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Supply Side Obstacles to Financing the Private Sector: Empirical Evidence from a Small Island Developing State

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Abstract

In light of the growing finance–private sector–economic growth findings, this article examines, from a *supply-side* perspective, obstacles to private sector financing in Fiji, a representative South Pacific small island, growth deprived, fragile economy. A survey of 80 percent of the formal financial sector suppliers reveals that financing the private sector may not be a major problem. However, the prevalent relationship–lending practices, good profits and well–managed risks also suggest that suppliers may be concentrating on a systematically selected small group of connected borrowers; the wider private sector, including many SMEs may be left out. Growth and development implications extend to developing economies beyond the South Pacific region.

Keywords: Fiji, South Pacific, banks, financing obstacles

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1.0 Introduction

Around the world, prompted by a growing body of evidence demonstrating a positive and strong finance–growth link¹, development of financial sectors continues to receive considerable attention by researchers and policy–makers alike. Conceivably, one interest has been in identifying and enhancing factors that may lead to greater demand and supply for credit to the private sector via mainly the banking and stock market channels. Here, research has identified a number of macro–level determinants, including the prominent legal institutions (La Porta et al., 1997, 1998; Demirguc–Kunt and Maksimovic, 1998; Beck et al., 2003) and others such as politics (Rajan and Zingales, 2003) and culture (Garretsen et al., 2004).

While these studies have advanced our understanding of obstacles to demand and supply of private sector credit across countries, implications for the South Pacific’s small island, vulnerable economies with lacklustre growth are only beginning to emerge, with an underlying message that solutions and policies applicable elsewhere may not necessarily be suitable for this region. For example, Sharma and Roca (2010) argue that the development of stock markets should be less pursued in the South Pacific since this component of the developed world’s financial system model may not be appropriate for the region, indicating that financial sector development in the South Pacific is likely to be synonymous with banking development. Indeed, as Sharma and Brimble (2010) show, in practice, the banking sector *is* more or less *the* financial sector in the region. On the development of the banking sector, in turn, Sharma and Nguyen (2010) demonstrate that the role of legal institutions may not be as prominent in this region as acclaimed elsewhere.

The above leads to the question of how could the demand as well as supply of bank credit to the private sector be enhanced in the South Pacific, keeping in mind that solutions applicable elsewhere may not necessarily be appropriate for the region. With respect to bank credit in the region, ‘relationship lending’ remains by far the dominant form of financing—for firms of all size, SMEs as well as large (Sharma and Brimble 2010). With relationship lending, as opposed to arms–length lending, ‘soft’ information gathered by the lender via a continuous process involving personalised and direct contact with the borrower and related environment is critical in mitigating opacity problems (e.g. Berger and Udell, 1998). Here too, studies have attempted to examine the influence of these traditionally embedded risk mitigating factors in the process of obtaining/granting external finance (Beck et al., 2005; Beck and Demirguc–Kunt, 2006; Beck et al., 2008a; de la Torre et al., 2008). Again, related research on the South Pacific economies appears sparse.

This paper fills the above void in literature by attempting to systematically understand, in relation to private sector credit, the views of the *suppliers* of credit (banks and non–banks) on obstacles to

¹ See Levine, 1997 and 2005 for comprehensive reviews; the link appears stronger in the case of developing economies.

private sector financing in the South Pacific². Given that worldwide liberalisation and deregulation processes have empowered suppliers to 'choose' its borrowers, it is critical to understand the 'willingness' of the financiers to advance credit, as much as it is important to understand the views of the fund-seeking firms. In this study, the overall private sector credit includes enterprise as well as household credit, since the latter has been shown to constitute a major part of the overall credit across countries with its prominence increasing in the overall credit volume (Beck et al. 2008b). The borrowers are also separated into *prospective* and *existing* groups. The analysis is based on opinions of professional and experienced lenders, including very senior management across various lending institutions gathered via a structured interview questionnaire³. Data was collected on institutions in Fiji, a representative South Pacific island economy.

