEs with a sole owner.

In terms of legal form, Mac an Bhaird (2013) found that SMEs with a sole proprietorship or partnership legal form had a greater probability of applying for bank finance than other limited liability firms. In contrast, Cassar (2004) noted that incorporation may be perceived by banks as an encouraging sign of the firm’s formality and creditability. Consequently, incorporated firms appear to be in a very favoured position in receiving external funding from banks in comparison with unincorporated
firms. Other studies (e.g. Storey, 1994b) concluded that limited private companies are more likely to be reliant on bank financing. Other studies, however, found that the type of business organisation (legal status) does not affect the likelihood of SMEs bank loan approval (Kutsuna and Cowling, 2003; Cowling, 1997).

IV. Geographical Location

Okpara and Wynn (2007) reported poor geographical location results in inaccessible businesses to both customers and suppliers as one of the reasons for SME failure in Nigeria. Additionally, a study by Reddy (2007) examined the challenges and obstacles encountered by SMEs in Fiji. He found that in spite of the relatively high cost of rentals SME owners preferred to move their firms activities to urban areas to escape the negative impact of the local environment features of rural areas on raising external finance including poor local transportation and communications infrastructure and consequently on the performance and growth of their firms which made their survival more difficult where such a climate exists.

The geographical area where a firm is located in the proximity of banks is also believed to have an influence on the firm’s ability to access bank finance. While some studies such as Perry (1988) found no clear evidence that rural-based SMEs are disadvantaged in the search for finance from banks other literature reports different findings. For example, it was found that SMEs located outside major cities face greater difficulties in acquiring external finance especially loans from banks (Abor, 2008a). A similar conclusion was made by Gilbert (2008) who indicated that urban SMEs have better chance in accessing credits from banks than those operating in rural areas or poor urban areas. In the same regard, Fatoki and Asah (2011) added that the geographical location of SMEs close to their banks advantages them in that they can better cement relationship lending with those banks. As a result, these SMEs are better able to access bank loans using no more than soft qualitative information.

V. Industry Sector

A number of studies evidenced that industry sector-related factors affect SMEs financial decisions (Mackay and Phillips, 2005; Michaelas et al., 1999). Firms in the services, for example, can differ from those in manufacturing or construction in terms of financial needs and choices. Michaelas et al. (1999) analysed the different capital structure determinants across industries utilizing a sample of 3500 SMEs across ten industries in the UK. They concluded that the impact of industry on short-term and long-term debt
varies greatly across industries. Employing the same data using a different approach, Hall, Hutchinson and Michaelas (2000) reported similar results.

The effect of industry classification on Ghanaian SMEs access to finance was examined by Abor (2007). The study concluded that short-term credit from banks is more used in wholesale and retail trade sectors compared with manufacturing SMEs whereas construction, hotel and hospitality, and mining industries appear to depend more on long-term bank finance. The results of another study by Roslan and Karim (2009) suggested that banks may be more willing to extend credit facilities to SMEs in the services or services support sector than to the agricultural sector due to the high level of risk associated with the latter.

Byiers et al. (2010) found that business sector of SMEs seems important for having credit access. Their results indicated that comparing to those in food processing sector SMEs in both metal-mechanic and wood-furniture sectors have significantly lower bank credit access. Their interpretation was that banks attach a lower risk premium to food processing sector in comparison with the other two sectors. Moreover, Silva and Carreira (2010) argued that for most SMEs in services, as the main input is human and not physical capital, it is harder to secure access to bank loans as no physical capital can be used as collateral.

However, González, Lopez and Saurina (2007) found that industry sector is not a driving variable in explaining Spanish SMEs access to external financing both from bank and non-bank sources. Further, an interesting argument is made by Hainz and Nabokin (2009) signifying that with respect to business sectors some sectors have a much lower use of bank loans simply because they do not need loans.

VI. Asset Structure

The impact of asset structure on SMEs access to finance is mainly reflected in the ability to provide collateral. As the provision of collateral plays an indispensable role in easing SMEs access to debt finance (Bougheas, Mizen and Yalcin, 2006). Firms with greater proportion of fixed assets tend to utilise higher financial leverage (Palacín-Sánchez, Ramírez-Herrera and Di Pietro (2013). The reason is that these firms can borrow at lower interest rates as their loans are secured with these assets serving as collateral. In a similar vein, an earlier study by Calomiris and Hubbard (1989) noted that when the firm is smaller, such as SMEs, the restrictions on credit are greater. A major part of the reason for that is smaller firms have less assets to offer as collateral.
Atanasova and Wilson (2004) examined the availability of bank credit to British SMEs using a disequilibrium model of lending. They found that firm total assets, as a proxy for available collateral, is an important determinant of bank loan availability. In addition, Johnsen and McMahon (2005) noted that because of collateral factor SMEs with more intangible assets tend to borrow less from banks compared with firms with more tangible assets.

Ono and Uesugi (2009) found a positive relationship between the use of collateral and the strength of the borrower-lender lending relationship resulting in easier SME access to external finance especially bank finance. A similar conclusion was reached by Odit and Gobardhun (2011). They further revealed that SMEs with a lower portion of tangible assets in their total assets are more likely to encounter difficulties in applying for outside finance including loans from banks because of their inability to provide the collateral required.

**VII. Business Plan**

A business plan is a formal document that submitted by entrepreneurs to a bank or any other financial institution in order to gain a financial support. A business plan may be either short term or long term. In addition, business plan can be a growth plan or a start-up plan. Besides serving as a roadmap for the improvement in the management of SMEs business plan can also serve as a means to assure better channels of communication between SMEs and external finance providers. This, in turn, will improve credit accessibility for SMEs that lack tangible assets to be pledged as collateral and also for those do not have a credit history.

Having an appropriate business plan could affect the chance of accessing external finance especially from banks. Yilmazer and Schrank (2006) found that most firms that apply for external financing cannot obtain it because, in most cases, lack of realistic and workable business plans. Likewise, Romano, Tanewski and Smyrnios (2001) argued that as they usually lack formal business plans family businesses rely more on informal finance especially at the early stages of their businesses’ lifecycle.

According to Bank of England report (1999) (cited in Irwin and Scott, 2006), among other factors lack of business planning explains why UK SMEs encounter difficulties accessing credit from banks. Another study found that in addition to insufficient collateral the lack of business plan was a main factor explained the rejection of SMEs bank finance requests (Egyptian Banking Institute, 2010). The same study reached a
conclusion that the existence of a business plan seems to be among the requirements for financing SMEs by banks. However, McCarthy, Oliver and Verreyenne (2014) highlighted what they called “a mismatch of expectations” as their results suggested that the preparation of a business plan has no significant relationship with SMEs access to bank finance.

4.5.2 Owner-manager Characteristics

The personal characteristics of SMEs owner-manager also make a difference to their firms’ ability and likelihood of accessing external finance (Irwin and Scott, 2010; Cassar, 2004). The reason is that the owner-manager in SMEs has the dominant position in the firm as the primary decision maker. For example, Berggren, Olofsson and Silver (2000) reasoned that most SMEs owner-managers do not prefer to finance their firm operations using external finance particularly as it entails changes in ownership structure whereby such financing may lead to control aversion. In the same vein, it has been shown that SMEs owner-managers themselves exert a noticeable influence on their firms’ financing decisions and subsequently performance and growth (Vos et al., 2007; Coleman, 2007).

I. Owner-manager’s Gender

Female and male entrepreneurs generally differ in the way they finance their businesses (Verhuel and Thurik, 2001; Carter and Rosa, 1998). As reported in the enterprise literature the issue of differences in financing sources related to gender among SMEs is more highlighted during the introductory (start-up) stage. For example, Verhuel and Thurik (2001) found that although men and women do not significantly differ with regard to the used type of capital women entrepreneurs appear to have a smaller amount of start-up capital.

With regard to bank finance Mijid (2009) found higher loan denial rates and lower loan application rates among female entrepreneurs. According to Badulescu (2011) women face more credibility issues when dealing with bankers. Coleman (2007) also provided evidence of credit discrimination against female entrepreneurs as they were more frequently charged higher interest rates and asked to pledge additional collateral in order for loans to be granted.

Explanations given in the literature for differences between men and women entrepreneurs with respect to access to finance can be categorised into discrimination,
abilities, and preferences and competition (Harrison and Mason, 2007). Moreover, Verhuel and Thurik (2001) divided the impact of gender on SME capital into direct and indirect effect. The former “gender effect” refers to the fact that while male and female entrepreneurs may share some characteristics they are different in the way in which they finance their firms. The latter “female profile” can be more attributed to differences related to business type, management, and experience.

II. Owner-manager’s Age

It is often found that the personal financing preferences of entrepreneurs appear to change according to their age (Agarwal et al., 2008). According to Romano, Tanewski and Smyrnios (2001) the effect of the owner-manager’s age on the financial behaviour of SMEs can be noted in that unlike younger entrepreneurs, older entrepreneurs are less likely to invest additional finance into their firms. This finding is in line with the earlier work of Van der Wijst (1989) who suggested that older SMEs owner-managers are more reluctant when it comes to accepting external ownership in the firm.

Vos et al., (2007) examined SME financial behaviour utilizing two data sets from the UK and the US. The results showed that younger owner-managers tend to use more overdrafts and loans from banks than older owner-managers who were found more dependent on retained profits. Similarly, a recent study conducted by Ogubazghi and Muturi (2014) reported a significant effect of the age of SMEs’ owner-managers on their firms’ access to bank loans. However, the results of other studies (e.g. Nguyen and Luu, 2013; Slavec and Prodan; 2012) did not find any evidence to support that age of SMEs’ owner-managers significantly impact their ability to borrow from banks.

From supply side perspective, bankers’ perception of different age group can affect SMEs access to bank loans. For example, owner-managers of older age group are generally perceived by bankers as non-innovative and non-dynamic and therefore less attractive to be granted loans. However, young aged owner-managers are perceived as innovative and good performers. In addition, it can be argued that older entrepreneurs are wiser and more responsible than younger entrepreneur who might be perceived risky portfolio.

III. Owner-manager’s Education and Training

Employed by institutional financiers as a proxy for human capital the educational background of SMEs’ owner-managers is often positively related to the firm’s usage of
leverage (Slavec and Prodan, 2012; Coleman, 2007). Watson (2006) concluded that an owner-manager’s education level is significant in explaining SMEs’ debt to asset ratio. Also it was found that SMEs owner-managers’ level of education is a major determinant of their financing preferences with less educated owner-managers rely more on internal sources while more educated ones are more willing to use external finance (Gebru, 2009).

A study by Bates (1990) examined the impact of owner-manager’s personal characteristics on SMEs longevity across a wide sample of SMEs across the US between 1976 and 1986. The study concluded that the level of education of entrepreneurs is a major determinant of banking loans amounts offered to SMEs. Ahmed and Hamid (2011) used the top manager’s level of education as a measure of the quality of human capital and found significant positive relationship between educational level and the probability of accessing bank finance. Storey (1994a) found that the only significant personal characteristic variable in predicting the use of bank financing by SMEs is their owner-managers’ educational qualification. He added that higher levels of education provide entrepreneurs with greater confidence in dealing with bankers when applying for loans.

Educated owner-managers are likely to have better managerial skills and are better equipped to go through difficult administrative procedures in the credit system increasing their standing in the eyes of bankers. The study by Irwin and Scott (2010) found that university graduates had the least difficulties in raising finance from banks. Byiers et al. (2010) reached similar conclusion. They explained this by stating that educated owner-managers have confidence to overcome obstacles of accessing bank loan and relatively well informed on bank credit service and its requirements.

Turning to training, training is related to the owner-manager’s level of training in the field of business management. Gebru (2009) emphasised the importance of management training in explaining the financing practices of SMEs owner-managers suggesting that researching the role of finance-related training could help in understanding the financing practices of SMEs. In this context, a significant positive relationship was revealed between training and applications for external finance suggesting that owner-managers who had undergone some training in business and management are more likely to approach external sources of finance (Wahab and Buyong, 2008).
Training has been shown to influence SMEs access to bank credit. Mukiri (2008) identified training as a component of entrepreneurial orientation that has a direct impact on SMEs access to bank credit. The results of Wahab and Buyong (2008) indicated that there is a significant association between training and the use of bank overdrafts. Another study by Kira (2013) found that SMEs’ owner-managers with some management training are more favoured by financial institutions especially banks.

**IV. Owner-manager’s Experience**

Along with education, experience is an indication of the firm’s human capital. Business experience is simply the number of years that an owner-manager has been managing or owning a business. Previous business experience was found to have a positive (though not always significant) impact on the willingness of SMEs’ owner-managers to seek external funding (Sena, Scott and Roper, 2012). Zhang (2008) found that owner-managers who run businesses for long are more likely to choose formal financing.

Cole (1998) concluded that the experience of SMEs’ owner-managers enhances the availability of bank credit. Nofsinger and Wang (2011) hypothesised that the experience of the owner-manager is one factor that explains the difference in bank financing levels available to SMEs. The findings of their study proved this hypothesis. They further explained that prior experience in the industry positively correlates with the share of external financing in the firm and the cumulative experience of owner-managers play a crucial role in overcoming some of the problems that hinder SMEs access to bank finance such as information asymmetry and moral hazard.

Moreover, Wu, Song and Zeng (2008) postulated that owner-managers with a greater level of business experience have higher probability to take advantage of bank financing. Likewise, Scherr, Sugrue and Ward (1993) concluded that SMEs’ owner-managers experience may increase bank loans availability. In contrast, Coleman and Cohn (2000) tested if firm owner-managers’ age, education, prior experience, and gender influence the financing decision of SMEs. The study found education of the firm’s owner-manager to be the only significant variable.

From banks’ perspective, as experienced entrepreneurs are believed to perform better than less experienced, it is then rational to factor experience into the process of evaluating the creditworthiness of SMEs (Gompers *et al*., 2010). Moreover, Nkuah, Tanyeh and Gaeten (2013) argued that for the lender bank an owner-manager’s expertise may rather be the most important determinant in making a credit decision.
4.6 Obstacles Faced by SMEs in Raising Bank Finance

Traditionally, bank financing is the main source of external finance for SMEs. However, in comparison with large firms SMEs face more obstacles in procuring financing resources. Beck, Demirgüç-Kunt and Martinez-Pería (2008) found that SMEs use less external finance especially bank finance. In addition, recent research provides evidence that SMEs face greater financing obstacles than large firms (Beck and Demirgüç-Kunt, 2006; Beck et al., 2006; Beck, Demirgüç-Kunt and Maksimovic, 2005). The literature has identified some important limiting factors that may prevent SMEs from obtaining adequate bank financing. Examples of such factors include, but not limited to, credit conditions relating primarily to asymmetry of information, high interest rates, and collateral requirements.

A key issue that affects the availability of bank loans to SMEs is the lack of sufficient information (information gap). Empirical studies (e.g. Berger and Udell, 1998; Jordan, Lowe and Taylor, 1998; Wright and Robbie, 1998; Himmelberg and Petersen, 1994) insist that information asymmetry is the most important characteristic of SMEs. In this context, information gap stipulates that bank officials might not have adequate information regarding certain SMEs proposals. This is because SMEs’ owner-managers have more information about their business proposals than bankers and, in most cases, this information is not readily accessible by banks. This means that reliable information on proposals for new products or services is usually scarce or, if any, is incomplete and unclear (Schmid, 2001; Hall, Hutchinson and Michaelas, 2000). The lack of adequate information about proposed SMEs is likely to result in the rejection of a loan application. For instance, banks may reject some SMEs loan applications because of detailed information on the proposal may be declined by entrepreneurs fearing that such disclosure may compromise their intellectual property or result in piracy (Shane and Cable, 2002).

The information gap can be also attributed to the fact that SMEs tend to have, if any, weaker accounting and management reporting. According to Gregory (2013), there are two reasons to explain this. First, the fixed cost involving in preparing accounts and management reports consumes a great proportion of SME revenues so they tend to produce less information. Second, SMEs are often controlled and managed by family or small group of insiders who may be totally satisfied with the information available and in a better position to understand, interpret, and use these limited information.
Therefore, the information requirements asked by banks may lead to SMEs low demand of bank finance may be because, from SMEs’ perspective, these information requirements seem onerous and costly to provide.

In addition, the lack of collateral is a major constraint to SMEs’ access to bank finance. It is argued that SMEs access to bank finance, especially long-term loans, depends, to a large extent, on whether the lending can be secured by tangible assets as collateral (Berger and Udell 1998, 1995; August et al. 1997; Ang, Lin and Tyler, 1995; Storey, 1994a). Manove, Padilla and Pagano (2001) stressed the significant role of collateral in a bank-entrepreneur relationship to the extent that they debated that without the pledging of collateral or the right to claim it in times of default and dispute the bank will not extend the credit to SMEs. Moreover, Sharma and Gounder (2012) claimed that credit from banks to SMEs seems to be available only upon acceptable collateral not only for start-up firms but also for existing SMEs with good track records as well. This situation exposes SMEs’ owner-managers to extra liability for business failure which discourages them from borrowing. Even for firms that have such assets which could be used as collateral the cost of registering and the inefficient and costly collateral registration process might deter SMEs from registering assets which is the centre for borrowing from banks (Gregory, 2013).

In reality, very few SMEs, especially at the early stages of growth, possess significant unencumbered assets that can be used as collateral. As such, the lack of collateral is probably the most widely cited obstacle encountered by SMEs in accessing bank finance (Zavatta, 2008). For example, the study by The European Bank for Reconstruction and Development (2005) found that SMEs in Romania perceive the excessive reliance on conventional collateral and the high collateral value which is sometimes higher than the loan value as the main constraints to seek loans from banks. The study concluded that in selecting a bank for applying for loans SMEs in Romania consider the lower collateral requirement as the most important determining factor. Another example comes from the study of Cerqueiro, Ongena and Roszbach (2016). The study concluded that in the absence of collateral SMEs are more likely to have their loan applications turned down by bankers.

Another factor contributes to the difficulties encountered by SMEs in accessing bank finance is the high interest rate charged on bank loans. As mentioned earlier, SMEs is characterised by information asymmetry a consequence of which is that these firms may
be subjected to credit rationing. To resolve this situation banks will introduce screening devices to assort high risk and low risk entrepreneurs. Hence, banks may charge higher interest rates to compensate high costs associated with screening and monitoring (Tucker and Lean, 2001). The commissions and fees charged in addition to the interest represent the loan financial cost. Generally, the nominal interest rate is considered the most important component of the loan financial cost.

The high interest rate has the tendency of discouraging entrepreneurs from seeking bank finance. For example, the results of the survey conducted by the National Council of Private SMEs in Romania showed that 70 percent of participants perceived “high interest rates on loans” among the major difficulties when using bank financing (Roman, 2011). Likewise, in their analysis, Pissarides, Singer and Svejnar (2003) found that high interest rate was amongst the most highly rated obstacles to source funding from banks. Another study by Buatsi (2002) showed similar results. The participants strongly agreed that credit from banks is not readily accessible emphasising interest rates are too high. In the study of Nasr (2010) of the surveyed SMEs that did not apply for bank loans a considerable percentage indicated that high interest rate as the reason hindered them from doing so.

Other constraints impeding SMEs’ accessibility to bank finance include bank paperwork and bureaucracy (Sharma and Gounder, 2012; Beck et al. 2006), high commissions (Roman, 2011), high bank charges and fees (Bartlett and Bukvič, 2001), short maturity periods (Aryeetey, 1998), cash flow problems (Van Auken, 1996), lengthy procedures, and insufficient loan size (Asiri and Al-Mossawi, 2005). All these factors reflect the likelihood that owner-managers of SMEs are reluctant to use bank financing for operating their firms which, as a consequence, contribute to low SMEs demand for bank finance.

4.7 Reasons for Rejecting SMEs Bank Loan Applications

On the other hand, SMEs which choose to apply for bank finance might have their applications turned down. Factors that may lead to reject SMEs loan proposals have been the focus of research in SMEs-bank finance literature. For example, the study by Buttner and Rosen (1992) revealed some reasons that might lead bankers to decline SMEs loan applications. These reasons included; insufficient collateral, bad timing, applicants’ lack of managerial and entrepreneurial skills, insufficient market research, and poor business plans. An earlier study by Fertuck (1982) identified several factors
contributed to rejecting SMEs loan applications by credit officers. Ranked in order of importance these factors were: poor credit rating, lack of competence, poor cash flows, poor market for product/service, inadequate collateral, and fraud and bankruptcy risks. Read (1998) found that the main reasons for declining SMEs loan proposals are those pertaining to lack of collateral, insufficient turnover, and poor cash flow.

Struck and Glassman (1983) concluded that refusing of SMEs bank loan applications can be attributed to factors such as: not enough owner-manager’s equity in the firm, start-ups with no track records, poor collateral quality, poor earning records, and bad credit history. Interestingly, slightly different reasons were reported by Barrett (1990). His study found that the reasons for rejecting SMEs funding applications were: owner-managers’ poor communication with bankers, over-optimistic proposals exceeding industry projections, rapid expansion of the business as against the capital available, and misuse of loans in the past.

In the study of Harif, Hoe and Zali (2011) the participant bankers were asked to identify the factors that cause loan applications from SMEs to be rejected. The results showed that the main reasons for that were: poor presentation in financial statements, not enough indicators of capacity, the inability of the business to generate enough income, poor management skills of applicants, lack of experience, and other industry-related factors. In addition to the most frequent reasons cited in the literature Desmond (1991) listed other reasons which he called performance factors. Under this categorization, he cited factors such as too high gearing, cash flow records, level of profits, poor presentation, and insufficient knowledge of finance.

4.8 Banks’ Non-Lending Services to SMEs

For banks, serving SMEs is proving to be profitable and rewarding. SMEs have important operational needs that banks, unlike other specialized funding providers, can meet with non-lending products and services. According to the Federal Reserve National Survey of SMEs in 1987 in the US, banks were the most frequently used source for other financial services, other than lending, demanded by SMEs such as checking accounts and savings accounts (Cole, 1995). The unmet SMEs demand for such products and services has become an indicator of opportunity to expand banks’ market share and increase profit.

Banks offer clients a variety of services and obtain an extremely significant proportion of their revenues from the fees they charge for these services. The range of the offerings
is important because it has an impact on the bank’s SME market share. The design of products and services also impacts the profitability of serving SME market. These non-lending products and services include, but are not limited to, deposits and savings, transactional products, and advisory services. Some of these products and services have the ability to effectively enable SMEs to outsource financial functions to the bank (IFC, 2010).

4.8.1 Deposit and Savings Products

Deposit and savings products provide SMEs with the basic financial management tools to assist in organising revenues and savings. In addition, mutual funds and other investment products provide businesses with opportunities to obtain earnings on extra capital.

4.8.2 Transactional Products

Such products and services facilitate the access of SMEs to and the use of available cash. Automatic payroll and payment collection, debit cards, and currency exchange are transactional bank offerings that lower the cost of doing business and streamline potentially complicated processes.

4.8.3 Advisory Products

When receiving advisory services SMEs can benefit from assistance in producing reliable financial statements, developing business plans, and selecting appropriate financing products. Such services can enhance SMEs’ access to finance by improving their capacity to apply for credit. In addition to channel funding from banks Graeme (1993) suggested that SMEs should look for some other non-lending services such as end of financial year tax planning including payment of interest in advance.

4.9 Islamic Methods of Finance for SMEs

In this section, the most common Islamic finance methods that applicable to SMEs as practiced by Islamic banks are discussed. These financing methods ranging from most popular methods such as; Musharakah, Murabahah, and Mudarabah to less popular ones such as; Ijarah, Bai Salam, Bai Muajjall, and Quard Hasan.

4.9.1 Musharakah

*Musharakah* is the Arabic translation of partnership. *Musharakah* as a mode of Islamic finance can be defined as “… a form of partnership where two or more persons combine
either their capital or labour together to share the profits enjoying similar rights and liabilities” (Al-Harran, 1993, p. 47). In this form, the profits are shared according to a pre-determined agreed ratio, however, in the case of loss it will be shared based on capital contribution ratio. See Figure 4.1 below. Additionally, in Musharakah contract all partners are entitled to have a role in the management of the project.

![Figure 4.1 Musharakah mode of finance](image_url)

According to Lewis and Algaoud (2001), Musharakah contract can be either permanent or diminishing contract. In the former, which may last to limited or unlimited period depending on the original agreement, annual equal shares of the profit/loss are ensured for both parties based on pre-agreed deal. In the latter, however, capital is not permanent since the financier receives profits on a regular basis diminishing his/her equity. Consequently, this will gradually increase the total capital of the client till he/she becomes the only owner of the project.

The findings of Ibrahim (2003) highlight some advantages of Musharakah contracts. First of all, compared to the rate of return of conventional finance (interest rate) rates of return for the capital provider in Musharakah are large, thus, financially, for the financing institution financing through Musharakah is profitable. Similarly, the rate of return of the partner’s capital is slightly higher than his/her share in the total capital even if this share is less than the financier’s. Another advantage for the entrepreneur is that since Musharakah does not require strict collateral guarantees it does not leave the...
entrepreneur with a heavy burden of debts or any other obligations. In addition, *Musharakah* is a suitable technique of financing for both fixed and working capital.

Sadique (2008) indicated that *Musharakah* instrument represents a high viable tool in facilitating SMEs obtaining necessary assets as well as financing complete ventures. Nevertheless, under *Musharakah* contract some ambiguity may exist regarding the title to assets in case of default or dissolution. In order to partially offset the increased risk in such situation the procedure that could be taken is to register the project’s assets under the co-ownership concept provided by a partnership or corporation arrangement (Samad, Gardner and Cook, 2005). Yet, capital providers especially banks may prefer to opt other Islamic financing method such as *Murabahah*.

### 4.9.2 Murabahah

Among all Islamic financing modes *Murabahah* is the most distinct. Under *Murabahah* contract the financier (often Islamic bank) purchases or imports certain goods/commodities (assets or raw materials) ordered by the client and then resells them to the entrepreneur after adding a negotiated profit margin (Dhumale and Sapcanin, 1999). The payment is due in installments. As such, *Murabahah* transaction entails two contracts. The first is between the financier (usually the bank) and the supplier of the goods/commodities. The second is between the financier and the client who applied for the goods/commodities. Figure 4.2 below depicts the *Murabahah* mode of finance.

![Murabahah mode of finance](image)

**Figure 4.2 Murabahah mode of finance**


The fundamental principles that characterize *Murabahah* contract are summarized in Gait and Worthington (2007). First, the goods/commodities must be classified clearly and identified on the base of accepted standards and must be provided by the time of
sale. Second, at the time of sale goods/commodities must be owned completely by the financier. Third, the entrepreneur must be informed of the cost price at the sale point. Finally, both the time of goods/commodities delivery and the due date of payment must be clearly specified. In addition, another key characteristic of Murabahah transaction is that beyond the time of sale the ownership of the goods/commodities remains with the financier until the last payment is made (Samad, Gardner and Cook 2005).

Shaban et al. (2014) argued that Murabahah contracts are perfect for financing SMEs. They explained that Murabahah contracts encourage Islamic bank managers to be less concerned with the asymmetry of information associated with financing SMEs. This is because Murabahah is based on collateralised contract, so the bank maintains ownership of the asset until the contract ceases. Further, Hassan and Dicle (2005) and Khan and Ahmed (2001) argued that the most important advantage of Murabahah is that since the financier collateralizes the debt beyond the good/commodity itself, as such, the risk of loss becomes much less than the risk of credit transaction in conventional transactions. In addition, Ibrahim (2003) asserted that Murabahah contracts will ensure that the client will have the intended goods/commodities so that avoiding using the money in a different purpose which is usually the case in the conventional loan contracts. Moreover, unlike Musharakah in Murabahah there is no ambiguity concerning title to the assets as they remain owned by the financier till the payment completed.

4.9.3 Mudarabah

Gafoor (2006) describes Mudarabah contract as profit sharing and loss absorbing rather than profit and loss sharing contract. According to Al-Jahri and Iqpal (2001), Mudarabah is a contract between two parties; a capital owner and an investment manager under which profit is distributed in accordance to a ratio that is pre-agreed between the two at the time of the contract whereas financial loss is borne solely by the capital provider and the manager loses his/her effort and the expected profit. In other words, Mudarabah refers to two parties involve together to establish a project whereby one party (individual or bank) provides the capital needed and plays no role in the project while the other (entrepreneur) offers his/her skills, experience, and effort. Profits are then divided between the two on the base of pre-determined ratio. In the case of loss, however, the financier entirely bears the financial loss and the entrepreneur bears the operating losses and receives no reward for his/her effort. One exception that the
entrepreneur becomes liable for the amount of capital invested is in the case of negligence and breach of the terms of the contract (Abdulrahman, 2007). Figure 4.3 illustrates the Mudarabah model between the entrepreneur and the bank.

![Mudarabah mode of finance](image)

**Figure 4.3** Mudarabah mode of finance

Source: Gait and Worthington (2007).

Segrado (2005) has categorized Mudarabah contracts into three categories. First category is demand deposits in which deposits are not restricted, payable on demand, and do not share in any profits. Second category is that of mutual investment deposits where these deposits are combined with the bank’s money with the aim to participate in mutual investment transactions conducted by the bank. The third of these categories is special investment deposits under which deposits will be invested in a specific project or investment in accordance with the depositor’s request. In this case, the depositor will be entitled to receive profits and is liable for the losses given that the bank is not negligent or in default. At the end of the deposit period the bank receives its share of profit against its contribution of experience and management while the depositor receives his/her share of profit as a capital share contributor.

Due to agency issues accompanied with it, Mudarabah has been perceived as a risky product. Since entrepreneurs usually do not keep track records or financial statements it is difficult to determine the actual profit to be shared between the two parties. Additionally, Warde (2000) concluded that Mudarabah contract was often associated with moral hazard and adverse selection. Part of the reason for this is because honesty, transparency, and trustworthiness presumably characterize the entrepreneur cannot be guaranteed. As such, difficulties are likely to be unavoidable in Mudarabah contracts. Segrado (2005) suggested that specific training to overcome these issues is needed,
thus, he confirms that *Mudarabah* mode might be more suitable for SMEs with a longer profit cycle.

**4.9.4 Ijarah**

Literally, *Ijarah* means to give something on rent (Lewis and Algaoud, 2001). It can be defined as “… a contract under which the Islamic financial institution buys and leases out an asset or equipment required by its client for a rental fee” (Ahmad and Ahmad, 2007, p. 254). Depending on the nature of the asset and the lessee’s requirements the lease duration varies from three months to five years or more.

Said, Ahmad and Javaid (n. d.) clarify the basic rules of *Ijarah*. They explain that during the period of lease which must be determined clearly at the time of contract all liabilities of ownership remain in the hands of the lessor who is responsible for its maintenance so that it continues to give the service for which it was rented. The authors add that the asset must be used for the purpose identified in the contract unless no specific purpose is identified. In that case the asset can be used for any purpose for which it is normally used. In addition, the lessee is liable to compensate the lessor for any damage to the leased asset caused by any misuse or negligence.

There are two types of *Ijarah* contract. The first is *Ijarah* contract ending with purchase which gives the lessee the choice to purchase the asset at the end of the lease period. The second is the one under which a known benefit arising from the leased asset is made available in return for the lessor whereas the ownership of the asset itself remains untransferred (Ahmad and Ahmad, 2007).

**4.9.5 Bai Salam**

*Bai Salam* is “… a sale contract in which the price is paid in advance at the time of contracting against delivery of the purchased goods/services at a specified future date” (Iqbal and Molyneux, 2005, p. 25). According to Hassan and Dicle (2005) in *Bai Salam* transactions it is required that goods/services, payment, and delivery terms to be identified in detail. As for the payment it has to be done in the time of the contract.

The legal requirements of *Bai Salam* were discussed by Gait and Worthington (2007). According to them these requirements are; (i) the commodities sold should not be available at the time of the contract; (ii) the quality and quantity of goods must be known; (iii) the time and location of delivery for the commodities should be defined; and (iv) at the time of contracting the price should be completely paid.
4.9.6 Bai Muajjal

Gait and Worthington (2007, p. 17) define this mode of Islamic finance as “… a sale on a deferred payment basis that allows business or individuals to receive products now and pay for their value in the future”. Fundamentally, in such contract three separate agreements are included (Shanmugam and Zahari, 2009). In the case of real property the first agreement details the supplier’s purchase of the property from the developer. In the second agreement the property to be sold to the client by the supplier is described. The third agreement stipulates that the supplier can sell the property in the event of default by the client.

4.9.7 Qard Hasan

*Qard Hasan* or a “benevolent loan” is perceived to be a "pure" form of Islamic finance. *Qard Hasan* is “… a gratuitous loan given to needy people for a fixed period without requiring the payment of interest or profit” (Farook, 2007, p. 47). This loan can be used for different purposes, for example, education, marriage, or housing. Under such arrangement the recipient is only required to repay the principal amount loaned. Additionally, *Qard Hasan* loans are very secure since the borrower can be subjected to a penalty in case of delay in repayment. Moreover, it is acceptable for the lender to demand assets as collateral and charge administrative expenses on the loan (Obidullah, 2005).

4.10 Banks and SMEs Finance in Libya

Banks are by far the strongest player in the Libyan financial system. Whilst the banking sector in Libya is not characteristically different from its counterparts in other developing countries it plays a more crucial role in contributing to the overall economy and social welfare in the country being almost the only source of finance and the only type of financial institutions that can provide individuals as well as businesses with loans and credit.

Libya’s banking system has been traditionally dominated by four (big) banks each of which is partially or fully owned by the state. These banks have branches operating in all over the country. These four banks constitute almost 90 percent of Libya’s banking sector assets. Although there is no clear demarcation for classification each one of the leading banks has total assets of a minimum of LD100 million. There are also four specialised state-owned banks and four substantial private banks. Further, there are a
number of regional banks that are coordinated by the National Banking Corporation. In addition, a number of foreign banks have established representative offices in Libya.

In general, the Libyan economy is characterised by low levels of financial intermediation (OECD, 2014b). As a result, banks only lend on a short-term basis mainly to low-risk activities such as trade financing. In addition, the level of non-performing loans in the economy is high, as such, banks limit their activities to short-term collateral-backed loans. This explains why Libya is ranked the 101th of 144 countries on ease of access to loans according to the 2011-2012 Global Competitiveness Report (Schwab and Sala-i-Martín, 2012).

Libyan banks have substantial liquidity in their books, however, banks are often unwilling to disburse loans to the private sector. According to a study conducted by Eltaweel (2012) the Libyan banking sector does not work well for SMEs. This is because this sector is highly concentrated, rudimentary, and shallow. Moreover, the financial conditions set by banks to finance business are either very difficult or difficult (Elmansori and Arthur, 2014). Several factors are contributing to this including: inflexibility, bureaucracy, interest-based loans, and centralisation.

Porter and Yergin (2006) reported that apart from privately owned companies in the energy sector which have better access to formal capital from banks thanks to their relative sophistication and profitability, other businesses in the Libyan private sector especially SMEs lack access to banking capital. Some of the reasons that have led to the mismatch of supply and demand of bank finance for SMEs in Libya include (Porter and Yergin, 2006):

- Since SMEs lack standardized and reliable information on their financial conditions and market share banks find it difficult to assess their riskiness. As such, Libyan banks disburse loans primarily to clients who are personally known by bank staff. Otherwise, substantial collateral, in some cases as much as 125 percent of the total loan amount, is demanded to mitigate lending risks.
- There is a low availability of privately owned land with clear undisputed titles of ownership that can be offered as collateral. This has resulted in SME borrowers being discouraged from applying for bank loans.
- As bank managers are not rewarded for disbursing good loans and face severe penalties in case of bad debts Libyan banks tend to follow a defensive lending policy avoiding lending to SMEs which are often perceived risky.
In addition, another main reason that Libyan SMEs demand for finance has not been met yet is the absence of Islamic finance products as conventional interest-based banking have been the sole ingredient of the country’s financial system. Elmansori and Arthur (2014) found that when seeking finance many Libyan SMEs have a cautious attitude towards the issue of interest regardless of the terms. The authors argued that the emergence of Islamic finance could make a significant difference in overcoming this obstacle. In the same vein, it was suggested that the implementation of Islamic banking and finance to meet the customers’ needs, including SMEs’, could play an important role in boosting the development in the Libyan society (Saleh, 2005).

4.11 Concluding Remarks

This chapter has examined the financing of SMEs particularly in relation to banks as the main external finance providers to this segment. On the driving side, it is evident that banks perceive this segment as being unsaturated with an accelerated rate of growth and very profitable to serve. Other factors attract banks to engage with SMEs are the high possibility to seek new clients through SMEs and the intense competition in other markets such as the large corporations. On the other hand, in terms of obstacles, financing SMEs is associated with information asymmetry, higher risk, high cost of lending, and the lack of collateral. As a result, banks find it difficult to determine the creditworthiness of SMEs and, therefore, are reluctant to lend to them. Other impeding factors include macroeconomic instability and competition.

There is general agreement in the literature that SMEs characteristics and those of their owner-managers have an impact on SME financing and in particular on their access to bank finance. It is also well reported that when seeking external financing from banks SMEs seem to have much difficulty. This situation is due to impeding factors such as high rate of interest and the amount of information requirements asked by banks. Another common problem is often the unwillingness of banks to grant or increase funding to SMEs without pledging or increasing in collateral which SMEs usually are unable to provide. By reviewing the principles of Islamic finance which emphasizing the transaction itself rather than the entrepreneur’s creditworthiness this chapter also discussed the appropriateness and uniqueness of financing methods offered by Islamic banks for financing SMEs.

Before making a decision to lend to SMEs banks have to assess the creditworthiness of the applicants. To do so a number of criteria are usually considered by bankers most
markedly the five Cs namely; capital, character, condition, collateral, and capacity. In addition, other criteria such as owner-managers’ managerial skills, trading experience, equity stake, risk of default, gearing, and profitability can be also considered in the evaluation process. Failing in meeting the criteria adopted by banks often results in declining the finance application.

In Libya, as the financial sector is underdeveloped and largely dominated by the public sector with the absence of non-bank financial activities banks remain the main, if not the only, external finance provider for local SMEs. However, access to this source is challenging for SMEs. This is mainly because of obstacles typically characterizing SMEs such as asymmetry of information and lack of collateral. Due to weaknesses in the legal and registry systems of ownership of land which is the main source of collateral in Libya, the lack of collateral is more problematic for Libyan SMEs. In addition, the absence of Islamic banks is also a factor why Libyan SMEs’ financial needs are underserved. In this context, the introduction of Islamic finance products could provide an opportunity for SMEs to channel funds for their operations from an alternative source.
Chapter 5. Research Design and Methodology

5.1 Introduction

The methodology in this thesis is geared towards understanding the financing of SMEs by banks in a developing country, namely Libya, where very few or no earlier studies have been conducted. We employed the population of SMEs in the Libyan city of Benghazi as representative of the demand side and Bank Al Tanmeya as a case study of the supply side. In fulfilling this aim, formulating the research problem is the first important step in the research process. The second important step is to decide on a system of methods to follow in conducting the research, or the methodology.