Results show that lending institutions in Fiji, and by implication the rest of the South Pacific⁴, may not face major obstacles in financing the private sector; the results hold for institutions of different size, profit levels, capital base, etc. and across prospective and existing, business and household borrowers. However, lenders may not, at the same time, be much interested in the wider private sector. Prevalent relationship lending practices, high profits and well-managed risks indicate that revenues may significantly be generated from a relatively small group of inter-connected borrowers and other non-credit sources. Per the finance-growth literature, the implications for growth and development appear considerable; if the wider community is indeed being left out, not only would opportunities for more and/or adequate growth may be compromised but improvements to the overall socio-economic profiles of individuals and the country are likely to be marginal, if any.

The rest of the paper is organized as follows. Section 2 provides an overview of the formal credit market in Fiji and the greater South Pacific region; section 3 discusses the methodology for data collection; section 4 discusses the methodology for data analysis; section 5 presents the results on perceptions about *prospective* borrowers; section 6 presents the results about *existing* borrowers; section 7 discusses the implications of the results; and section 8 concludes.

2 Research is underway on the views of demanders (firms) re obstacles to financing in the South Pacific; Sharma and Gounder, 2011.

3 The study was funded by the Griffith Business School, Griffith University, Australia.

4 In addition to similar socio-economic geo-political circumstances, the economies share similar financial institutions as well, e.g. major banks are the same across the region.

2.0 The credit market in the South Pacific: a brief overview

In the South Pacific, the main source of formal external credit for the private sector is banks⁵; bond markets are infinitesimal and confined to government and statutory bodies, and where a stock does exist—only in Fiji and PNG—they are small and illiquid. In fact, in the case of Fiji, the larger of the two, the market is so small, illiquid and inefficient that Sharma and Roca (2010) believe that it may be a misfit in the country's financial system model; accordingly, the authors' recommend its gradual withdrawal from the system.

Moreover, banking activities are still highly traditional, confined mainly to deposit–lending activities; investment banking and venture capital are virtually non–existent. Further, 'relationship lending' is virtually the most prominent form of credit assessment and granting, but without the modern credit scoring methods. All things considered, for majority of start–up, newly established and/or established firms, as well as for the household sector, banks may be the only (at least primary) source of formal credit; arms–length lending is virtually not an option for most firms at any stage of development or for the household, relationship lending is the dominant form.

Consequently, in the South Pacific, from a formal external credit viewpoint, as Demirguc–Kunt and Levine (2008) point out, a bank is likely to considerably arbitrate who can/cannot start/expand a business, who can/cannot purchase a car/home; essentially, who can/cannot attempt to realise one's economic aspirations. More importantly, from a financial sector perspective, it is the banking sector that largely arbitrates the rate of economic growth and development in the region (Levine, 2005). In light of such a pivotal role of banks in the socio–economic growth and development of the region, it is imperative to understand—from their point of view—obstacles to financing the private sector.

3.0 The survey

In designing the survey, we were mindful that while successful borrowers are likely to contribute to growth and development, a declined credit is a foregone opportunity. Thus, a lender's perception about *prospective* borrowers appears at least as important as that about *existing* borrowers. Accordingly, to understand lenders' perceptions regarding obstacles to financing the private sector in Fiji, we designed a survey questionnaire to examine the difficulties they experienced in lending to (a) *prospective business* borrowers; (b) *existing business* borrowers; (c) *prospective household* borrowers; and (d) *existing household* borrowers⁶. Thus, we had four groups of borrowers.

5 Here banks resemble all types of institutions engaged primarily in lending to the private sector and include, apart from commercial banks, institutions such as finance companies and development banks.

6 As required, Griffith University's Ethical clearance was sought. Among others, respondents were clearly informed about the confidentiality of data collected.

With respect to the deemed obstacles from a lender's perspective, we reviewed two main sources: (i) regulatory requirements in the country; and (ii) extant literature; both sources revealed similar suggestions. In relation to regulatory requirements, operations of most lenders (especially licensed, see figure 1 and discussion below) in Fiji are subject to BIS-standard, Reserve Bank of Fiji (RBF) regulations, including policies and guidelines on capital adequacy and asset quality. The capital adequacy policy essentially requires that regulated institutions adhere to Basel Capital Adequacy Requirements⁷. Institutions are also encouraged to closely follow RBF's guidelines on 'Loan Classification and Provisioning for Impaired Assets'⁸, another adaptation of Basel Committee's recommendations, which sets rules and best-practice guidelines on credit risk-mitigating factors, among others. The risk-mitigating factors, as cited also in the literature, (e.g. Beck et al., 2005; Gup and Kolari, 2005; Clauretie and Sirmans, 2010; Koch and MacDonald, 2010) include, *inter alia*, collateral, capital contribution, financial and other documents, loan repayment, compliance with terms and conditions, collateral repossession and legal issues. In addition, overall creditworthiness and knowledge about applying for a loan also appear important. See table 1 for the list of deemed obstacles to finance from a lender's perspective.

Figure 1: Lending institutions in Fiji, 2010

This figure captures the structure of the formal financial sector lending institutions in Fiji. There were 10 institutions operating at the beginning of 2010 of which, 8 were licensed i.e. by the Reserve Bank. In trying to understand the suppliers' views on obstacles to financing the private sector, the survey included all 8 licensed institutions.

7 Banking Supervision Policy Statement No 1: Capital Adequacy Requirements for Licensed Financial Institutions: www.Reservebank.Gov.Fj

8 Banking Supervision Policy Statement No 3: Revised 2009 Guidelines for Loan Classification and Provisioning for Impaired Assets.: [Http://www.Reservebank.Gov.Fj](http://www.Reservebank.Gov.Fj)

Using a Likert scale to capture a respondent's perception, we asked the question: 'on a scale of 1 (major obstacle) to 7 (no obstacle), how would you generally rate the problems associated (with each of the above factors) in relation to making a loan to a (above type of) borrower?' Respondents could at all times view a scale information sheet. A pilot test returned negligible concerns with the instrument and the interview process. The survey was confined to the wider capital city area of Suva, which is the country's main business division and houses the head offices and major branches of all financial institutions operating in Fiji. Moreover, for most institutions, loan application assessments and approvals are largely centralised at the head office.

Table 1: Deemed obstacles to financing the private sector: a lender's perspective

This table lists the variables considered in understanding the obstacles lenders in Fiji may face in financing the private sector. The variables were drawn from two main sources: (a) regulatory policies for licensed institutions such as those on 'Loan Classification and Provisioning for Impaired Assets' and literature; both sources revealed similar suggestions. Lenders views were obtained via a survey where they were asked to rate on a 1 (major obstacle) to 7 (no obstacle) scale the difficulties they experienced with respect to each of the listed variable.

Code	Description
KNOW	lack of knowledge in applying for a loan
COLL	obtaining adequate/proper collateral
CAP	obtaining adequate capital or down payment or contribution
FINR	obtaining adequate/proper financial records
ODOC	obtaining adequate other required documents
CREDIT	creditworthiness
COMPL	compliance with the terms and conditions of the loan
RPAY	repayment of credit and interest
RCOLL	repossessing collateral
LEGAL	instigating legal action against a defaulting borrower

At the time of the survey, there were ten lending institutions in Fiji; five banks and five non-banks (credit institutions)⁹. Of the non-banks, two are finance companies, two residential mortgage providers, and one development bank (figure 1). Of these, eight—all five banks, both finance companies, and one residential mortgage provider—are 'licensed' lending institutions i.e. authorised by the regulator (RBF) to accept deposits from the public, which automatically subjects them to BIS-standard regulations on capital, asset quality, etc. The survey was confined to licensed institutions only and all were included. The banks included: Australia and New Zealand Banking Corporation Ltd (ANZ); Bank of Baroda (BOB); Bank of South Pacific Limited (BSP); Colonial National Bank Limited (CNB); and Westpac Banking Corporation Limited (WBC). The non-banks included Credit Corporation Fiji Limited (CCFL); Merchant Finance Limited (MF); and Home Finance Company Limited (HFC), of

⁹ One of the banks has recently been taken over by another existing bank.

which, CCFL and MF are finance companies, and HFC is a residential mortgage provider. These institutions account for around 90% of the total loans of all lending institutions in Fiji.