Wagner (2003) defines methodology as the process, principle, and procedure by which problems can be approached and solutions for these problems can be searched. Others define it as the study’s entire process including procedural framework within which that study is conducted (Creswell, 1994). Remenyi and Williams (1996) argue that methodology only describes the approach that may make problems operationalized into research program. Therefore, it can be said that while methodologies are important in themselves, they only provide generic guidelines rather than definite directions on how the study should be conducted which means that they are not absolute prescriptions (Remenyi and Williams, 1995). According to Silverman (2001) all methodologies are never true or false but only more or less useful. Thus, some methodologies and methods are more appropriate than others for certain demands of a piece of research.

The purpose of this chapter is to present the study’s methodology and methods with the rationale for these choices. The data collection process and the fieldwork are also outlined. The remainder of this chapter proceeds in sections as follows. The next section discusses qualitative and quantitative methods as research instruments. This is followed by explaining the triangulation approach and the justification for adopting it. Thereafter, a discussion of the research design is given. Then, a description of the research data collection tools, including questionnaires, interviews, and documentation is provided. Stages and aspects of the fieldwork and data collection process are elaborated in the appropriate section. This includes drafting, pre-testing, and samples of both the questionnaire and the interviews as well as the processes of administrating the former and conducting of the latter. Consequently, the data collected is linked to the analytical
techniques in the following section. The subsequent section addresses the ethical consideration of the research. Finally, the chapter concludes with concluding remarks.

5.2 Quantitative and Qualitative Methods

The literature shows a diversity of methodologies and research instruments available that can help with the generation of data and information relating to particular research topics. In this regard the two main distinct approaches process of data to empirical research in social science are quantitative research and qualitative research.

The quantitative approach can be described as an interdisciplinary field which uses a multi-method approach to research. It refers to how human experience can be understood by using numbers and statistics, examples, experiments, correlation studies by surveys and standardised observational protocols, simulations, and supportive materials (Corbetta, 2003; Janesick, 1998). As argued by Johnson and Christensen (2004) by generally focusing on hypothesis testing and theory testing the quantitative research approach emphasises the deductive component of the scientific method. Data of quantitative nature are not usually abstract, they are rather hard and reliable; they measure tangible, countable, and sensate features of the world (Bouma and Atkinson, 1999).

On the other hand, qualitative research approach is a process of inquiry to understand a social or human problem based on building a complex and holistic picture formed with words, reporting detailed views of informants, and conducted in its natural setting (Creswell, 1994). Focusing on the meanings, experiences, and description qualitative research approach can be described as “subjective” in nature (Naoum, 1998). In other words, qualitative research is about finding answers to questions begin with why, how, and what. Therefore, it can be inferred that qualitative research is an attempt to increase researchers’ understanding of why people act the way they do and why things are the way they are in their field of study.

Both approaches, quantitative and qualitative, have some advantages as well as disadvantages. Bader (1982) explains these advantages and disadvantages in terms of “reality stance” focusing on the relationship between the researcher and the topic being investigated. According to the author, quantitative research methodology uses a deductive form of logic. As such, theories and hypotheses can be tested to judge how they affect relationships. In such methodologies, concepts, variables, and hypotheses are selected prior to starting the study and remain fixed with the intention of formulating
generalisations that contribute to the study and enable better explanation, prediction, and understanding of a phenomenon. This outcome is valuable only if the instruments employed are both valid and reliable. However, qualitative methodology is reliant on inductive logic. Here the data emerge from informants rather than being previously identified by the researcher. Such evolving data is useful information that leads to an explanation of the phenomenon.

Marsh (1988) argues that qualitative methods are accurate and provide more facts, however, they can be slower to emerge and are more expensive and sometimes more complicated. On the other hand, quantitative methods are quicker, cheaper, simpler, and provide more-ranging overviews. Nonetheless, they are more subjective and prone to bias. With regard to external validity, reliability, and precision, Wagner (2003) stresses that measurements in quantitative methods are qualitatively accurate whereas evaluations in qualitative methods are always subjected to human judgments and, consequently, can be flawed. Due to the fact that the context and the subject of the study are not artificially separated, the author adds, external validity is greater in qualitative research. In terms of validity and reliability, quantitative research is high in terms of internal validity and reliability; however, it is low in ecological validity or naturalisation (Gill and Johnson, 1997). This can be attributed to the fact that this approach is highly structured. On the contrary, because its structure is weak, qualitative research is low in internal validity and reliability.

David and Sutton (2004) argue that to some extent, the terms quality and quantity are hardly distinguished. However, a number of authors (e.g. Maxwell, 2012; Corbetta, 2003; Thomas, 2003) have explained the differences between qualitative and quantitative research. For example, Corbetta (2003) demonstrates that whereas quantitative research is structured and theory precedes observation, qualitative research is open and interactive and observation precedes theory. He also has identified different issues between the two approaches in the nature of data. In quantitative research, the author argues, the data is hard, objective, and standardized, however, on the other hand, in qualitative research the data it is soft, rich, and deep.

 Nonetheless, more recently the competing approaches of quantitative and qualitative research have become almost partners in some social research. This technique of combining methods is called triangulation.
5.3 Triangulation

Many researchers advocate that both quantitative and qualitative research are very important and can often be mixed in a single research study (Naoum, 1998; Patton, 1990). The concept of mixing methods “triangulation” was first introduced by Jick (1979) as a means for seeking convergence across qualitative and quantitative methods within social science. Patton (1990, p. 247) has promoted the use of triangulation by stating that “triangulation strengthens the study by combining methods”.

The lexical definition of triangulation is that it is the process of using trigonometry in determining an unknown point or location by using the position of two fixed points a known distance apart (Webster’s New Collegiate Dictionary, 1983). In methodological terms, Bryman and Bell (2007) refer to that triangulation of methodology takes place when more than one research strategy and data source are used in a single study of social phenomena. Also, triangulation can be defined as “…the combination of two or more data sources, investigators, methodological approaches, theoretical perspectives, or analytical methods within the same study” (Thurmond, 2001, p. 253).

The use of triangulation methodology in social sciences enables cross checking of validity of findings from different research strategies as well as allowing access to different levels of reality and thus enhancing induction of meaning from the findings (Deacon, Bryman and Fenton, 1998). In addition, by employing triangulation of methodologies different types of data can be collected which, in turn, enables examination of different aspects of the study as well as the development of multiple measures to improve confidence in the research’s findings. Furthermore, the combination of both qualitative and quantitative strategies is recommended and used by researchers in situations where one of the approaches is insufficient to expose all what is required to be known about a phenomenon (Bryman, Stephens and Campo, 1996). In other words, triangulation has the potential of revealing unique differences or meaningful information that could remain undiscovered with the use of only one approach or data collection technique in the study.

According Flick (1992), four types of triangulation approach can be identified:

- Data triangulation: The use of a variety of data gathering methods in a study.
- Investigator triangulation: The use of a variety of researchers in a study.
- Theory triangulation: The use of multiple perspectives to interpret a single set
of information data.

- Methodological triangulation: the use of multiple methods to study a single problem or phenomena.

In the light of the above definitions and taking the nature of the study problem and its objectives into account it was decided that both data and methodological triangulation are better suited for this study. As the candidate believes that qualitative and quantitative methods can be used together as a valuable option to obtain complementary findings and to strengthen the results as well as to achieve the study objectives both quantitative methods, in the form of a questionnaire survey, and qualitative methods, in the form of interviews, were used in order to attain all the data needed for the study.

5.3.1 Rationale for Choosing the Triangulation Approach

In recent years, Libya has developed a major interest in SMEs, however, little has been written about financing SMEs in general and bank financing in particular. As such, the current study aims to explore the status of bank financing for SMEs in Libya from the perspectives of both sides supply and demand. In this regard, it has been assumed that triangulation can be a powerful tool that can play a significant role in accomplishing this aim. There are several reasons for this. First and foremost, the objectives of this study cannot be achieved by using a single approach since the nature of the current research requires dealing with two parts have different characteristics and organisational structure each, which are the demand side (SMEs) and the supply side (Bank Al Tanmeya). Second, triangulation approach will enable the use a variety of tools such as questionnaire and interviews together. As a result, this will help forming an overall picture about the subject of the study which should enable an in-depth view of the topic of bank financing for SMEs in the Libyan environment in its different guises. Third, employing such combination increases reliability, validity, confidence, and arguability (Thurmond, 2001). Fourth, to a large extent, the adopted approach can enhance the understanding of the phenomenon studied and increases the accuracy of the study (Hussein, 2009).

According to Denzin (1970) one way to increase the validity, strength, and interpretative potential of a study, decrease investigator biases, and provide multiple perspectives is to use methods involving triangulation. Therefore, this research study aims to collect multiple sets of data using different research methods in such a way that
the resulting mixture or combination would have complementary strengths and non-overlapping weaknesses.

5.4 Research Paradigm

Research paradigm is also known as research philosophy. It relates to the development of knowledge and the nature of that knowledge. In other words, research philosophy reflects the perspective by which research knowledge and findings can be established. There are three main philosophical paradigms in business research; positivism, realism, and interpretivism.

Hussey and Hussey (1997) define positivism as a paradigm based on the natural sciences which assumes that social reality is independent of humans and exists regardless of whether or not humans are aware of it. Therefore, the act of investigating reality has no effect on that reality and little regard is paid to the individual subjective state.

Realism stands for a position in which objects exist independently of human minds. It is similar to positivism as it also assumes a scientific approach to the development of knowledge. There are two types of realism; direct realism and critical realism (Saunders, Lewis and Thornhill, 2007). Direct realism is about what you see is what you get meaning what we experience through our senses portrays the world accurately. On the other hand, critical realism argues that what we experience are sensations, the images of the things in the real world, not the things directly.

The third main research philosophy is interpretivism. This philosophy contrasts the previous two. It emphasises the differences between conducting research among people and among objects. It assumes that the subject matter of social is fundamentally different from natural science (Bryman and Bell, 2007). Interpretivism advocates that it is necessary for the researcher to understand differences between humans as social actors (Saunders, Lewis and Thornhill, 2007).

This study utilised a triangulation approach to explore the topic of bank financing for SMEs in Libya. Using both qualitative and quantitative methodologies was necessary to encompass the different aspects of the two dimensions of the study (demand and supply). The quantitative methodology shares its philosophical foundation with the positivist paradigm which argues that there is one objective reality. Therefore, valid research is demonstrated only by the degree of proof that can be corresponded to the
phenomena that study’s results stand for (Hope and Waterman, 2003). The qualitative methodology shares its philosophical foundation with the interpretive paradigm which supports the view that there are many truths and multiple realities. This paradigm focuses on the holistic perspective of the person and environment.

Considering to the nature of this study research, there was no single paradigm that could satisfactorily deal with all of the required methodological aspects. Therefore, it was necessary to combine the quantitative/positivist paradigm with the qualitative/interpretive paradigm in order to answer the established questions and achieve the objective of the study that is to seek to understand how the interactions of SMEs and loan officers relate with the business environment and the bank lending policies and structures shape the status of bank financing for SMEs in Libya.

5.5 Research Design

A research design is defined as “… a procedural plan adopted by the researcher to answer questions validly, objectively, accurately, and economically” (Kumar, 2011, p. 94). As such, it can be said that a research design is used to structure the research to signpost how all the major parts of the research work together to address the central study questions. This means that a research design provides a framework for the collection and analysis of data. It therefore, represents a structure that guides the execution of a research method and the analysis of the subsequent data associated with the phenomenon under investigation.

There are two main functions of research design (Bryman, 2012). First, identifying and developing procedures and the logistical arrangements required so the study can be undertaken. Second, to ensure that these procedures are adequate, objective, and accurate to answer the study’s questions.

Depending on the research problem and the associated objectives there is a variety of research designs from which the researcher can choose. Bryman (2012) suggests five main types of designs which frequently mentioned in the literature. A fairly basic treatment of these types is as follows:

**Experimental design:** this type allows the researcher to explore the impact of one independent variable on another dependent variable provided that all other variables which may influence the relationship between these two variables are kept neutralized. The most important characteristics of this design are that it is based on a clear cut
theoretical framework and that the focus is on a small number of variables. Additionally, it is possible for the experiment to be repeated many times over to study the independent effects of isolated variables on one another.

**Case study research design:** in such a design a single case or unit is investigated in depth by the researcher by highlighting all aspects of the case in detail within a limited time scale. The unit here could be a homogenous society such as a single school, a single community, a single organisation, or some kind of event. This design is suitable in cases where adequate information about the unit need to be gathered particularly in cases where knowledge of all aspects of the unit or the case history of the people involved is indispensable.

**Comparative design:** this design requires studying two contrasting cases (could be organisations, nations, communities, etc.) by using more or less identical methods. In such designs making comparisons at different levels and relating to different features is significant. It is argued that by using this design the researcher is in a better position to establish the conditions in which a theory will or will not hold. Furthermore, the comparison may suggest some concepts which are relevant to an emerging theory.

**Survey design:** this type is also known as a cross-sectional design. It could include all the social elements, in such case it would be referred to as comprehensive survey. However, the design could include a limited number of elements as in the case with survey through using samples which is very common in social sciences which researchers refer to as a social survey. The major elements of such design entail collection of data on more than one case at a single point in time. The data collected constitute a body of quantitative and quantifiable data which are connected to at least two variables to enable, after examination, detecting any patterns or association.

**Longitudinal design:** this type of research design is usually associated with the areas of social sciences such as sociology and social policies. It allows the researcher to study the development of the phenomenon within a certain period of time. Unlike the survey design, the sample in the longitudinal design is surveyed and surveyed again one further time at least. Consequently, this design may be more able to allow causal inferences to be made as it allows some more insights into the time order of variables.

An important aspect of ensuring that this research is robust with respect to academic rigour is having a clear and unambiguous research design. Yin (2002) cited that the type of research questions is an important factor in determining the design of each research.
As a result and considering the research questions and the nature of the topic under investigation, the design of the current study, as has been previously mentioned, was based on a triangulated approach which employed both qualitative and quantitative research methods.

For the purpose of this study Libyan SMEs within the city of Benghazi were targeted to explore their experiences with regard to bank finance. To achieve this, a quantitative design in the form of survey questionnaire was adopted to gather the required primary data on the demand side (SMEs population). In addition, in order to supplement this work and to offer a complete picture of the status of bank finance for SMEs in Libya, Bank Al Tanmeya, Benghazi branch, was chosen as a case study to represent the supply side for two main reasons. First, Bank Al Tanmeya is one of the main supplier of external finance to SMEs in Libya. Second, Libya is huge country which means it will not be possible to investigate this topic in the entire Libyan region considering the limitation of study time and resources.

5.5.1 Exploratory Research

While the explanatory study attempts to identify the relationship between variables, on the other hand, exploratory research seeks to discover what is happening and assess the phenomenon in a new light and in such case the researcher is unsure of the precise nature of the problem (Saunders, Lewis and Thornhill, 2007). The primary objective of this type of research is to provide new insights and an understanding of the problem confronting the researcher (Selltiz, Wrightsman and Cook, 1976). It therefore tends to be used most heavily in disciplines where the emphasis is on description and explanation rather than on prediction and as such, it is undertaken for heuristic purposes (Bell, 1991).

Marshall and Rossman (2010) argue that the purpose of exploratory study is to investigate phenomena, identify or discover important categories of meaning, and generate further research. Given some recent studies relevant to SMEs (e.g. Peel and Wilson, 1996; Burns and Walker, 1991) this study is mainly exploratory in nature in the sense that not much is known about the topic of bank finance for SMEs in Libya as it has not been addressed as extensively as it deserves. So that, the study aimed at exploring more about this topic through investigating the experience of SMEs operating within the city of Benghazi and that of Bank Al Tanmeya to response to the raised issues.
5.5.2 Descriptive Research

A descriptive study is an attempt to accurately portraying the characteristics of the entity being studied either an individual or a population (Sellitz, Wrightsman and Cook, 1976). Therefore, it can be said that this type of research deals with questions like “what are things like?” or “what is going on?” (De Vaus, 1995). The purpose of descriptive research is to provide a picture of a phenomenon as it naturally occurs (Gray, 2004). In other words, this type of research attempts to answer questions about the current status of the subject of study.

According to Gay and Airasian (2000) studies which are descriptive in nature involve studying the preferences, attitudes, practices, concerns, or interests of a group of people. Hence, this type of research is mainly used to describe relevant aspects of the phenomenon subjected to the study from an individual, organisational, industrial, or other perspective (Sekaran, 2003).

This study can be also identified as descriptive because its aim is to provide a general overview and a broad description of a phenomenon within its context which is that of the status of bank financing for SMEs in Libya. That is exploring Libyan SMEs’ experiences, attitudes, concerns, and constraints with respect to bank finance as well as the experience of Bank Al Tanmeya as an external finance provider for Libyan SMEs.

5.5.3 Case Study

A case study is defined as “…an empirical inquiry that investigates a contemporary phenomenon within its real-life context when boundaries between phenomenon and context are not clearly evident and in which multiple sources of evidence are used (Yin, 2009, p. 13). The case study approach is relevant in work that focuses on understanding particular areas of an organisation’s functions that are not well documented but can be investigated best through interaction with the organisation (Bryman, 1989). This approach encompasses the use of an in-depth analysis of the subject of the study including archives, interviews, questions, and observations which consequently facilitating the collection of meaningful information (Lang and Heiss, 1984).

According to stake’s (1995) classification of case studies and in the view of the research questions which involve investigating the role of Bank Al Tanmeya in providing finance to SMEs in Libya, an intrinsic case study which can be employed to understand and
learn more about a particular case is the most appropriate approach for the issues regarding the supply side in this study.

The adoption of case study design is to gain in-depth understanding of the information necessary to identify and explore the status of Bank Al Tanmeya’s involvement with SMEs in Libya. Yin (2009) states that the case study is the preferred design when “how” or “why” questions are being posed. This allows the researcher to determine not only what happened but also why it happened. In addition, due to the nature of characters involved in this study (senior bank officers) and the nature of the research arena’s characteristics (confidentiality, integrity, and regulatory issues) the case study is the most appropriate design in line with the research objectives.

The nature of the current research requires gathering information held by Bank Al Tanmeya senior managers and loan officers. Therefore, an explorative and descriptive approach is required to conduct this research. Overall, case studies, action research, and ethnographic approach are all possible options to satisfy/convince conducting the research because they can be used for exploratory and descriptive analysis and no distinction can be made between them in terms of exploration and description. Nevertheless, ethnographic research and action research are not the most favoured options because they are highly rooted in social science and characterised by high level of involvement of the researcher with the subject of the research. Therefore, they require the researcher to be a participant observer and to interact with the subject undertaken.

According to the aim of the study the researcher’s intervention with what is being studied is not required since the phenomenon in this study was to be examined within its real-life context. For that reason, the case study remains the most appropriate approach and design with a higher degree of suitability and is, therefore, preferred in this study against the other two approaches.

In addition, this study pursues to secure rich descriptions and deep understanding of bank financing for SMEs in Libya which is currently ill-defined and not well-documented. Due to the originality of this research and the lack of focused previous research on this subject, this study is the first academic detailed research addressing this topic. It is an exploratory study investigates the experience of Bank Al Tanmeya as a main supplier of external finance for Libyan SMEs. Thus, the exploratory
single case study design is the appropriate one to be applied in this study for depth analysis.

5.6 Data Collection Methods

In general, there are two main sources of data which can be used in a research; primary and secondary data. Primary data are original data collected by the researcher to meet the research objectives including survey and experimental data. Secondary data, on the other hand, are data that already exist, have been produced or collected by others for some other purposes, and can be found in various sources such as books, journals, published statistics, annual reports, films, and government surveys.

Based on the triangulation of methods and consistent with the methodology adopted, this research has drawn its data collection methods. Accordingly, primary data on the demand side were collected mainly through administrating a survey questionnaire on Libyan SMEs operating within the city of Benghazi. On the supply side, primary data were collected by conducting a number of semi-structured interviews with managers and loan officers at Bank Al Tanmeya.

5.6.1 Survey Questionnaire

Questionnaire is the most popular tool of data collection and the most frequently used method in the field of social sciences. A questionnaire is a list of questions designed to elicit and attain information from the views of respondents who have been chosen in some designed manner (Miller, 1991). Researchers use questionnaires so that information about the thoughts, feelings, attitudes, beliefs, values, perceptions, personality, and behavioural intentions of research participants can be obtained. As a result, those information can be analysed, patterns extracted, and comparisons made (Bell, 1991).

Hussey and Hussey (1997) argue that individuals’ perspectives can be examined by utilising either questionnaires or interviews. The advantage of a questionnaire survey here is that it enables many more individuals to be covered by the study. This is particularly important when the amount of knowledge about a field is limited. In addition, quantitative data collected by using questionnaires are in a standardized way so that they are internally consistent and coherent for analysis.

In general, questionnaires can be posted to respondents or personally administered. More recently, email surveys have become popular. In the current study, due to the
unreliable Libyan post services which could cause a low response rate and be time consuming in addition to the fact that the use of information technology among Libyan SMEs is still limited, if not absent, the personally administered questionnaire method was chosen. In addition to being the best way to gain the greatest possible number of respondents, that is to maximise the response rate, this method also gave the research team the opportunity to explain the study when that was required by the targeted respondents.

5.6.2 Interviews

Interview is a direct verbal contact between the researcher and the studied population. In qualitative research, interviews are one of the most common methods of data acquisition. They have been utilised in various forms to attain additional information from people’s perceptions and their deep insights and definitions about the investigated topic as case studies deal with human affairs and these affairs should be interpreted through the knowledge of people who can provide it (Easterby-Smith, Thorpe and Lowe, 2012). The three main features of interview method as data collection tool that distinguish it from other methods are; high flexibility, the production of great depth data, and that it can be almost used anywhere (King, 2004). Table 5.1 summarizes the advantages of interview as data collection technique.

Table 5.1 Advantages of interviews

<table>
<thead>
<tr>
<th>In-depth information</th>
<th>By producing data which deal with the topic in depth and detail.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insights</td>
<td>The possibility to gain valuable insights based on the depth of the information gathered and the wisdom of the key informants.</td>
</tr>
<tr>
<td>Equipment</td>
<td>Simple equipment relies on conversation skills which researchers already have.</td>
</tr>
<tr>
<td>Informants</td>
<td>The opportunity to expand on ideas, explain views, and identify what participants regard as crucial factors.</td>
</tr>
<tr>
<td>Flexibility</td>
<td>Adjustments to lines of enquiry can be made during the interview itself.</td>
</tr>
<tr>
<td>Validity</td>
<td>Direct contact at the point of the interview means that data can be checked for accuracy and relevance as they are collected.</td>
</tr>
<tr>
<td>High rate of response</td>
<td>Prearranged and scheduled for a convenient time and location.</td>
</tr>
</tbody>
</table>

Source: Denscombe (2007).

In research in the field of social sciences, there are many forms of interviews. The most common forms of interviews are: structured, unstructured, and semi-structured (Saunders, Lewis and Thornhill, 2007; Miller and Brewer, 2003; Dawson, 2002). In a structured interview, a standard interview schedule is designed and the questions are predetermined ready for answering in usually a face-to-face interview. This form of interviews is more convenient for survey style interviews. In an unstructured interview,
no questions are predetermined. This is sometimes called an exploratory interview and is usually associated with ethnographic research. Finally, sharing characteristics of both structured and unstructured interviews, the third form is semi-structured interviews. This type of interviews has specified and predetermined questions, nonetheless, it allows the researcher delving further by facilitating discussion. This, in turn, allows the investigation to provide more clarification and the generated data will be rich.

The decision to choose between these forms largely depends on the research’s problem, objective, and variables (Babbie, 1990). Therefore, as this study seeks to gain rich and in-depth information about the experience of Bank Al Tanmeya in financing SMEs in Libya, semi-structured interviews, which facilitate cross-questioning in the process, with senior bankers within Bank Al Tanmeya were also employed as the main source of data collection on the supply side. There is a number of reasons behind this.

- It has a capacity to gain large amount of in-depth data in a relatively short period of time, and immediate follow up and clarification are possible (Marshall and Rossman, 2010). This is critically important for this study which had resources and time constraints.
- It allows the researcher to explore complexity, ambiguity, contradictions, and process which might be encountered by the interviewees.
- It gives the researcher a great opportunity to explore and discuss potential meanings of questions and answers and clarify any unclear or incomplete answers (Yates, 2004; Flick, 1998).
- It allows the researcher to generate his own questions to develop interesting areas of inquiry while the interview progresses (Ghauri, Grønhaug and Kristianslund, 2008); and
- Finally, it provides insights into the previous history of the situation as well as current activities (Yin, 2009) which are both essential for this study.

5.6.3 Document Analysis

As a means of triangulation, document analysis is often used in combination with other qualitative research methods. Document analysis is a systematic procedure for reviewing or evaluating documents both printed and electronic materials (Bowen, 2009). Generally, documents could include letters, study reports, administrative documents, maps and charts, organisational or institutional reports, newspaper articles, or any items that could add to the database. Merriam (1988) believes that documents in
all forms can help the researcher uncover meaning, develop understanding, and discover insights relevant to the research problem.

Yin (2009, p. 87) stated "... the most important use of documents in research is to corroborate and augment evidence from other sources". Hence, in this study, a document review was used as an additional source of data to gather any relevant information relating to the supply side. The conducting of the interviews on the case study site helped the candidate to access some appropriate documents related to the research topic. Therefore, official documentation relating to Bank Al Tanmeya’s financing for SMEs in Libya were investigated including bank documents and reports.

Indeed, the process of assembling such data in a developing country like Libya has proved a difficult challenge. Thus, it is worth mentioning that most of the secondary data used in this study have been obtained through direct contact with different sources in the bank context during the fieldwork in Libya. However, not all the relevant documents were obtainable nor accessible due to restrictions imposed by the bank policy.

5.7 Conducting the Fieldwork

In order to address the objectives of the research a fieldwork study was undertaken in Libya for a period of four months from May to August in 2013. The aim was to collect the required data on bank financing for SMEs in Libya relating to both demand and supply. As has been mentioned throughout this chapter, it was decided that primary quantitative data on the demand side (SMEs population in the city of Benghazi) to be collected by using a self-administered questionnaire. As for the supply side (Bank Al Tanmeya) qualitative data were collected by holding in-depth semi-structured interviews with senior managers and loan officers within the bank. In addition, secondary data on this side also were gathered by studying some relevant documents and reports, wherever possible, to attain adequate understanding and specific details about the subject under investigation.

5.7.1 The Survey Questionnaire

For gathering primary data on the population of SMEs operating within the city of Benghazi representing the demand side, survey questionnaire was selected as the most appropriate method. It was used as a robust tool in which a large sample can be taken
and then more different views and better understanding of bank financing for SMEs from the demand side’s point of view can be obtained.

I. Designing and Drafting the Questionnaire

Sudman and Bradburn (1982) argue that a well-designed questionnaire can make the tasks of both respondents and researchers easier and reduces errors. In this regard, a questionnaire should be done with the aim of providing answers to certain questions that will allow the stipulated research objectives to be achieved. In the light of this, the candidate read and reviewed many research methodology books and incorporated ideas into the design of the questionnaire. This is in addition to reviewing previous research experiences relating to bank finance for SMEs in the existing literature.

Prior to construction the questionnaire a number of considerations that have been suggested by Hussey and Hussey (1997) had to be taken into account. The following are examples of some of these considerations in terms of the general rules of designing questions, choice of wording, and layout:

- The purpose of the questionnaire had to be explained to all participants;
- The questions had to be formulated in a series and linked to each other;
- It is preferable that to lead the respondent from general to more specific questions when answering the questionnaire, moving through questions in a logical sequence, without making major shifts or gaps for the respondents;
- There must be a specified objective for each question that is related to the research problem and objectives;
- Using simple, direct, and familiar language to make the questionnaire applicable to all the respondents and avoid, where possible, the use of technical terms which may have more than one meaning;
- The length of each question was kept as short as possible in a way that does not affect its content and meaning; and
- Consistency in style and clear instructions for answering each question had to be assured.

After defining the elements of an appropriate questionnaire, the first version of the questionnaire was drafted. Short questionnaires are often recommended as they result in higher response rates (Dillman, 1978). Therefore, the questionnaire was restricted to a limited number of pages and items. See Table 5.2.
Table 5.2 The questionnaire’s sections

<table>
<thead>
<tr>
<th>Section No.</th>
<th>Section Focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>One</td>
<td>SMEs Firms Information: e.g. the firm’s age, size, activity etc.</td>
</tr>
<tr>
<td>Two</td>
<td>Owner-managers Information: e.g. age, level of education, experience etc.</td>
</tr>
<tr>
<td>Three</td>
<td>Financing Information: e.g. start-up financing, different financing options available, experiences with bank financing.</td>
</tr>
<tr>
<td>Four</td>
<td>Islamic finance to SMEs.</td>
</tr>
<tr>
<td>Five</td>
<td>SMEs selection of banks.</td>
</tr>
</tbody>
</table>

There was a covering letter topping with Griffith University official logo accompanying the questionnaire explaining the purpose and the importance of the study and ensuring the respondents that all the responses of the questions will be confidential and anonymous. The covering letter also provided the personal contact details of the candidate in case of any inquiries or concerns may emerge during completing the questionnaire.

The questionnaire adopted a close-ended questions structured in a mixed format of nominal and ordinal responses. The first section concerns the general characteristics of the businesses surveyed (e.g. the business sector, their size in terms of the number of employees and the legal form of the business). In the second section, participants were asked questions regarding their background (e.g. age, level of education, years of experience). In the third section the questions inquired about SMEs’ owner-managers financing behaviour and experiences (e.g. start-up capital, the priority of finance sources and any experiences with bank finance). The questions in the fourth section sought to explore Libyan SMEs’ awareness, inclination, and priorities of Islamic methods of finance. Finally, the questionnaire concluded with a question seeking factors affecting SMEs’ choice of banks as business partners.

II. Pre-Testing the Questionnaire

Pre-testing or piloting refers to testing the questionnaire on a small sample of respondents to identify and eliminate any potential problems (Hunt, Sparkman and Wilcox, 1982) and also to ascertain how it works and what changes are necessary prior to commencing the study. This is important to ensure that the final version contains questions that are specific, understandable, and capable of obtaining responses from those answering the questionnaire.

The process of pre-testing commenced by subjecting the first draft to a discussion with the principal supervisor to ensure that the questionnaire design was convenient for the research’s objectives pertaining to the demand side and suiting the nature and the
circumstances of the Libyan business environment. Following his comments some amendments were taken into account.

The questionnaire in this study was initially constructed in English. However, since all the participants to be targeted by the questionnaire were Arabic native speakers who are believed not to be proficient in either spoken or written English the questionnaire had to be translated into Arabic. It was firstly translated by the candidate himself. Subsequently, the translated version was then discussed with a bilingual Arabic/English colleague who has obtained his Master degree in applied linguistics from the same university where the candidate was studying (Griffith University). This step resulted in some important positive points and comments which led to the revision of the questionnaire translated version.

In order to refine the questionnaire and clarify that respondents would have no problems answering the questions and also to ascertain that the right data were to be collected a pilot test was conducted. A sub-sample of 10 respondents was handed the questionnaire with explaining the aims of the study and all issues relevant. Later when completed questionnaires were collected, there was a discussion with each respondent to obtain feedback about any unclear instructions, ambiguous wording, confusing questions, and the ability of the respondents to answer the questions and their length.

Valuable feedback was obtained from the respondents who commented that the questions were clear, understandable, and straightforward to complete. In addition, they indicated that the length of the questionnaire was suitable and not onerous. As such, finally, final draft of the questionnaire was developed for the field study involving the study sample. Both Arabic and English versions of the questionnaire with their covering letters can be seen in Appendixes A to D.

III. Population and Sample

The research population is the entire group of people, events, or things of interest that the researcher wishes to investigate in order to collect the required data for the research problem (Sekaran, 2003). In conducting a research project, it is usually unlikely and almost impossible to survey the entire relevant population. Hence, researchers usually survey just a sample of the relevant population. A sample is defined as “.. a subset of population” (Collis and Hussey, 2003: p. 56). Accordingly, sampling is the process of selecting a group from the population for the purpose of studying, estimating, and predicting facts, attitudes, or outcomes regarding the whole population in general. In
simple words, sampling means taking part of the population to represent the whole population.

In this study, the population targeted was that of SMEs operating within the Libyan city of Benghazi. In the last official census available this population was 1097 (Chamber of Commerce and Industry, 2010). This population is based on the definition of SMEs in place in Libya, previously mentioned in this thesis, whereby these businesses are defined based on the number of employees and the amount of capital invested. The questionnaire targeted both small and medium enterprises and did not focus on a specific industry as it included SMEs in trade, services, and manufacturing.

According to Easterby-Smith, Thorpe and Lowe (2012) when the population is small (less than 500) it is customary to use 100 percent sample, which is called a census sample. However, in this research, following Krejcie and Morgan (1970) for a population of 1097, a sample size of 278 is required (see Appendix E).

Considering some factors such as the limitation of resources available for the candidate, the lack of a post-coding system to use, and that no reliable list of SMEs’ names and addresses could be obtained, the sampling approach used was snowball sampling. This technique of sampling involves approaching a group of initial respondents who are known as members of the population and asking them to assist the candidate in identifying other potential respondents. Accordingly, a number of businesses that fit the definition were asked for help in either identifying other businesses matching the definition or by passing copies of the questionnaire to them.

It is worth mentioning that no sample is guaranteed to be representative of the entire population. However, some considerations were taken into account to ensure that the sample is as representative as possible. This included the following: only firms that fit the official definition of SMEs in Libya were targeted, it included firms operating in all the three main business sectors namely trade, manufacturing, and services, and the suitable sample size was determined based on the recommendations of Krejcie and Morgan (1970). Also, the sample was geographically representative as it included firms located throughout the study arena and was not concentrated in one or two districts.

**IV. Administering the Questionnaire**

Once the final draft of the questionnaire is produced and pilot tested it is ready to be used for data collection by distributing it amongst the target sample (Saunders, Lewis
and Thornhill, 2007). This stage is called “questionnaire administration” the main purpose of which is to guarantee the greatest number of respondents. As mentioned in the previous section it was decided to use snowballing sampling.

Two research assistants who are familiar with data collection procedures from the SME sector volunteered to help in administering the questionnaire. They were trained on how to administer the research instruments, how to check on completeness of the questionnaires, and how to answer any questions which could be asked by the respondents. Training process took place during the stage of pilot testing. The candidate and the research assistants together visited the pilot firms. The research assistants watched how the candidate administered the questionnaire to the first two firms, and thereafter they administered the questionnaire while the candidate watched. In order to enhance their performance in the core distribution and collecting stages were to be followed, feedback on how they performed was provided afterwards.

In order to have an efficient and cost effective survey, the distribution of the questionnaire was done on a locality basis. Accordingly, the arena of the study was geographically divided to five districts. The research team members moved from one district to another distributing the questionnaire to businesses that fit the criteria. Considerable attention was made to meet with participants in order to introduce the main aim of the survey and clarify any possible issues. Moreover, a single informant approach was chosen wherein only owner-managers were approached and asked to complete the questionnaire.

When the questionnaires were handed to the participants, the objectives, framework, and the relevant issues to the research were explained. The respondents were given an outline of the research and then were asked to read all the questions in the questionnaire in order to clarify any unclear questions. Finally, before they were left to complete the questionnaire they were asked to give a certain time for collecting the completed questionnaires. In addition, they were encouraged to contact the candidate at any time in case they had any question by using the contact details shown on the covering letter. Due to the fact that the questionnaire was not that long and its questions were easy to understand some respondents preferred to complete the questionnaire immediately in the presence of the research team member. However, on the other hand, others requested the questionnaire to be left behind and be allowed some time to complete the questionnaire.
Two weeks after handing the questionnaire the research team started to contact respondents either by phone or by personal visit to the premise of their firms asking for the completed questionnaires. Participants who acknowledged that their forms were not completed yet were given one more week to complete them.

Despite the effort that was made to obtain all the distributed copies back (e.g. encouraging participants to complete and return the questionnaire within two weeks, following up on slow respondents either by revisiting their businesses’ premises or calling them by phone wherever it was possible) not all the distributed copies were obtained back. Only 213 questionnaires were returned of which 202 were completed in a satisfactory manner and eleven were excluded. This was based on the grounds that those questionnaires were not fully completed or not completed in a satisfactory manner. Thus, the questionnaire achieved a response rate of 72.6 percent (see Table 5.3 below).

<table>
<thead>
<tr>
<th>Distributed</th>
<th>Never returned</th>
<th>Returned</th>
<th>Valid</th>
<th>invalid</th>
<th>Response Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>278</td>
<td>65</td>
<td>213</td>
<td>202</td>
<td>11</td>
<td>72.6 %</td>
</tr>
</tbody>
</table>

It is noteworthy that the literature suggests that a response rate of 60 percent is considered to be exemplary (e.g. Remenyi, Williams and Swartz, 1998; Mangione, 1995). Moreover, according to Saunders, Lewis and Thornhill (2007) the likely response rate for business surveys is between 30-50 percent for self-administered questionnaires. Thus, this response rate obtained from this study is very satisfactory.

V. Questionnaire’s Validity and Reliability

The use of reliability and validity are common when employing quantitative methods. Validity and reliability in research design refer to the need to ensure that concepts used in the study measure what they are actually intended to measure and that this measurement is consistent and stable for all respondents (Bryman and Bell, 2007). Validity relates to whether the findings are relevant to assist the researcher in solving the research problems (Cooper & Schindler, 2003). Reliability describes how far a particular test, procedure, or tool will produce similar results in different circumstances assuming nothing else has changed (Roberts, Priest and Traynor, 2006).

The instrument used in attaining a valid and reliable measurement is vital to the research and for the results. In this study, a questionnaire was used to gain specific information
about a sample representing a particular population. The questionnaire results will be used to understand the practices, experiences, and attitudes of this population. Accordingly, the gathered data would only be useful if it measures what was supposed to be measured. To ensure this a number measures to improve the reliability and validity of the questionnaire were taken into consideration including:

- The questionnaire was developed from the relevant literature with the support and assistance from the supervision team.
- Ensuring that the questionnaire covered the range of the aspects and issues that were to be investigated.
- Discussing the questionnaire with fellow Libyan PhD students to gain feedback with regard to the content and consistency of questions.
- Pre-testing the questionnaire by targeting a small SMEs sample to ensure it was clear and easy to understand. This step also served as training session for the research team to increase clarity and familiarity with questionnaire administration.
- Informal discussions with participants during and after the pilot study provided some comments that were later incorporated in the questionnaire final review.
- Only owner-managers, who are believed to possess the best overview of their enterprises and of their financing experiences, practices, and strategies, were approached and asked to complete the questionnaire.
- Seeking assistance from an expert in statistics in managing, coding, and entering the data into SPSS software for the statistical analysis.
- Using SPSS software the reliability of the questionnaire was assured by computing Cronbach’s alpha coefficient index test which indicated satisfactory value of 0.83 (values above 70.0 indicate reliable scales (Pallant, 2010)).