We obtained responses from 63 different individuals across the eight institutions. The respondents included executive management, branch/line/department managers and other senior loans officers; most responses (85%) were from the last two groups. Given that banks (as opposed to non-banks) provide around 92% of all credit to the private sector in Fiji and ANZ and WBC together control around 70% of the country's total bank loans (Sharma and Brimble, 2010), the intention was to focus more on the banks and particularly on the 'big two'.

Coincidentally, the banks and particularly the 'big two' were more responsive and cooperative resulting in 70% of the total responses obtained being bank responses and 41% of the total from the 'big two'. ANZ and WBC are also the oldest institutions in Fiji with establishments dating back to 1880 and 1901, respectively; in fact, these are the pioneer institutions across the South Pacific. All banks in Fiji are foreign-owned and incorporated and one of the non-banks covered in the survey (CCFL) is also foreign owned. Of the foreign banks, three are Australian (ANZ, CNB and WBC), one from the Sub-continent (BOB) and one from Papua New Guinea (BSP). In addition to ANZ and WBC, other institutions also have operations across the region. For example, BSP operates in Fiji, PNG, Niue and the Solomon Islands and CCFL operates in Fiji, PNG, Vanuatu and Solomon Islands.

4.0 Data analysis

The ordered-probit modelling technique was employed to analyse and understand respondents' perceptions on the extent to which the identified factors (table 1) may influence a decision to provide credit to a firm or household. To do this, we proceeded as outlined below.

Quantifying perceptions

An essential pre-requisite for using the ordered-probit model is that the data to be analysed should be ordered or ranked. While our Likert scale-obtained data was already ranked, for a more meaningful analysis, we collapsed it to a three-point score. To do this, first, we ascertained a respondent's overall perception regarding borrowers in the four different groups where, P_PB = perception on *prospective business* borrower; P_EB = perception on *existing business* borrower; P_PH = perception on *prospective household* borrower; and P_EH = perception on *existing household* borrower. To compute the overall perception, we followed the approach adopted by La Porta et al. (1998) in their seminal paper on law and finance, i.e. a simple average of the individual scores. Thus, for respondent X, say if the perception regarding an *existing business borrower* (P_EB) were as follows: KNOW = 7; COLL = 5; CAP = 2; FINR = 1; ODOC = 3; CREDIT = 4; COMPL = 3; RPAY = 7; RCOLL = 5; and LEGAL = 3; then, that respondent's overall score would be 4 or P_EB (X) = 4. (Please see table 1 for details regarding the obstacles, e.g. KNOW = 'lack of *knowledge* in applying for a loan'.)

Second, the overall scores were distributed into the pre-determined three clusters as follows: (i) 0 = overall scores in the range 1 to 3, indicating that identified factors are considerable obstacles to financing; (ii) 1 = an overall score of 4, indicating that factors are moderate obstacles; and (iii) 2 = scores in the range 5 to 7, indicating that identified factors are less important obstacles to financing.

Independent variables

It was possible that a respondent's affiliation with a particular institution could influence their perception such that a respondent associated with a larger institution might perceive the obstacles differently from one associated with a smaller institution. To understand the influence of such factors, we identified the independent variables listed in table 2: total assets; total liquid assets; capital base; deposits; profits before taxes; and type of institution (bank/non-bank). Intuitively, larger, more liquid, better capitalised, better funded, and more profitable institutions are likely to be less risk averse compared to smaller institutions and/or those less confident about their liquidity, capital, funding, and profitability positions. That is, it might be easier for better and stronger institutions to grant credit even in less favourable circumstances. Accordingly, with respect to institution type, banks, due to their expected better and stronger positions, are likely to be less risk averse compared to the non-banks. A back-of-the-envelope analysis shows that banks are indeed more profitable, better capitalised, etc. compared to non-banks.

Table 2: Independent variables influencing perceptions

This table lists variables deemed to influence perceptions of respondents, and notes the expected relationships. For example, larger institutions are expected to be less risk averse such that as size (measured by total assets) increases; the identified factors are expected to become less problematic.

Variable	Expectation
Size of financial institution (measured by total assets)	Larger institutions are likely to be less risk averse (positive relationship expected: as size increases, factors become less problematic)
Liquid assets	More liquid institutions may be less risk averse (positive relationship expected: as liquidity increases, factors become less problematic)
Capital base (capital to capital of all institutions)	Larger institutions need not necessarily be better capitalised; institutions with more capital may be prepared to take more risk (positive relationship expected: as capital increases, factors become less problematic)
Deposits	Deposits being very cheap source of funds, institutions with more deposits may be less risk averse (positive relationship expected: as deposit increases, factors become less problematic)
Net profit (before tax)	More profitable institutions may be less risk averse (positive relationship expected: as profit increases, factors become less problematic)
Type of institution	Banks, due to their better and stronger positions are expected to be less risk averse compared to non-banks (positive relationship expected)
Position of respondent	More senior staff expected to be less risk averse

Further, the potential for cross-selling other products, once a lending relationship has been established, is likely to compensate for otherwise higher costs and risks associated with lending to certain sectors and types of borrowers (de la Torre, 2008). This practice of offering a variety of other services and products to established clients is likely to create opportunities for generating additional and sometimes, significant, revenues in the form of fees and charges. The expected ability of bigger, better funded and stronger institutions to offer a wider range of non-credit as well as other credit services and products is likely to make them less risk averse in granting a credit in the first place. A similar argument applies in the case of bank versus non-bank institutions. Accordingly, all relationships are expected to be positive such that as an institution's size, deposits etc. increased, perception scores are expected to shift towards the value of 2, reflecting the idea that the identified independent factors become increasingly less problematic in the credit granting process.

The model

In view of the foregoing, the following theoretical model is specified:

$$y_i^* = x_i' \beta + \varepsilon_i$$

where, y_i^* is the unobserved latent variable, x_i' is a set of observed characteristics and ε_i the unobserved characteristics. The dependent variable y_i^* is a discrete variable that represents a choice from a set of mutually exclusive choices. Commonly known as the *probit* model, it has become a popular tool for explaining binary choice decisions in econometrics (Amemiya, 1981; Maddala, 1983). Since this paper considers the unobserved latent variable in more than two categories, i.e. major, moderate and less important obstacle to finance, the *ordered-probit*, an extension of the probit model is utilised.

The ordered-probit model is also based on one latent variable but with a different match from the latent variable, y_i^* , to the observed one ($y_i = 1, 2, \dots, n$). It can be written as

$$y_i^* = x_i' \beta + \varepsilon_i$$

$$y_i = j \quad \text{if} \quad \lambda_{j-1} < y_i^* \leq \lambda_j$$

for unknown λ_j with $\lambda_0 = -\infty$, $\lambda_1 = 0$ and $\lambda_n = \infty$. To model the outcomes, $y_i = 1$ (identified factors are considerable obstacles to financing), $y_i = 2$ (factors are moderate obstacles) and $y_i = 3$ (factors are less important obstacles), it should be noted that there appears to be logical ordering in these answers. It is also rational to assume that there exists observed characteristics $x_i' \beta$ such that higher or lower values for these characteristics correspond with, on average, larger or smaller values for y_i . As a result, the ordered response model for this analysis can be written as:

$$y_i^* = x_i' \beta + \varepsilon_i$$

$$\begin{aligned}
y_i &= 1 \quad \text{if } y_i^* \leq 0 \\
&= 2 \quad \text{if } 0 < y_i^* \leq \lambda \\
&= 3 \quad \text{if } y_i^* > \lambda
\end{aligned}$$

where, y_i^* can be interpreted as banks perception about borrowers, where the borrower groups include: (i) prospective business; (ii) existing business; (iii) prospective household; and (iv) existing household. The empirical model for this study can therefore be written as follows:

$$P = \beta_0 + \beta_1 TA + \beta_2 TC + \beta_3 TD + \beta_4 LA + \beta_5 NPBT + \beta_5 INST + \epsilon_i$$

where, TA = total assets; TC = total capital; TD = total deposits; LA = Liquid assets; NPBT = net profit before tax; and INST = institution type. The model will estimate the statistical significance and direction of the relationship between each explanatory variable and the corresponding level of perception.

5.0 Perceptions about *prospective* borrowers

Preliminary observations

With respect to prospective *business* borrowers, the worst perceived obstacle overall appears to be ‘instigating legal action against a defaulting borrower’ (LEGAL); the average for this factor was 3.55 (based on raw data, on a 1–7 scale, where 1 = worst obstacle and 7 = no obstacle; figure 2). The factor of least concern was ‘compliance with terms and conditions’ (COMPL); the average was 4.92. With respect to *household* borrowers, on the other hand, the worst obstacle overall appears to be ‘creditworthiness’ (CREDIT)—the average was 3.47 and the least obstacle was ‘loan repayment’ (REP), with an average of 4.04. Overall, these scores indicate that while the lenders in Fiji may be slightly less positive about *household* borrowers, they do not generally appear too apprehensive about any of the identified factors; the scores for the worst obstacle in both cases reflect only moderate difficulty; a score of 1, 2 or even 3 do not emerge in the averages.

Figure 2: Respondents’ perception about *prospective* borrowers

This graph shows, on a scale of 1 (major obstacle) to 7 (no obstacle), the average perceptions of respondents about *prospective* business (P_PB) and household (P_PH) borrowers with respect to each of the variables listed in table 1. As the graph shows, the averages exceed a value of 3, indicating that lenders may not have any major problems with any of variables with respect to both the business and household borrowers. For example, the average scores for KNOW (knowledge in applying for a loan) is 4.23 and 3.76 respectively, for P_PB and P_PH. The definitions of the variables are provided in table 1.

Simple correlations

Simple correlation tests reveal some interesting findings. First, the correlations between a respondent's perception and the independent variables (table 3) are generally weak. For example, a respondent's perception does not appear to be noticeably influenced by whether they are associated with a large or small institution or with one that has a large or small deposit base. However, there are a couple of relationships that do stick out, even if not too strongly, from the rest. One is with the type of institution (Ins type) and another is with the position of the respondent (pos). With respect to the type of institution, results seem to suggest that banks may be more cautious than non-banks, and within the banking sector, larger banks may be more vigilant than smaller banks. The correlations also seem to suggest little, if any, difference in perceptions across banks and non-banks and, across institutions generally. Respondents also seem to be a bit more cautious about the household group.

Table 3: Simple correlation coefficients: perceptions versus selected independent variables

This table shows how the selected independent variables (table 2) might influence a lender's decision to grant credit. As the coefficients indicate, the correlations are generally weak, i.e. none of the independent variables appear to strongly influence a lender's credit-granting decision. Thus, size, for example, may not matter. Moreover, unexpectedly, some correlations are negative, indicating inverse relationships.