5.7.2 The Interviews

Interviews are ways of gathering rich and broad data from a small number of people about a particular research issue. Saunders, Lewis and Thornhill (2007) mention that where the topic seen by interviewees as relevant to their current jobs people cooperate and mostly prefer to be interviewed rather than having to complete a questionnaire. In conducting interviews it is important to build a rapport and trust. This gives the interviewees the confidence to express their opinions and share their experiences and also to illustrate and expand on their initial responses. In this study, as mentioned earlier
in this chapter, semi-structured interviews were chosen to collect the required primary data on the supply side.

**I. Drafting the Interview’s Questions**

For the purpose of interview, the candidate prepared a number of questions developed from the relevant literature mainly from different versions of the studies conducted by the World Bank between 2007-2011 in different parts of the world including the MENA region. These questions covered four aspects. See Table 5.4 below.

<table>
<thead>
<tr>
<th>Section No.</th>
<th>Section focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>One</td>
<td><em>Bank Al Tanmeya’s</em> strategic view of SME sector.</td>
</tr>
<tr>
<td>Two</td>
<td>SMEs market and products offered by the bank to SMEs.</td>
</tr>
<tr>
<td>Three</td>
<td>Islamic finance to SMEs.</td>
</tr>
<tr>
<td>Four</td>
<td>Data request</td>
</tr>
</tbody>
</table>

Three types of questions that might be used in semi-structured interviews are recommended by Saunders, Lewis and Thornhill (2012). Open questions for describing and defining a situation or event, probing questions for exploring significance response to the research topic, and specific closed questions for gaining specific information. Thus, open-ended and closed-ended questions as well as open-closed questions were formulated in order to obtain detailed information about the current status of *Bank Al Tanmeya’s* financing for SMEs and exploring the bank’s attitude towards Islamic finance methods and any future plans to implement them.

**II. Piloting Interviews**

To refine the questions and procedures, before drawing the final draft an initial draft of the interview questions was discussed with the researcher’s supervisory to enhance the validity of the interview questions. Accordingly, the interview questions were revised and drafted then reviewed by the candidate’s supervisor to ensure that the same key areas of inquiry would be pursued with each interviewee. As a result, the final version of the interview was structured.

The interview guidelines were then literally translated into Arabic with the help of a bilingual Arabic/English colleague who helped in translating the questionnaire. This method led to non-major changes being made to the original version.
Furthermore, to revise and strengthen the translation, the Arabic version of the interview was discussed with a number of fellow Libyan PhD students who have a fair understanding of doing research in subjects related to the Libyan banking system. According to their suggestions, the Arabic version was amended to make the questions clearer and fully understandable. As such, the final version of the interview questions was drafted. See Appendixes F to I for interview guides and consents forms in English and Arabic.

III. Interview Sample

According to Kumar (2011) in qualitative research the issue of sampling has little significance since the main aim is to either explore or describe the diversity in a situation, phenomenon, or issue. However, Sekaran (2003) argues that in organisational settings the opinions of leaders who are very knowledgeable and who can provide the desired information should be included in the sample. This is either because they are the only ones who possess that information or to conform to some criteria set by the researcher.

In this study, the candidate has primarily relied on interviewing a number of prominent people from Bank Al Tanmeya as the main source of data on the supply side. Accordingly, it was decided that interviews to be conducted with the manager of Bank Al Tanmeya (Benghazi branch) along with other senior managers and loan officers within the bank. Those individuals were chosen because they are the sole ones with the requisite information about Bank Al Tanmeya’s experience in financing SMEs in Libya. The number of the sample was relatively small (seven interviewees) and this is considered as one of the limitations. However, a major advantage was that the participants are among key decision-makers with respect to bank financing for SMEs in the Libyan context.

IV. Conducting the Interviews

Prior to flying to Libya to commence the fieldwork, a contact had been made with Bank Al Tanmeya in seeking of an agreement for the bank to be the arena for this study. The contact had been made through a colleague of the candidate who is a human resources lecturer at Benghazi University. Once the agreement was obtained in April 2013, it was decided to commence the data collection process in May 2013.
Easterby-Smith, Thorpe and Jackson (2008) highlight that an important factor in conducting qualitative interviews is to develop trust between the researcher and the targeted interviewees. Based on this, an introductory and preparatory visit was made by the candidate to the bank. The purpose of the visit was to give a brief explanation of the aim and objectives of the study and the objective of the interview as well as the confidentiality and benefits of data to be obtained. This included handing the list of topics and questions to be discussed in the interview. As result of this visit, the interview schedules were fixed. As such, according to the interviewee’s preference all the interviews were held at the bankers’ offices during official work hours. All the interviews took place in June 2013.

The interviews were conducted on the premises of the bank in Arabic for the interviewee’s convenience and to ensure that any potential misunderstandings were avoided. At the beginning of each interview the candidate introduced himself to the participants and briefed them on the research, the research question as well as its purpose reassuring them that they could discuss things at their own pace without intervention from the researcher. Moreover, the following points were emphasised. First, the interviews would be strictly anonymous and no one, apart from the researcher, would know who took part. Second, there were absolutely no right or wrong answers to the questions. Third, the interviewees should indicate any questions that they were not happy to answer. Finally, the interviewees should feel free to discontinue their participation in the interview or halt it at any stage.

Interviews took the form of conversations between the candidate and the interviewees and lasted from 30-70 minutes in duration. At the start of each interview the candidate asked interviewees a simple and conventional question to describe the nature of their job. The idea behind this question was to enable the candidate to understand the position of the interviewee and then deciding which section of the interview its questions to be stressed the most. Although the checklist was used during each interview, questions were not necessarily asked in the same order each time. However, the checklist was used at the end of each interview to ensure that all the topics were adequately covered.

It should be mentioned that during the interviews the candidate noted that most of the interviewees were friendly and interested in the subject of the study. This characteristic encouraged them to welcome the interviewer in a relaxed manner without fear of highly confidential information being misused. However, in terms of recording the interviews
not all the interviewees agreed to have their interviews recorded expressing that they
would be more relaxed without the use of audio-taping and that their answers would be
more realistic. From the seven interviews conducted only four persons agreed to the use
of audio-taping. For those who did not give permission for tape-recording notes were
taken immediately as they replied to the questions.

Finally, it should be stated that access and obtaining data for such a study in a country
like Libya were not an easy mission, nevertheless, social and personal relationships
played an important role in collecting the required data from the research setting.

V. Interview’s Validity and Reliability

As in quantitative research, validity and reliability are important concepts in qualitative
research. Validity is assessed in terms of how well the research tool measures the
phenomenon under investigation (Punch, 2005). The essence of reliability for
qualitative research lies with consistency (Leung, 2015). Lincoln and Guba (1985)
argue that when using qualitative methods the idea of discovering truth through
measures of reliability and validity is replaced by the idea of trustworthiness which is
“defensible” and establishing confidence in the findings. Regardless of the terms, a
number of measures were undertaken to enhance the credibility of the current research,
including:

- All the questions in the interview guide were directly related to the research’s
  objectives.
- Before commencing the interview the questions were discussed with the
  supervision team and fellow Libyan PhD students who provided valuable
  comments.
- All the questions were worded clearly and asked in a natural tone of voice.
- All interviewees were given the opportunity to explain their own beliefs and
  thoughts freely without any intervention.
- The secondary sources of data used were initially assessed to determine the
  validity of the information given.

5.8 Data Analysis

Yin (2009: p. 126) describes data analysis as “examining, categorising, tabulating,
testing, or otherwise recombining the evidence to draw empirically based conclusions”.

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This means that making sense of data collected in a way that enables the researcher to present findings and draw specific conclusions.

The data analysis method to be employed in a research depends on whether the data collected is quantitative or qualitative. Analysing the data quantitatively involves collecting and analysing numerical data and applying statistical tests. However, the qualitative approach is more subjective in nature and the focus is on interpreting and examining perceptions and behaviours in order to attain a deeper understanding of social and human activities under study.

As the current study employed a triangulated approach resulted in gathering quantitative as well as qualitative data, therefore, both methods of analysis were undertaken to meet the study’s objectives.

5.8.1 Quantitative Data Analysis

Following the completion of the questionnaire and its collection in August 2013, the candidate took a number of steps to process the data. The first step was to check the usability of those questionnaires for the analysis and exclude the invalid ones. The second step was to seek the advice from an expert in relation to the use of Social Package for Social Science SPSS and exchange ideas about the ideal way for codifying and analysing the data. The next step involved entering the variables from the questionnaire forms separately. Thereafter, chosen descriptive and inferential statistical analysis techniques were used to analyse the data and interpret the findings.

The Statistical Package for Social Sciences SPSS software 22 was used to process the data to meet the objectives of the research. Descriptive statistics such as frequencies, percentages, cross tabulations, and other appropriate statistical measurements to describe the sample and to verify some interrelationships between different characteristics of the respondents and the responses they provided were performed. In addition, by using a combination of SMEs and their owner-managers characteristics as independent variables and the status of bank finance application (approved/rejected) as the dependent variable a logistic regression analysis to understand the relationships between the variables and to estimate a logistic model for SMEs access to bank finance was computed. To estimate the best possible model stepwise likelihood ratio forward regression was used. In addition, the maximum likelihood was used to estimate the coefficients in the model.
5.8.2 Qualitative Data Analysis

Unlike quantitative data, qualitative data may not be sufficiently precise to allow statistical analysis or use any software to build matrices. Therefore, the candidate utilised the interpretative method in a manual manner in analysing responses obtained during the interviews. This method is most suitable when “rich” information about a small number of subjects is needed, when a flexible or informal approach is desirable, or when members of the sample population involved are better researched by encouraging description and analysis of situations in their own words (Ticehurst and Veal, 2000) which was the case regarding data related to the supply side in this research.

The data obtained from the interviews was processed and analysed through a number of steps. The process started when the candidate finished collecting the data. It started by listening carefully to the tapes wherever applicable and otherwise read the notes taken and then transcribing them by writing down each participant’s response on a separate sheet of paper. The candidate read transcribed data accurately in order to identify the topic area related to the study objectives. Each question’s responses were collated and rewritten on different sheets of paper, so all answers to a particular question were together. Once a final version of each transcript is defined and all transcripts have been coded to it, the template serves as the basis for the researcher’s interpretation or illumination of the data set and the writing of findings.

5.9 Ethical Considerations

Human research ethics committee approval was granted to the candidate prior to commencing the collection of data which involved administrating the questionnaire and conducting the interviews. See (Appendix J).

Research ethics are concerned with the appropriateness of the researcher’s behaviour and attitudes in relation to the rights of the target audience or interviewees who become the subject of the research work (Saunders, Lewis and Thornhill, 2007). In considering the nature of this research study and its involvement with human participants (SMEs entrepreneurs and bank officials) ethical issues were an important consideration and thus were viewed as fundamental to the successful completion of this study. The candidate paid close attention to ensure that nobody is harmed as a result of the research.
In this study, the candidate kept in mind and also followed the ethical guidelines provided by Griffith University. Accordingly, SME owner-managers participating in the study were informed about the purpose and the objectives of the research via the front page (the Covering Letter) attached to the questionnaire. With regard to interviewing bank officials, an agreement was reached between the selected bank (Bank Al Tanmeya) and the candidate on engaging in the study by participating in the interviews. Additionally, prior to conducting each interview participants were fully informed about the research aims and objectives by providing them with verbal and written information via Informed Consent Forms.

In addition, the respondents in both cases (questionnaires and interviews) were not asked any personal questions; therefore, there was no potential for any respondent to come to harm. The respondents were also informed that their participation in the research was entirely voluntary.

Finally, it is worth mentioning that the data collection task was successfully completed without any ethical concerns capable of invalidating the collection of data.

### 5.10 Concluding Remarks

Methodology is an important factor in conducting any academic work. This chapter concerned a discussion of the research methodology design and the justification for its adoption. The chapter reported that a triangulated approach, combining qualitative and quantitative techniques, was adopted to achieve the intended objectives of the research.

Self-administrated questionnaires and semi-structured interviews were chosen as the most effective tools for obtaining the data required for both dimensions of the study; the demand and the supply respectively. These two research methods were used in a complementary manner to ensure that all the research objectives were addressed. One method on its own would have been insufficient.

Further, the chapter detailed the collection of quantitative data using a questionnaire survey yielding a relatively high response rate directed to SME population in the city of Benghazi (the demand side). This included the design of the questionnaire, the study population, the sample size, the sampling technique, administrating the questionnaire, the questionnaire validity and reliability, and the subsequent analysis process.

In this chapter, the interviews conducted with managers and senior officers within Bank Al Tanmeya (Benghazi branch), representing the supply side, were also highlighted.
This included giving a detailed description of the design of the interview questions, the sample targeted, collection of data, validity and reliability of the interview, and the analysis approach. Finally, a brief attention was given to ethical considerations regarding the conduct of the fieldwork study.
Chapter 6. Empirical Results: Questionnaire Analysis

6.1 Introduction

To restate, the aim of this study is to obtain an informed understanding of the status of bank financing for SMEs in Libya. The purpose of this chapter is to report on the results from responses to the questionnaire targeted SMEs operating within the Libyan city of Benghazi. The questionnaire survey was conducted with the aim of exploring the views, experiences, and perceptions of Libyan SMEs representing the demand-side on bank finance. The analysis and discussion presented in this chapter relates to the following research objectives:

- To identify the financing sources used by Libyan SMEs at the formation stage.
- To identify the alternative sources of funding available to Libyan SMEs and the position of bank finance among them.
- To identify the constraints/difficulties faced by Libyan SMEs in accessing bank finance.
- To identify the determinants of Libyan SMEs access to bank finance.
- To explore the attitudes of Libyan SMEs towards the potential use of Islamic finance methods as an alternative channel for SMEs for sourcing funding.

To achieve the objectives above descriptive and inferential statistics were calculated using the SPSS statistical analysis program version 22.

The questionnaire survey was administered in Benghazi, the second largest and the second most important commercial centre in Libya, targeting the population of SMEs within this city and covering the three main business sectors namely; trade, services, and manufacturing. As mentioned earlier in this thesis a total of 278 questionnaires were distributed. This resulted in 213 returned questionnaires of which 202 were completed and usable making a response rate of 72.6 percent (see Table 5.3 Chapter 5). As for the remaining 11 returned questionnaires, they were deemed invalid and unusable. The reason was because they were poorly or inadequately completed creating difficulty in understanding. Thus, they were considered unsuitable as the objectives of the research were not completely served.

The analysis and discussion in this chapter are categorised into some main sections which are divided into a number of subsections. Section 6.2 provides a descriptive analysis of the data (firms’ characteristics, owner-managers’ profile, SME financing
information, Islamic finance for SMEs, and SMEs/banks partnership). Section 6.3 explores the factors affecting Libyan SMEs access to bank finance. Section 6.4 concludes the chapter.

6.2 SMEs Profile

The first section in the questionnaire (Section A) was intended to gather general information on SMEs participated in this study. In questions 1 to 5 the respondents were asked to provide information relating to their firms. The information examined include, size in terms of number of employees, the firm’s business sector, ownership type, age, and the use of business plan. These characteristics are summarised in Table 6.1.

<table>
<thead>
<tr>
<th>Variable</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size</td>
<td></td>
</tr>
<tr>
<td>Small</td>
<td>57.4</td>
</tr>
<tr>
<td>Medium</td>
<td>42.6</td>
</tr>
<tr>
<td>Business Sector</td>
<td></td>
</tr>
<tr>
<td>Trade</td>
<td>30.2</td>
</tr>
<tr>
<td>Services</td>
<td>22.8</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>47.0</td>
</tr>
<tr>
<td>Ownership Type</td>
<td></td>
</tr>
<tr>
<td>Sole ownership</td>
<td>49.5</td>
</tr>
<tr>
<td>Limited partnership</td>
<td>44.1</td>
</tr>
<tr>
<td>Shareholding firms</td>
<td>6.4</td>
</tr>
<tr>
<td>Firm Age</td>
<td></td>
</tr>
<tr>
<td>0–5 years</td>
<td>12.4</td>
</tr>
<tr>
<td>6–10 years</td>
<td>36.6</td>
</tr>
<tr>
<td>11–15 years</td>
<td>29.7</td>
</tr>
<tr>
<td>16–20 years</td>
<td>14.9</td>
</tr>
<tr>
<td>Over 20 years</td>
<td>6.4</td>
</tr>
<tr>
<td>The Use of Business Plan</td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>14.4</td>
</tr>
<tr>
<td>No</td>
<td>85.6</td>
</tr>
</tbody>
</table>

6.2.1 Size of the Firm

According to the SMEs definition in place in Libya (see Table 2.7 Chapter 2) in terms of the number of employees firms with 25 or less employees are considered small whereas those have a maximum of 50 are medium. On these grounds, Table 6.1 shows
that the majority of the firms within the study sample (57 percent) were small while the remaining 43 percent of respondents categorized their firms as medium.

It is worth mentioning that the questionnaire did not ask participants to declare the amount of invested capital in their firms which is the other criterion adopted by the Libyan official definition for SMEs. The reason behind this was twofold. First, when asked such questions, which can be sensitive especially in the context of a country like Libya, respondents may simply refuse to answer or not give the right answer for different reasons which, in turn, may lead to misleading results. Second, the purpose of this question was to illustrate the profile of the businesses surveyed in terms of size which has been already achieved by using the employment size as a proxy of the firm size without the need to employ other measures.

6.2.2 Business Sector

The three main sectors of the economy in which SMEs are substantially engaged namely; trade, services, and manufacturing were targeted by the questionnaire. Table 6.1 shows the distributions of the participated firms between these three sectors. The table shows that 30.2 percent of the surveyed firms were operating in the trade sector. The larger number of businesses was more likely to be in the manufacturing sector constituted about half the sample (47 percent). The group of enterprises operating in the services sector represented 22.8 percent of the whole sample.

6.2.3 Ownership Type

Among the questions in the first section of the questionnaire which focused on general information of participant SMEs was the one inquired the type of firm ownership. Table 6.1 shows how SMEs responded to the questionnaire were distributed based on types of ownership. The figures indicate that enterprises that are solely owned by their owner-managers accounted for nearly half the whole sample (49.5 percent). On the other hand, 44.1 percent were of limited partnership (joint liability) and the remaining 6.4 percent represented the shareholding firms.

6.2.4 Firm Age

One of the demographic factors of SMEs included in the first section of the questionnaire was the age of the firm. As shown in Table 6.1 SMEs in the sample that have been in business for 6–10 years were the most frequent with more than 36 percent of the sample. This is followed by adolescent enterprises that have been running
between 11–15 years accounting for approximately 30 percent of the sample. Older SMEs aging between 16–20 years formed nearly 15 percent of the sample. Finally, interestingly, the oldest and the youngest firms were the least represented groups in the sample with only 6.4 percent in the former group and 12.4 percent fitted in the latter.

6.2.5 The Use of Business Plan

Regarding whether firms participated in the study employing business plans the table reveals that the vast majority of SMEs in the sample (85.6 percent) do not have business plans. However, only a mere of 14.4 percent indicated having a business plans in place.

6.3 Owner-manager’s Profile

The second section (Section B) was intended to gather information on owner-managers. Questions 6 to 9 asked respondents to provide information relating to their personal profile. This included, the age of the owner-manager, owner-manager’s education and experience, and whether the respondent had undergone any type of entrepreneurial and managerial training. This general information is presented in Table 6.2.

**Table 6.2 Owner-managers’ profile**

<table>
<thead>
<tr>
<th>Variable</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Age</strong></td>
<td></td>
</tr>
<tr>
<td>Under 21 years</td>
<td>2.5</td>
</tr>
<tr>
<td>21–30 years</td>
<td>21.3</td>
</tr>
<tr>
<td>31–40 years</td>
<td>36.1</td>
</tr>
<tr>
<td>41–50 years</td>
<td>33.1</td>
</tr>
<tr>
<td>Over 50 years</td>
<td>7.0</td>
</tr>
<tr>
<td><strong>Level of Education</strong></td>
<td></td>
</tr>
<tr>
<td>Primary school</td>
<td>5.9</td>
</tr>
<tr>
<td>Elementary school</td>
<td>9.9</td>
</tr>
<tr>
<td>Secondary school</td>
<td>9.4</td>
</tr>
<tr>
<td>Diploma</td>
<td>22.8</td>
</tr>
<tr>
<td>University degree</td>
<td>48.5</td>
</tr>
<tr>
<td>Higher degree</td>
<td>3.5</td>
</tr>
<tr>
<td><strong>Years of Experience</strong></td>
<td></td>
</tr>
<tr>
<td>Less than 5 years</td>
<td>34.6</td>
</tr>
<tr>
<td>5–10 years</td>
<td>42.1</td>
</tr>
<tr>
<td>11–15 years</td>
<td>18.8</td>
</tr>
<tr>
<td>More than 15 years</td>
<td>4.5</td>
</tr>
<tr>
<td><strong>Management Training</strong></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>15.3</td>
</tr>
<tr>
<td>No</td>
<td>84.7</td>
</tr>
</tbody>
</table>
6.3.1 Age of Owner-managers

Age is an important characteristic of SMEs’ owner-managers that cannot be easily separated from their businesses and decisions. Table 6.2 shows that the group of owner-managers aged between 31–40 years (36.1 percent) was the most represented age group in the sample. This was followed by the group of owner-managers aged between 41–50 years (33.1 percent) and the group of the young ones representing the age group of 21–30 years with 21.3 percent. Only 7 percent of the sample was of the oldest age group whereas the youngest owner-managers aged less than 21 years were the least represented group (2.5 percent).

Across the sample it can inferred that middle-aged owner-managers aged between 31–50 years constituted the majority of respondents in the sample (more than 50 percent). This might be an indication that most Libyan SMEs’ owner-managers tend to have some prior work experience before they establish their own businesses later in their lives.

6.3.2 Education of Owner-managers

In this question respondents were asked about their educational background. As in the table above the highest frequency was for first university degree holders with 48.5 percent. Almost quarter of the sample (25.2 percent) attended at least secondary school. Owner-managers with professional diplomas accounted for 22.8 percent of the sample. Finally, the category of owner-managers with level of education that is beyond first university degree was represented only by 3.5 percent making it the least frequent category.

It is interesting to note that respondents with first university degree were the most frequent. In addition, by looking at tabulation tables (not shown here) owner-managers in services tend to be more educated with the highest percentage of higher education degrees. There were very few owner-managers in trade who had been educated to higher degree level and none in manufacturing had done so. This may suggest that in order to establish a project in manufacturing more mid-high-level education ranging from diploma to undergraduate degree is needed.

6.3.3 Owner-managers’ Business Experience

As a part of the personal information inquired in this section, participants were also asked about their cumulative working experience in relation to SMEs. The years of
experience were classified into; no experience, less than 5 years, 5–10 years, 11–15 years, and more than 15 years of experience.

As can be seen in Table 6.2 owner-managers having the most experience in the field of managing SMEs were the least presented group. They only accounted for 4.5 percent. However, the most frequent category in the sample was the one with number of experience years ranging from 5 to 10 years. Owner-managers fitted into this category represented 42.1 percent of the sample. The remaining two categories were distributed as follows; 34.6 percent participants with less than 5 years of experience and those with 11 to 15 years of experience accounted for 18.8 percent of the whole sample.

6.3.4 SME Management Training

Table 6.2 illustrates the responses regarding the question of whether owner-managers have received any training relating to managing SMEs. The figures show that only just above 15 percent indicated receiving some training relating to managing SMEs whereas the vast majority of the sample (84.7 percent) answered in the negative.

6.4 SME Financing

The third section of the questionnaire (Section C) was designed to gather information in relation to SME financing in start-up stage and stages of post start-up. This entailed identifying the source of finance used by the firm at the establishment stag in addition to the other financing alternatives available to SMEs in the subsequent stages. This section also included questions regarding any experiences that SMEs had with banks as finance providers.

The use of bank finance variable, which is of primary interest to this study, was collected by asking all SMEs’ owner-managers in the sample to indicate whether they had employed bank finance at any stage of their firms’ lifecycle “filter question”. For those who have obtained and employed bank finance they were asked to indicate their reasons for approaching bank finance instead of other external sources available. They were also asked to indicate the purpose for applying for bank finance. Based on their experience with bank finance, successful bank finance applicants were further asked to indicate a statement summarizing the whole process of applying for and obtaining bank finance in terms of ease and difficulty. Further, those indicated difficulties were asked to indicate these difficulties. As for respondents who have not employed bank finance there were two possibilities. First, they were not able to apply for bank finance or they
were not in need to do so. Second, they have applied but their applications were rejected. In the former case respondents were asked to indicate the obstacles hindered them from applying for bank finance. In the latter, owner-managers were asked to indicate the reasons behind their applications’ rejection.

In order to enrich the discussion and gain more information about the raised issues the analysis in the next sections will consider SMEs financing practices and experiences across the three targeted business sectors and highlight any interesting findings wherever appropriate.

6.4.1 Start-up Finance

Without doubt, one of the most important factors for SMEs success is the ability to access capital for initial start-up. At the early stages of their lifecycle, SMEs may source funding from both internal and external channels. However, at the very earliest stage (start-up) the frequently held view is that SMEs have difficulty accessing external sources of finance since start-up firms are arguably the most informationally opaque. As a result, at this stage the most important and commonly used sources of finance are believed to be internal such as personal savings and/or finance from friends and family members.

Question 10 in the questionnaire aimed at identifying the main sources of start-up capital used by SMEs in the sample. This question was developed under 5 broad categories namely; personal savings, assistance from family and friends, bank finance, venture capital, and government assistance programs. Respondents were asked to indicate which source they employed when they first started their businesses. Table 6.3 summarizes their answers.

<table>
<thead>
<tr>
<th>Start-up finance</th>
<th>Trade</th>
<th>Services</th>
<th>Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>%</td>
<td>Frequency</td>
</tr>
<tr>
<td>Personal savings</td>
<td>52</td>
<td>85.2</td>
<td>10</td>
</tr>
<tr>
<td>Assistance from family</td>
<td>3</td>
<td>6.5</td>
<td>1</td>
</tr>
<tr>
<td>and friends</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank finance</td>
<td>2</td>
<td>3.2</td>
<td>19</td>
</tr>
<tr>
<td>Venture capital</td>
<td>4</td>
<td>6.6</td>
<td>16</td>
</tr>
<tr>
<td>Government assistance</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Other</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>61</strong></td>
<td><strong>100</strong></td>
<td><strong>46</strong></td>
</tr>
</tbody>
</table>
As SME financing literature suggests the vast majority of trading firms (85.2 percent) relied on internal sources such as their owner-managers’ personal savings as a source of start-up finance. Venture capital and funding from relatives and friends came as the second and the third most used source of start-up finance respectively. 6.6 percent used venture capital while assistance from family and friends were employed by only 5 percent of the surveyed SMEs. The less popular source of start-up finance among trading firms, however, was bank finance with just 3.2 percent of trading firms relied on this source in the start-up stage.

In the services sector a different picture emerges. Overall 41.3 percent obtained their start-up finance from banks. Second in ranking was venture capital since 34.8 percent of respondents financed their start-up stage through this channel. As the figures in the table show, personal savings of owner-managers tend to be less familiar as a source of start-up finance for firms in the services sector. This source was used only by 21.7 percent. Assistance from family and friends was the less frequent source of start-up finance for firms in the services sector with only 2.2 percent of firms relied on this source.

Similar to the trading firms, owner-managers’ personal savings was the most important source of start-up capital for manufacturing SMEs. A total of 44.2 percent of respondents in this sector relied on their owner-managers’ personal savings when they first started. After personal resources, SMEs in the manufacturing sector were more likely to depend on venture capital (34.7 percent) followed by bank finance (20 percent) for starting a business. As the case for SMEs in services, assistance from family and friends was again the less popular source of start-up finance for SMEs in manufacturing with just one firm used this source for start-up finance.

Overall, the three most common sources of funds used by SMEs in the sample to finance business start-up were as follows; owner-managers’ own savings, venture capital and bank finance. Just above half of enterprises in the whole sample had used the own savings of their owner-managers as the primary source for start-up capital. For the trading sector, the high reliance on the personal financial resources (85.2 percent) against the small amount of firms used otherwise might suggest that entrepreneurs in this sector are more likely to start a business only when they have the necessary capital to do so.

While it is natural for SMEs to heavily rely on internal sources for starting a business since they have no experience and credit history yet, interestingly, this does not seem to
be the case for those in the services sector. Compared to the other two sectors SMEs in the services sector were less reliant on owner-managers’ own savings. Rather than relying on informal internal sources such as personal savings and family and friends, owner-managers in services were more likely to primarily establish their firms from other sources namely; bank finance and venture capital. This may suggest that they were not able to personally secure the required capital to start and also desired to avoid the personal involvement of family and friends preferring instead to deal with outsiders who are presumably more professional.

Interestingly, assistance from relatives/friends was not widely used by firms in all the three sectors alike at the establishment stage. Only a mere of 2.5 percent of the whole sample stated this source was the main one of start-up funding. In addition, none of respondents in neither sector had any government assistance as a source of start-up finance. This may be attributed to the fact that such programs have been just recently introduced in the country and thus they may need to be better marketed to the targeted groups especially for those operating out of the capital city of Tripoli.

Considering that banks are often perceived to be reluctant to deal with SMEs especially those in the seed stage, it can be said that it is remarkable that approximately 20 percent of the whole sample used bank finance to start their businesses. Access to bank finance for start-up varied considerably among firms in different sectors. 41.3 percent of firms in services used bank finance in start-up finance against only 3.2 percent of trading firms were able to do so. For firms in the manufacturing sector only 20 percent of respondents were able to start their business after obtaining finance from banks.

6.4.2 Post Start-up Finance

In advanced stages of their life cycle, SMEs might seek additional finance for different needs and scenarios. For example, working capital might be needed to boost cash flow to enable expansion or to cover late or non-payment by major customers. Another motive can be to make a significant investment in premises or purchasing new equipment, machines, vehicles etc. Ongoing finance to fund working capital is important for SMEs in terms of its scale and frequency as well as of course its source. In comparison with start-up phase, SMEs may have better access to additional funds for ongoing finance from various sources internally or externally in the forms of equity and/or debts.
After having indicated the sources of finance they employed for start-up, in question 11 the respondents were further probed about which sources of finance they prefer to seek and would choose if they had a particular need for finance in the future. In this regard, respondents were asked to rank the available sources in a descending order of preference and priority from the most preferred source to the least preferred one by giving numbers from 1 to 5 to each one of the listed sources.

One important point worth emphasizing here is that the rationale behind this question was to identify the position of bank finance as a source of ongoing finance among other alternatives available for SMEs in the sample and not to investigate the determinants of these preferences nor judging the capital structure of participant SMEs. This view of how the financing preferences of SMEs are established could enable understanding how likely banks might be approached by Libyan SMEs to secure additional funding for their ongoing operations.

Table 6.4 below shows the participants’ responses regarding the most preferred sources of finance for current and ongoing operations of their firms in the total sample and for each sector apart. The available sources of finance are ranked according to the calculated weighted average rank scores. All sources that were ranked by respondents first were given a score of 5, sources ranked second were given a score of 4, and those ranked third a were assigned a score of 3 etc. The total score obtained for each source was then divided by the total number of responses to arrive at the rank score.

### Table 6.4 Owner-managers’ preferences of ongoing finance

<table>
<thead>
<tr>
<th>Sources of ongoing finance</th>
<th>Weighted average rank score</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Overall</td>
<td>Trade</td>
<td>Services</td>
<td>Manufacturing</td>
</tr>
<tr>
<td>Internal funds</td>
<td>3.67</td>
<td>3.93</td>
<td>3.73</td>
<td>3.48</td>
</tr>
<tr>
<td>Bank finance</td>
<td>3.61</td>
<td>3.43</td>
<td>3.65</td>
<td>3.43</td>
</tr>
<tr>
<td>Trade credit</td>
<td>3.29</td>
<td>3.65</td>
<td>2.17</td>
<td>3.15</td>
</tr>
<tr>
<td>Equity finance</td>
<td>2.64</td>
<td>2.36</td>
<td>2.30</td>
<td>3.05</td>
</tr>
<tr>
<td>Government assistance</td>
<td>2.29</td>
<td>2.55</td>
<td>3.00</td>
<td>2.33</td>
</tr>
</tbody>
</table>

From the table above, across the sample financing sources generated internally (retained earnings and personal savings) were the most preferred source for ongoing financing. This source received the highest weighted average rank score (3.67). This suggests that among all the various sources and types of financing available for SMEs owner-managers would prefer to first of all use internal sources of finance such as retained earnings or providing their own funds to accomplish the much needed funding for their ongoing operations. The results also revealed that when it comes to external sources
banks and trade credit from suppliers were found to be the most preferred. With the second highest weighted average rank score of (3.61) bank finance would be the most preferred source of external finance for ongoing financing needs. Third in ranking is trade credit from suppliers with a rank score of (3.29). Other sources of financing (equity financing and government assistance) were found to be least preferred with government assistance programs being the least preferred of all.

The results of financing preferences of owner-managers in each sector revealed a strong preference for internally-raised finance. In trade, services, and manufacturing alike internal sources were the most desired option for ongoing financing needs. As for bank finance, the focus of this study, with the exception of SMEs in trade for which trade credit from suppliers was prioritised; the figures show that bank finance in the form of short term loans and overdrafts is the most favoured external option of finance for current operations. This suggests that after internal sources are exhausted or if they are insufficient SMEs’ owner-managers in trade and manufacturing are more likely to approach banks in order to source any needed additional funding for their firms. However, in a similar scenario SMEs in trade would first seek trade credit funding from suppliers prior to resort to bank finance.

In obtaining additional financing entrepreneurs face many questions including which one of the sources available may be most advantageous in the long run and what specific source is best suited for a particular type of operations. It is argued in the literature that although SMEs’ owner-managers usually are hesitant to use external funds, but if they do, then the first external source of finance will be banks. The finding that bank finance being ranked second by respondents in order of preference and priority after internally generated finance may indicate that this source of finance to be sought when there is a shortage of cash or some financial problems.

Bank finance had gained premier attention as the main supplier of external finance for Libyan SMEs seeking working capital for their ongoing businesses. In fact, the reliance of SMEs on banks’ credit is not an uncommon as the same scenario is evidenced in many countries, developed as well as developing ones. One possible explanation for this is that after the start-up stage, SMEs are supposed to have built a good rapport with their banks. This situation could lead to a number of benefits for SMEs including greater availability of credit due to efficient gathering of information, protection against credit crunches, or the provision of implicit interest rate or credit risk insurance. As a result,
mature SMEs may feel more confident to approach banks as first option of external finance either for a loan or for an overdraft for ongoing finance.

Next, the chapter proceeds to examine any real experiences that participant SMEs had with banks as an external finance provider then attempted to obtain more information about the experiences of successful bank finance applicants as well as about those who were not.

### 6.4.3 Bank Finance

The literature has demonstrated that the primary source of external funds for SMEs is bank finance. In this context, the common finance option for SMEs is bank overdrafts (for working capital needs) and short-term loans (for capital expenditure needs). They provide a mechanism for investments in equipment, construction, raw materials, employees, and other inputs. Question 12 of the questionnaire sought to discover SMEs which had used bank finance. Respondents were asked to answer yes or no regarding whether they had, at any stage, employed bank finance to finance their firms’ operations. Table 6.5 summarises their answers.

**Table 6.5 SMEs use of bank finance**

<table>
<thead>
<tr>
<th>Having employed bank finance</th>
<th>Trade</th>
<th>Services</th>
<th>Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>%</td>
<td>Frequency</td>
</tr>
<tr>
<td>Yes</td>
<td>3</td>
<td>5</td>
<td>28</td>
</tr>
<tr>
<td>No</td>
<td>58</td>
<td>95</td>
<td>18</td>
</tr>
<tr>
<td>Total</td>
<td>61</td>
<td>100</td>
<td>46</td>
</tr>
</tbody>
</table>

As can be inferred from the table the respondents who had employed bank finance made up 41.1 percent of the whole sample. Conversely, the remaining 58.9 percent indicated that they had not employed bank finance. The table shows that SMEs operating in trade are far less likely to use banks to finance their operations (only 5 percent) than SMEs in services sector (61 percent) and those in manufacturing (54.7 percent).

To capture more information regarding the experiences of SMEs with banks as finance supplier respondents who answered in the affirmative on the previous question were further questioned about their reasons for choosing banks for raising finance rather than other finance sources. They also were asked about the main purpose for applying for bank finance as well as about the type of collateral, if any, they pledged to secure bank finance. They were also requested to judge their experiences with regard to applying and obtaining bank finance in terms of how easy or difficult it was. Finally, bank finance successful applicants were inquired regarding any problems or difficulties they
had experienced with bank finance. The answers to these questions are discussed in the following sections.

I. The Reasons for Choosing Bank Finance

As can be inferred from the table above 41 percent of the whole sample was successful in getting bank finance. Table 6.6 below presents the reasons given by those entrepreneurs when asked why bank finance was chosen over other sources of finance available showing both the mean score of the given reasons as well as the standard deviation. Respondents were asked to rate these factors on a five-point Likert scale (1 = strongly disagree, 2 = disagree, 3 = uncertain, 4 = agree, and 5 = strongly agree).

<table>
<thead>
<tr>
<th>Reasons for choosing bank finance</th>
<th>Strongly agree</th>
<th>Agree</th>
<th>Uncertain</th>
<th>Disagree</th>
<th>Strongly disagree</th>
<th>Mean</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Most accessible</td>
<td>2 2.4</td>
<td>6 7.2</td>
<td>42 50.6</td>
<td>20 24.1</td>
<td>13 15.7</td>
<td>2.566</td>
<td>.9264</td>
</tr>
<tr>
<td>Most appropriate</td>
<td>47 56.7</td>
<td>27 32.5</td>
<td>4 4.8</td>
<td>3 3.6</td>
<td>2 2.4</td>
<td>4.373</td>
<td>.9201</td>
</tr>
<tr>
<td>Close relationship</td>
<td>2 2.4</td>
<td>20 24.1</td>
<td>48 57.8</td>
<td>13 15.7</td>
<td>-</td>
<td>3.132</td>
<td>.6944</td>
</tr>
<tr>
<td>Least costly</td>
<td>2 2.4</td>
<td>3 3.6</td>
<td>43 51.8</td>
<td>34 41</td>
<td>1 1.2</td>
<td>2.651</td>
<td>.6884</td>
</tr>
</tbody>
</table>

Most of the respondents strongly agreed that the main reason for choosing bank finance over other financing sources was because they see it as the most appropriate source of finance for their firms. This reason had the highest mean score (4.373) and a standard deviation of (0.9201). For some respondents, the close and ongoing relationship which they had with some banks was a significant factor for choosing and employing bank finance. This factor had a mean score of (3.132) with standard deviation of (0.6944).

Other factors suggesting that banks are the most accessible source of finance and the least costly of all were considered less important by the respondents. The former received a mean score of (2.566) and (0.9264) of standard deviation while these figures were (2.651) and (0.6884) respectively for the latter.

Across the three sectors it appears that the most appropriate source of finance for the firm’s stage of growth to be the major reason for choosing bank finance as it had the highest scoring mean. The mean figures were (4.333), (4.250), and (4.442) in trade, services, and manufacturing respectively. Similarly, having an ongoing and close relationship with the bank seems to be the second important factor cited by the respondents in each sector. In the trade sector this factor had a mean score of (3.00) with
standard deviation of (1.00) and for the services sector it was (3.178) for the mean score and (0.5479) standard deviation level. As for SMEs in the manufacturing sector these statistics were (3.115) and (0.5780) for the mean and the standard deviation in that order. See Table 6.7 for the three sectors statistics.

<table>
<thead>
<tr>
<th>Reasons for choosing bank finance</th>
<th>Trade</th>
<th>Services</th>
<th>Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>Std. Dev.</td>
<td>Mean</td>
<td>Std. Dev.</td>
</tr>
<tr>
<td>Most accessible</td>
<td>2.00</td>
<td>1.000</td>
<td>2.464</td>
</tr>
<tr>
<td>Most appropriate</td>
<td>4.333</td>
<td>.5773</td>
<td>4.250</td>
</tr>
<tr>
<td>Close relationship</td>
<td>3.00</td>
<td>1.000</td>
<td>3.178</td>
</tr>
<tr>
<td>Least costly</td>
<td>2.667</td>
<td>.5773</td>
<td>2.964</td>
</tr>
</tbody>
</table>

For the other two factors which are the cost of employing bank finance and banks being the most accessible source of finance the statistics show that for SMEs in trade and services the former was more significant than the latter in approaching banks for funding. The mean scores for the former were (2.667) for trade and (2.964) for SMEs in services comparing to (2.00) and (2.464) for the latter in trade and services respectively. Conversely, for manufacturers SMEs, the latter factor was more significant with a mean score of (2.653) comparing to (2.480) for the former.

The results suggest that in post start-up stages SMEs are more willing to apply for external finance from banks. However, the reasons for this trend differ. For SMEs which have over the years built a track record they may consider bank finance more accessible as these businesses, as a result, become attractive for external finance providers especially banks. Other SMEs seem to benefit from a relationship lending they may have with some banks which may affect the pricing and availability of bank finance in their favour.

**II. The Purpose for Using Bank Finance**

As for the purpose for applying for bank finance the reasons given by the respondents varied. Table 6.8 indicates the purposes for using the bank finance given by SMEs in the sample.

Overall, it is evident that the most cited purpose among the participants was modernization. Notably, it was the purpose stated by 27.7 percent out of total of those who had successfully approached banks for finance. Second in ranking was working capital needs. 25.3 percent approached banks in seeking of finance to support their working capital. The need to finance expansion and entering new markets were equally
cited by 22.9 percent each as their purpose for applying for bank finance. Only one respondent indicated other purposes namely relocation of the firm as the reason for employing bank finance.

Table 6.8 The purpose for using the bank finance (the whole sample)

<table>
<thead>
<tr>
<th>The purpose for applying for bank finance</th>
<th>Frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expansion</td>
<td>19</td>
<td>22.9</td>
</tr>
<tr>
<td>Modernization</td>
<td>23</td>
<td>27.7</td>
</tr>
<tr>
<td>Working capital</td>
<td>21</td>
<td>25.3</td>
</tr>
<tr>
<td>Entry new markets</td>
<td>19</td>
<td>22.9</td>
</tr>
<tr>
<td>Other (relocation)</td>
<td>1</td>
<td>1.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>83</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

In the trade sector, the most cited purpose for applying for bank finance among SMEs was for working capital purposes which was named by two thirds of firms in this sector. Expansion was the other purpose stated by the remaining of trade firms. In the services sector, 21.4 percent of respondents said that their purpose was to expand their firms while 28.6 percent indicated it was for modernization purposes and 21.4 percent had used bank finance for capital purchases. Other purposes were; 25 percent for financing product development to enter new markets and only one owner-manager stated that bank finance was needed for relocation. For SMEs of manufacturing activities the most commonly cited reasons for using bank finance were as follows; 28.8 percent of respondents said it was for modernization, 25 percent for working capital. Other purposes included expansion and new markets entry equally named by 23.1 percent of respondents for each purpose. (See Table 6.9).

Table 6.9 The purpose for using the bank finance (by sector)

<table>
<thead>
<tr>
<th>Purposes for applying for bank finance</th>
<th>Trade</th>
<th></th>
<th>Services</th>
<th></th>
<th>Manufacturing</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>%</td>
<td>Frequency</td>
<td>%</td>
<td>Frequency</td>
<td>%</td>
</tr>
<tr>
<td>Expansion</td>
<td>1</td>
<td>33.3</td>
<td>6</td>
<td>21.4</td>
<td>12</td>
<td>23.1</td>
</tr>
<tr>
<td>Modernization</td>
<td></td>
<td>–</td>
<td>8</td>
<td>28.6</td>
<td>15</td>
<td>28.8</td>
</tr>
<tr>
<td>Working capital</td>
<td>2</td>
<td>66.7</td>
<td>6</td>
<td>21.4</td>
<td>13</td>
<td>25</td>
</tr>
<tr>
<td>Entering new markets</td>
<td></td>
<td>–</td>
<td>7</td>
<td>25</td>
<td>12</td>
<td>23.1</td>
</tr>
<tr>
<td>Other (relocation)</td>
<td></td>
<td>–</td>
<td>1</td>
<td>3.6</td>
<td>–</td>
<td>–</td>
</tr>
</tbody>
</table>

III. Collateral Requirements

In theory and practice, collateral is an important element of financing decisions especially when financing SMEs. Financial institutions especially banks often require SMEs seeking finance to provide collateral as security. By demanding collateral banks try to mitigate the information asymmetry problem. The survey respondents who had
successfully applied and obtained bank finance were requested to indicate the type of collateral they provided to support their applications. Table 6.10 below illustrates the different types of collateral pledged by those respondents.

**Table 6.10 The type of collateral pledged to secure bank finance**

<table>
<thead>
<tr>
<th>Type of collateral</th>
<th>Trade</th>
<th>Services</th>
<th>Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>Frequency</td>
<td>Frequency</td>
</tr>
<tr>
<td>Personal guarantees</td>
<td>3</td>
<td>11</td>
<td>4</td>
</tr>
<tr>
<td>Machineries /equipment</td>
<td>–</td>
<td>15</td>
<td>46</td>
</tr>
<tr>
<td>Real estate</td>
<td>–</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Other</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
</tbody>
</table>

All the three SMEs with bank finance in the trade sector had pledged personal guarantees of their owner-managers to secure bank finance. In the services sector, the dominant type of collateral used was machineries and equipment (53.6 percent). This was followed by personal guarantees of owner-managers (39.3 percent). Just 7.1 percent had pledged real estate as collateral.

The vast majority of SMEs in the manufacturing sector pledged machineries and equipment to support their bank finance application. 88.5 percent pledged this type of collateral. The less common types of collateral among SMEs in the sector of manufacturing, however, are personal guarantees and real estate. Each type was stated as the used type of collateral by just 3.8 percent.

It can be observed that all SMEs with bank finance had to pledge some kind of collateral with machineries and equipment securities being the most common form. In some cases it was personal collateral in the form of either personal guarantees or the pledging of personal assets. This also seems to be the case for those firms which may have been able to access to bank finance as a result of developing lending relationships with some banks. This may suggest that only SMEs that were able to provide collateral, even though in the form of personal guarantees/commitments, in order to secure access to finance from banks had access to bank finance.

**IV. Difficulties with Bank Finance**

In Libya, the financial system is focused on banks so bank finance has an overwhelming share from the resources of external finance for SMEs. However, these firms face many difficulties in the process of applying and obtaining bank finance. The purpose of this question was to explore some of the barriers facing entrepreneurs in raising bank finance to support and grow their businesses. Table 6.11 below presents the
participants’ responses regarding their experiences with the process of applying for and obtaining bank finance.

**Table 6.11 SMEs’ experience with the process of obtaining bank finance**

<table>
<thead>
<tr>
<th>The process of applying for bank finance</th>
<th>Trade</th>
<th>Services</th>
<th>Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>%</td>
<td>Frequency</td>
</tr>
<tr>
<td>Very easy</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Fairly easy</td>
<td>–</td>
<td>–</td>
<td>2</td>
</tr>
<tr>
<td>Fairly difficult</td>
<td>2</td>
<td>66.7</td>
<td>20</td>
</tr>
<tr>
<td>Very difficult</td>
<td>1</td>
<td>33.3</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>3</td>
<td>100</td>
<td>28</td>
</tr>
</tbody>
</table>

As reported earlier in this chapter only 5 percent in the trade sector had been successful in gaining bank finance. From the table above it can be seen that all these three firms stated that they had some difficulties in applying for and obtaining bank finance. In the services sector 61 percent had successfully applied for and obtained bank finance. Only 7.2 percent had no difficulties in that process while the remaining successful applicants in this sector (92.8 percent) reported that they had confronted some difficulties in the process of applying for and gaining bank finance. For SMEs operating in manufacturing, 54.7 percent had been able to secure bank finance of which some 7.7 percent reported that they had no difficulties when applying for and obtaining bank finance. However, all the remaining respondents in this sector (92.3 percent) stated that they had faced some difficulties in the process.

Therefore, for the whole sub-sample of successful bank finance applicants it can be easily inferred that the vast majority (92.8 percent) had encountered some difficulties when dealing with banks in order to apply for and obtain the bank finance. On the other hand, of those applicants only (7.2 percent) reported no difficulties encountered during the same process.

Those respondents who experienced difficulties were further asked to indicate what difficulties they faced during the process of applying for and obtaining bank finance. Those difficulties according to their responses are presented in Table 6.12.

It is clear that across the three sectors the high rate of interest is by far the main difficulty encountered by SMEs in the process of applying for and obtaining bank finance. High interest rate was cited as the main difficulty by two thirds of successful bank finance applicants in the trade sector. In the services sector it was cited by 84.6
percent. For SMEs in manufacturing high interest rate was the main difficulty for three quarters of respondents.

**Table 6.12** Difficulties with bank finance

<table>
<thead>
<tr>
<th>Difficulties when applying for and obtaining bank finance</th>
<th>Trade</th>
<th>Services</th>
<th>Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>Frequency</td>
<td>Frequency</td>
</tr>
<tr>
<td>High interest rate</td>
<td>2</td>
<td>22</td>
<td>36</td>
</tr>
<tr>
<td>Insufficient amount of finance</td>
<td>–</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Short loan duration</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Repayment conditions</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Unreasonable level of security</td>
<td>–</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Paper work required</td>
<td>–</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Time taken to grant finance</td>
<td>1</td>
<td>–</td>
<td>–</td>
</tr>
</tbody>
</table>

Other types of difficulties seem to have far less rating, however, for some participants they were significant. Time taken to grant the finance was reported as the main difficulty by 33.3 percent and 6 percent in trade and manufacturing respectively. Other issues cited were the complexity and amount of paper work required and the unreasonable security level (collateral). Those two issues were indicated by only 3.7 percent in services sector and 4 percent in the manufacturing sector for the latter. As for the former, 7.4 percent in services and 4 percent in manufacturing had it as the main issue. Moreover, insufficient amount of fund was cited only by 4 percent in manufacturing and 3.7 percent in services. 4 percent in manufacturing indicated the short maturity as the main issue while the conditions of repayment was the one raised by two percent of respondents in the same sector.

It can observed that some of the difficulties listed within the question such as short loan maturity and conditions of repayment were named by none as issues in both the trade sector and the services sector. Likewise, none of the traders cited the unreasonable level of security nor the requirements of paper work and red tape involved in the process of applying for and getting bank finance as a major issue. This was also the case for SMEs in the services sector regarding the time taken to grant finance. Each of the difficulties mentioned in the question was at least selected once by respondents in the manufacturing sector as a main issue.

While all these factors are believed to be issues encountered by SMEs’ owner-managers when seeking bank finance everywhere, the explanation for this situation can be that; within the question the respondents were instructed to indicate just the main problem or
source of difficulty they had in their experiences when applying for bank finance, otherwise, they might have chosen more than one factor.

V. Unsuccessful Applicants and Discouraged Borrowers

As mentioned earlier in this chapter for respondents whose firms have not employed bank finance there were two possibilities. First, they had applied for bank finance but their applications were rejected (unsuccessful applicants). Second, they were not able or not willing to apply for bank finance or they felt that their applications had no chance to be approved if they were to apply for bank finance (discouraged borrowers). Either group has its own reasons. In the former case respondents were asked to indicate the reasons behind the rejection of their applications from their point of view. In the latter, owner-managers were asked to indicate the obstacles hindered them from applying for bank finance. Table 6.13 below presents the status of applying for bank finance for all SMEs across the sample.

Table 6.13 The status of applying for bank finance

| The status of bank finance application | Trade | | | Services | | | Manufacturing | |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| | Frequency | % | Frequency | % | Frequency | % | Frequency | % | |
| Successful | 3 | 5 | 28 | 61 | 52 | 54.7 | |
| Declined | 24 | 39.3 | 11 | 23.9 | 29 | 30.5 | |
| Never applied | 34 | 55.7 | 7 | 15.1 | 14 | 14.8 | |
| Total | 61 | 100 | 46 | 100 | 95 | 100 | |

Respondents who had their bank finance applications rejected by banks were asked to indicate in their opinions the reasons for this rejection. In order to assist them to suitably rate these factors, a five-point Likert scale (1 = strongly disagree, 2 = disagree, 3 = uncertain, 4 = agree, and 5 = strongly agree) was offered within the question. The reasons for failure in obtaining the required bank finance are listed below in Table 6.14.

Table 6.14 Reasons for rejecting bank finance applications

| Reasons for rejecting bank finance application | Trade | | | Services | | | Manufacturing | |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| | Mean | Std. Dev. | Mean | Std. Dev. | Mean | Std. Dev. | Mean | Std. Dev. | |
| High risk project | 3.541 | .7790 | 3.636 | .6742 | 3.448 | .5723 | |
| Lack of track records | 3.750 | .5316 | 3.727 | .4671 | 3.655 | .4837 | |
| Lack of guarantees or collateral | 4.041 | .4643 | 3.818 | .6030 | 3.827 | .5391 | |
| Lack of convincing business plan | 3.708 | .5500 | 3.545 | .5222 | 3.586 | .5680 | |
| Inadequate sources of repayment | 3.625 | .4945 | 3.727 | .4671 | 3.448 | .5061 | |
For SMEs in the trade sector the major cause for failure in securing access to bank finance was the lack of collateral or guarantees. This factor received the highest mean scoring (4.041). The second most cited reason was the lack of proper accounting track records with a scoring mean of (3.750). Also not having a complete and convincing business plan was considered an important issue receiving a mean score of (3.708). The lowest scoring means were those of inadequate repayment source (3.625) and the high level of risk involved with the proposed project (3.541).

In the services sector, similarly, lack of collateral and securities received the highest mean scoring (3.818) as the major reason for not obtaining bank finance. Equally important were the factors of inadequate sources of repayment and lack of business track records with a mean scoring of (3.727). Factors rated less important were risks involved with the project and having incomplete or weak business plans which received scoring means of (3.636) and (3.545) respectively.

The picture in the manufacturing sector does not appear to be so different. Again lack of guarantees and collateral followed by lack of track records were cited as the main reasons for rejecting bank finance applications. Those two factors received the highest means scoring; (3.827) for the former and (3.655) for the latter. In order of importance the other reasons of failure in getting bank finance cited by SMEs’ owner-managers in manufacturing were; lack of convincing business plan (3.586), high level of risk associated with the project (3.448), and inadequate sources of repayment (3.448).

Most often, the two most frequent reasons for bank finance applications being rejected were the lack of quality collateral and the lack of proven track records. These two factors were the most consistent main reasons for rejections across the three sectors. Unconvincing or incomplete business plan appears to be more significant in the case of SMEs in trade and manufacturing. Other reasons such as high levels of risk and insufficient sources of repayment were relatively less frequent. This may suggest that banks in Libya tend to apply a strict policy lending in terms of SMEs applicants’ creditworthiness resulting in rejecting, more likely, applications lacking collateral and/or reliable track records.

On the other hand, the other group of non-bank finance recipients who indicated never applying for bank finance were inquired about the reasons for not approaching banks in seeking of finance or the obstacles prevented them from doing so. Within the question
respondents were offered the option to indicate their own reasons if they are not among the listed. Table 6.15 below presents a summary of the results.

**Table 6.15 Reasons/obstacles for not applying for bank finance**

<table>
<thead>
<tr>
<th>Reasons/obstacles for not applying for bank finance</th>
<th>Trade</th>
<th>Services</th>
<th>Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>%</td>
<td>Frequency</td>
</tr>
<tr>
<td>The inability to provide collateral</td>
<td>5</td>
<td>14.8</td>
<td>2</td>
</tr>
<tr>
<td>Weak financial position of the firm</td>
<td>3</td>
<td>8.8</td>
<td>2</td>
</tr>
<tr>
<td>Lack of relationship with bankers</td>
<td>3</td>
<td>8.8</td>
<td>-</td>
</tr>
<tr>
<td>Inconsistent cash flow</td>
<td>1</td>
<td>2.9</td>
<td>-</td>
</tr>
<tr>
<td><strong>Other reasons:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Charging interest</td>
<td>16</td>
<td>47</td>
<td>3</td>
</tr>
<tr>
<td>No need for extra capital</td>
<td>4</td>
<td>11.8</td>
<td>-</td>
</tr>
<tr>
<td>Banks’ complex procedures</td>
<td>2</td>
<td>5.9</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>34</td>
<td>100</td>
<td>7</td>
</tr>
</tbody>
</table>

The table shows that the reasons for not applying for bank finance varying. The inability to provide the required collateral was a major obstacle. The collateral requirements by banks posed the major obstacle for 14.8 percent of SMEs’ owner-managers in trade, 28.6 percent in services, and 28.6 percent in manufacturing. A further 8.8 percent, 28.6 percent and 14.4 in trade, services, and manufacturing respectively indicated that the weak financial position of their firms as the major obstacle prevented them from applying for bank finance. Moreover, other reasons indicated by the participants were poor relationship with bankers and inconsistent cash flow. The former was signified by 8.8 percent in the trade sector and 7.1 percent in manufacturing, while the figures for the later were 2.9 percent in trade and 7.1 percent in manufacturing. Interestingly, none of these two constituted an obstacle for SMEs in the services sector.

Based on the results, the most important reason as to why SMEs had not applied for bank finance was charging interest (religious factor). Although interest charging by banks in providing finance to SMEs was not included within the question as a factor hindering SMEs from applying for bank finance it was cited more than any other one as the main obstacle under the option of “other reasons”. It was reported so by 47 percent in trade, 42.8 percent in services, and 28.6 percent in manufacturing. This can be explained by aspect of religion whereby interest (Riba) in Islam, which is the religion of all Libyans, is prohibited in all affairs including in the business transactions. As such, considering the fact that Islamic banking and finance are yet to be practiced in the
country and finance from conventional banks must be repaid with interest those respondents chose not to apply for bank finance due to this religious factor.

Moreover, under the option of “other reasons” other reasons were reported. For 11.8 percent in the trade sector and 7.1 percent in manufacturing having an adequate and sufficient capital resulting in the situation where no extra capital is needed was their main reason for not applying for bank finance. Bureaucratic complex procedures involved in the process of applying for bank finance was indicated as the major obstacle by 5.9 percent and 7.1 percent in trade and manufacturing respectively. Again, none of these two factors were indicated as obstacles for SMEs in the services sector.

The chapter now proceeds to the section which describes SMEs’ owner-managers perceptions and opinions in relation to Islamic finance for SMEs.

### 6.5 Islamic Finance for SMEs

This section intended to discover the perceptions and opinions of SMEs’ owner-managers with reference to Islamic finance. As such, in this section, participants were asked questions related to their awareness of Islamic finance methods, their willingness to use such methods if offered, how to prioritize these methods in case they would use them in financing their firms, and finally respondents were also asked to express their opinions on the Islamic finance methods viability as an option for financing SMEs in Libya. As Islamic banking and finance, at the time of the fieldwork study, had not yet been practiced in Libya which means none of the respondents in either sector had used this type of financing the results in this sector will be shown across the three sectors as a whole.

In answering the question pertaining to their knowledge and awareness Islamic financing methods existence the majority of the respondents in the sample (67.8 percent) acknowledged that they were aware of the existence of Islamic finance. The results also showed that the remaining 32.2 percent of respondents were, however, unaware of the existence of such type of financing. Table 6.16 below presents these figures.

<table>
<thead>
<tr>
<th>Awareness of Islamic finance existence</th>
<th>Frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>137</td>
<td>67.8</td>
</tr>
<tr>
<td>No</td>
<td>65</td>
<td>32.2</td>
</tr>
<tr>
<td>Total</td>
<td>202</td>
<td>100</td>
</tr>
</tbody>
</table>
In a similar way respondents were further asked to indicate if they would use Islamic finance modes to finance their firms’ operations. Table 6.17 below summarises their responses.

**Table 6.17 Willingness to use Islamic finance methods**

<table>
<thead>
<tr>
<th>Willingness to use Islamic finance methods</th>
<th>Frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>194</td>
<td>96</td>
</tr>
<tr>
<td>No</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>202</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The vast majority of respondents (96 percent) indicated their willingness to use the modes of Islamic finance if available. However, just a small percentage (4 percent) gave negative indication that they would not consider utilising Islamic finance methods.

The results here reveal that the largest proportion of respondents is aware of the existence of Islamic financing methods for SMEs. Moreover, almost all the participants in the study, with the exception of a small percentage (4 percent), indicated their willingness to use such methods to inject their firms with funding. In addition, a glance at the cross-tabulation (not shown here) of the two variables (awareness of Islamic finance and willingness to use them) indicates that most respondents who are aware of Islamic finance existence represent potential users (97 percent). Moreover, 93.8 percent of unaware respondents also represent potential users of this type of finance if offered. These results seem to suggest that Islamic methods of finance enjoy high levels of acceptance among Libyan SMEs and, if offered, would be largely used.

Having indicated their willingness to utilise Islamic finance methods those respondents were further asked to indicate which type of Islamic finance would be their first option. Only the most common three modes of Islamic finance were included in the question namely; *Musharakah*, *Mudarabah*, and *Murabahah*. Again, these modes of finance were ranked according to the calculated weighted average score for each model. Accordingly, the order of priority of the Islamic modes of finance was as follows; *Musharakah* (2.35), *Mudarabah* (2.20), and third is *Murabahah* (1.20). *Musharakah* mode of Islamic finance was the most desirable as a first option with more than half of the respondents prioritised it ahead of the other two options. Following that *Mudarabah* was the first option chosen by 45.4 percent. Less cited as a first option of finance, however, was the *Murabahah* with only 2.6 percent indicated that where available they would use this model over the other two. See Table 6.18 summarizes these findings.
Table 6.18 SMEs preferences of Islamic finance modes

<table>
<thead>
<tr>
<th>Islamic finance modes</th>
<th>Weighted average rank score</th>
<th>1st option Frequency</th>
<th>1st option %</th>
<th>2nd option Frequency</th>
<th>2nd option %</th>
<th>3rd option Frequency</th>
<th>3rd option %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Musharakah</td>
<td>2.35</td>
<td>101</td>
<td>52</td>
<td>79</td>
<td>46.8</td>
<td>14</td>
<td>7.2</td>
</tr>
<tr>
<td>Mudarabah</td>
<td>2.20</td>
<td>88</td>
<td>45.4</td>
<td>75</td>
<td>38.6</td>
<td>31</td>
<td>16</td>
</tr>
<tr>
<td>Murabahah</td>
<td>1.20</td>
<td>5</td>
<td>2.6</td>
<td>40</td>
<td>20.6</td>
<td>149</td>
<td>76</td>
</tr>
</tbody>
</table>

*Musharakah* being the most preferred method is really interesting because it means that SMEs’ owner-managers, in contrast to the common norm, would not mind sharing ownership of their firms in return of the provision of capital. This seems to be in accordance with the conclusion of Rammal (2004) who states that in the future more contracts will be established using *Musharakah* option. The reason, which could explain this, is that unlike in *Musharakah* mode, when it comes to practice there is a fear that other Islamic financing instruments are essentially providing interest-bearing products under the guise of profit and mark-up.

The viability and suitability of Islamic finance as an option of finance for Libyan SMEs to consider was next investigated. Likewise, as the majority of respondents expressed their willingness to use methods of Islamic finance, the findings also show that the majority of entrepreneurs perceived Islamic finance as a viable suitable option of financing for SMEs in Libya. Out of the whole sample 93.5 percent responded in the affirmative whereas the remaining 6.5 percent indicated otherwise (see Table 6.19).

Table 6.19 Participants’ opinions on the viability of Islamic finance for SMEs

<table>
<thead>
<tr>
<th>Viability of Islamic finance for SMEs</th>
<th>Frequency</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>189</td>
<td>93.5</td>
</tr>
<tr>
<td>No</td>
<td>13</td>
<td>6.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>202</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

6.6 SMEs’ Selection of Banks

For SMEs, banks represent a vital business partners since they facilitate various functions necessary for their existence, survival, and growth. For example, banks provide SMEs with cash management services, both domestic and foreign exchange transactions, letters of credit and they also, of course, are an important source of finance.

In the process of completing the survey, respondents were asked to provide information concerning their banking partners. First, respondents were asked to declare with which bank they hold their firms’ bank accounts. The options to answer this question confined
to just two answers namely; *Bank Al Tanmeya*, which is one of the key banks focussing on SMEs in the country and represents the case study of the supply side in this study, and other banks. Table 6.20 summarises the answers.

**Table 6.20 SMEs’ banking partners**

<table>
<thead>
<tr>
<th>SMEs’ bank</th>
<th>Trade</th>
<th></th>
<th>Services</th>
<th></th>
<th>Manufacturing</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>%</td>
<td>Frequency</td>
<td>%</td>
<td>Frequency</td>
<td>%</td>
</tr>
<tr>
<td>Bank Al Tanmeya</td>
<td>14</td>
<td>23</td>
<td>18</td>
<td>39</td>
<td>51</td>
<td>53.7</td>
</tr>
<tr>
<td>Other</td>
<td>47</td>
<td>77</td>
<td>28</td>
<td>61</td>
<td>44</td>
<td>46.3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>61</strong></td>
<td><strong>100</strong></td>
<td><strong>46</strong></td>
<td><strong>100</strong></td>
<td><strong>95</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The results revel that almost 40 percent of the SMEs participated in the study had their bank accounts with *Bank Al Tanmeya*. By sectors, only 23 percent in the trade and 39 percent in services had *Bank Al Tanmeya* as their major bank while 77 percent and 61 percent in trade and services respectively reported having a partnership with other banks. SMEs in the manufacturing, however, were more likely to establish a business partnership with *Bank Al Tanmeya* (53.7 percent) against 46.3 percent stated otherwise.

After that each respondent was provided with a list of some possible factors and asked to indicate the most important one considered in the process of selecting the banking partner. Table 6.21 below illustrates the responses as for the main factors for choosing a banking partner in the three sectors.

**Table 6.21 Bank selection factors**

<table>
<thead>
<tr>
<th>Why this particular bank was chosen</th>
<th>Trade</th>
<th></th>
<th>Services</th>
<th></th>
<th>Manufacturing</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>%</td>
<td>Frequency</td>
<td>%</td>
<td>Frequency</td>
<td>%</td>
</tr>
<tr>
<td>The nearest/convenient location</td>
<td>16</td>
<td>26.2</td>
<td>9</td>
<td>19.6</td>
<td>8</td>
<td>8.4</td>
</tr>
<tr>
<td>Only bank in the locality</td>
<td>6</td>
<td>9.8</td>
<td>–</td>
<td>–</td>
<td>5</td>
<td>5.3</td>
</tr>
<tr>
<td>Only bank that would finance the project</td>
<td>2</td>
<td>3.3</td>
<td>9</td>
<td>19.6</td>
<td>21</td>
<td>22</td>
</tr>
<tr>
<td>Recommended by business associate/friend</td>
<td>4</td>
<td>6.6</td>
<td>2</td>
<td>4.3</td>
<td>5</td>
<td>5.3</td>
</tr>
<tr>
<td>Offers the best terms and conditions for SMEs</td>
<td>5</td>
<td>8.2</td>
<td>8</td>
<td>17.4</td>
<td>24</td>
<td>25.3</td>
</tr>
<tr>
<td>Already had my private account with this bank</td>
<td>28</td>
<td>45.9</td>
<td>18</td>
<td>39.1</td>
<td>32</td>
<td>33.7</td>
</tr>
<tr>
<td>Other</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>61</strong></td>
<td><strong>100</strong></td>
<td><strong>46</strong></td>
<td><strong>100</strong></td>
<td><strong>95</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

In general, as the figures in the table show the most important bank selection factor for SMEs across the sample was the factor stating that the owner-manager already had a personal bank account with the selected bank. This factor was cited by approximately 46 percent in trade, 39 percent in services, and 34.7 percent in manufacturing. As for the
other factors it seems that SMEs in trade and services were more interested in the bank’s location. 26.2 percent in trade and 19.6 percent in services indicated that where the bank is located, how close it is from their firms, as the main criterion of bank selection. However, other factors such as the terms and conditions of the bank’s services offered to SMEs and its willingness to provide finance were more significant for SMEs in manufacturing.

6.7 Determinants of Bank Finance Application Approval

Having presented the descriptive analysis of the survey data, the results in this session are presented in terms of the determinants of SMEs access to bank finance. For this purpose the status of bank finance application was used as the dependent variable. From 202 respondents included in the sample 147 respondents had applied for bank finance. Out of them only 83 were able to access bank finance (their applications were approved) whereas the remaining 64 were unsuccessful (their applications were rejected). Therefore, the analysis here was limited only to those SMEs which had applied for bank finance (83 successful applicants and 64 unsuccessful) excluding those whose their owner-managers decided not to apply for bank finance irrespective of the reasons behind their decision. The rationale behind that is that if this last group to be included in the analysis the results would be misleading.

Several approaches can be used by a researcher to model binary variables; including probit, logistic regression, and discriminate function analysis. Mostly, logistic regression is the best option among all approaches to analyse the relationship between binary dependent variables and independent dichotomous variables because of its flexibility and strongly on violation of the normality assumption (Agresti, 1996). Considering the nature of data involved in this study it was opted to analyse the data by using logistic regression to establish the extent to which each of the variables plays a part in SMEs access to bank finance. Firstly, a standard logistic regression was computed for factors relating to SMEs (SMEs characteristics) and for those relating to their owner-managers (owner-managers characteristics) separately. Then, a full model was computed combining the two sets of variables together. Finally, for more accurate results the model was further refined by computing a stepwise logistic regression to determine the most significant factors contributing to Libyan SMEs access to bank finance.
Prior to employing the logistic regression the data were tested for possible violations of regression assumptions. The data were subjected to possibility of multicollinearity issues using Variance Inflation Factors (VIF) and Pearson’s Correlation.

6.7.1 Test of Multicollinearity

Before conducting any regression analysis procedure a multicollinearity test should be performed (Mansfield and Helms, 1982). Multicollinearity is often detected by using a two-step procedure. First, by inspecting the variance proportion matrix and second, by comparing the results with the Variance Inflation Factor (VIF) and tolerance values. A collinearity problem exists when the same dimension accounts for more than 90 percent of the variance for two or more variables (Hair et al., 1998).

It is recommended that the acceptable value of VIF of each independent variable should not exceed 10 and that the tolerance value should not fall below 0.1 (Field, 2009; Hair et al., 1998). By computing VIF for all the independent variables, it was found that none has a VIF greater than 10 (ranged from 1.469 to 1.845). In addition, tolerance values were found to be between 0.542 and 0.681 which were reasonably far above the critical tolerance value of 0.1. As a result, the initial analyses indicated that multicollinearity not to be a problem for the regression analyses. See Table 6.22.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Tolerance</th>
<th>VIF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firm’s size</td>
<td>.681</td>
<td>1.469</td>
</tr>
<tr>
<td>Business sector</td>
<td>.670</td>
<td>1.493</td>
</tr>
<tr>
<td>Ownership type</td>
<td>.602</td>
<td>1.662</td>
</tr>
<tr>
<td>Firm’s age</td>
<td>.544</td>
<td>1.839</td>
</tr>
<tr>
<td>Business plan</td>
<td>.554</td>
<td>1.805</td>
</tr>
<tr>
<td>Owner-manager’s age</td>
<td>.556</td>
<td>1.800</td>
</tr>
<tr>
<td>Owner-manager’s education</td>
<td>.543</td>
<td>1.842</td>
</tr>
<tr>
<td>Owner-manager’s experience</td>
<td>.554</td>
<td>1.806</td>
</tr>
<tr>
<td>SMEs management training</td>
<td>.542</td>
<td>1.845</td>
</tr>
<tr>
<td>Bank partnership (Bank Al Tanmeya effect)</td>
<td>.542</td>
<td>1.845</td>
</tr>
</tbody>
</table>

Another simple way of identifying multicollinearity is to scan the correlation matrix of all the independent variables in order to find out if there is any very high correlation among them. The least restrictive conventional critical value is \( r = 0.90 \) (Field, 2009; Hair et al., 1998) and the most restrictive critical value is \( r = 0.60 \) (Pallant, 2010). As Table 6.23 shows that there are positive and negative correlations between the variables, however, most of the correlations between variables are relatively low. The highest and lowest values were 0.565 and 0.020 respectively.
Table 6.23 Correlation between the independent variables

<table>
<thead>
<tr>
<th>Variables</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Firm size</td>
<td>1.00</td>
<td>.565</td>
<td>.378</td>
<td>.131</td>
<td>-.136</td>
<td>.148</td>
<td>.186</td>
<td>.054</td>
<td>.027</td>
<td>-.433</td>
</tr>
<tr>
<td>2. Business sector</td>
<td>1.00</td>
<td>.119</td>
<td>.040</td>
<td>.129</td>
<td>-.042</td>
<td>.092</td>
<td>-.003</td>
<td>.093</td>
<td>-.221</td>
<td></td>
</tr>
<tr>
<td>3. Ownership type</td>
<td>1.00</td>
<td>.061</td>
<td>-.303</td>
<td>-.065</td>
<td>.295</td>
<td>-.109</td>
<td>-.089</td>
<td>-.290</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Firm age</td>
<td>1.00</td>
<td>.021</td>
<td>-.068</td>
<td>.027</td>
<td>.310</td>
<td>.120</td>
<td>-.161</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Business plan</td>
<td>1.00</td>
<td>.009</td>
<td>-.216</td>
<td>.020</td>
<td>.094</td>
<td>.185</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Owner-manager’s age</td>
<td>1.00</td>
<td>.014</td>
<td>.433</td>
<td>-.016</td>
<td>.067</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Owner-manager’s education</td>
<td>1.00</td>
<td>.005</td>
<td>-.086</td>
<td>-.195</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Owner-manager’s experience</td>
<td>1.00</td>
<td>.109</td>
<td>-.075</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. SME management training</td>
<td>1.00</td>
<td>.168</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Bank partnership (Bank Al Tanmeya effect)</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).
6.7.2 Variables Description

Before reporting on the results of logistic regression this section identifies the variables included in the model. The dependent variable is presented at the top portion of Table 6.24. The dependent variable is represented in the form of Yes/No response to whether the firm has been ever granted bank finance. The table also includes the other independent variables in the study and their descriptions.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BF</td>
<td>Access to bank finance {1 if the firm has been ever granted bank finance, 0 if denied}</td>
</tr>
<tr>
<td>SZE</td>
<td>The staff strength of the firm {1 if &lt;= 25 (small), 0 if &gt;= 26 and &lt;=50 (medium)}</td>
</tr>
<tr>
<td>TRD</td>
<td>1 if the firm is in the trade sector, 0 if otherwise</td>
</tr>
<tr>
<td>SRV</td>
<td>1 if the firm is in the services sector, 0 if otherwise</td>
</tr>
<tr>
<td>MNF</td>
<td>1 if the firm is in the manufacturing sector, 0 if otherwise</td>
</tr>
<tr>
<td>OWN</td>
<td>Ownership type of the firm {1 if the firm is of sole ownership, 0 if otherwise}</td>
</tr>
<tr>
<td>EST</td>
<td>How long the firm has been established in years{1 (1–5), 2 (6–10), 3 (11–15), 4 (16–20), 5 (over 20)}</td>
</tr>
<tr>
<td>PLN</td>
<td>The use of business plan {1 if yes, 0 if otherwise}</td>
</tr>
<tr>
<td>AGE</td>
<td>Owner-manager’s age {1 (under 21), 2 (21–30), 3 (31–40), 4 (41–50), 5 (over 50)}</td>
</tr>
<tr>
<td>EDU</td>
<td>Owner-manager level of education{1 if at least university degree or equivalent (diploma) , 0 if otherwise}</td>
</tr>
<tr>
<td>EXP</td>
<td>Owner-manager’s years of experience {1 (less than 5), 2 (5–10), 3 (11–15), 4 (over 15)}</td>
</tr>
<tr>
<td>TRN</td>
<td>Attending any SMEs management seminars/workshops {1 if yes, 0 if otherwise}</td>
</tr>
<tr>
<td>BAT</td>
<td>Having Bank Al Tanmeya as the main business partner {1 if yes , 0 if otherwise}</td>
</tr>
</tbody>
</table>

It is worth mentioning that while age and experience represent good continuous variables it was decided to define them as categorical for the purpose of the analysis taking into consideration the exploratory nature of the study which is more concerned with determining the shape of the functional relationship with the outcome variable rather than explaining it. Some previous studies relating to access to bank finance did exactly the same (e.g. Holton, Lawless and McCann, 2012; Habara, 2010; Hainz and Nabokin, 2009).

6.7.3 The Model

Based on the above, the independent variables in the base model include characteristics of the owner-managers, SMEs firms and an independent variable of banking partnership as follows:

\[
BF = \alpha + \beta_0 SZE_i + \beta_1 TRD_i + \beta_2 SRV_i + \beta_3 MNF_i + \beta_4 OWN_i + \beta_5 EST_i + \beta_6 PLN_i + \beta_7 AGE_i + \beta_8 EDU_i + \beta_9 EXP_i + \beta_{10} TRN_i + \beta_{11} BAT_i + \epsilon_i
\]
Where $\alpha$ is a constant (the regression intercept), $\beta$s are the regression coefficients (also called partial regression coefficient or metric coefficient), $\varepsilon$ is the error term and the other variables are as previously defined. The variable for the age of the firm was given the abbreviation $EST$ for establishment to distinguish it from the age of the owner-manager variable $AGE$.

### 6.7.4 Logistic Regression Results

This section is dedicated to identify the determinants of Libyan SMEs access to bank finance considering some of the characteristics of SMEs and their owner-managers in addition to the banking partnership variable. As mentioned before first the analysis was confined only to SMEs characteristics. Table 6.25 shows the results for the logistic regression analysis for SMEs characteristics.

<table>
<thead>
<tr>
<th>Variables</th>
<th>B</th>
<th>S. E.</th>
<th>Wald</th>
<th>Sig.</th>
<th>Exp (B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SZE</td>
<td>-1.888</td>
<td>.546</td>
<td>11.940</td>
<td>.001*</td>
<td>.151</td>
</tr>
<tr>
<td>TRD</td>
<td>1.499</td>
<td>.772</td>
<td>3.774</td>
<td>.052</td>
<td>4.478</td>
</tr>
<tr>
<td>SRV</td>
<td>-1.305</td>
<td>.624</td>
<td>4.372</td>
<td>.037*</td>
<td>.271</td>
</tr>
<tr>
<td>OWN</td>
<td>.034</td>
<td>.455</td>
<td>.006</td>
<td>.940</td>
<td>1.035</td>
</tr>
<tr>
<td>EST1</td>
<td>1.107</td>
<td>1.438</td>
<td>.593</td>
<td>.441</td>
<td>3.027</td>
</tr>
<tr>
<td>EST2</td>
<td>.553</td>
<td>1.332</td>
<td>.173</td>
<td>.678</td>
<td>1.739</td>
</tr>
<tr>
<td>EST3</td>
<td>.542</td>
<td>1.341</td>
<td>.164</td>
<td>.686</td>
<td>1.720</td>
</tr>
<tr>
<td>EST4</td>
<td>.096</td>
<td>1.393</td>
<td>.005</td>
<td>.945</td>
<td>.908</td>
</tr>
<tr>
<td>PLN</td>
<td>.587</td>
<td>.650</td>
<td>1.116</td>
<td>.291</td>
<td>1.987</td>
</tr>
<tr>
<td>Constant</td>
<td>.929</td>
<td>2.146</td>
<td>.187</td>
<td>.665</td>
<td>2.532</td>
</tr>
</tbody>
</table>

* Significant at 0.05 level.

The results indicate a significant association between the employment size and access to bank finance ($p \leq 0.05$) suggesting that smaller SMEs tend to have significantly lower probability of bank finance approval. This means that the smaller the firm is, in terms of employment size, the less likely to be granted bank finance. In addition, the figures in the table suggest that SMEs operating in services are more likely to be successful when applying for bank finance ($p \leq 0.05$). However, the statistics in the table do not support any association between the variables; $TRD, OWN, EST1, EST2, EST3, EST4$, and $PLN$ and the successfulness of SMEs bank finance applications ($p > 0.05$).

In a similar way the characteristics of owner-managers inquired by the questionnaire were considered independent variables and tested using the SPSS software for possible association with Libyan SMEs access to bank finance as the dependent variable. The
results for this analysis are shown in Table 6.26. The figures in the above table provide no evidence of a significant relationship between owner-managers-related variables and the success in obtaining bank finance of the Libyan SMEs ($p > 0.05$). However, owner-managers’ age group (21-30) and education level are the only exceptions ($p \leq 0.05$). This result is an indication that SMEs with young and more educated owner-managers are more likely to obtain bank finance, presumably due to their owner-managers’ knowledge in the bank finance application process and their knowledge in financial management. This also can be positively related to preparing a proposal for bank finance and convincing the banker during the client interview.

**Table 6.26 Logistic regression results (owner-managers’ characteristics)**

<table>
<thead>
<tr>
<th>Variables</th>
<th>B</th>
<th>S. E.</th>
<th>Wald</th>
<th>Sig.</th>
<th>Exp (B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGE1</td>
<td>17.465</td>
<td>401.970</td>
<td>.000</td>
<td>1.00</td>
<td>384.443</td>
</tr>
<tr>
<td>AGE2</td>
<td>-1.817</td>
<td>.898</td>
<td>4.095</td>
<td>.043*</td>
<td>.163</td>
</tr>
<tr>
<td>AGE3</td>
<td>-1.025</td>
<td>.785</td>
<td>1.704</td>
<td>.192</td>
<td>.359</td>
</tr>
<tr>
<td>AGE4</td>
<td>-.201</td>
<td>.795</td>
<td>.064</td>
<td>.800</td>
<td>.818</td>
</tr>
<tr>
<td>EDU</td>
<td>-2.317</td>
<td>.544</td>
<td>18.146</td>
<td>.000*</td>
<td>.099</td>
</tr>
<tr>
<td>EXP1</td>
<td>1.381</td>
<td>1.544</td>
<td>.801</td>
<td>.371</td>
<td>3.980</td>
</tr>
<tr>
<td>EXP2</td>
<td>.949</td>
<td>.632</td>
<td>2.257</td>
<td>.133</td>
<td>2.582</td>
</tr>
<tr>
<td>EXP3</td>
<td>-.213</td>
<td>.526</td>
<td>.164</td>
<td>.685</td>
<td>.808</td>
</tr>
<tr>
<td>TRN</td>
<td>.985</td>
<td>.583</td>
<td>2.854</td>
<td>.091</td>
<td>2.677</td>
</tr>
<tr>
<td>Constant</td>
<td>.387</td>
<td>1.439</td>
<td>.072</td>
<td>.788</td>
<td>1.472</td>
</tr>
</tbody>
</table>

* Significant at 0.05 level.

In the third step the two groups of variables (SMEs characteristics and owner-managers’) were combined into one model as possible predictors of Libyan SMEs access to bank finance. In addition, the variable $BAT$ was also added. The results are presented in Table 6.27.

In this analysis it can be seen that SMEs operating in services $SRV$ and having $Bank Al Tanmeya$ as the main bank $BAT$ are the only significant explanatory variables for access to bank finance ($p \leq 0.05$). Other variables included in the analysis were insignificant.
Table 6.27 Logistic regression results (SMEs and owner–managers’ characteristics)

<table>
<thead>
<tr>
<th>Variables</th>
<th>B</th>
<th>S. E.</th>
<th>Wald</th>
<th>Sig.</th>
<th>Exp (B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SZE</td>
<td>–.800</td>
<td>.973</td>
<td>.676</td>
<td>.411</td>
<td>.450</td>
</tr>
<tr>
<td>TRD</td>
<td>3.008</td>
<td>1.620</td>
<td>3.447</td>
<td>.063</td>
<td>20.243</td>
</tr>
<tr>
<td>SRV</td>
<td>–2.184</td>
<td>1.051</td>
<td>4.315</td>
<td>.038*</td>
<td>.113</td>
</tr>
<tr>
<td>OWN</td>
<td>.545</td>
<td>.751</td>
<td>.525</td>
<td>.469</td>
<td>1.724</td>
</tr>
<tr>
<td>EST1</td>
<td>–2.835</td>
<td>2.483</td>
<td>1.304</td>
<td>.254</td>
<td>.059</td>
</tr>
<tr>
<td>EST2</td>
<td>–2.602</td>
<td>2.371</td>
<td>1.205</td>
<td>.272</td>
<td>.074</td>
</tr>
<tr>
<td>EST3</td>
<td>–2.229</td>
<td>2.258</td>
<td>.975</td>
<td>.323</td>
<td>.108</td>
</tr>
<tr>
<td>EST4</td>
<td>–3.323</td>
<td>2.300</td>
<td>2.087</td>
<td>.149</td>
<td>.036</td>
</tr>
<tr>
<td>PLN</td>
<td>–.088</td>
<td>1.100</td>
<td>.006</td>
<td>.936</td>
<td>.916</td>
</tr>
<tr>
<td>AGE1</td>
<td>11.640</td>
<td>401.97</td>
<td>.000</td>
<td>1.00</td>
<td>113.73</td>
</tr>
<tr>
<td>AGE2</td>
<td>–2.521</td>
<td>1.901</td>
<td>1.760</td>
<td>.185</td>
<td>.080</td>
</tr>
<tr>
<td>AGE3</td>
<td>–2.512</td>
<td>1.662</td>
<td>2.284</td>
<td>.131</td>
<td>.081</td>
</tr>
<tr>
<td>AGE4</td>
<td>–1.365</td>
<td>1.715</td>
<td>.634</td>
<td>.426</td>
<td>.255</td>
</tr>
<tr>
<td>EDU</td>
<td>–.855</td>
<td>1.559</td>
<td>.301</td>
<td>.992</td>
<td>.000</td>
</tr>
<tr>
<td>EXP1</td>
<td>.051</td>
<td>2.195</td>
<td>.001</td>
<td>.982</td>
<td>1.052</td>
</tr>
<tr>
<td>EXP2</td>
<td>1.345</td>
<td>1.187</td>
<td>1.285</td>
<td>.257</td>
<td>3.840</td>
</tr>
<tr>
<td>EXP3</td>
<td>.350</td>
<td>.936</td>
<td>.140</td>
<td>.708</td>
<td>1.419</td>
</tr>
<tr>
<td>TRN</td>
<td>–.406</td>
<td>.991</td>
<td>.168</td>
<td>.682</td>
<td>.667</td>
</tr>
<tr>
<td>BAT</td>
<td>6.035</td>
<td>1.353</td>
<td>19.911</td>
<td>.000*</td>
<td>417.98</td>
</tr>
<tr>
<td>Constant</td>
<td>–4.324</td>
<td>4.568</td>
<td>.896</td>
<td>.344</td>
<td>.013</td>
</tr>
</tbody>
</table>

* Significant at 0.05 level.

In the final step the forward likelihood stepwise regression method which is based on the probability of a likelihood-ratio statistic and the maximum partial likelihood estimates was the one used to refine the model. This method is considered the least prone to error. The entry testing of variables is based on the significance of score statistic and removal testing based on the probability of a likelihood-ratio statistic based on the maximum partial likelihood estimates. Table 6.28 shows the results for the base logistic regression analysis.

The score statistics from the table are used by SPSS as measures for selecting variables in the next stepwise procedure. In reviewing the statistics of variables not in the equation at the base model it can be seen that there are variables statistically significant but stepwise method selects the highest score statistics. Accordingly, the variable BAT to be added in the first step. This process of stepwise procedure continued to identify which of the variables best add to the significance of the model.
Table 6.28 Summary of logistic regression results

<table>
<thead>
<tr>
<th>Step 0 Variables</th>
<th>Value: 192.329</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>–2 Log likelihood (–2LL)</td>
</tr>
<tr>
<td></td>
<td>Score</td>
</tr>
<tr>
<td>SZE</td>
<td>24.011</td>
</tr>
<tr>
<td>TRD</td>
<td>22.167</td>
</tr>
<tr>
<td>SRV</td>
<td>4.540</td>
</tr>
<tr>
<td>MNF</td>
<td>2.510</td>
</tr>
<tr>
<td>OWN</td>
<td>11.920</td>
</tr>
<tr>
<td>EST1</td>
<td>1.385</td>
</tr>
<tr>
<td>EST2</td>
<td>.025</td>
</tr>
<tr>
<td>EST3</td>
<td>.097</td>
</tr>
<tr>
<td>EST4</td>
<td>3.048</td>
</tr>
<tr>
<td>EST5</td>
<td>.093</td>
</tr>
<tr>
<td>PLN</td>
<td>7.929</td>
</tr>
<tr>
<td>AGE1</td>
<td>1.360</td>
</tr>
<tr>
<td>AGE2</td>
<td>1.302</td>
</tr>
<tr>
<td>AGE3</td>
<td>.705</td>
</tr>
<tr>
<td>AGE4</td>
<td>2.917</td>
</tr>
<tr>
<td>AGE5</td>
<td>.014</td>
</tr>
<tr>
<td>EDU</td>
<td>21.860</td>
</tr>
<tr>
<td>EXP1</td>
<td>.729</td>
</tr>
<tr>
<td>EXP2</td>
<td>1.085</td>
</tr>
<tr>
<td>EXP3</td>
<td>1.945</td>
</tr>
<tr>
<td>EXP4</td>
<td>.049</td>
</tr>
<tr>
<td>TRN</td>
<td>2.120</td>
</tr>
<tr>
<td>BAT</td>
<td>75.711</td>
</tr>
</tbody>
</table>

Residual Chi-Squares are not computed because of redundancies

As such, variables with non-significant contribution and the lowest score statistics were excluded and vice versa. Table 6.29 below shows that six steps were required to select the best model. The variables entered in each step were; having Bank Al Tanmeya as the main bank (BAT), owner-managers’ education (EDU), owner-managers’ age group over 50 years (AGE5), whether the firm is operating in services sector (SRV), the size of the firm (SZE), and the firm has been established for more than 20 years (EST5) respectively.
Table 6.29 Variables in the analysis after each step

<table>
<thead>
<tr>
<th>Variables</th>
<th>Score</th>
<th>df</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 1</td>
<td>BAT</td>
<td>75.711</td>
<td>1</td>
</tr>
<tr>
<td>Step 2</td>
<td>EDU</td>
<td>24.329</td>
<td>1</td>
</tr>
<tr>
<td>Step 3</td>
<td>AGE5</td>
<td>14.181</td>
<td>1</td>
</tr>
<tr>
<td>Step 4</td>
<td>SRV</td>
<td>5.950</td>
<td>1</td>
</tr>
<tr>
<td>Step 5</td>
<td>SZE</td>
<td>5.322</td>
<td>1</td>
</tr>
<tr>
<td>Step 6</td>
<td>EST5</td>
<td>4.242</td>
<td>1</td>
</tr>
</tbody>
</table>

6.7.5 Testing Overall Model Fit

The logistic regression model for Libyan SMEs accessing bank finance, as in the table above, includes six independent variables. To assess this model, two methods were used; statistical measures of overall model fit and pseudo $R^2$. Firstly, as for the statistical measures of overall model fit, the first statistical measure is the likelihood ratio for the change in the $-2$ likelihood value from the baseline model. Table 6.30 presents the chi-square test for the six steps in which an independent variable provided a significant improvement in the fit of the model. The table shows that there is a negative relationship between $-2$ Log Likelihood value and chi-square. In addition, the significance of chi-square refers to the existence of a relationship between the independent variables and the dependent variable.

Table 6.30 Overall model fit (chi-square)

<table>
<thead>
<tr>
<th>$-2$ Log Likelihood value</th>
<th>From base model</th>
<th>From Prior step</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Change $\chi^2$</td>
<td>Sig.</td>
</tr>
<tr>
<td>Step 0</td>
<td>192.329</td>
<td></td>
</tr>
<tr>
<td>Step 1</td>
<td>104.265</td>
<td>88.064</td>
</tr>
<tr>
<td>Step 2</td>
<td>85.655</td>
<td>106.674</td>
</tr>
<tr>
<td>Step 3</td>
<td>78.542</td>
<td>113.787</td>
</tr>
<tr>
<td>Step 4</td>
<td>68.942</td>
<td>123.387</td>
</tr>
<tr>
<td>Step 5</td>
<td>55.793</td>
<td>136.536</td>
</tr>
<tr>
<td>Step 6</td>
<td>51.543</td>
<td>140.786</td>
</tr>
</tbody>
</table>

The second statistical measure of overall model fit is the Hosmer and Lemeshow measure of overall fit model. Table 6.31 presents the Hosmer and Lemeshow for the six steps. The Hosmer and Lemeshow test in the final step is now nonsignificant which means the model has improved compared to the base model. This means that there are significant differences between actual and predicted values.
Table 6.31 Hosmer and Lemeshow test

<table>
<thead>
<tr>
<th>Step</th>
<th>Chi-square</th>
<th>df</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.000</td>
<td>0</td>
<td>.</td>
</tr>
<tr>
<td>2</td>
<td>8.206</td>
<td>2</td>
<td>.017</td>
</tr>
<tr>
<td>3</td>
<td>6.642</td>
<td>4</td>
<td>.156</td>
</tr>
<tr>
<td>4</td>
<td>9.954</td>
<td>6</td>
<td>.127</td>
</tr>
<tr>
<td>5</td>
<td>2.539</td>
<td>7</td>
<td>.924</td>
</tr>
<tr>
<td>6</td>
<td>3.687</td>
<td>5</td>
<td>.595</td>
</tr>
</tbody>
</table>

Secondly, the overall model fit was measured using Pseudo $R^2$ measures. Table 6.32 presents the six different $R^2$ which used in logistic regression model. In the first step, the values of Cox & Snell $R^2$, Nagelkerke $R^2$, and Pseudo $R^2$ are .465, .624, and .457 respectively. It can be said that these values of variation in the dependent variable is explained by the variable having Bank Al Tanmeya as the main bank $BAT$. The figures in the table also show that in the last step with six independent variables contributed to variation in the dependent variable as the value of Pseudo $R^2$ went up to .732 the values of the two first measures improved and reached a value of .632, .848 respectively.

Table 6.32 Measures of $R^2$

<table>
<thead>
<tr>
<th>Step</th>
<th>Cox &amp; Snell $R^2$</th>
<th>Nagelkerke $R^2$</th>
<th>Pseudo $R^2$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.465</td>
<td>.624</td>
<td>.457</td>
</tr>
<tr>
<td>2</td>
<td>.531</td>
<td>.713</td>
<td>.554</td>
</tr>
<tr>
<td>3</td>
<td>.554</td>
<td>.744</td>
<td>.591</td>
</tr>
<tr>
<td>4</td>
<td>.583</td>
<td>.783</td>
<td>.641</td>
</tr>
<tr>
<td>5</td>
<td>.620</td>
<td>.833</td>
<td>.709</td>
</tr>
<tr>
<td>6</td>
<td>.632</td>
<td>.848</td>
<td>.732</td>
</tr>
</tbody>
</table>

6.7.6 Logistic Coefficients Test

The logistic regression model estimated coefficients for the six independent variables and the intercept. Table 6.33 displays the six independent variables in the final step.

Table 6.33 Variables in the model

<table>
<thead>
<tr>
<th>Variables</th>
<th>B</th>
<th>S. E.</th>
<th>Wald</th>
<th>Sig.</th>
<th>EXP (B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 6</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SZE</td>
<td>-3.536</td>
<td>1.311</td>
<td>7.281</td>
<td>.007</td>
<td>.029</td>
</tr>
<tr>
<td>SRV</td>
<td>-4.812</td>
<td>1.456</td>
<td>10.926</td>
<td>.001</td>
<td>.008</td>
</tr>
<tr>
<td>EST5</td>
<td>1.988</td>
<td>1.423</td>
<td>5.580</td>
<td>.018</td>
<td>7.298</td>
</tr>
<tr>
<td>AGE5</td>
<td>-1.028</td>
<td>.582</td>
<td>3.121</td>
<td>.025</td>
<td>.358</td>
</tr>
<tr>
<td>EDU</td>
<td>3.457</td>
<td>1.290</td>
<td>7.188</td>
<td>.007</td>
<td>31.513</td>
</tr>
<tr>
<td>BAT</td>
<td>5.535</td>
<td>1.083</td>
<td>26.099</td>
<td>.000</td>
<td>253.357</td>
</tr>
<tr>
<td>Constant</td>
<td>4.270</td>
<td>1.144</td>
<td>13.934</td>
<td>.000</td>
<td>71.539</td>
</tr>
</tbody>
</table>

Accordingly, the mathematical model constructed from the analysis can be formulated as the predicted logit of:

The significance of the independent variables is assessed using the Wald statistics. It can be noted that the six variables have shown significance level of Wald statistics at 0.05 level of significance. Alternatively, the likelihood ratio test of individual parameters can be used to assess significance of the independent variables. This test shows how the regression would put variables into logistic function and then test whether they met a removal criterion. Accordingly, the six variables selected by the stepwise method should all have significant changes in –2 log-likelihood. Table 6.34 illustrates the effects of removal of these variables from the model. It is important to be noted that the significant values of the log-likelihood ratio which means that removing the independent variable from the model would have a significant effect on the predictive ability of the model. Therefore, removing the independent variables form the model is not advisable.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Model Log Likelihood</th>
<th>Change in –2 Log Likelihood</th>
<th>df</th>
<th>Sig. of the Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 6</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SZE</td>
<td>–31.800</td>
<td>12.058</td>
<td>1</td>
<td>.001</td>
</tr>
<tr>
<td>SRV</td>
<td>–37.081</td>
<td>22.619</td>
<td>1</td>
<td>.000</td>
</tr>
<tr>
<td>EST5</td>
<td>–29.955</td>
<td>8.368</td>
<td>1</td>
<td>.004</td>
</tr>
<tr>
<td>AGE5</td>
<td>–27.896</td>
<td>4.250</td>
<td>1</td>
<td>.039</td>
</tr>
<tr>
<td>EDU</td>
<td>–39.775</td>
<td>28.008</td>
<td>1</td>
<td>.000</td>
</tr>
<tr>
<td>BAT</td>
<td>–69.052</td>
<td>86.562</td>
<td>1</td>
<td>.000</td>
</tr>
</tbody>
</table>

**6.7.7 Interpretation of the Results**

Results of the logistic analysis indicate that the six-independent variables model provides a statistically significant improvement over the constant-only model, \( \chi^2 (6, N=147) = 140.786, p < .001 \). Nagelkerke Pseudo \( R^2 \) indicated that the model accounted for approximately 85 percent of the total variance. This suggests that the set of the independent variables discriminate between successful and unsuccessful bank finance applications.

The coefficients of the logistic model are examined to assess the direction and the impact that each independent variable has on the predicted probability and the dependent variable (the status of bank finance application). The direction of the relationship can be interpreted directly from the sign of logistic coefficients in Table 6.33. The independent variables SZE, SRV and AGE5 have negative signs indicating a
negative relationship with the predicted probability of bank loan granting, therefore increasing the likelihood that the finance application is more likely to be declined and vice versa. On the other hand, the independent variables \( EST5, EDU \) and \( BAT \) have positive sings which indicates positive relationships with predicted probability of the application and hence increasing the likelihood that the application will be successful and vice versa. Similarly, the same conclusion can be reached using the exponentiated coefficients to identify the directions of the relationships between the variables in the model. Accordingly, variables with (Exp (B)) values above 1.0 refer to a positive relationship and those below 1.0 refer to a negative relationship.

6.7.8 Concluding Remarks

This chapter presents the empirical findings relating to the demand side of the study represented by SME population in Benghazi city. In this context a number of areas of interest were investigated. First, demographic information about the participants were summarised. This provided a description of the studied sample both SMEs firms and their owner-managers.

The second area of investigation was the one explored SMEs financing information and experiences especially in relation to bank finance. The results in this part revealed that bank finance was found, along with venture capital, the most used source of finance after the internal sources to start a business. Likewise, during post start-up stages for the different ongoing financing needs of SMEs banks with trade credit from suppliers were found to be the most preferred source of finance in case of the internal sources are exhausted or insufficient.

The results also showed that the main reasons for applying for bank finance were that it was seen as the most appropriate source of finance and close relationship with some bank officers. Bank finance was mainly used for purposes of modernization and working capital needs as well as expansion. In terms of difficulties with bank finance high interest rate, unreasonable level of security and the red tape involved were the most cited. In addition, while the lack of quality collateral and the lack of proven track records were found the most frequent reasons for SMEs bank finance applications being rejected, charging interest and the inability to provide the required collateral discouraged some SMEs’ owner-managers from applying for bank finance.

Moreover, in investigating the perceptions and opinions of SMEs’ owner-managers on Islamic finance the study found that Islamic finance methods were perceived as a viable
suitable option of finance for SMEs in Libya and would enjoy a significant support if implemented. The results indicated a strong preference for Islamic finance methods with *Musharakah* being the most preferred.

The last part of the analysis involves binary logistic regression analysis. In this section, selected characteristics of SMEs and their owner-managers were tested as factors determining Libyan SMEs access to bank finance. The results showed that there is an influence of some characteristics on the status of bank finance application. The estimation of the model showed that the logistic regression produced six independent variables. These variables are the size of the firm, the business sector of the firm, how long the firm has been in business, owner-manager’s age and education, and having a business relationship with *Bank Al Tanmeya*. 
Chapter 7. Empirical Results: Interview Analysis

7.1 Introduction

The previous chapter reported the findings pertaining to the demand side of bank financing for SMEs in Libya represented by the population of SMEs in Benghazi city. As it has been previously mentioned in this thesis Bank Al Tanmeya has been chosen to represent the supply side of bank financing for SMEs in Libya. Bank Al Tanmeya is one of the leading banks in serving SME sector in the country. As such, for the purpose of this research seven semi-structured interviews were conducted with senior bankers and loan officers within the bank in order to explore their experiences, opinions, and perceptions on issues relating to bank financing for SMEs in Libya. Therefore, this chapter discusses the supply side perspective of bank financing for SMEs in Libya by reporting the primary findings of the empirical investigation carried out within the case study organisation. The findings are based mainly on the interpretations, discussions, and observations made by the candidate during the interviews. Wherever applicable, narrative quotations are used to illustrate the arguments and the findings.

The data gathered was transcribed, translated, collated, classified, summarised, and analysed into meaningful categories to achieve the aim of the research questions being addressed. The main issues that were covered and investigated in the interviews were related to the following areas:

- Bank Al Tanmeya’s strategic view of SMEs.
- Lending criteria adopted by Bank Al Tanmeya.
- Bank Al Tanmeya’s credit decision making.
- Types of financing offered by Bank Al Tanmeya.
- Potential use of Islamic financing models.

The main reason for using interviewing was its ability to uncover the interviewees’ subjective side and experience relating to their dealing with SMEs and the role of the bank in financing these entities. The open-ended question was the main tool used in the interviews. The questions concern general aspects of bank financing for SMEs in the Libyan context. Each category contained a number of related questions. Therefore, the sections in this chapter aim to pursue the bankers’ perceptions on these subjects.

In presenting the findings, the chapter proceeds as follows. Following this introduction Section 7.2 provides a brief background of the case study organisation (Bank Al
Section 7.3 focuses on Bank Al Tanmeya’s strategic view of SMEs in terms of SMEs definition and the drivers and obstacles of the bank’s involvement with this sector. The findings derived from the responses of the participants to the questions focusing on Bank Al Tanmeya’s experience and practices in financing SMEs are discussed in Section 7.4. Specifically, this section deals with the eligibility criteria of lending to SMEs, information gathered on SMEs applicants, credit decision making and approval, reasons for rejecting SMEs loan applications, and credit products offered to SMEs. In Section 7.5 the findings concerning the perceptions on and the potential provision of Islamic finance are presented. Finally, Section 7.6 concludes.

7.2 Brief Background of Bank Al Tanmeya

Bank Al Tanmeya is a state-owned bank. The bank was established to replace the Manufacturing Division in the Manufacturing and Construction Bank (now the Saving and Real Estate Investment Bank) with the purpose to enhance the industrial sector with the aim of increase production. The bank started its activities in 1981 in accordance with the decree No. 8 of that year with a capital of LD 100 000 million as a Libyan joint-stock company that fully owned by the Libyan government. By 2005 the bank’s capital has increased to reach to LD 628 800 million in order to be able to finance the industrial projects throughout the country. For example, it is allowed to establish manufacturing industries and to develop or extend those which have been established earlier to increase their ability to expand as well as to provide individuals and firms with short and long-term loans (Central Bank of Libya, 2000). The number of loans granted by the bank increased from just 21 loans with LD 592 700 in amount in 1981 to 5053 loans with total amount of LD 20 721 900 in 2005. More recently, specifically in 2010, the figures were LD 167.9 million in amount granted to 402 SMEs. These figures are clearly an indication of the importance of this bank in the development of the national economy especially in catering for SMEs financial needs.

According to articles 2 and 3 of the pre-mentioned decree (No. 8 legislated in 1981) the main duties of Bank Al Tanmeya are (Central Bank of Libya, 2000):

- Provide loans and funds needed for production work in all manufacturing, services, and tourism projects as well as any other economic projects in Libya.
- Provide consultation and/or technical assistance especially to projects with direct or indirect funding from the bank and also others without funding from the bank.
Predict the investment opportunities in the wider economy of Libya and thus promoting diversity in Libya’s income streams by considering suitable projects and presenting these to potential investors.

Encouraging foreign participation in the funding of projects in line with Libyan economic policy.

The bank grew rapidly so that branches and offices had been opened in almost every part of the country with a number of branches distributed throughout Libya which by the end of 2000 had reached 23. In 2010, this number had become 27. *Bank Al Tanmeya* has staff strength of over 800. The bank has its main headquarters in the capital city of Tripoli. In addition, other two regional headquarters have been recently launched located in Benghazi in the east and Sabha in the southern region.

### 7.3 Strategic Approach to SME Banking

In this section, some aspects of *Bank Al Tanmeya*’s engagement with SME segment are presented. This includes the criteria used by the bank in identifying and classifying SME clients and exposures and providing an overview of the extent of the bank’s involvement with the SME sector in terms of the drivers and the obstacles.

It has to be mentioned here that throughout this chapter bankers, participants, respondents, and loan officers are used interchangeably to refer to the interviewees.

#### 7.3.1 SMEs Definition

The official categorisation of SMEs in Libya was described earlier in this thesis. Accordingly, classification of SMEs could range from, in terms of employment size, only one employee up to 25 employees for small enterprises and from 26 employees to a maximum of 50 employees for medium enterprises. In parallel, small enterprises are classified as those with an invested capital of maximum LD 2.5 million whilst enterprises have an invested capital above LD 2.5 million but less than LD 5 million are considered medium (General People’s Committee, 2006).

In order to have a clear vision of *Bank Al Tanmeya*’s relation with SMEs, at the beginning and as a part of the introduction the interviewees were asked to provide *Bank Al Tanmeya*’s own criteria of definition for SMEs. The question asked was:

*What are the definition criteria for SMEs used by the bank?*
In response to this question one interviewee indicated that the bank categorizes SMEs according to the loan size and the ceiling of lending. He stated that;

“When dealing with our clients there are three possibilities; first, individuals; second, small and medium enterprises; and third big companies. As for small and medium enterprises the criterion that we consider is the ceiling of lending to these businesses. So, businesses apply for loans less than LD 75 000 are small and businesses apply for up to LD 2 00 000 we consider them medium”.

After obtaining this answer and in order to gain more information about Bank Al Tanmeya’s classification of SMEs the candidate paraphrased the question inquiring about the employment size of the business and whether it is taken into account at all by Bank Al Tanmeya when identifying SME clients. At that time one of the bank’s legal department staff was contacted by phone by the interviewee and asked to come to the office where the interview was taking place. When arrived he was asked by the interviewee about the criteria employed by the bank to classify SMEs. His answer was, to some extent, consistent with the criteria formally specified in the official definition above. He answered;

“We use basically two criteria which have to be both met; the size of the business and the amount of the loan. The size of the business is a maximum of 25 people for small businesses and from 26 to 50 people for medium enterprises. Also, the upper limit to lend to small business is LD 75 000 and it is LD 2 00 000 for medium businesses regardless of what sector the business belongs to”.

The interviewee added that until recently in 2010 the cut-off of loans to small business was LD 50 000 then it was raised to LD 75 000. He further explained that:

“In a recent meeting in the headquarters in Tripoli it was emphasised that loans to small and medium enterprises should not exceed LD 2 00 000 and businesses apply for more than that to be classified either big or strategic”.

Interviews with senior bankers in Bank Al Tanmeya indicate that although the bank does acknowledge the definition suggested by the General People’s Committee in 2006 and adopted by the National Council for Economic Development (NCED, 2008), nevertheless, in practice it uses its own criteria. Bank Al Tanmeya employs two
quantitative criteria to define an SME. The most important one seems to be the loan size as it was emphasised frequently during the discussion of SMEs definition by the interviewees and the legal staff member involved in this stage of the interview. An additional criterion used by the bank to classify SMEs is the employment size. In terms of employees, the figures adopted by the bank are broadly consistent with those suggested by the official definition of SMEs in Libya (small business ≤ 25 employees; medium enterprises ≤ 50 employees). However, it seems that Bank Al Tanmeya has replaced the criterion of total amount paid in capital of the business by its own classification of borrower type based on the qualifying amounts of loans. This can be due to its relevance to loan analysis and repayment capacity. Accordingly, the cut-off of loans to SMEs adopted by the bank are; a ceiling of LD 75 000 for small enterprises and a higher ceiling of loans to medium enterprises that equals to LD 2 00 000.

Table 7.1 Bank Al Tanmeya’s definition of SMEs

<table>
<thead>
<tr>
<th>Firm size</th>
<th>Number of employees</th>
<th>Loan size proxies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td>≤ 25</td>
<td>≤ LD 75 000</td>
</tr>
<tr>
<td>Medium</td>
<td>≤ 50</td>
<td>≤ LD 200 000</td>
</tr>
</tbody>
</table>

LD: Libyan Dinar.

This finding is in line with what was found by the study of Rocha et al. (2011) that is there are differences in the definitions of SMEs across banks and countries in MENA region as banks are adapting their own definitions of SMEs to the reality of their markets. This implies that definitions adopted by banks are not necessarily the same ones being endorsed by national laws and legal frameworks within the country in which they operate.

It was also found that as part of its business strategy Bank Al Tanmeya categorizes SMEs into sectors based on the business activity. The rationale behind that is to enable the allocation of resources in terms of specialist expertise and identify lending targets in accordance with national development plans. A review of some official documents presented during the discussion showed that SMEs are categorised into a number of sectors include, but not limited to, mining, textiles, paper and leather products, food production, wood products, plastic and chemicals, services, trade, and constructions. Under each category fall a number of business and economic activities. It has to be noted that Bank Al Tanmeya does not engage with SMEs in agriculture as another bank,
the Agriculture Bank, is the one typically approached by businesses and projects of agricultural nature including SMEs.

7.3.2 Drivers and Obstacles of Serving SMEs

The questions here were designed to gather information about the factors that drive Bank Al Tanmeya’s increasing focus on SMEs. It starts with discussing drivers that foster this involvement followed by the obstacles to the bank’s involvement with this segment as identified by the interviewees.

One can say the involvement with SMEs is more or less similar for all banks. To understand its interest in SMEs, participants were asked to indicate the main drivers behind Bank Al Tanmeya’s involvement in the SME market. The question asked was:

*Based on your opinion, what are the factors that drive Bank Al Tanmeya to engage with SMEs?*

The perceived profitability of SME sector was a major driver cited. According to the bankers the sector has potential high profits for the bank. One interviewee answered;

“SME sector is important for our bank. Actually, I can say that the majority of our clients are SMEs”.

The same interviewee added;

“Profitability and growth potential are important factors. Under normal circumstances, we will give a loan to a profitable or potentially viable business”.

This potential does not only come from loans but also from other banking services and products offered by the bank to SMEs. The potential for cross-sale that SMEs entail does not necessary mean that lending is involved. One interviewee said:

“There is also the potential for cross-selling. Because of the services and products we offer to SMEs they recommend us to each other”.

In addition, Bank Al Tanmeya’s engagement with SMEs can be described as a matter of strategy. Bank Al Tanmeya considers the SME segment to be a strategic sector to the bank’s business. This explains why SMEs account for a large share of the bank’s customer base. This is also can be attributed to the fact that, as mentioned earlier in section 7.2, Bank Al Tanmeya was originally established to replace the Manufacturing
Division in the Manufacturing and Construction Bank with the aim to enhance the industrial sector of which SMEs have been the main ingredient.

In the words of one of the interviewees:

“Historically Bank Al Tanmeya has been very close to SMEs. It is somehow a specific area of specialization for the bank”.

To some extent this view was supported by another interviewee who commented:

“Even though we have some big companies as clients such as the Prefabricated Buildings Company, meeting borrowing needs of no greater than LD 200 000 for SMEs is more convenient for us comparing to the credit needs of large companies”.

In the light of the above, it can be said that after all banking is largely a lending business and its main source of income is the interest received from loans as well as fees from other services and products they provide for their clients. Contrary to the perception that banks in general are not interested in lending to SMEs, Bank Al Tanmeya does engage largely in serving SMEs. Bank Al Tanmeya’s interest towards dealing with SMEs is largely driven by the business objective of profit pursuit since it finds this segment profitable mainly through lending. In this respect, supply chain links and cross selling also seem to be important drivers for this involvement. In addition, as a state-owned bank established during a period of time (1980s) that was characterised by passing a number of laws and regulations aiming at expanding the role of the private sector (i.e. medium and small-scale industries) known at that time as “tashrukiyat” (Joint Stock Company), Bank Al Tanmeya has a historical link and traditions in serving SMEs especially in manufacturing. This trend can be seen as a matter of strategy.

Turning to the obstacles, the question asked was:

In your opinion, what are the factors considered as important obstacles to the bank’s involvement with SMEs?

In answering this question responses were various. Primarily bankers complain about the opacity of SMEs and their weak financial infrastructure (lack of reliable collateral, unreliability of financial statements, and their informality). Unlike what was found in other studies, bankers in Bank Al Tanmeya did not complain about excessive competition in the SME sector or weak demand for loans and other banking services by SMEs. However, one interviewee raised the issue of centralization when it comes to
make decisions to lend to SMEs. He explained that bureaucratic red tape involved in that is a major barrier. He also mentioned that policies and procedures change frequently by the headquarters sometimes even without notice. According to the interviewee, this situation led, in many cases, to some tensions with SMEs owners. Moreover, another banker mentioned the lack of contractual enforcement as a hurdle to the bank’s involvement in the SME market.

It can be noted that the obstacles to *Bank Al Tanmeya’s* involvement with SMEs cited by the interviewees such as unavailability and unreliability of financial statements, lack of collateral, and inadequate information are similar to those reported in other studies (e.g. Rocha *et al.*, 2011; Bratanovic *et al.*, 2007). Such factors can be considered as specific to SMEs worldwide. In addition, in this study, participants as well cited high mortality rates among SMEs as another hinder. For this particular reason respondents indicated that they prefer to engage with mature and already established businesses rather than immature ones and start-ups.

The interviewees also stressed the existence of what is known as “moral hazards” where SMEs could use the granted loans for alternative purposes which makes it difficult for the bank to monitor them. In fact, this problem is clearly noticeable in the Libyan business environment. Part of the reason for that can be attributed to some laws and regulations shaped the business culture in the country. For example, a program implemented during the last decade known as “Wealth Redistribution Project” according to which state oil revenues would be distributed to citizens. As a result of this, people wrongly think that it is their right to obtain loans from banks and used them for whatever purpose without having to repay them or to be accountable to banks as a result of their actions. A similar case was discussed by some bankers at the premises of the bank in the presence of the candidate where a small business owner who were granted a loan by the bank has not been seen in the bank neither was able to be contacted for a period of time (three months).

Among the obstacles, two issues are particularly distinctive for the setting of this study; economic instability and centralization. As for the former, due to the unrest lasted for the most of 2011 eventually resulted in throwing away the old regime which had controlled the country for more than four decades, at the time of the study the country was undergoing a period of a transition not only politically but also in economic terms. As a result, a number of laws and regulations were changing. A salient example is the
ongoing discussion at high levels of government tiers regarding converting the whole national banking system to operate in accordance with Islamic finance principles. Combined with the political instability, this situation has had an impact on banks’ involvement with SMEs directly and indirectly.

From the bankers’ perspective, centralization is also an obstacle hindering *Bank Al Tanmeya* from more engaging with SMEs. Due to *Bank Al Tanmeya*’s hierarchical organisational structure and decisional approach, when it comes to lending bankers at *Bank Al Tanmeya*, Benghazi branch, have very few authorities to actively make loans to SMEs and increase the loan book. They have no prospect of financial rewards if they disburse good loans and, on the other hand, could face severe penalties in case of bad debts. Therefore, it can be imagined the effect of this approach on what is called “relationship lending” since the bank cannot guarantee its close clients to have a better credit access as a result of this relationship and thus may lose its clients to other decentralized competitors.

Before proceeding to the finance-related section, as a part of the introduction the interviewees were also asked another question that was:

*Does the bank have a special department specializes in serving SMEs?*

The aim of the question was to gain a clear vision of the *Bank Al Tanmeya*’s credit policy with regard to SMEs. The answers indicated that the bank does not have a special department to deal with SMEs. The interviewees explained that the same credit department at the branch deals with all kinds of clients; individuals, SMEs as well as large corporations. Some of the interviewees stated that they do not see the need for that as the majority of the bank’s clients are SMEs with just a minority of them fall in the other two categories.

### 7.4 Financing of SMEs

In this part of the interview, questions were designed to gather information related to *Bank Al Tanmeya*’s experiences and practices as a financier of SMEs. Information sought included what factors are considered when dealing with SMEs finance proposals (the eligibility criteria) and the importance of collateral. Questions about the credit decision making process, financing products supplied, and the reasons for rejecting SMEs finance applications were also asked.
7.4.1 Eligibility Criteria of Lending to SMEs

It has been suggested that several criteria are considered by loan officers when assessing loan applications especially from SMEs. There is no doubt that understanding such criteria used by bankers in their assessment of SMEs loan propositions and applications can provide crucial insights to SME borrowers when applying for loans from banks. To capture the perceptions of the bankers at Bank Al Tanmeya on such criteria when assessing SMEs loan applications this section of the interviews had focused on gathering information on the eligibility criteria which loan officers at Bank Al Tanmeya consider when making decisions on accepting finance applications from SME clients. The interviewees were asked the next question:

What are the most important factors that are considered when making decisions regarding applications for business loans to SMEs?

The answers to this question reveal that a number of criteria are considered when assessing SMEs loan applications. According to the interviewees, SMEs’ business proposals and loan applications are considered case by case. In this respect, some criteria are given more importance than others. The most important criteria highlighted by the participants during the interviews are discussed below.

I. The Profitability of the Business

In general, under normal circumstances, banks will grant loans to a profitable or potentially viable business. In this respect, SMEs is no exception. The findings of the current study reveal that the profitability of the project for which the fund is being sought seems to be a top factor. Profitability here means that the granted loan must generate profit for the bank. The bankers’ argument implied that they were interested in the ability of the potential applicants to generate profit. They pointed out that profitability is very important in determining the success or failure of a business. They further indicated that the profitability of an enterprise reflects the true position of the business and thus demonstrates the capability to repay the loan. In other words, from the point of view of the bankers the ability to generate profit is sought as an indication of the applicant’s business ability to generate enough profit to pay back both the principal and interest on the loan. One interviewee stressed that:

“It is very important to explore whether the project to be financed by the bank is profitable for the bank or not. As such, there is a need to assess the
profitability of the project. If the project has a good indication of certain profitability it will be more likely funded”.

The findings also show that they a business plan supporting the loan application is expected to include indications for the project’s growth and profitability. Almost all the participants agreed that profitability ratio is viewed as an important variable to identify and measure the creditworthiness of SME borrowers. This result seems to support the conventional view that firms that have a higher level of profitability will have a better chance to access fund from banks. It is also in accordance with what was reported earlier in this chapter that Bank Al Tanmeya’s engagement with SME sector is driven by the profitability of this sector which suggests that to be funded by the bank the project has to be able to generate profit for the bank.

In addition, it is worthy to mention that the discussion with some of the bankers regarding the profitability as a criterion used in assessing SMEs loan applications revealed that the profitability of the business would be assessed in a number of ways. According to these bankers as the ultimate objective is to judge the viability of the business and the ability of the potential borrower to repay the loan, profit figure of the business should not be looked at in isolation. They explained that such a figure should be observed in terms of trends. These trends could include profit figures, profit margins, profit trends, trends of sales, and also any losses in the past. This information can be obtained from other sources such as personal interviews with applicants and the bank’s visibility study. From the point of view of the bankers altogether these figures can lead to a better understanding of the true performance of the business and therefore a better judgement of the creditworthiness of the applicant.

II. Business Plan

It is acknowledged in the literature that business plan is strategically important in bridging the gap of information asymmetry problems in SME lending. In the same vein, in the current study, the provision of a business plan seems to be among the top lending criteria identified during the interviews with the bankers at Bank Al Tanmeya. The majority of the bankers argued for the significance of a good business plan supporting the loan application in the evaluating process of that particular application. They emphasised that a well-prepared business plan can reflect some aspects serving in assessing the applicant’s creditworthiness. One interviewee explained that for taking forward the loan application it has to be supported by a written business plan which
should explain some business aspects such as predictions of cash flow, sales forecasts in addition to profitability ratios for instance. Moreover, another loan officer interviewed stressed that to process the loan application a good business plan is a “crucial element”. In the words of this participant:

“Business plan is a key to better understand the clients' business. A full business plan incorporating financial forecasts and growth intentions is a crucial element to justify the lending application”.

The same interviewee stressed and maintained the importance of a full and convincing business plan by adding:

“Among other important factors, presenting a full business plan is a good indication of the eligibility for accessing bank finance. Generally, clients with better business plans have a big advantage over others who do not”.

The discussion of the importance and the role of business plans to process SMEs loan applications raised the question about what a good business plan should include. Consequently, the interviewees were asked what they in general expect to see in a good business plan presented by SMEs when assessing their lending requests. There was some variability between the interviewed bankers in answering this question. However, in general, the views that were noted amongst the responses implied that a good business plan should basically provide information which is mostly of financial nature. Such information, according to the interviewees, include, for example, profitability ratios, growth ratios, liquidity related ratios, variable and fixed costs of the business, sales projections, and cash flows. In addition, some of the interviewees also mentioned that other general information such as marketing strategy, main suppliers and a brief background of the business and its current position would be of some interest.

Therefore, it can be said that having a good business plan that includes financial considerations and projections as well as business strategies is a positive sign for the bankers when assessing loan applications of SME clients. This seems to be in agreement with findings of an earlier study where the financial aspects were the most important information that bankers look for in a business plan when considering lending to SME clients (Mason and Stark, 2004).
III. The Provision of Collateral

Findings from the interviews reveal that in assessing SMEs loan applications the existence of collateral is vitally important. There was an agreement between the interviewees in their views that collateral security is central for considering SMEs’ loan applications. It was indicated that the provision of collateral is a requirement by the bank’s credit policy. Moreover, it was inferred by the interviewer during the discussions with the participants that if no collateral can be provided then the probability of rejecting the loan application is very high. That is to say loans to SME clients, in general, have to be secured.

The following quotation from one banker demonstrates the importance of collateral to process the loan application:

“Generally speaking, all applicants have to be able to provide collateral. I know that providing good collateral is a challenge for most of these businesses, but that is something we have to consider... There are policies and guidelines to follow. Customers have to understand that the bank needs to feel safe”.

Normally, collateral requirements by Bank Al Tanmeya are in the form of physical fixed assets, especially real estate, land, machinery, and equipment. However, according to some bankers, in some cases personal guarantees/commitments are also accepted.

It is well acknowledged in the literature as well as in practice that banks typically require collateral in order to lend to SMEs. Collateral requirements are usually a function of the size of the loan. According to Bank Al Tanmeya lending policy, provision of collateral is required before loans could be granted to SMEs. For loans that exceed LD 100 000 in amount the collateral required can reach up to 50 percent of the loan value. As for loans that are less than LD 100 000 personal commitments (in the form of personal assets, personal wealth, and personal guarantees) are accepted. This was also confirmed by the loan officers during the interviews. However, in the former case according to some participants, an SME applicant can be also asked to pledge supplementary collateral if the value of the primary collateral (generally real estate) is not sufficient. This supplementary collateral can be personal guarantees or other forms of movable properties. One respondent explained that collateral of tangible nature such as real estate, machinery and equipment pledged by SME clients must go through an evaluating process prior to be accepted. This process is done by a team of experts under
the supervision of the local court. A further explanation was given by the participant that in some cases as a way of financing Bank Al Tanmeya provides funding to SME clients by purchasing machinery or equipment according to their demand. In such cases SMEs would be required to pledge these assets as collateral and thus they will remain the property of the bank till the loan is fully repaid.

During the discussion interviewees were asked about the main kinds of collateral accepted by Bank Al Tanmeya. Their responses can be summarised as below:

- Real estate; the most popular and the main type of collateral which is usually required by the bank.
- Machinery, equipment and vehicles: this type of collateral is usually required from SME clients operating in manufacturing and transportation.
- Products and goods (inventory): this type of collateral should be protected from damage and immune to changes in supply and demand.
- Personal guarantees: this type of collateral is usually in the form of securities and letters of exchange and can also be the borrower’s own salary or bank deposits.
- Any other types decided by the headquarters.

The participants’ responses regarding the importance of providing collateral for assessing the loan application by SMEs led the interviewer to inquire whether the provision of collateral by SMEs means charging less interest rate. According to the information sourced from the bankers in answering this question, the interest rate charged by Bank Al Tanmeya on loans to SMEs is a fixed rate regardless of the value or the quality of the collateral provided. The answer from all interviewees indicated that the demand for collateral is to reduce moral hazard and adverse selection problems and to demonstrate the ability and willingness of the applicant to repay the loan with the interest on time and has nothing to do with the terms of the loan. One interviewee commented that collateral is viewed as an indicator that the applicant has the intention to use the loan for the purpose specified in the loan application which can then increase the security margin for the bank, nevertheless, the applicant still has to repay the loan with the stated interest rate.

Consequently, it could be understood that the provision of collateral does not lead to better credit terms for SMEs nor to the approval of loan applications that otherwise
could not be granted. Furthermore, based on the discussions with the bankers inability to provide collateral is an important factor that can lead to the rejection of loan applications by SMEs. This “conservative” policy of lending which strongly relies on the provision of collateral may lead to the phenomenon of “discouraged borrowers” where some SME clients may choose not to apply for bank loans even if they are in need of funding because of fear of rejection. In fact, from the results presented in chapter six concerning the demand side it can be argued that this phenomenon exists. According to the results in chapter six collateral requirements by banks posed the major impediment among businesses that had not applied for bank finance.

In addition, in the light of the above discussion it might be rational as well to conclude that the ‘lazy banks’ proposition of Manove et al. (2001) wherein highly collateralized loans have no incentive to screen even when the screening costs are low, is, to some extent, supported by the results of this analysis. In such cases the pledging of collateral may lead to reduce the screening effort of banks. In the setting of this study the need for evaluating creditworthiness is reduced since the loans to SMEs are strictly secured on collateral (usually fixed assets). Finally, from the discussion about collateral there was no evidence to suggest that long relationships with the bank do reduce collateral requirements.

Based on the above, the questions listed in the interview guide concerning the requirement of collateral and the types of collateral accepted by the bank had been already answered and there was no need to repeat them again when proceeding with interview’s questions as they appear in the guide.

**IV. The Purpose of the Loan**

Typically, in a loan application the applicant will be asked about the purpose for which the loan is requested. The rationale behind that is that bankers are willing to know if the type as well as the amount of the loan requested suit that purpose or not. In this respect, there was a consensus agreement among the interviewees that the purpose of the loan is another important criterion considered by Bank Al Tanmeya’s staff when assessing SMEs loan applications. This is in line with the results of prior studies such as Mahmood and Rahman (2007) and Owualah (1988) where the purpose of the loan was found to be an important factor in the assessment process and lending decisions to SME clients.
Loans granted by Bank Al Tanmeya to its SME clients, according to the bankers, are, in general, for purposes such as developing new products, expansion and modernisation, and also for start-ups. They stressed that the purpose of the loan is a significant variable in the lending assessment of SME clients. Their responses implied that applicants must specify the purpose of the loan within the loan application. It was further explained that understanding the intended use of the loan helps to understand whether the request of the loan is reasonable, justifiable, and therefore acceptable.

In the light of the above, it is clear that the bankers at Bank Al Tanmeya are highly concerned about what SME borrowers will use the loans for. In other words, they are interested in ensuring that the intended purpose for which the loan is requested will be adhered to. This may also indicate that they are concerned that SMEs may use the loan for other purposes than the ones originally declared when applying. This is actually very true in the Libyan environment. One interviewee commented that:

“From experience, it is very common that SME borrowers might use the loans granted for other purposes, usually personal purposes”.

It is also, from the bankers’ point of view, essential to inquire about the purpose of the loan in order to verify whether the requested amount is correct and can be justified for that purpose or not. In this regard, in terms of practice loan officers can also act as advisors assisting SME applicants in determining the right amount for which to apply to meet their intended purposes. One interviewee said:

“It is also important to question the candidate regarding the purpose of the loan so we can discuss whether the requested amount is suitable for that purpose. In fact, some clients do not specify the amount and leave it to the banker’s advice and experience”.

V. Type of Business

When assessing SMEs lending applications the type of business activity of potential SME applicants is another criterion considered by loan officers at Bank Al Tanmeya. According to the bank’s lending policy and guidelines loan applications by SMEs in certain sectors are prioritised. However, according to the interviewees, this does not mean that these firms will receive any preferential lending conditions such as a lower rate of interest or less collateral requirements.
In line with the national economic plans certain business activities should be given priority by banks. As a state-owned bank, Bank Al Tanmeya prioritizes some business activities when lending to SMEs. Some of the interviewed bankers explained that in general, all sectors would be considered, nevertheless, based on the firm’s specific industry or type of activity some loan applications might be given a priority. It was further explained that the policy of the bank encourages targeting specific client types and activities which are deemed to be of long term prospects and in accordance with the national economic and development plans. One senior banker revealed that over the last few years Bank Al Tanmeya had granted loans to various businesses operating in health and medical services, transportation, and constructions based on their specific sectors. He further explained that this policy is not confined on the nature of the business as it also, in some cases, takes the characteristics of the entrepreneur into account. In the words of the banker:

“Each year we have a certain number of loans allocated to our branch’s SME clients which have to be directed to certain sectors of business or certain types of entrepreneurs. For example, this year (2013) 2000 loans were allocated to our branch to target SMEs mainly those of manufacturing nature. Also, according to the bank’s policy, last year (2012) we were instructed to receive loan applications mainly from the youth (young people aged between 25-40 years) who have a first university degree or equivalent”.

The discussion with the participants revealed that whilst the type of business activity would be favourably considered when processing SMEs loan applications it is no more important than other assessment criteria. The participants remarked that they might not be willing to process the loan application if other criteria such as collateral security and convincing business plan are not going to be met. In other words, apart of given the priority there will be no difference in the evaluation process of SMEs loan applications of firms operating or intend to operate in certain business sectors. Therefore, the type of business activity or industry sector, on its own, does not indicate that the loan application would be ultimately approved.

VI. The Applicant’s Credit History

The credit history of the SME applicant is among the criteria which loan officers at Bank Al Tanmeya consider when assessing SMEs loan applications. Credit history here
refers to the past experience of SME customers in repaying their loans. In this context, the nature of the credit history of the client is viewed as essential piece of information by most the respondents. The majority of the respondents were of the view that such historic information is equally important as projections for existing businesses. Those bankers perceived good records of loan repayment of SME clients as a positive sign for taking the funding applications forward. On the other hand, almost all of the interviewees agreed that clients with bad credit history would be more likely denied access to finance and eliminated at early stages of the process.

One banker commented that:

“From my perspective, credit history of the clients is important and it can directly or indirectly have some effects on the loan application assessment process. I look at this quality not only as an indicator of the client’s commitment and success in meeting repayment requirements in the past but also as an indicator of his willing to repay the loan if granted. It also can indicate how the client is managing the business effectively or otherwise”.

Whilst most of the interviewees stressed that they consider clients’ credit history as critical, some other interviewees were less firm in this regard however. Some interviewees stated that they are interested in information related to the applicants’ credit history, nonetheless, they would be willing to proceed with the applications even if such information are not provided as long as other “top” criteria such as collateral requirements and convincing business plan…etc. have been met. Their argument was that the payment capacity of the firm and securities are more important than historical figures. This view also may reflect some flexibility that some loan officers have when dealing with businesses that have not been trading long enough and thus have limited credit records such as start-ups.

As sourced from the interviewees it is worth mentioning that the importance of information relating to credit history is not confined to previous loan activities with Bank Al Tanmeya. The discussions also revealed that such information are equally important with regard to loan activities that SME applicants had with other banks. This means that more information is needed on businesses that had or are having existing dealings with other banking institutions (more details are provided in the next section concerning Bank Al Tanmeya collecting information on SME applicants).
VII. Business Experience

In addition to their credit history the interviewed bankers referred to the trading and business experience of the owner-managers to be also important. From the point of view of the bankers the success of the business depends largely on the management skills and expertise of the owner-manager. Therefore, in their opinion, experience acquired from prior self-employment, prior employment in the same business, and also from prior business failures could be a good indication of the capability of running a viable business which, in turn, may indicate an ability to generate profit and repay the loan.

One of the bankers commented:

“Business experience of the applicant is really important. I would prefer to deal with people who know what they are going to do and are aware of the environment of their business and any challenges involved. Such people with experiences are more likely to experience future growth and success which is good for the bank in the long run”.

Surprisingly, this contradicts the finding in the preceding chapter where owner-manager’s age and educational background were the only elements of human capital found to be determinant factors of SMEs access to bank finance. Perhaps this could be attributed to some issues with experienced SME applicants that were highlighted during the interviews. According to some of the interviewees, while it is realistic and reasonable to expect that experienced owner-managers have generally more ability to set and consequently present good business plans, however, in practice that is not usually the case. These interviewees explained that in many cases SMEs’ owner-managers applicants with business experience think that they can just rely on their experience and knowledge of the business to have their loan applications approved. As such, they think that they do not need to prepare business plans which are very critical to proceed with the loan applications. For this particular reason it was found that in terms of practice bankers at Bank Al Tanmeya seem to attach less importance to the business experience of SMEs’ owner-managers when assessing their loan applications if it is introduced by SME applicants as a substitute to business plans.

VIII. Financial Statements

In theory and practice financial statements are critical and play a key role in lending decisions made by banks. Regarding this, the interviewees were asked to comment on
how important financial statements are in the process of appraising SMEs lending applications. Their responses indicated that in general financial statements are important elements in lending decisions; however, in the case of SMEs the story is rather different. There was an agreement among the interviewed bankers that financial statements are not vital for the lending application approval process. The interviewees mentioned that financial statements are requested only when they are available. This argument is supported by the fact that most SMEs do not have financial statements and, if any, only a very small minority would have them audited or certified. The respondents argued that even if the financial statements of the business are audited that does not mean that they would be accepted for granted, they rather would investigate them and discuss the details with the applicant. One interviewee said:

“When dealing with SME borrowers you cannot expect them to have proper financial statements. They are just not reliable. In most cases they are prepared for avoiding taxes and do not give an accurate picture of the health of the business…. When it comes to the interview discussing some of the figures in the statements is a regular part”.

Interestingly, some of the bankers stated that they would not ask SME clients for their firms’ financial statements if it was not there in the bank’s policy credit. According to Bank Al Tanmeya’s policy credit SME applicants are asked to provide balance sheets and income statements if they are available. These particular bankers argued that there are other aspects that matter more for the loan application approval. Their argument was based on their experience that if the project has a good business plan and can satisfy the other requirements such as security/collateral imposed by the bank, it is highly likely that the loan application will be processed without taking into account the information from financial statements.

It could be understood from the comments made by participants that since the majority of SMEs do not have reliable financial statements the bankers cannot entirely rely upon financial reports provided by SMEs to process lending applications. This is not surprising given the very informal business culture that the country has which results in incomplete and unreliable financial statements. Nevertheless, as indicated by some interviewees in the absence of trusted reliable financial statements the availability of security collateral and a convincing business plan could be key factors in the approval process.
IX. The Applicant’s Character

At the end of the discussion regarding the eligibility criteria which considered by Bank Al Tanmeya when dealing with SMEs loan applications the respondents were asked whether the characteristics of the applicants (SMEs’ owner-managers) have any impact on the process of loan applications. Here the discussion was directed towards some personal attributes of the applicant that are not directly related to his/her business and management knowledge and experience which were discussed earlier in this chapter. Rather, personality attributes such as integrity, honesty, and morality were the subject of the inquiry.

The interviewees referred to this as “assessment of character”. According to them character assessment is usually performed to form an idea about the willingness of borrowers to repay the loan. Interestingly, there was some variability between the interviewed bankers on the importance of this type of information. Specifically, two different views were noted amongst the responses. The majority of the interviewed bankers regarded some personality characteristics of the applicant such as trustworthiness, reputation, honesty, and integrity as of particular important to process and recommend the application for lending. Such characteristics, according to this group of bankers, have the ability to create trust between them and the applicants and thus facilitate their decisions in relation to recommending loan applications. In addition, these bankers explained that as a part of the process of SMEs loan applications the bank does gather information about the applicants’ ethics and reputation. Some characteristics can be also observed during the interviews with the clients. This can be seen as an indication of how important is this type of information for loan officers to make decisions on SMEs loan applications.

In the words of one banker:

"We are meant to deal with different people from different sectors of the society.... I can comfortably say it is always easier to process with the applications of those who are honest and transparent. This kind of clients will always have my support although the final decision is not mine”.

On the other hand, however, some respondents indicated that this type of information is considered less important and seems to be rather informal. In the point of view of this group of bankers, personal attributes of SME borrowers might be of some importance but should not influence their assessment of loan applications. They appeared to be
more concerned with other type of personal information. They believe that when it comes to the borrowers themselves other information relates to the their credit history and business knowledge are far more important. One banker of this view commented:

“\textit{When judging SMEs loan applicants, I can see the need for the personal characteristics of the manager to be taken into account, however, in my opinion, more consideration and attention should be given to business-related qualities such as their experience, management skills, and knowledge of the business that can reflect how healthy the business is}.”

Nevertheless, all the respondents stated that personality characteristics of SME borrowers in themselves generally are not sufficient enough to have a real impact on the final decision on the loan application.

In summary, from the analysis and discussions above regarding the eligibility criteria for SME loans it can be concluded that according to \textit{Bank Al Tanmeya}’s credit policy SMEs’ business proposals and loan applications are considered case by case. Both existing SME clients and prospective customers go through the same credit process and the same eligibility criteria apply in both cases. It has been realized that the bankers do not clearly assign weight or priority to each factor/criteria, however, the discussion revealed that some criteria are more important and can be considered as “top criteria” such as security/collateral and good business plans. Profitability is also a key factor. Based on discussions with the bankers, the typical criteria for assessing SMEs loan applications by \textit{Bank Al Tanmeya} are highlighted below:

\begin{itemize}
  \item The profitability of the business.
  \item The provision of good business plan.
  \item The availability of collateral.
  \item The intended purpose of the loan.
  \item The type of the business activity.
  \item The applicant’s credit history.
  \item The applicant’s business experience.
  \item Financial statements.
  \item The applicant’s character.
\end{itemize}
All these parts together create an overall picture of the business which lies as a base for the credit decision for SME clients. The next section discusses how Bank Al Tanmeya collects information on the applicants and their businesses to assess in the credit decision making.

7.4.2 Gathering Information on SME Applicants

In order to make the right decision and not misjudge a client, banks have to be careful in their credit assessment of SME customers. In this respect, banks have to collect necessary relevant information in order to make a good judgement. This approach is used by banks in the way that they themselves collect information about the client and the business. Having explained the criteria they employ when assessing SME finance applications the interviewed bankers were then asked whether Bank Al Tanmeya gathers other information on the potential borrowers and their businesses before forwarding the applications to credit committees to decide whether or not to grant loans. The question asked was:

_In the process of judging the creditworthiness of SMEs does the bank itself collect any other information and how?_

First of all, in the process of information gathering the bankers stressed that the applicant provides the necessary information the information that is required. They stated that the provision of this information with no delay shows the commitment and the willingness of the client to enter in a business relationship with the bank. Subsequently, the bank has to ensure that the requested loan is to be used for the stated purpose. If the purpose is property or leasing, the customer is required to provide primary invoices before the application is processed. In the case of business loans, for instance, overdraft credit, it was stated that it is more challenging to get proves what the money is used for. Consequently, the interviewees emphasised the importance of a good relation with the client and a mutual trust. In addition, the bankers added that in almost all cases visit to the business premises is necessary to personally investigate the firm’s situation and inspect its operations ensuring that the firm is operating in the industry which is claimed in the application.

Referred to in the literature as third party opinion, Bank Al Tanmeya also seeks information about the client from other formal and informal sources. The interviewees explained that as a part of the information collection process general information about the applicant and the business are collected by asking other people through what one
called “unwritten survey” conducted by the bank’s staff. The information sought is generally related to the applicant’s ethics, general attitude and behaviour, sincerity, integrity, and his/her business and trade reputation. In addition, information about the business is collected from other sources of information such as local industry directories.

According to the interviewees, local industry directories is usually unreliable source because the industries’ statistics are out of date and prone to errors and omissions and also because most SMEs firms tend to be frequently changing. Information from other sources such chamber of commerce and industry and tax agencies is more reliable, however, access to these sources is said to be limited. As for the credit information, bankers at other banks, suppliers, and retailers are asked to share information on the creditworthiness of the borrower. Moreover, potential borrowers are required to provide copies of draft or actual loan agreements with other banks or lending institutions if they have any.

In addition, it was revealed by the interviewees that to support the process of decision making on SME finance applications a feasibility study is conducted for SMEs firms seeking loans from the bank. The interviewees indicated that in addition to all the information provided by the applicant Bank Al Tanmeya also carries out its own pre-feasibility study regarding the proposed business. The aim of such studies, as the bankers confirmed, is to uncover the strengths and weaknesses of the business to help discovering its true possibilities and opportunities. To serve this purpose the bank’s staff at the Department of Studies within the branch use the CComputer Model for Feasibility Analysis and Reporting software shortly known as COMFAR. This program is applicable for the analysis of the expansion or rehabilitation of existing businesses as well as for new projects. The bank’s feasibility study then is compared with the business plan provided by the applicant and with the feasibility study if he/she has provided any. Based on the results of the comparison and in the light of the bankers’ experience regarding the type of business and its prospects and also considering the amount requested, the application is either forwarded to the credit committee at the branch level for approval or to be declined. However, in some cases the decision is delayed till the applicant is interviewed by one of the bank’s loan officers wherein more information and details to be pursued regarding the finance application and the business situation.
In addition to the above the discussion with bankers further revealed that the personal interview with the potential borrowers is an important source of information for the loan officers. The interviewees stated that personal interview is a good opportunity to gain insights into the applicant’s mind-set and integrity and to know more about the business proposal. During the interview the loan officer would ask questions about specific items in the financial statements and the business plan. Applicants will be also asked to justify the amount of the loan as well as the purpose for which the loan is being requested. If the loan officer is convinced about the answers given by the client and about the business in general then the details of repayment are discussed.

The following quote in the words of one of the bankers illustrates the importance of the personal interview with the client in the process of collecting information:

“The interview with the applicants allows us to interact with them personally. It gives us the opportunity to discuss any important issues regarding the finance application directly with the applicant who is supposed to have the knowledge and provides accurate answers to the raised questions. During the interview frequently asked questions relate to the purpose of the loan and the sources of repayment, the prospect of the business, and its ability to generate profits. The applicant may also expect questions in the areas of management, performance, and marketing. .... To recommend the application to the credit committee at the branch level the borrower has to be able to provide convincing answers”.

According to one of the respondents, the business knowledge of the applicants and their personalities which can be identified during the interview can facilitate the decision-making regarding their applications. Another interviewee added to that the willing of the applicants to share information during the interview increases the understanding and the trust and hence, improves the likelihood of the endorsement of their loan applications. In addition, business consultation can be provided if required. Moreover, it was explained by the bankers that during the interviews greater information is required from the applicants in case of start-up proposals.

It appears from the interviews with the bank officers at Bank Al Tanmeya that several important aspects about the applicant and the business to be investigated so the credit decision is not entirely based just on the information received from the clients. This includes, according to the interviewees, reputation of the client, reputation of the firm,
the business viability and, if any, how it paid off its previous loans. The bankers emphasised the importance of collecting such information in order to judge if the potential borrower is creditworthy. After these investigations bankers either ask for more documents and information from the client or the request might be rejected in the early stages. During this process the bankers may also offer the client business consulting services. The gathered information is supplemented with the basic information provided by the clients so the bankers can conduct assessments and formulate arguments that are forwarded to credit committee at the branch level which, in turn, decides whether or not to recommend the application for approval to the central credit committee at the headquarters.

7.4.3 Credit Decision Making and Approval

This section focuses on the decision-making of Bank Al Tanmeya with respect to loans to SME clients. The purpose is to provide an overview of the practices of the bank regarding SME lending decisions. The question asked was:

*Can you describe how the bank’s credit decision to SMEs is made?*

According to the interviewees the decision of Bank Al Tanmeya to grant loans to SMEs is based on the formation of opinion by loan officers on the potential borrower and his/her loan application. This opinion formation, in turn, is based on the evaluation of the applicant’s creditworthiness and the prospects of the business. It starts with the customer approaching the branch with the application which must not be in conflict with the banks’ lending policies and guidelines. Generally speaking, the application from the customer should contain:

- The purpose of the loan requested.
- The amount of the loan requested.
- Mode of repayment.
- Source of repayment.
- Proposed security.

As indicated above, before Bank Al Tanmeya makes a decision to provide a loan; an evaluation of the prospective borrowers to determine their creditworthy has to be done. The evaluation is based on the information provided by the client combined with the information gathered by the bank. During process potential borrowers will be requested
to provide basic documents such as financial statements, if available, and business plans. In addition, the feasibility study conducted by the bank constitutes a vital part of the evaluation. Then, the bankers will arrange an interview with the potential borrower to know better about the customer and the business proposal. A second interview could be organised if needed.

As discussed earlier in this chapter, in essence, to be eligible SME applicants must satisfy a number of criteria that are examined by the bankers. Subsequently, if the loan officer supports the proposal a recommendation is written and passed on to the Credit Committee at branch level under the direct supervision of the branch manager. If approved, the application is submitted with the recommendation to the main headquarters in Tripoli for final approval. According to Bank Al Tanmeya’s lending policies and guidelines the general manager in the headquarters is authorised to approve applications of no more than LD 50,000 per application, otherwise, loan applications to be approved by the Central Lending Committee. The Central Lending Committee is a centralized committee formed by a decision by the general manager and operates within the main headquarters. In either case, if approved, the documentation phase concludes the process where the details and other terms and conditions under which the loan is granted are documented as a loan agreement. Finally, the client is requested to come to the bank branch to sign a loan contract. The branch manager is only authorised to sign the loan agreement if the amount approved is no more than LD 50,000.

According to the information sourced from the bankers and also from some of the documents presented to the interviewer the loan agreement should include the following details:

- The amount approved.
- The purpose of the loan.
- The loan maturity.
- The security/collateral provided.
- Mode of repayment.
- The loan must be used for the stated purpose.
- The bank’s charges which contain interest rate and management processing fee.
The commitment of the client to implement the agreement within 6 months of the date of signing it otherwise it will be terminated.

It has to be mentioned here that the approval is only given if all documents have been completed correctly. The main basic documents needed to complete an application file are as follows:

- The prospective client’s national identification card and proof of residence.
- A duly completed copy of the application for a loan.
- A copy of the business license.
- A copy of the commercial registration.
- A copy of the land lease agreement for the allotted plot of land, or a copy of the land title deed.
- Detailed and recent business plan or feasibility study of the project, or both.
- Bank statement of the applicant (at latest 6 months).
- A list of major suppliers and buyers.
- Any other document/paper which may be necessary as per requirement of the case.

Answering the related query the interviewees indicated that once the borrower’s application along with the required documents are forwarded to the headquarters it can be expected that the duration till a decision is made about the application range from 30 to 45 days. However, the process might be significantly delayed in case of incomplete or unclear applications.

During the interviews with the bankers at Bank Al Tanmeya it was indicated that the standard processes and terms of lending decisions to SMEs were largely unchanged with occasionally slight adjustments primarily related to approval and disbursement in order to better fit within the existing structure and hierarchy of the bank. In addition, it was found that without being given enough authority to finalise lending decisions at branch level the interviewed bankers were not satisfied with the lending approval authority which is entirely concentrated at the headquarters level. They complained that they have to strictly follow the structure as provided in the lending regulations in order to have the loan application processed and approved. They believe that the lending decision is extremely centralised at the headquarters which results in delaying
approving the applications causing problems with the branch’s costumers and affecting the branch’s reputation.

### 7.4.4 Reasons for Rejection of SME Applications

After discussing the criteria used by *Bank Al Tanmeya* in assessing loan applications from SME clients the interviews had proceeded to discuss the main reasons for declining SMEs’ loan applications. It is noteworthy here that in terms of practice even though that the final decision to grant loans to SMEs is made at the head office level the bankers at *Bank Al Tanmeya* branch level have some authority to reject applications from SME clients at earlier stage. The main aim of the question asked was to identify what factors that cause the applications from SME applicants to be rejected. Specifically, the bankers were asked to identify the most frequent reasons for SME proposals being rejected. The question asked was:

*Based on your experience, what are the most frequent factors that cause the finance application from SMEs to be rejected?*

Not surprisingly, the interviewed bankers made frequent reference to collateral-related reasons as common factors that the financing proposals from SME clients are rejected. Respondents mentioned that the bank expects collateral security from loan applicants to secure the requested loans. Subsequently, the failure of the applicants to provide or prepare a suitable security for financing simply means that their loan applications to be declined. The bankers mentioned that to take the funding application further they expect suitable collateral preferably in the form of fixed assets or other assets of tangible nature to be provided. These collateral-related reasons, according to the interviewees, range from not adequate collateral and collateral of insufficient quality to the inability to provide any.

Another factor mentioned by the respondents which frequently leads to the rejection of the application of financing was the type of the business activity itself. It was emphasised that the bank is not keen to finance certain businesses or industries because of high risk involved with them. In addition, as it was mentioned previously in this chapter *Bank Al Tanmeya* employs some kind of sector-based lending in which credit is allocated to certain types of businesses (e.g. new products and new technology) or certain categories of entrepreneurs are targeted (e.g. university graduates) in accordance with national developments plans. As such, applications meet these criteria will be given a priority which means in some cases, considering the amount of credit allocated
to the branch and the size of credit demand, applications from other businesses to be declined even though in normal circumstances all sectors and businesses are considered. Moreover, from the bankers’ perspective if the result of the evaluation of the ability of the business to generate income, based on the bankers’ experience of business activity, which is a main source of repayment, is not satisfactory the application will be rejected. One of the bankers explained why some applicants could be rejected just because of the business to which they belong. He indicated that some people establish some kind of business just to follow the fashion because other people are doing the same after obtaining funds from the bank. He added, this trend has become known to the bank and, as a result, certain businesses are no longer attractive for the bank because their market is simply “saturated or overloaded”.

In addition, the responses given by the interviewees showed that poor indication of the capacity of the potential borrower is another common factor for rejecting SMEs loan applications. During the evaluation process, based on information from the business plan, the feasibility study, and the financial statements (if provided), if loan officers are not satisfied with the performance of the business and the capacity of the applicant to repay the loan the application will not be considered for financing. Likewise, a review of the interviewees’ answers revealed that in many cases poor repayment records of the applicant with other lenders can lead to reject the application.

During the discussions with the interviewees they also made mention of other common reasons that cause rejection of SMEs loan applications. These reasons included lack of expertise, size of the requested loan, bad or incomplete business plan, previous banking history of the applicant, and level of profits. Other reasons mentioned by the interviewees were insufficient business case and proposals inconsistent with the credit policy of the bank.

Interestingly, the bankers revealed that it is not an obligation by Bank Al Tanmeya credit policy that rejected applicants should be informed formally in writing about the reasons for rejecting their applications. However, the bankers mentioned that in some cases they do inform the clients in an informal way.

It can be concluded from the respondents’ answers that various reasons resulting in rejection of SMEs’ loan applications by Bank Al Tanmeya. However, in general, they all can be attributed to applications are not robust enough to meet lending criteria adopted by the bank. It also was found that only one single factor, from the mentioned above, is
enough to be the reason for the rejection. It is lack of collateral security which was found the most frequent reason. Other important factors include, but not limited to, weaknesses in business plan, concerns about the loan repayment, bankers do not see the viability of business ventures, and the proposal being against the bank’s policy.

These findings are, to some extent, in agreement with what was found in the previous chapter from the perspective of SMEs. Nevertheless, a notable difference is that among the reasons given by SMEs was the lack of track records which was not raised by the bankers as an important factor for rejection in this chapter. This can be ascribed to the fact that, as mentioned above, Bank Al Tanmeya does not inform its clients about the reason for rejecting their applications so it can be said that when answering the related question SMEs’ owner-managers were just assuming that they were unsuccessful due to lack of track records. Another possible explanation is that since the SMEs sample targeted by the questionnaire did not confine to Bank Al Tanmeya’s clients this could mean that those SMEs declined bank finance on the basis of not having track records might have approached other banks which, supposedly, do consider track records as an important criterion when lending to SMEs as it is believed that different banks have different criteria and different internal credit policies.

7.4.5 Credit Products Offered to SMEs

Banks provide a broad range of loan products to their clients including SMEs. On the other hand, clients may borrow for either individual needs or business purposes. For SME clients, to meet their business needs they may borrow for either working capital needs or fixed asset purchases and acquisition. In this context, the question asked was related to the types of financing offered to SMEs. Accordingly, information about the types of financial products Bank Al Tanmeya offers to its SME clients were sought through discussions with the bankers as well as from reviewing some relevant bank documents. The question asked was:

*What are the main types of financing offered by the bank to SME clients?*

As indicated earlier in this chapter Bank Al Tanmeya loan amounts to SMEs can reach up to LD 200 000. According to the information sourced regardless of their types loans to SMEs must be used for business purposes only.

The most commonly types of Bank Al Tanmeya’s credit products tailored to SME needs can be generally and briefly described as follows:
➢ Term loans: these loans are used to acquire fixed assets (immovable, properties i.e. land and buildings, as well as commercial vehicles). Such loans can be short term (within 18 months), medium term (up to 3 years) and long term (more than 3 years up to 10 years).

➢ Working capital loans: this type is used for the ongoing cash needs of the business. Both short-term loans and medium-term loans can be categorised as working capital loans as well.

➢ Industrial hire-purchase: this type is very common and is sought by SMEs to acquire capital assets such as equipment and machineries. In this type the asset is purchased by the bank and hired to SMEs with the ownership being retained by the bank until the loan is repaid via predetermined periodic repayments.

➢ Letters of credit: another common type of finance offered by Bank Al Tanmeya mainly sought by manufacturers SMEs to import or purchase materials or equipment. For this type the bank has recently signed a number of agreements with companies from Italy, Greece, Turkey, Egypt, and China in addition to some local ones to be the main suppliers of any materials, equipment, and machineries requested by the bank’s SME clients.

➢ Overdrafts: used by account holders usually to meet urgent working capital needs i.e. payment of salaries, purchases, utilities etc. this type is also considered as a source of short-term funding.

It was recognized from the discussion with the respondents that some of these facilities are cash facilities while others are non-cash facilities. The former category includes term loans (short, medium and long), loans for working capital purposes, and overdrafts. It was indicated by the respondents that in comparison with other types loans of long-term maturity are the least granted. On the other hand, the latter, the non-cash facilities category, includes products such as industrial hire-purchase and letters of credit. As such, it can be said that such diversity of credit products provisioned by the bank enables SMEs’ owner-managers to choose the proper option depending on their financing needs and the suitability of the financing product to their business.

However, as it was found in the analysis of the demand side findings in the previous chapter that many SMEs are unwilling to approach the bank for funding most likely due to religious believes given the fact that these types of finance are offered under
conventional banking which is interest-based which is prohibited in Islam the dominant religion in the country. As such, one could argue that through Islamic modes of financing the bank can attract more SMEs businesses that are unwilling to deal with conventional banking system. In the light of this in the next section the focus of the interview shifts to address the Islamic finance with the objective of exploring Bank Al Tanmeya’s staff attitudes towards Islamic finance and the potential of offering Islamic methods of finance to meet SMEs’ demand.

7.5 Islamic Finance for SMEs

According to the results in the previous chapter one of the reasons why Libyan SMEs demand for bank finance is still unmet is the absence of Islamic finance. Moreover, it was also found that there is a significant demand for Islamic finance among the SME population. At the time of this study it is believed that there was no any financial institution, bank or otherwise, offers Islamic finance within the country. As such, it was decided to widen the scope of the study to include aspects related to Islamic banking and finance from a supply point of view. The aim was to investigate the perception of the bankers at Bank Al Tanmeya towards offering Islamic financing to the SME sector. Due to the absence of Islamic banking and finance in the Libyan banking system which means that the bankers have no past practice experience of this kind of banking, the discussion was meant to be limited to the general knowledge of the participants about the conception of Islamic finance and its financial products as well as Islamic finance viability and suitability for SMEs in addition to any plans by the bank to introduce Islamic finance in the future.

7.5.1 General Knowledge of Islamic Banking and Finance

First of all, it is worth mentioning that some of the participants (specifically three participants) chose not to engage in the discussion about Islamic finance because of their lack of understanding and knowledge about the subject. As an introduction to the theme and to help the interviewees become familiar with the topic, the respondents were first asked to indicate their knowledge of the differences between Islamic and conventional banking. The following question was asked:

What do you know about the differences between Islamic banking and conventional banking?
The answers indicated some knowledge and awareness of some basic differences between the two types of banking. All the respondents cited the prohibition of interest as a major difference between Islamic banks and conventional banks which are in essence interest-based banks. One of the respondents commented on that by explaining that in Islam both paying and receiving interest is prohibited and the main aspect of Islamic banking is the absence of Riba (interest). He also further explained that as an alternative of interest Islamic finance is based on profit based returns through economic and investment activities based on trade transaction or physical asset-based investment. In addition, the respondents also referred to the prohibition of investment in industries and products that are forbidden in Islam such as alcohol, gambling, and pork based products. The respondents also were aware that Islamic banking prohibits major uncertainty in all forms of transactions.

Furthermore, the participants were asked about their knowledge and awareness of financing methods offered by Islamic banks and institutions. The interviewees indicated some knowledge and awareness of Islamic finance methods namely Murabahah and Musharakah. Only one banker indicated his knowledge of Ijarah (leasing contract). The answers show some lack of understanding of the wide range of Islamic finance products in Islamic finance as no mention was made to other products such as; Mudarabah, Bai Salam, Qard Hasan, and Istisna.

The participants were asked another question regarding their perceptions on Islamic finance and whether it could be a viable option for SMEs in Libya if implemented. The question was:

*In your opinion, is Islamic finance a viable option for SMEs in Libya?*

The majority of interviewees’ major argument relevant to this issue was that in Libya as a Muslim society Islamic finance would be useful for SMEs. Considering the religious features of the Libyan society the interviewees presumed that introducing Islamic banking and finance would be of high demand and could enjoy rapid development. The interviewees based their argument on that Muslim people should be able to conduct their business according to Islamic law as it for other aspects of their daily life. However, from a financial point of view these interviewees were not certain about the viability of Islamic finance for SMEs. The reason for this can be attributed to the fact that none of the interviewees had any previous experience with regard to practicing
Islamic banking and finance since, as it was mentioned above, this kind of banking dealings is yet to be implemented and practiced in the country.

Nevertheless, one of the interviewed bankers who had recently attended some workshops pertaining to the application of Islamic finance argued that Islamic banking is feasible and capable of successfully serving SMEs in Libya. He stated that the absence of Islamic banks in Libya remains a hinder for SMEs to apply for bank finance. As a result, establishing an Islamic finance system that offers various financing methods, he added, would attract many SME clients who have been reluctant to approach conventional banks for funding even if they are in need of capital. The interviewee gave an example of some SMEs’ owner-managers he knew who avoid dealing with banks and the interest they charge or pay. He further explained that the variety of financing products in Islamic finance would allow SME clients to choose the best type of product considering their type of business and its stage of development.

It is clear from the above that the participant bankers showed basic level of knowledge and awareness of Islamic banking concept and a lack of knowledge about the wide range of Islamic finance products. The reason behind this can be attributed to the fact that at the time of data collection only a few of the respondents had had the opportunity to attend seminars on Islamic banking and finance organised by the bank’s headquarters in Tripoli. However, all the respondents showed a positive attitude towards Islamic banking and finance. From a religious perspective, the interviewees underlined the importance of the adherence to Islamic principles in the daily life of Muslim people including how business should be conducted. On the other hand, from a financial perspective, it was expressed by some of the bankers that Islamic banking can play a dynamic and effective role in providing for SMEs financing needs by offering a variety of unique financial products that are able to meet the different types and levels of Libyan SMEs financing demand.

Having observed the participants understanding and knowledge regarding Islamic banking concept and Islamic banking products the discussion then was directed to the case of Bank Al Tanmeya and whether there are any plans to offer Islamic finance modes of finance for SME clients and, if any, what financial products and services to be offered.
7.5.2 Potential Implementation of Islamic Banking and Finance

The prospect of Islamic finance products to be provided by Bank Al Tanmeya was another question in the interviews. The participants were asked if there are any plans by the bank to offer Islamic financing modes for SME clients in the near future. The question asked was:

*Does Bank Al Tanmeya have any plan to offer Islamic finance products in the future?*

In answering this question the participants mentioned that there has been always a demand for Islamic banking by both individuals and business firms, nevertheless, according to the interviewees, the state was not ready or not willing to support the implementation of Islamic banking in the country. Consequently, only small steps have been taken by banks and the financial authority in favour of Islamic banking. However, after the revolution in 2011 the situation has changed and in line with the demand there has been a pressure for a system of Islamic finance to be provided. As a result, the new authorities have taken some steps such as waiving the interest from loans granted to individuals. This is seen as a sign of the intention and willing to introduce the Islamic banking system in the way towards a full Islamic banking system.

Turning to the case of Bank Al Tanmeya the interviewees revealed that consistent with this general tendency the plan adopted by the bank is to provide existing and potential customers with new products in accordance with Islamic banking principles. In fact, at the time of interviewing the bank was in the process of building up towards implementing Islamic banking operations. It was because of this policy of converting to Islamic banking the bankers expressed that they were more concerned with loan recovery rather than obtaining new costumers and granting new loans. The findings also demonstrated that the launching and implementation of Islamic banking and finance could eventually take 12 months. In addition, it was indicated that by having to look at all the policies and procedures to Islamic banking and finance it may take up to 18 months for full implementation that is early in 2015.

In parallel, human capital component as it is the centre of development in the transformation process has been given special consideration. In this context, the bank had arranged for its staff a number of seminars, workshops, and formal training programs on Islamic banking and finance. Initially, the staff members receive introductory training sessions provided by the bank’s headquarters in Tripoli. These training sessions are largely theoretical with the aim of building the knowledge and the
skills base of the employees. For more advanced training a further stage of training takes place in Jordan and it is organised cooperatively with the Jordanian Islamic Bank, one of the leading Islamic banking institutions in the region. As has been mentioned previously in this thesis, at the time of interviewing a number of the branch staff members were away attending these advanced training courses in Jordan. These programs are more practical and vocational combining theoretical knowledge with role-playing in an inter-active environment which offers participants a strong platform in which to work. One of the bankers expressed his satisfaction with what had been achieved through these training courses stating and hoping that by 2015 the bank will be ready, though partially, to serve and meet the SMEs’ demand for Islamic finance products.

In order to understand the financial products that SME customers can have access to the bankers were further asked to indicate what types of Islamic financing or financial products to be offered to serve the SME market. The interviewees were asked the next question:

*Can you indicate what Islamic finance products the bank is planning to offer to its SME clients?*

The responses from the interviewees in answering this question indicated that till the time of interviewing no final decision had been made in this regard, however, according to some of the bankers responded to this question it is more likely that the main modes of Islamic finance that to be implemented and offered to SME clients include *Murabahah* (cost plus) financing, which is more typically used for financing working capital needs and *Ijarah* (leasing contact). It was further explained that the mode of *Ijarah* targeted by the bank is the form known as *Ijarah muntahia bittamleek* (a form of leasing in which the lessee has the option to purchase the leased asset by the end of the lease term). In addition, for projects that are of high feasibility and that expected to achieve high rates of growth and profitability the *Musharakah* mode (profit-and-loss sharing) to be considered.

According to the findings in the previous chapter, the demand side findings, in addition to *Musharakah* SMEs operating in the city of Benghazi showed more interest in *Mudarabah* mode of finance than *Murabahah* mode. This may suggest that *Bank Al Tanmeya* may need to reconsider what modes of Islamic finance to be implemented to
meet the demand of SMEs although as indicated above no final decision in this regard has been made.

Finally, to complete the picture from the supply side perspective represented by Bank Al Tanmeya’s experience in financing SMEs the candidate was hoping to gain access to data relevant to the trends of SMEs’ demand for bank finance in terms of number of loan applications received and number of those approved and how that was met by the bank in terms of loans disbursed in number and amount for at least the last two years. However, unfortunately, for reasons mainly related to the bank’s centralization structure in addition to the building up towards Islamic banking that was not possible to achieve.

7.6 Concluding Remarks

The purpose of this chapter was to highlight how Bank Al Tanmeya, a state-owned bank in Libya representing the supply side of bank financing for SMEs in this study, is involved in financing SME sector. For this purpose senior bankers at the case study organisation were interviewed.

Contrary to the conventional perception that banks are not interested in serving SMEs, the results of this chapter show that Bank Al Tanmeya does engage largely in serving this sector. This interest is mainly driven by the business objective of profit pursuing since this segment is perceived as profitable with promising prospects. In terms of the hurdles, however, some issues typically characterising SMEs such as moral hazard, lacking of collateral, and asymmetry of information were mentioned. In addition, two other issues which are particularly distinctive for the setting of this study; economic and political instability and centralization of the bank were also cited among the obstacles.

In general, the fundamentals of profitability, security, and suitability are applied in assessing SMEs’ loan proposals. In this respect, the ability to provide collateral and good business plans alongside the profitability of the business seemed to be of particular importance. Other criteria of eligibility include, but not limited to, the credit history of the applicants, their business experience, and the business activity. In addition, in order to not misjudge their creditworthiness Bank Al Tanmeya does also collect other information on the applicants mainly related to the reputation of the client and that of the firm. This type of information is sourced from local industry directories, tax agencies, and other banks. Subsequently, based on the assessment of the applicant’s creditworthiness the credit decision is mainly and almost exclusively made by the central credit committee at the headquarters.
The financial products offered by Bank Al Tanmeya to serve SMEs are in the form of term loans (short, medium and long), loans for working capital purposes, industrial hire-purchase, credit letters, and overdrafts. Moreover, in exploring the potential of Islamic finance implementation to meet SMEs’ demand the results revealed that by 2015 the bank will be ready to offer its SME clients products that are in accordance with the Islamic finance principles with Murabahah, Ijarah, and Musharakah modes are the main ones to be offered.
Chapter 8. Conclusion

8.1 Introduction

The objective of this thesis was to obtain an informed understanding of the status of bank financing for SMEs in a developing country in transition, namely Libya, and the factors that facilitate or hamper SMEs access to bank finance. For this purpose, we examined both the demand and the supply sides to address the issues relating to SMEs access to bank finance. Accordingly, the population of SMEs within the Libyan city of Benghazi and Bank Al Tanmeya (Benghazi branch) were approached for the required data by employing a combination of quantitative and qualitative methods. The thesis further discussed the potential use and implementation of Islamic finance to serve SME sector from the point of view of both sides. The study has been successful in fulfilling its objectives. Thus, it is anticipated that the study has helped to develop a better understanding of and rich insights into bank financing for SMEs in Libya.

The remainder of this chapter is structured as follows. Section 8.2 provides a summary of the thesis which includes some discussions of the main results. Some theoretical and empirical contributions of the current thesis and its industry and policy implications are outlined in Section 8.3. In Section 8.4, some of the limitations of the thesis are discussed. Finally, Section 8.5 offers some directions for further research.

8.2 Summary of the Thesis

For the purpose of investigating its topic which is the current status of bank financing for SMEs in the Libyan context this thesis comprised eight chapters including this chapter. The previous seven chapters can be summarized as follows.

Chapter 1 Introduction began with a general background to introduce the research topic at hand. The chapter then indicated the research context and the motivations for conducting the investigation along with the thesis aim and objectives. The final part of this chapter outlined the structure of the thesis.

Chapter 2 Small and Medium-Sized Enterprises Review provided an overview of some general aspects related to SME sector. Taking into account the importance of providing a conceptual background for understanding this sector the review was initiated by discussing the different methods that usually used by countries and international institutions to identify SMEs. Both quantitative and qualitative criteria were discussed.
Although there is no consensus on SMEs' definition, the number of employees is the most common and the most used. However, in practice terms, usually a mix of criteria is used to identify SMEs.

The discussion then extended to highlight precisely what distinguishes SMEs from entrepreneurship as well as from large organizations. We concluded that entrepreneurship is a process that results in creating SMEs whereas SMEs are just business ventures, which are managed by individuals. The chapter also highlighted that SMEs have some unique characteristics, which differentiate them from large organizations, however, they are considered as complementary to large companies.

The role of SMEs in the social and economic development is widely acknowledged worldwide. In spite of that they face many challenges and difficulties impeding their growth. On the top of these challenges are the availability and cost of capital and the unflavoured government regulations. For SMEs in Libya the situation is no different. Despite the increasing importance of SMEs for the national economy during this transitional period they encounter many challenges foremost of which is access to finance.

Chapter 3 Financing of Small and Medium-Sized Enterprises presented a discussion of SME financing behaviour and practices. It highlighted the role of finance as a critical element for SMEs' development. The chapter began with introducing theories that explain SME financial behaviour. The theories discussed included: the life-cycle paradigm, the pecking order theory, the trade-off theory, and the asset side theory. For raising the finance they need SMEs have a range of options. In general, these options can be in the form of equity or debt. The former category encompasses owner-manager/s’ personal savings, retained earnings, venture capitalists, and business angels. Sources included in the latter category are trade credit from suppliers and long or short-term loans from banks or other finance institutions. Funding can also be obtained from government assistance schemes. In addition, Islamic finance provides an additional source of finance for SMEs.

However, not all these sources are easily accessible. There are obstacles that hinder SMEs from accessing these sources. Most notably, the existence of informational asymmetries between SMEs and their perceived financiers and the high risk linked with investing in SMEs. There is also the issue of high transaction costs. Another problem,
more pronounced in the case of debt finance, is SMEs’ lack of collateral. As a result, SMEs face financing gaps in terms of equity finance and debt finance.

In the Libyan context, because of the pre-mature financial infrastructure and the low levels of financial intermediation in the country SMEs are heavily dependent on internal sources of finance. The problem of Libyan SMEs access to finance is compounded by factors include, but not limited to, lack of planning and regulatory support, bureaucracy, and owner-managers’ poor management skills.

Chapter 4 Literature Review reviewed the theoretical and empirical literature relating to bank finance for SMEs. It covered the relevant aspects of the demand and the supply-related literature on SMEs access to bank finance. On the supply side, the review revealed that contrary to the conventional wisdom banks perceive SME sector as a market of good prospect that is profitable to serve. Banks also engage in serving SMEs to seek new clients and extend their operations. On the other hand, however, banks’ engagement with SME sector is hindered by factors such as information asymmetry, high risk, the high cost of lending, and the lack of collateral. These factors make it difficult for bankers to assess the creditworthiness of SMEs and therefore, they are usually reluctant to finance this type of firms.

The chapter also discussed the transactions methods and practices used by banks to lend to SMEs. The methods reviewed included; financial statement lending, asset-based lending, credit scoring lending, relationship lending, factoring, and leasing. Prior to making the decision to lend to SMEs bankers have to judge the creditworthiness of the SME applicants. In this respect, there is a number of criteria which are usually considered. Basically the 5Cs namely; capital, character, condition, collateral, and capacity are widely adopted and used. Examples of other criteria that can be used are managerial skills of owner-managers, their business experience, the default risk involved, and profitability. In general, failing in meeting these often leads the finance application to be rejected.

In the demand side literature, the chapter reviewed the impact of SMEs characteristics and those of their owner-managers on SMEs access to bank finance. There is general agreement in the literature that these characteristics do act as determinants of SMEs access to bank finance. However, other factors such as the information gap, high interest rates, and the inability to provide the required collateral are described as hurdles discouraging SMEs from seeking bank finance.
The review in this chapter also indicated that there is a strand of the literature promotes Islamic finance methods’ suitability for financing SMEs. The argument supports this is that the emphasis in Islamic finance methods is on the transaction itself rather than the applicant’s creditworthiness.

The final part of this chapter discussed bank finance for SMEs in Libya. Overall, the literature on Libyan SMEs and bank finance is scarce. In the absence of non-bank financial activities in the country, banks remain practically the sole provider of external finance for SMEs. However, access to this source remains a challenge. This is because of obstacles typically characterising SMEs such as information asymmetry and lack of collateral in addition to weaknesses in the legal and registry systems of ownership of land which is the main source of collateral in Libya. The review also showed that the absence of Islamic finance is a reason explaining why Libyan SMEs’ financial needs have not been met.

Chapter 5 Research Design and Methodology presented the research methodology adopted and used to achieve the study’s objectives on both dimensions demand and supply. Firstly, the chapter explained the quantitative and qualitative approaches and the combination of both (triangulation) employed in this thesis. The selection of the research design was based on the need to obtain in-depth insights to fully understand the issues related to bank financing for SMEs in Libya from the perspective of both demand and supply. The design involved the use of survey questionnaire and interviews to gather the required data. Further, this chapter detailed the conduct of the field study by describing the process of preparing, piloting, and the administrating the questionnaire and conducting the interviews which were the main data collection tools used in this thesis.

The first empirical methodology detailed the preparation of the questionnaires. The questions in the questionnaire were extracted from the relevant literature. SMEs operating in trade, services, and manufacturing within the city of Benghazi were targeted as the source of data on the demand side. A snowball sampling technique was used when administrating the questionnaire. The questionnaire was self-administrated by the candidate and two assistants. Various types of questions including closed-ended questions, five-point Likert scale along with simple Yes and No responses were used. The questionnaire consisted of five sections namely; SMEs information, owner-
managers information, financing experiences, Islamic finance, and SMEs selection of banks.

To gather data on the supply side the second empirical methodology used in the study was semi-structured interviews. This type of the interviews was deemed the most suitable to obtain rich insights relating to Bank Al Tanmeya’s experience in serving SMEs since they provide flexibility when investigating certain subjects in greater depth. After pre-testing the interview questions managers and loan officers at the bank were approached and interviewed to respond to the raised issues from a supply-side perspective.

The chapter furthermore highlighted the statistical analysis techniques and procedures employed to obtain empirical results from the data. In general, descriptive statistics, logistic regression analysis, and an interpretive method were used to analyse the data gathered. Finally, the chapter briefly mentioned the ethical considerations of the research.

Chapter 6 Empirical Results: Questionnaire Analysis presented the empirical results concerning the demand side of the study (SMEs). The first part of the chapter provided a description of the sample both SMEs firms and their owner-managers. The characteristics summarised included; firm size, business sector, ownership type, firm age, the use of business plan, owner-manager’s age, education, experience, and management training. These characteristics were later used to identify what factors determine SMEs successful bank loan applications.

The second part of the chapter analysed the financing sources used for starting a business and the preferable sources for ongoing financing needs following the start-up stage. The findings revealed that internal sources of finance mainly owner-managers’ own savings and assistance from family and friends were the most used sources to start a business. This result is in line with the extant literature in suggesting that internal sources of finance, mainly owner-managers’ savings are the most important for starting a business. In the Libyan context, this result also supports the finding of the studies by Eltaweel (2012) and Porter and Yergin (2006) who underlined the importance of owner-managers’ personal wealth to start a business in the Libyan business environment. Bank finance and seeking venture capital (through business partners not venture capital institutions) came second and third respectively as the most used sources at the start-up stage.
Likewise, for ongoing financing needs bank finance was the most preferable external source of finance jointly with trade credit. This seems consistent with SME financing literature in developing and developed countries in suggesting that bank finance is the most important external source of finance for SMEs. In addition, the results concerning the financing preferences for SMEs seem to support the pecking order hypothesis.

A main focus of this chapter was the experiences of SMEs with bank finance. In this context, SMEs’ owner-managers in the sample were initially prompted to indicated whether they had used bank finance at any stage to provide for their firms’ financing needs. The findings revealed that less than half of the firms in the sample have had access to bank finance while the remaining firms either have their applications rejected or they never applied. The low percentage of SMEs accessing bank finance is line with the findings of Elmansori and Arthur (2013) and Wahab and Abdesamed (2012) who found that less than 25 percent of Libyan SMEs in their samples had access to loans from banks. The previous question concerning access to bank finance was used as a filter question so the two different experiences that SMEs could have with bank finance could be investigated further (the experience for SMEs with bank finance and the experience for those that never used bank finance).

For those firms that used bank finance, they were asked to indicate the main reason for choosing bank finance over other sources and the purpose for which they used bank finance. The findings showed that the main reason for approaching banks for finance was that bank finance was seen as the most suitable source of finance considering the stage of development of the firm. A close relationship with bankers was also a factor drove these firms to apply for bank finance. The purposes for which bank finance was used ranged from expansion and entering new markets to modernization and working capital needs. To secure their access to banks finance these firms had to pledge collateral in most cases in the form of machineries and equipment. Other types of collateral used were personal guarantees and less commonly real estate.

This group of firms (successful applicants) was also asked about any difficulties they had with bank finance. Charging high rates of interest, collateral requirements in addition to the red tape involved in the process were the most cited. Again, these results appear consistent with the extant literature in the sense that high interest charges, unreasonable collateral requirements, and banks bureaucracy are among the most cited difficulties facing SMEs when dealing with banks in Libya and elsewhere (e.g. Kotey

The second experience was that of firms that had not used bank finance. These firms can be split into two. The first group consisted of firms where their applications for bank finance were rejected. The reasons for rejecting their applications varied. Most notably, they were rejected because of lack of sufficient collateral, lack of track records, and lack of good business plans. Other reasons that led to rejection was high risk investments and inadequate repayment sources.

The second group was the group of firms whose owner-managers chose not apply for bank finance. The reasons indicated by those owner-managers included; inability to provide collateral, weak financial position of the business, and having sufficient capital. This finding supports the theory of discouraged borrowers developed by Kon and Storey (2003) wherein firms requiring finance may choose not to apply for bank finance because of the fear of rejection. In addition, the charging of interest on bank loans (religious factor) was of the main reasons for not applying for bank finance among this group. This alligns with the findings by Ahmad (2015) and Elmansouri and Arthur (2013) that interest-based loans are one of the main reasons SMEs in Libya do not apply for loans from banks. Interestingly, this could be seen as a unique dimension of the discouraged borrowers theory that is more applicable to countries with large Muslim populations where Islamic finance is not yet practiced by banks, as is the case in Libya.

This chapter also examined the perceptions and opinions of the participants on Islamic finance as an alternative source of finance for SMEs in Libya. It was found that Islamic finance methods were perceived as a feasible option of finance for SMEs in Libya and would be largely supported and employed if offered. This underpins the results from a recent study by Abdesamed and Wahab (2015) who concluded that the possibility of using Islamic finance is high among SMEs in Libya especially among those firms that used to rely on informal sources of finance. These outcomes, along with the findings of Gait and Worthington (2009), illustrate the importance of implementing Islamic finance products to meet Libyan business firm demands for finance.

The findings also indicated a strong preference for Musharakah over other Islamic finance methods. Interestingly, this strong preference for the Musharakah mode of finance seems to support the argument of Saad and Razak (2013) who suggested that
Islamic banks should consider *Musharakah* contracts as the main products for financing SMEs because they are an ideal product well suited for this purpose.

The strong preference towards *Musharakah* is interesting because it indicates that contrary to conventional wisdom, owner-managers of SMEs would not mind sharing ownership of their firms in return for capital provision. This supports the conclusion of Rammal (2004) that *Musharakah* contracts will be the most used mode of Islamic finance contracts in the future because in terms of practice, there is a fear that other Islamic financing methods (especially *Mudarabah* and *Murabahah*) may be merely providing interest-bearing products under the guise of profits and mark-ups.

As it is believed that SMEs participants had no past experience using such financing methods as indicated earlier, it is most likely that these entrepreneurs based their opinions on religious beliefs rather than on thorough understanding of the financial principle involved. This is consistent with work by Gait and Worthington (2007) in exploring Libyan business firms’ attitudes towards Islamic methods of finance and another study in the region by Jabnoun and Khalifa (2005) measuring service quality in UAE conventional and Islamic banks where the religious factor was found to be a major reason for patronizing Islamic finance.

Regarding the results of SME-banks business relationships reported in this chapter, it is interesting to note that all of the SMEs in the study sample declared having special bank accounts for their firms. This suggests that they regularly use the services of banks. This is consistent with observation of Nasr and Pearce (2012) who reported that although SMEs in MENA region have low rates of credit usage from banks, they are better served with bank accounts. The results showed that personal relationship with banks appears to be the most important driver for SMEs’ owners in choosing a banking partner for their firms. Locational convenience, accommodation of credit needs, and price competitiveness (including charges, fees, and credit interest rates) were also found to be important. In contrast, other factors such as day-to-day efficiency, recommendations from business associate or friend, and kindliness of the bank’s staff appeared to have much less influence on Libyan SMEs’ selection of banks. The results suggest that Libyan SMEs employ a mix of external and internal bank-related factors in choosing their banking partners with external factors seem to be more important. With the exception of the factor of having choosing the bank because it is the same one where the owner-manager had opened his own account (which seems specific to the Libyan
context) the results are, to a large extent, comparable with other studies, especially in developing countries (e.g. Narteh, 2013; Abou Aish, Ennew and McKechnie, 2003).

The last part of the chapter involves reporting the results of logistic regression computed to estimate a model for SMEs successful bank loan applications. The characteristics of participants SMEs firms and their owner-managers described in the first part of this chapter were used as independent variables (predictors) while the dependent variable was the status of bank finance application (successful/unsuccessful). The analysis started with computing a binary logistic for each set of the independent variables separately then combined them. Afterwards, a stepwise technique was computed to refine the model to ascertain which combinations of SMEs and owner-managers variables are the most important in predicting the dependent variable.

The analysis results indicated that some independent variables do have impact on the dependent variable. Specifically, the model produced by using forward likelihood stepwise regression included the variables; the size of the firm, the business sector of the firm, how long the firm has been in business, owner-manager’s age, and education. In addition, having a business relationship with *Bank Al Tanmeya* was included in the model as one of the predictors.

The model explains 85 percent of the total variance in the dependent variable (the status of the loan application) which suggests that the set of the independent variables included in the model effectively distinguish between successful and unsuccessful bank finance applications. According to the model, SMEs successful in securing bank finance are more likely to be larger in size, owned-managed by relatively younger people with university or above education attainments, more established, and operate in manufacturing or trade. In addition, having business relationship with *Bank Al Tanmeya* seems to increase the likelihood that the firm’s loan application will be approved.

Chapter 7 Empirical Results: Interviews Analysis reported the empirical results and findings concerning the interviews conducted with *Bank Al Tanmeya*’s staff in accordance with the methodology explained in Chapter 5. A number of seven interviews were conducted with *Bank Al Tanmeya*’s managers and loan officers at the premises of the bank. The purpose of the interviews was to investigate the bank’s experiences and practices in serving SMEs in Libya as the bank is a leading one in this regard.

The investigation involved in-depth discussion of some selected areas of bank finance for SMEs from a supply-side perspective. This included; the bank’s strategic view of
SME sector, eligibility criteria for lending to SMEs, credit decision-making regarding lending to SMEs, and types of financing offered to SMEs in addition to any potential plans for implementing Islamic finance methods to meet SMEs’ demand.

The results of this chapter revealed that Bank Al Tanmeya has set its own classification of SMEs borrowers. In addition to the employment size the bank classifies SMEs according to the qualifying amounts of loans. The adoption of this criterion is understandable for its relevance to loan analysis and repayment capacity. This finding is in line with the findings of Rocha et al. (2011) that banks in MENA region countries are adapting their own definitions of SMEs as relevant to their own markets and they are not necessarily using the same ones endorsed by national laws and legal frameworks within the country in which they operate.

The results in this chapter also showed that SMEs represent a strategic market for the bank considering the perceived profitability of this sector and its promising prospects. This strategic view comes also in accordance with national economic plans targeting the private sector in order to help in restructuring the national economy. In this respect, supply chain links and cross selling also appear to be important motives for this involvement. As a result, the vast majority of the bank’s clients have been SMEs. This is consistent with the results of some previous studies investigated banks involvement with SMEs in developing countries in which the potential profits and capacity for market growth of SMEs were found important factors that motivate banks to engage in serving SMEs (e.g. Yeboah, Asirifi and Adegbo, 2014; Rocha et al., 2011; Bratanovic et al., 2007).

However, other factors were found acting as obstacles hindering the bank from extending its engagement with this sector. Some of these factors which were also found in other studies (e.g. Rocha et al., 2011; Stephanou and Rodriguez, 2008) are inherent SME features typically associated with this type of firms such as moral hazard, lack of collateral, and asymmetry of information. Others, however, can be attributed to the economic and political instability in the country. This is quite understandable especially considering that the fieldwork study was carried out after the 2011 popular uprising in the country when the country was changing remarkably not only in economic and political terms but on almost all levels.

A notable difference from similar studies (e.g. Rocha et al., 2011; Stephanou and Rodriguez, 2008) is that the weak demand of SMEs for funds and high competition in
the SME market were not cited as obstacles hindering Bank Al Tanmeya from serving SMEs. While the former can be partially because of the lack of bank services articulated according to Shariah (Islamic law) (Ahmad, 2015; Elmansouri and Arthur, 2013), the later can be ascribed to the fact that the Libyan banking sector is highly concentrated and dominated by the state, and that bank lending is usually only available for state-owned enterprises and some privately owned companies in the energy sector (Porter and Yergin, 2006).

The interviewees also indicated the remarkable degree of centralization in the bank’s decision-making process for loan approval as one of the obstacles. This is particularly the case as loan officers at the case study bank are expected to strictly follow the decision-making structures and lending guidelines and therefore, they are deprived of flexibility in the making of lending decisions. This strict control of the bank is in fact consistent with the argument of Berger and Udell (2002) that banks need proper structures which guarantee that loan officers are able to carry on their lending decisions, but under strict monitoring to reduce any risk of moral hazard on the part of the loan officer.

A central part of the investigation on the supply side aimed at understanding how decisions on lending to SMEs are made. More specifically, to understand the lending criteria used when assessing SMEs loan applications. The findings in this regard suggested that Bank Al Tanmeya’s credit policy draws on the principle that applicants are bankable and their businesses are profitable. We found that the ability to provide collateral and good business plans alongside the profitability of the business are the most important criteria. In this respect, the findings indicated that Bank Al Tanmeya relies too heavily on collateral. Collateral is perceived not just as insurance for the bank but also as an indication of the commitment of the borrower to repay. This supports the statement of Porter and Yergin (2006) who reported that when it comes to lending to SMEs Libyan banks tend to follow a defensive lending policy demanding large collateral (as much as 125 percent of the total loan amount in some cases).

It seemed that loan officers are relatively conservative when analysing SMEs propositions. The heavy reliance on collateral and security suggests that loan officers mainly employ a gone concern approach. The focus in this approach is on how a loan would be repaid in case the business fails rather than on the future prospects of the business. Other criteria, which were also found important included the applicants’ credit
history, their business experience, and the type of business activity. Loan officers indicated that they cannot only rely upon financial reports provided by SMEs as the majority of Libyan SMEs have no audited financial statements.

The discussion with the interviewees revealed that the branch is the frontline clients' approach when applying for finance. It was also found that in the process of assessing SMEs loan applications, the branch gathers supplementary soft information on the perceived borrowers and their businesses through contacting local industry directories, tax agencies, other banks, and other people in the industry. In addition, interviewing the applicants and conducting a pre-feasibility study are very important parts of the assessment process.

These findings indicate that Bank Al Tanmeya uses hard and soft information on SME borrowers in a complementary manner. While hard information plays a more significant role in the assessment process, soft information plays an important supplementary role. This is consistent with results of some previous studies on lending decisions to SMEs (e.g. Hoang, 2014; Bartoli et al., 2013; Uchida, Udell and Yamori, 2006) regarding the superiority of hard information and the supplementary role of soft information in lending decisions to SMEs. The results also confirm the conclusion of Berger and Udell (2006) who suggested that banks may combine different lending technologies in loan approval process though one key lending technology may be emphasised (in the case of this study the lending technology is based on hard information such as information on collateral, credit history, and business plans).

The bank has adopted the bottom-up model of relationships amongst the borrowers, loan officers, and branch manager. As such, after approving it by the branch manager the loan application is then forwarded with the collected documentation to the central credit committee at the headquarters for consideration and making decisions on lending.

Bank Al Tanmeya offers its SME clients a wide range of financial products. Most commonly, the bank offers short-, medium-, and long-term loans, loans for working capital purposes, industrial hire purchase, overdrafts, and letters of credit. Additionally, in order to meet SMEs demand of alternative source of finance that is not interest-based the finding revealed that the bank has a plan in place to offer products that are in accordance with the Islamic finance principles. The main methods to be offered include Murabahah, Ijarah, and Musharakah. To achieve this the bank’s staff have been undergoing an ongoing training on Islamic banking and finance with relevant seminars.
and workshops that are organised locally and abroad in banks in neighbouring countries which are pioneering in the industry.

8.3 Contributions and Implications

This study concerns bank financing for SMEs in Libya with regards to financing practices and experiences from the point of view of both demand and supply. By accomplishing its objective that is investigating the status of bank financing for SMEs in Libya, this thesis achieves further contributions.

The existing literature in this area has largely focused on the patterns and practices of financing among SMEs in developed countries with very limited investigations focusing on developing countries. As such, the current study contributes to the body of knowledge on SME financing in general and on bank financing in particular in the context of developing countries by providing an exploration of the current trends and practices in bank financing for SMEs in a developing country in transition which is Libya. Thus, the findings of this study contribute towards an increased understanding on the subject, especially in the developing countries’ context where the existing literature has so far been found to be lacking.

In the Libyan context, the current state of knowledge on SME financing is limited as this area of research has been only recently been addressed by industry researchers and academics. This study therefore makes its own specific contribution by providing knowledge of financing practices and experiences relating to bank finance as the main source of external finance for SMEs. This research is unique because not only does it address the issues associated with SMEs demand and use of bank finance but also because it is the first to clarify and address such issues from both demand and supply perspectives. Consequently, it is expected that the results of this thesis yielded a much clearer picture of bank financing to the SME sector in Libya, which in turn, will result in gaining a better understanding of its potential to become the growth engine for Libya’s private sector development in the current transition period. The results also have the ability to increase awareness of the state of bank financing for SMEs with additional information as to the factors that may affect their access to bank finance from a demand perspective as well as a supply perspective.

In addition, exploring the attitudes of both sides of supply and demand towards Islamic finance methods as an alternative source of finance for SMEs also makes this thesis distinct. In this respect, the findings of the current study are expected to help in the
ongoing search for more readily accessible sources of funding for SMEs that provide better business funding terms to meet the needs and desired financing type of SMEs. Moreover, the extensive review of SME financing methods relating to Islamic finance may serve as a reference for education and practice in Libya to increase the knowledge about this topic especially increasing the awareness of Islamic finance methods and their applicability to SMEs which will certainly contribute to the Libyan economic development as the results indicate that the majority of SMEs are potential users of Islamic finance.

SMEs’ owner-managers may also find the findings of this study useful. For example, the finding in relation to the criteria/requirements employed by bankers to approve SMEs’ loan applications could enhance owner-managers’ understanding of the credit approval process. This information may assist them to prepare in advance for their future loan applications and thus increase the probability of success.

For banks, the study also provides information on factors shaping the selection of banks by SMEs as business partners from the client viewpoint. Such a close insight into the SME-bank partnership has the potential to provide banks, practitioners, and policymakers, as along with researchers with a much-needed understanding of the environment in which these firms operate and also offers a better overview of these businesses’ needs and viability. The findings in this respect can be beneficial for banks in order to be more effective in serving this sector. As a result, it is hoped that SMEs will be better served. The results may also create more business opportunities between banks and SMEs. The results also revealed that there is a need to increase the level of involvement of loan officers in the design of lending guidelines and in the credit decision in order to enhance their understanding of applicability of such guidelines and to ensure credit decision are made accurately.

From a policy-making perspective, the results regarding the financing preferences of Libyan SMEs suggest that government schemes and initiatives designed to help SMEs have not been successful as they were ranked low in importance. Consideration should be given to what can be done to ensure such schemes reach a wide range of SMEs nationwide and be more effective. In addition, government institutions and training establishments should create appropriate education and training programs for prospective SMEs practitioners. The requirement for feasibility studies and attractive business plans in loan applications as a standard practice should be encouraged and
enforced. Furthermore, it is hoped that the results indicating the high demand and potential use of Islamic finance methods by SMEs will be taken on-board towards a timely implementation of such services to serve this viable niche market of SMEs.

Finally, the limited availability of data on SMEs in Libya has been proved to be an issue among academic and policy researchers, including this thesis. For more precise information and empirically based policy-making there is an urgent need to generate a comprehensive database containing complete data and statistics on SMEs in Libya. Regarding the implementation of Islamic finance there is a need for a national centre dedicated to the function of training experts and staff in Islamic banking and finance system. In addition, the experience of other countries in the region, particularly those resource-rich countries, would be very helpful in the development process of Islamic finance in Libya.

8.4 Limitations of the Thesis

Typically, any human work cannot be perfect and thesis is no different. First, considering the fact that the study was conducted within only one country the findings may lack generalizability. Although SMEs in the region may have many common characteristic; country-level heterogeneity is quite evident. Consequently, the results from this study cannot be readily generalised to countries in the MENA region nor any other developing country.

Second, the range of independent variables used in the model for bank finance accessibility could be considered small. The limited number of variables included was decided upon to avoid confusing respondents or discouraging them from responding through excessive complexity. This was especially important given that many respondents were not familiar at all with research questionnaires.

Third, for the qualitative data gathered during the interviews, some interviewees refused to permit tape-recording which could have been more helpful than note taking in interpreting the results as recorded interviews can be revisited again and again which gives the opportunity each time to grasp new thoughts and attitudes. This might to some extent, have affected the interpretation of the qualitative data and hence the study results on the supply side.

Fourth, due to constraints on secondary data, it was not possible to quantitatively analyse the trends of Bank Al Tanmeya’s financing of SMEs in recent years in terms of
the number and the amount of SMEs loan applications received, rejected, approved, and disbursed. Such approach would have contributed to better understanding of the extent to which SMEs demand for bank finance have been met by the bank.

Fifth, the candidate was confronted with a severe deficiency in academic work pertaining to the SME sector in Libya. This meant that the candidate was obliged to rely largely on the questionnaire administrated and the interviews conducted to gain the information needed for the purpose of this study. In this respect, the findings of the study are limited by the honesty of the responses of the questionnaire respondents and the participants during the interviews. Therefore, the answers might be less than complete. There is a potential that some of the respondents to the questionnaire might have completed the questionnaire without reading it thoroughly as they might have considered it as a waste of time and of no benefits. Therefore, the answers given might not be as accurate as possible.

Finally, reflecting on the previous limitation that there was a lack of similar studies conducted in Libya, this study was exploratory and descriptive in nature and thus the methodology used should not be inferred as the “best” approach in understanding the issues addressed in the study with regard to bank finance for SMEs in Libya.

8.5 Directions for Further Research

This study is the first to examine the status of bank finance for SMEs in Libya. Therefore, to gain more comprehensive understanding of this area of investigation there is still an opportunity to extend the research. From a methodological point of view, due to reasons of practicality and time and resources constraints, the investigation in this thesis was confined to one region on the demand side and one bank as a case study on the supply side. Although, arguably there may not be significant differences in the outputs due to the similar economic environment characteristics throughout the country, it is still interesting to replicate this study using a nation-wide sample and include other banks and compare the results to provide better understanding of this topic in the wider Libyan context.

In addition, the chosen research methodology was appropriate given the research questions and scope. The exploratory nature of the study meant that propositions rather than hypotheses were used to develop the questions. So the findings are restricted by the limitation of the chosen methodology. Future research of explanatory and confirmatory nature is needed to develop the findings. In such case, replicating the study would
facilitate replacing propositions with hypotheses based on the findings of this study. In addition, more variables could be added to refine the findings regarding the accessibility of SMEs to bank finance.

On the demand side concerning SMEs there are a number of areas that can be suggested for further research in the future. Future studies may consider expanding the survey to include SMEs in other sectors such as agriculture, tourism, and constructions and those in rural areas to detect any interesting differences in their financing behaviour and practices especially when it comes to bank finance. In addition, one might consider a different approach to provide insights on the motivations and business goals behind SMEs’ financing decisions in general and in particular the decisions to employ bank finance. Large-scale qualitative studies would be valuable. Likewise, more in-depth studies are encouraged to explore why some SMEs choose not to apply for bank finance. Moreover, further research should be dedicated to issues relating to SMEs access to finance at the start-up stage.

Research on the supply side could consider studying the degree of intuition involved in lending decision by bankers. In addition, variables relating to trust characteristics in the bank-SME owner-manager relationship and their impact on credit decisions should be studied. This could provide useful insight should Bank Al Tanmeya adopt relationship lending approach to lend to SMEs, which could mitigate the problem of SMEs’ lack of collateral. In addition, there is a need for additional research to compare the success and failure of SMEs whose bank finance applications were approved and those were denied access to bank finance. This could provide useful indications of the effectiveness of Bank Al Tanmeya’s lending decisions. This equally applies to other banks in the country and beyond.

Finally, regarding Islamic finance, though it is too early to assess the Islamic finance in Libya as it is still in its infancy, further research should examine its viability, performance, and impact on SME growth as more data should become available in the future.
Appendices
Appendix A: Questionnaire Covering Letter in English

Bank Financing for Small and Medium-sized Enterprises in Libya

Questionnaire for SMEs’ owner–managers

Dear respected participant

I am Abdulaziz Abdulsaleh, a PhD student at Griffith University in Australia. I am doing my study in finance and the title of my research is “Bank Financing for Small and Medium-sized Enterprises in Libya”, under the supervision of Professor Andrew Worthington (a.worthington@griffith.edu.au) and Dr Rakesh Gupta (r.gupta@griffith.edu.au).

The core objective of this study is to investigate the current status of bank financing for SMEs in Libya. Accomplishing the goals of this research entails gathering information from the owner–managers of Libyan SMEs. Thus, I would like to invite you to participate in this research by answering the questions included in this questionnaire. Your participation will help me to obtain real findings which expected to contribute towards improving Libyan SMEs access to finance in general and bank financing in particular.

I would like to ensure you that any information provided by you will be only used for scientific research purposes, and your response will be treated confidentially. Your cooperation is highly appreciated.

Thanks in advance.

Abdulaziz Abdulsaleh
Department of Accounting, Finance and Economics
Griffith University, Nathan Campus
170 Kessels Road, Nathan campus, QLD 4111 Australia
a.abdulsaleh@griffith.edu.au
Mobile: +61412648017
Appendix B: Questionnaire in English

SECTION A: Firm General Information:
To answer the questions in this part, please tick the box that indicates your answer.

1) How many persons does your firm currently employ (including yourself)?
   
   | 1-25 employees | 26-50 employees |

2) What is the main activity of your company?

   | Trade | Services | Manufacturing |

3) Which of the following best describes the form of your business organisation?

   | Sole ownership | Limited Partnership | Shareholding firm |

4) How long has your firm been in business?

   | 0-5 years | 6-10 years | 11-15 years | 16-20 years | Over 20 years |

5) Does your firm have business plan?

   | Yes | No |
**SECTION B: Owner-manager Information:**

To answer the question in this part, please tick the box that indicates your answer.

6) Please indicate your age group from the following?

<table>
<thead>
<tr>
<th>Age Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 21 years</td>
</tr>
<tr>
<td>21-30 years</td>
</tr>
<tr>
<td>31-40 years</td>
</tr>
<tr>
<td>41-50 years</td>
</tr>
<tr>
<td>Over 50 years</td>
</tr>
</tbody>
</table>

7) What is your level of education?

<table>
<thead>
<tr>
<th>Level of Education</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary school</td>
</tr>
<tr>
<td>Elementary school</td>
</tr>
<tr>
<td>Secondary school</td>
</tr>
<tr>
<td>Diploma</td>
</tr>
<tr>
<td>University degree</td>
</tr>
<tr>
<td>Higher degree</td>
</tr>
</tbody>
</table>

8) How many years of business experiences do you have?

<table>
<thead>
<tr>
<th>Years of Experience</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 5 years</td>
</tr>
<tr>
<td>5-10 years</td>
</tr>
<tr>
<td>11-15 years</td>
</tr>
<tr>
<td>More than 15 years</td>
</tr>
</tbody>
</table>

9) Have you attended any entrepreneurial development or SME management courses?

<table>
<thead>
<tr>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
</tr>
</tbody>
</table>
SECTION C: Financing Information:

10) Which of the following sources of finance did you use when you first started your business? Please tick the box that indicates your answer.

<table>
<thead>
<tr>
<th>Personal savings</th>
<th>Venture Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assistance from family/friends</td>
<td>Government assistance schemes</td>
</tr>
<tr>
<td>Bank finance</td>
<td>Other: please specify:</td>
</tr>
</tbody>
</table>

11) What are the financing methods that are available to finance your business? Please list in order of preference by circling the numbers that indicate your answer.

<table>
<thead>
<tr>
<th>Internal funds</th>
<th>1st</th>
<th>2nd</th>
<th>3rd</th>
<th>4th</th>
<th>5th</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank finance</td>
<td>1st</td>
<td>2nd</td>
<td>3rd</td>
<td>4th</td>
<td>5th</td>
</tr>
<tr>
<td>Trade credit</td>
<td>1st</td>
<td>2nd</td>
<td>3rd</td>
<td>4th</td>
<td>5th</td>
</tr>
<tr>
<td>Equity finance</td>
<td>1st</td>
<td>2nd</td>
<td>3rd</td>
<td>4th</td>
<td>5th</td>
</tr>
<tr>
<td>Government assistance</td>
<td>1st</td>
<td>2nd</td>
<td>3rd</td>
<td>4th</td>
<td>5th</td>
</tr>
<tr>
<td>Other: please specify:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

12) Has your firm used bank finance? Please tick the box that indicates your answer.

<table>
<thead>
<tr>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
</tr>
</tbody>
</table>

If No go to question 14.

13) If yes, a. Why bank finance was used by your firm?

Please circle the numbers that indicate your answer.
1 = Strongly disagree, 2 = Disagree, 3 = Uncertain, 4 = Agree, 5 = Strongly agree.

<table>
<thead>
<tr>
<th>Most accessible type of finance</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Most appropriate type of finance for firm’s development stage</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Close ongoing relationship with the bank</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Least costly type of finance</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Other: please specify:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
b. What was the main purpose for your application for bank finance?
Please tick the box that indicates your answer.

<table>
<thead>
<tr>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expansion</td>
</tr>
<tr>
<td>Modernization</td>
</tr>
<tr>
<td>Working capital</td>
</tr>
<tr>
<td>Entering new markets</td>
</tr>
<tr>
<td>Other: please specify:</td>
</tr>
</tbody>
</table>

c. What was the type of collateral you provided to secure access to bank finance?
Please tick the box that indicates your answer.

<table>
<thead>
<tr>
<th>Collateral</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal guarantees</td>
</tr>
<tr>
<td>Machineries and equipment</td>
</tr>
<tr>
<td>Real estate</td>
</tr>
<tr>
<td>Other: please specify:</td>
</tr>
</tbody>
</table>

d. In the process of applying and obtaining the bank finance, in your opinion was it:
Please tick the box that indicates your answer.

<table>
<thead>
<tr>
<th>Difficulty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very easy to obtain</td>
</tr>
<tr>
<td>Fairly easy to obtain</td>
</tr>
<tr>
<td>Fairly difficult to obtain</td>
</tr>
<tr>
<td>Very difficult to obtain</td>
</tr>
</tbody>
</table>

e. In the case of difficulties what was the main difficulty?
Please tick the box that indicates your answer.

<table>
<thead>
<tr>
<th>Difficulty</th>
</tr>
</thead>
<tbody>
<tr>
<td>High interest rate</td>
</tr>
<tr>
<td>Insufficient amount of finance</td>
</tr>
<tr>
<td>Short loan duration</td>
</tr>
<tr>
<td>Repayment conditions</td>
</tr>
<tr>
<td>Unreasonable level of security</td>
</tr>
<tr>
<td>Paper work required</td>
</tr>
<tr>
<td>Time taken to grant finance</td>
</tr>
<tr>
<td>Other: please specify:</td>
</tr>
</tbody>
</table>

Now please proceed to question 15.
14) According to your case answer either (a) or (b).
a. If your application was declined, in your opinion, which of the following was the main reason for declining your application. Please circle the numbers that indicate your answer.
1 = Strongly disagree, 2 = Disagree, 3 = Uncertain, 4 = Agree, 5 = Strongly agree.

<table>
<thead>
<tr>
<th>Reason</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>High risk associated with the project</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of track records</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of guarantees or collateral</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of convincing business plan</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inadequate sources of repayment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other: please specify:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

b. If your firm never applied for bank finance, what was the main reason behind that? Please tick the box that indicates your answer.

<table>
<thead>
<tr>
<th>Reason</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>The inability to provide collateral</td>
<td></td>
</tr>
<tr>
<td>Weak financial position of the firm</td>
<td></td>
</tr>
<tr>
<td>Lack of relationship with bankers</td>
<td></td>
</tr>
<tr>
<td>Inconsistent cash flow</td>
<td></td>
</tr>
<tr>
<td>Other: please specify:</td>
<td></td>
</tr>
</tbody>
</table>

SECTION D: Islamic finance for SMEs:

15) Are you aware of Islamic finance methods existence? Please tick the box that indicates your answer.

Yes
No

16) Would you be willing to use Islamic finance methods if they are available? Please tick the box that indicates your answer.

Yes
No
17) Which mode of Islamic finance modes would you prioritize in financing your business? 
Please list in order of priority by circling the numbers that indicate your answer.

<table>
<thead>
<tr>
<th>Mode</th>
<th>1st</th>
<th>2nd</th>
<th>3rd</th>
</tr>
</thead>
<tbody>
<tr>
<td>Musharakah</td>
<td>1st</td>
<td>2nd</td>
<td>3rd</td>
</tr>
<tr>
<td>Mudarabah</td>
<td>1st</td>
<td>2nd</td>
<td>3rd</td>
</tr>
<tr>
<td>Murabahah</td>
<td>1st</td>
<td>2nd</td>
<td>3rd</td>
</tr>
</tbody>
</table>

18) Do you think that Islamic finance is viable financing option for Libyan SMEs? 
Please tick the box that indicates your answer.

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
</table>

SECTION E: SMEs banking partnership:

19) With what bank is your firm's bank account? 
Please tick the box that indicates your answer.

<table>
<thead>
<tr>
<th>Bank Al Tanmeya</th>
<th>Other</th>
</tr>
</thead>
</table>

20) Why did/does your firm use that particular bank? 
Please tick the box that indicates your answer.

<table>
<thead>
<tr>
<th>The nearest/convenient location</th>
<th>Offers the best terms and conditions for SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Only bank in the locality</td>
<td>Already had my private account with this bank</td>
</tr>
<tr>
<td>Only bank that would finance the project</td>
<td>Other: please specify:</td>
</tr>
<tr>
<td>Recommended by business associate/friend</td>
<td></td>
</tr>
</tbody>
</table>

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If you have any further comments on this topic you would like to add, please feel free to do so in the space below:

……………………………………………………………………………………………………………………………………
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If you wish to receive the findings of this study please contact the researcher.

** End of the questionnaire**

Thank you for your co-operation.
Appendix C: Questionnaire Covering Letter in Arabic

عزيزي المشارك

السلام عليكم ورحمة الله وبركاته

أنا الطالب عبدالعزيز عبدالصالح طالب دكتوراة بجامعة غريفث بمدينة غريفث الأسترالية أقوم بإعداد بحث عنوان التمويل المصرفى للمشاريع الصغيرة والمتوسطة في ليبيا. يهدف البحث إلى التعرف على الواقع الحالي لتوفير المصارف للمشاريع الصغيرة والمتوسطة في ليبيا والتعرف على أهم العقبات والصعوبات التي تواجه المشروعات الصغيرة والمتوسطة في هذا السياق. بصفتي أحد أصحاب المشروعات الصغيرة والمتوسطة الواقعة في مدينة بنغازي أرجو من سيادتكم التفضل والتكرم بملء هذه الاستبانة والتي تعد جزءاً مهماً لاستكمال البحث المذكور.

إن ملئك لهذه الاستبانة هو أمر تطوعي تماماً وبالتالي فإني أقدر لك لتجديده هذا البحث مع التأكيد على أن الإطلاع على المعلومات الواردة في الاستبانة سوف يكون مقتصرًا على الباحث والمشرفين على الرسالة، ما يعني أن سرية ردودكم محفوظة ومؤكدة وأن نتائج البحث سيتم عرضها بشكل إجمالي في رسالة الدكتوراة، وفقًا لأغراض علمية بحتة.

عزيزي المشارك لقد روعى في تصميم هذه الاستبانة أن تكون قصيرة وواضحة بحيث أن الوقت المقدر لاستكمال ملئها لن يمتد لأكثر من عشر دقائق. خاتماً أود أن أحيطكم علمًا بأن الوقت المتاح لإقامةي في ليبيا محدود لذا أرجو التفضل بملء الاستبانة وإعادتها في مدة أقصاه عشرة أيام.

شكرًا لكم حسن تعاونكم وتشجيعكم للبحث العلمي.

الباحث

عبدالعزيز عبدالصالح
Appendix D: Questionnaire in Arabic

الجزء الأول: معلومات عامة عن المشروع

للاجابة على الأسئلة في هذا الجزء رجاءً ضع علامة √ أمام العبارة التي تمثل إجابتك.

1) كم عدد العاملين في المشروع حالياً (بمن فيهم أنت)؟

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1-25</td>
<td>√</td>
</tr>
<tr>
<td>26-50</td>
<td></td>
</tr>
</tbody>
</table>

2) من فضلك صنف مشروعك طبقاً لطبيعة نشاطه؟

<p>| |</p>
<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>تجاري</td>
</tr>
<tr>
<td>خدمي</td>
</tr>
<tr>
<td>صناعي</td>
</tr>
</tbody>
</table>

3) من فضلك حدد كيف يمكن وصف نوع ملكية مشروعك؟

<p>| |</p>
<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>ملكية فردية</td>
</tr>
<tr>
<td>ملكية محدودة (شركاء)</td>
</tr>
<tr>
<td>شركة مساهمة</td>
</tr>
</tbody>
</table>

4) كم مضى من الوقت على إنشاء مشروعك هذا؟

<p>| |</p>
<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>5 سنوات أو أقل</td>
</tr>
<tr>
<td>6 - 10 سنوات</td>
</tr>
<tr>
<td>11 - 15 سنوات</td>
</tr>
<tr>
<td>16 - 20 سنوات</td>
</tr>
<tr>
<td>أكثر من عشرين سنة</td>
</tr>
</tbody>
</table>

5) هل للمشروع خطة عمل مكتوبة؟

<p>| |</p>
<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>نعم</td>
</tr>
<tr>
<td>لا</td>
</tr>
</tbody>
</table>
الجزء الثاني: معلومات عن صاحب المشروع:

للاجابة على الأسئلة في هذا الجزء رجاءً ضع علامة √ أمام العبارة التي تمثل إجابتك.

6) إلى أي فئة من الفئات العمرية التالية تنتمي:

<table>
<thead>
<tr>
<th>فئة عمرية</th>
<th>cháteau</th>
</tr>
</thead>
<tbody>
<tr>
<td>أقل من 21 سنة</td>
<td>√</td>
</tr>
<tr>
<td>21 - 30 سنة</td>
<td></td>
</tr>
<tr>
<td>31 - 40 سنة</td>
<td></td>
</tr>
<tr>
<td>41 - 50 سنة</td>
<td></td>
</tr>
<tr>
<td>أكثر من 50 سنة</td>
<td>√</td>
</tr>
</tbody>
</table>

7) من فضلك حدد مستواك التعليمي:

<table>
<thead>
<tr>
<th>مستوى تعليمي</th>
<th>cháteau</th>
</tr>
</thead>
<tbody>
<tr>
<td>المرحلة الإبتدائية</td>
<td>√</td>
</tr>
<tr>
<td>المرحلة الإعدادية</td>
<td></td>
</tr>
<tr>
<td>المرحلة الثانوية</td>
<td></td>
</tr>
<tr>
<td>البكالوريوس</td>
<td></td>
</tr>
<tr>
<td>شهادة جامعية</td>
<td></td>
</tr>
<tr>
<td>شهادة عليا</td>
<td></td>
</tr>
</tbody>
</table>

8) ما هو عدد سنوات خبرتك في مجال عملك هذا؟

<table>
<thead>
<tr>
<th>سنوات خبرة</th>
<th>cháteau</th>
</tr>
</thead>
<tbody>
<tr>
<td>أقل من 5 سنوات</td>
<td>√</td>
</tr>
<tr>
<td>5 - 10 سنوات</td>
<td></td>
</tr>
<tr>
<td>11 - 15 سنة</td>
<td></td>
</tr>
<tr>
<td>أكثر من 15 سنة</td>
<td>√</td>
</tr>
</tbody>
</table>

9) هل تلقيت أي برامج تدريبية في مجال ريادة الأعمال أو إدارة المشروعات الصغيرة والمتوسطة؟

<table>
<thead>
<tr>
<th>نعم</th>
<th>لا</th>
</tr>
</thead>
<tbody>
<tr>
<td>√</td>
<td></td>
</tr>
</tbody>
</table>
الجزء الثالث: معلومات متعلقة بالجانب التمويلي:

10) أي من مصادر التمويل التالية كنت قد استعملت عند بدأ مشروعك؟

للإجابة على هذا السؤال راجع ضع علامة ✅ أمام العبارة التي تمثل إجابتك.

<table>
<thead>
<tr>
<th>مصادر التمويل</th>
<th>الملاحظة</th>
</tr>
</thead>
<tbody>
<tr>
<td>رأس مال مستثمر (شركاء)</td>
<td>مصادر تمويل من أحد المصارف</td>
</tr>
<tr>
<td>برامج مساعدة حكومية</td>
<td>مساعدة من الأقارب والأصدقاء</td>
</tr>
<tr>
<td>أخرى: راجع ذكرها</td>
<td></td>
</tr>
</tbody>
</table>

11) ما هي مصادر التمويل المتاحة حالياً لتمويل مشروعك؟

رجاءً رتب من الأكثر أهمية إلى الأقل أهمية من وجهة نظرك بوضع دائرة حول الرقم الذي يمثل أولوية اختيارك.

<table>
<thead>
<tr>
<th>مصادر التمويل</th>
<th>الرقم</th>
</tr>
</thead>
<tbody>
<tr>
<td>أموال خارجية (أرباح محتجزة مساعدة من الأقارب والأصدقاء)</td>
<td>5</td>
</tr>
<tr>
<td>مصارف (قرص وسحب على المكشوف)</td>
<td>4</td>
</tr>
<tr>
<td>إمكانيات تجارية من الموردين</td>
<td>3</td>
</tr>
<tr>
<td>رأس مال مستثمر (شركاء جدد)</td>
<td>2</td>
</tr>
<tr>
<td>مصادر مساعدة حكومية</td>
<td>1</td>
</tr>
<tr>
<td>أخرى: راجع ذكرها</td>
<td></td>
</tr>
</tbody>
</table>

12) هل سبق لك استعمال أي مصرف تجاري كمصدر لتمويل مشروعك هذا؟

<table>
<thead>
<tr>
<th>الطلب</th>
<th>الإجابة</th>
</tr>
</thead>
<tbody>
<tr>
<td>نعم</td>
<td>لا</td>
</tr>
</tbody>
</table>

إذا كانت الإجابة بلا اذهب إلى 14.

13) إذا كانت إجابتك على الفقرة أعلاه بنعم: ما هو السبب وراء استعمال التمويل المصرفي دون غيره؟

من فضلك لكل فقرة ضع دائرة حول الرقم الذي يناسب إجابتك طبقًا للمقياس التالي:
1 = غير موافق بشدة، 2 = غير موافق، 3 = موافق، 4 = موافق بشدة

<table>
<thead>
<tr>
<th>الطلب</th>
<th>الملاحظة</th>
</tr>
</thead>
<tbody>
<tr>
<td>التمويل المصرفي أكثر المصادر التي يمكن بسهولة الوصول إليها</td>
<td>التمويل المصرفي كان أكثر المصادر ملاءمة لعمر المشروع</td>
</tr>
<tr>
<td>علاقة جيدة ومتميزة مع المصرف الممول</td>
<td>التمويل المصرفي أقل مصادر التمويل المتاحة تكلفة</td>
</tr>
<tr>
<td>أخرى: راجع ذكرها</td>
<td></td>
</tr>
</tbody>
</table>
ب. ماذا كان الغرض الذي من أجله تم اللجوء للتمويل المصرفي؟

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>التوسع</td>
<td></td>
</tr>
<tr>
<td>للتطوير والتحديث</td>
<td></td>
</tr>
<tr>
<td>دعم رأس مال التشغيل</td>
<td></td>
</tr>
<tr>
<td>دخول أسواق جديدة</td>
<td></td>
</tr>
<tr>
<td>أخري: رجاء اذكرها</td>
<td></td>
</tr>
</tbody>
</table>

c. في حالة تقديمك لضمان ماذا كان نوع هذا الضمان؟

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>ضمانات شخصية</td>
<td></td>
</tr>
<tr>
<td>آلات ومعدات</td>
<td></td>
</tr>
<tr>
<td>عقارات</td>
<td></td>
</tr>
<tr>
<td>أخري: رجاء اذكرها</td>
<td></td>
</tr>
</tbody>
</table>

d. من خلال تجربتك مع التمويل المصرفي برأيك هل كان:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>من السهل جدا الحصول عليه</td>
<td></td>
</tr>
<tr>
<td>من السهل نسبيا الحصول عليه</td>
<td></td>
</tr>
<tr>
<td>من الصعب نسبيا الحصول عليه</td>
<td></td>
</tr>
<tr>
<td>من الصعب جدا الحصول عليه</td>
<td></td>
</tr>
<tr>
<td>أخري: رجاء اذكرها</td>
<td></td>
</tr>
</tbody>
</table>

e. في حال وجود صعوبات ماذا كانت هذه الصعوبات؟

- مستوى التأمين غير معقول
- الإجراءات الروتينية
- الوقت الذي يستغرقه منح التمويل
- ارتفاع معدل الفائدة
- مبلغ التمويل غير كافي
- قصر مدة السداد
- صعوبة شروط الدفع
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>رجاء اذهب إلى السؤال 15</td>
<td></td>
</tr>
</tbody>
</table>

242
بناءً على ما يناسب حالتك أجب عن (أ) أو (ب).
أ. إذا كان طلبك الحصول على تمويل من المصرف قوبل بالرفض فما هو سبب ذلك من وجهة نظرك.
من فضلك لكل فقرة ضع دائرة حول الرقم الذي يناسب إجابتك طبقا للمقياس التالي:
1= غير موافق بشدة 2= غير موافق 3= غير متأكد 4= موافق 5= موافق بشدة

<table>
<thead>
<tr>
<th>عدد وجود مصادر كافية للمشاريع</th>
<th>عدد وجود ضمانات</th>
<th>عدد وجود خطة مناسبة ومقدمة لإدارة المشروع</th>
<th>ارتفاع مستوى المخاطر المرتبطة بالمشروع</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>4</td>
<td>3</td>
<td>2</td>
</tr>
</tbody>
</table>

أخرى: رجاءً اذكرها

ب. في حالة عدم تقدمك أبداً للحصول على تمويل مصرفي ما هي العقبات التي حالت دون تقدمك؟

<table>
<thead>
<tr>
<th>عدم القدرة على توفير الضمان المطلوب</th>
<th>ضعف التمويل المالي للمشروع</th>
<th>عدم وجود علاقة مع موظفي المصرف</th>
<th>التوقعات النقدية للمشروع لا تتوافق مع متطلبات المصرف</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>4</td>
<td>3</td>
<td>2</td>
</tr>
</tbody>
</table>

أخرى: رجاءً اذكرها

الجزء الرابع: التمويل الإسلامي للمشروعات الصغيرة والمتوسطة:

15) هل أنت على علم بوجود مصادر إسلامية للتمويل؟

نعم
لا

16) في حالة احتلت لك فرصة تمويل مشروعك بأحد مصادر التمويل الإسلامية فهل ستقوم بذلك؟

نعم
لا
17) كيف سيكون ترتيب أولوياتك لمصادر التمويل الإسلامية التالية إذا ما احتلت لك الفرصة لاستخدامها؟

من فضلك ضع دائرة حول الرقم الذي يمثل ترتيب أولويته.

<table>
<thead>
<tr>
<th></th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>مشاركة (مشاركة الأرباح والخسائر)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>مضاربة</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>مشاركة (مشاركة الأرباح دون الخسائر)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

18) هل تعتقد أن مصادر التمويل الإسلامية خيار تمويلي ملائم ومناسب للمشروعات الصغيرة والمتوسطة في ليبيا؟

نعم
لا

الجزء الخامس: الشراكة بين المشروعات الصغيرة والمتوسطة والمصارف:

19) مع أي مصرف الحساب الجاري لمشروعك؟

<table>
<thead>
<tr>
<th></th>
<th>مصرف التنمية</th>
<th>مصرف آخر</th>
</tr>
</thead>
</table>

20) ما هو السبب الذي جعلك تختار أن يكون الحساب الجاري لمشروعك مع هذا المصرف؟

<table>
<thead>
<tr>
<th></th>
<th>الأقرب جغرافياً</th>
<th>المصرف الوحيد القريب من مشروعك</th>
<th>المصرف الوحيد الذي يمكن أن يقدم التمويل للمشروع</th>
<th>بناءً على توصية من صديق أو زميل</th>
</tr>
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<td>هذا المصرف يقدم أفضل الشروط والتسهيلات للمشروعات الصغيرة والمتوسطة</td>
<td>نفس المصرف الذي فتحته مع حسابي الشخصي</td>
<td>أخرى: رجاءً اذكرها</td>
<td>أخرى: رجاءً اذكرها</td>
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244
إذا كنت ترغب في الحصول على نتائج هذه الدراسة يرجى الاتصال بالباحث.

** نهاية الاستبيان **

شكرًا جزيلاً لتعاونك
## Appendix E: Krejcie and Morgan (1970) Table for Determining Sample Size

Determining sample size from a given population size (Krejci and Morgan, 1970).

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N” is population

“S” is sample size.
# Appendix F: Interview Consent Form in English

## Bank Financing for Small and Medium-sized Enterprises in Libya

### Consent Form

<table>
<thead>
<tr>
<th>Research Team</th>
<th>Primary Investigator</th>
<th>Senior Investigator</th>
<th>Senior Investigator</th>
</tr>
</thead>
<tbody>
<tr>
<td>Name</td>
<td>Abdulaziz Abdulsaleh</td>
<td>Andrew Worthington</td>
<td>Rakesh Gupta</td>
</tr>
<tr>
<td>Title</td>
<td>PhD student in finance</td>
<td>Professor in finance</td>
<td>Doctor in finance</td>
</tr>
<tr>
<td>School</td>
<td>Griffith Business School</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Address</td>
<td>Griffith University, Nathan Campus</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Email</td>
<td><a href="mailto:a.abdulsaleh@Griffith.edu.au">a.abdulsaleh@Griffith.edu.au</a></td>
<td><a href="mailto:a.worthington@griffith.edu.au">a.worthington@griffith.edu.au</a></td>
<td><a href="mailto:r.gupta@griffith.edu.au">r.gupta@griffith.edu.au</a></td>
</tr>
<tr>
<td>Phone</td>
<td>+61 412 648 017</td>
<td>+61 7 373 54273</td>
<td>+61 7 373 57593</td>
</tr>
</tbody>
</table>

By signing below, I confirm that I have read and understood the information package and in particular have noted that:

1. I understand that my involvement in this research will include participation in an interview about the bank financing for small and medium-sized enterprises in Libya;
2. I have had questions answered to my satisfaction;
3. I understand that any third party will not know my participatory status in this research;
4. I understand that my responses will not to be disclosed to any third party (only research team will have right to use the information and only aggregated results will be reported to PhD thesis);
5. I understand the risks involved;
6. I understand that my participation in this study is voluntary and I am free to withdraw at any time, without comment and penalty;
7. I understand that if I have any additional questions I can contact the research team;
8. I understand that I can contact the Manager of Research Ethics, at Griffith University Human Research Ethics Committee on +61 7 3735 5585 (or email to researethics@griffith.edu.au), or can contact Akram Farag on +218928123426 as a contact person in Libya if I have any concern about the ethical conduct of the research; and I agree to participate in the project.

Name, …………………    Signature, …………………    Date .../...../.....
Appendix G: Interview Guide in English

STRATEGIC OVERVIEW

- What are the definition criteria for SMEs used by the bank?
- Based on your opinion, what are the factors that drive Bank Al Tanmeya to engage with SMEs?
- In your opinion, what are the factors considered as important obstacles to the bank’s involvement with SMEs?
- Does the bank have special department specializes in SMEs?

SME FINANCING

- What are the most important factors that are considered when making decisions regarding applications for business loans to SMEs?
- Does the bank require collateral for loans to SMEs?
- What types of collateral are commonly required for lending to SMEs?
- In the process of judging the creditworthiness of SMEs does the bank collect any other information and how?
- Can you describe how the bank’s credit decision is made?
- Based on your experience, what are the most frequent factors that cause the finance applications from SMEs to be rejected?
- What are the main types of financing offered by the bank to SME clients?

ISLAMIC FINANCE

- What do you know about the differences between Islamic banking and conventional banking?
- In your opinion, is Islamic finance a viable option for SMEs in Libya?
- Does Bank Al Tanmeya have any plan to offer Islamic finance products in the future?
- If so, Can you indicate what Islamic finance products the bank is planning to offer to its SME clients?
DATA REQUEST

- Please provide the TOTAL number of loan applications received from SMEs as of latest year available …………… As of year…………
- Please provide the TOTAL number of loan applications approved for SMEs as of latest year available …………… As of year…………
- Please provide the TOTAL number of loans granted to SMEs as of the latest year available.
- Please provide the AMOUNT of loans granted to SMEs of latest year available.
Appendix H: Interview Consent Form in Arabic

جامعة غريفث
التمويل المصرفي للمشروعات الصغيرة والمتوسطة
نموذج قبول المشاركة

فريق البحث

<table>
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<td>أندر ورثينقتون</td>
<td>عبدالمعيز عبدالصالح</td>
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<td>بروفيسور في التمويل</td>
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كلية التجارة
جامعة غريفث، حرم ناين

الاسم: راكيش قوبتا
البريد الإلكتروني: r.gupta@griffith.edu.au
العنوان: +61 737357593

الاسم: ناياتن
البريد الإلكتروني: a.worthington@griffith.edu.au
العنوان: +61 737354273

الاسم: عبد العزيز عبدالصالح
البريد الإلكتروني: a.abdulsaleh@Griffith.edu.au
العنوان: +61 412648017

أنا الموقع أدناه أقر بأني قرأت وفهمت المعلومات المقدمة وخصوصاً قد لاحظت ما يلي:

1. مساهمتي في هذا البحث تنطوي على المشاركة في مقابلة حول تمويل المشاريع الصغيرة والمتوسطة في ليبيا.
2. لن يكون لأي طرف ثالث العلم بمشاركةي في هذا البحث.
3. انتم ان إجاباتي خلال المقابلة لن يتم الإطلاع عليها من أي طرف ثالث (فقط فريق البحث من يملك الحق في الإطلاع على المعلومات وفقط النتائج النهائية سيتم عرضها في رسالة الدكتوراه).
4. انتم أن طبيعة المخاطر المترتبة على مشاركتي في هذه الدراسة.
5. انتم أن مشاركتي في هذه الدراسة تطوعية تماماً وأنني حر لإنسحاب في أي وقت بدون أي التزام أو غرامة.
6. انتم أنه في حالة كان لدى أي أسئلة إضافية يمكنني الاتصال بفريق البحث.
7. انتم أنه يمكنني الاتصال بمدير أخلاقيات البحث بجامعة غريفث على الرقم 006137355585 أو مراسلتهم على البريد الإلكتروني (researethics@griffith.edu.au) أو يمكنني الاتصال بالأخ أكرم فرج على الرقم 0926123426 كمراسل في ليبيا إذا كان لدي ما يدعو للقلق حيال أخلاقيات القيام بالبحث، وعلى أية أوقف على المشاركة في المشروع.

الاسم: ........................
التوقع: ........................
التاريخ: ........................
Appendix I: Interview Guide in Arabic

النظرة الاستراتيجية

1. ما هي المعايير التي يستخدمها المصرف لتعريف المشروعات الصغيرة والمتوسطة؟

2. في اعتقاداتك، ما هي العوامل التي تدفع مصرف التنمية إلى الانخراط في خدمة المشروعات الصغيرة والمتوسطة؟

3. في رأيك، ما هي أهم العوامل التي تعيق اندماج المصرف مع هذا القطاع؟

4. هل يوجد في المصرف قسم خاص للتعامل مع العملاء من المشروعات الصغيرة والمتوسطة؟

تمويل المشروعات الصغيرة والمتوسطة

5. هي أهم العوامل التي تؤخذ في الاعتبار عند اتخاذ قرار بشأن منح قروض للمشروعات الصغيرة والمتوسطة؟

6. هل يطلب المصرف ضمان مقابل منح القروض للمشروعات الصغيرة والمتوسطة؟

7. ما هي أنواع الضمانات التي عادةً تطلب مقابل منح القروض للمشروعات الصغيرة والمتوسطة؟

8. خلال عملية تقييم الجدارة الإئتمانية للمشروعات الصغيرة والمتوسطة هل يقوم المصرف بجمع أي معلومات أخرى؟ وكيف يتم ذلك؟

9. هل بإمكانك توصيف كيف يتم اتخاذ قرار منح الإئتمان؟

10. بناءً على خبرتك ما هي أكثر العوامل التي تؤدي إلى رفض طلبات الإفراط المقدمة من المشروعات الصغيرة والمتوسطة؟

11. ما هي أنواع التمويل التي يقدمها المصرف لعملائه من المشروعات الصغيرة والمتوسطة؟

التمويل الإسلامي

12. إذا تعرف عن الاختلافات بين الصيرفة الإسلامية والصيغة التقليدية؟

13. في اعتقاداتك هل التمويل الإسلامي خيار حيوي للمشروعات الصغيرة والمتوسطة في ليبيا؟

14. هل لدى مصرف التنمية أي خطط لعرض منتجات تمويل إسلامية في المستقبل؟

15. في حالة وجود مثل هذه الخطط هل بإمكانك ما هي المنتجات التي يستهدف المصرف تقديمها لعملائه من المشروعات الصغيرة والمتوسطة؟
طلب بيانات

16. من فضلك هل يمكنك تحديد العدد الكلي لطلبات الإقراض المقدمة من المشروعات الصغيرة والمتوسطة حسب آخر ما هو متاح من بيانات.

17. من فضلك هل يمكنك تحديد العدد الكلي لطلبات القروض المقدمة من المشروعات الصغيرة والمتوسطة التي تمت الموافقة عليها حسب آخر ما هو متاح من بيانات.

18. من فضلك هل يمكنك تحديد العدد الكلي للقروض التي تم منحها للمشروعات الصغيرة والمتوسطة حسب آخر ما هو متاح من بيانات.

19. من فضلك هل يمكنك تحديد المبلغ الكلي للقروض التي تم منحها للمشروعات الصغيرة والمتوسطة حسب آخر ما هو متاح من بيانات.
Appendix J. Ethical Clearance

GRIFFITH UNIVERSITY HUMAN RESEARCH ETHICS COMMITTEE

27-Jun-2013

Dear Mr Abdulsaleh

I write further to the additional information provided in relation to the conditional approval granted to your application for ethical clearance for your project "NR: Bank Financing for Small and Medium-sized Enterprises in Libya" (GU Ref No: AFE/08/13/HREC).

This is to confirm receipt of the remaining required information, assurances or amendments to this protocol. Consequently, I reconfirm my earlier advice that you are authorised to immediately commence this research on this basis.

The standard conditions of approval attached to our previous correspondence about this protocol continue to apply.

Regards

Dr Kristie Westerlaken
Policy Officer
Office for Research
Bray Centre, Nathan Campus
Griffith University
ph: +61 (0)7 373 58043 fax: +61 (07) 373 57994
email: k.westerlaken@griffith.edu.au web:

Cc:

Researchers are reminded that the Griffith University Code for the Responsible Conduct of Research provides guidance to researchers in areas such as conflict of interest, authorship, storage of data, & the training of research students.
You can find further information, resources and a link to the University’s Code by visiting http://policies.griffith.edu.au/pdf/Code%20for%20the%20Responsible%20Conduct.pdf

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References


Cooper, P. J. (1975). Four P’s for Lending (Shaking the Dust off the Four C’s of Credit). *Journal of Commercial Bank Lending*, 46-50.