	Prospective Business	Prospective Household	Existing Business	Existing Household
Position	-0.3076	-0.2402	-0.2291	0.0010
T. Assets	-0.0113	-0.0928	0.1838	-0.0211
T. Capital	0.0591	-0.0371	0.2380	0.0251
Net Profit (b.t.)	0.0703	-0.0561	0.2324	-0.0146
Liquid Ass.	-0.1346	-0.2763	0.0034	-0.2464
Deposits	-0.0220	-0.0989	0.1745	-0.0242
Ins type	0.2705	0.4431	0.1408	0.4237

With respect to the position of respondents, the correlations are negative, i.e. as the role of the lender changes from executive management to staff in the loans section, the average level of perception falls (smaller numbers reflect greater obstacle), indicating that less senior lenders may be more sceptical about the identified factors as obstacles to financing private sector credit.

Second, apart from the above negative correlation, other relationships are unexpectedly negative as well, including that with the size of the institution, deposit base, liquidity, and number of branches. Again, while the relationships are weak, they are more pronounced with respect to perceptions on *household* borrowers. These results seem to indicate that institutions with more assets, deposits, liquid assets and outlets may be generally more cautious in financing the private sector and are relatively more sceptical about the *household* sector.

Regression results

We tested various combinations of the independent variables (table 3) on the perception of respondents. Table 4 shows the results of the ordered probit regression. The first row shows the dependent variables i.e. perceptions of respondents about prospective business (P_PB) and household (P_PH) borrowers and the first column shows the independent variables, which include total assets, total capital, etc.

Table 4: Perceptions about *prospective* borrowers: ordered probit regressions

This table presents the more meaningful results of the ordered–probit regressions between perceptions about *prospective* borrowers and selected independent variables. As the table shows, only occasionally are the correlations significant (denoted by *). That is, the selected independent variables do not appear to strongly influence granting credit to prospective private sector borrowers. Also, some correlations are unexpectedly negative. Results are generally consistent with simple correlation tests (table 3).

Dependent Variable:	Business (P_PB)			Household (P_PH)	
Independent Variable	Model 1	Model 2	Model 3	Model 1	Model 2
Total assets	-259.73 (0.0801)*	-189.71- (0.1606)	-231.89 (0.1797)	-13.69 (0.9550)	25.42 (0.9076)
Total capital	45.68 (0.3096)	29.17 (0.0124)*	46.34 (0.3049)	26.85 (0.5693)	-1.36 (0.9235)
Total deposits	230.52 (0.0748)*	167.65 (0.2104)	201.32 (0.2057)	5.69 (0.9810)	-19.13 (0.9306)
Liquid assets	-11.85 (0.0779)*	-9.71 (0.4355)	-8.35 (0.5178)	4.18 (0.8687)	-1.36 (0.9493)
Net profit (b.t.)	-7.16 (0.7235)		-8.088 (0.6931)	-14.37 (0.5313)	
Institution type		0.25 (0.7918)	0.29 (0.7512)	2.23 (0.2534)	1.88 (0.2668)
Pseudo R squared	0.11	0.11	0.11	0.15	0.15

p-values are given in parenthesis under the coefficients; individual coefficients are statistically significant at the *5% level.

With respect to *business* borrowers, as table 4 shows, total and liquid assets, and deposits appear to significantly influence perception in only one case (model 1; significance denoted by *). However, the coefficient signs suggest that perception may be negatively related with the total and liquid assets but positively with deposits. That is, on one hand, larger and more liquid institutions are inclined to be more cautious in providing credit to prospective business borrowers, on the other hand, though, institutions with more deposits, as expected, are inclined to be less risk averse in providing credit¹⁰. However, when ‘institution type’ is introduced and ‘profits’ excluded from the model (Model 2), a different variable—capital—appears to significantly and positively influence perception; others are not significant anymore. Further, when ‘profits’ are re-introduced together with ‘institution type’ (Model 3), none of the variables appear to significantly influence perception. The insignificant relationship trend continues with respect to *household* borrowers; there is no significant relationship between any of the independent variables and perception.

The picture that emerges from these results is hazy. For instance, if anything, it appears that larger, more liquid and more profitable institutions are likely to be more, rather than less, risk averse in providing credit to *prospective* borrowers generally; a result that contradicts expectations. On the other hand, institutions with more deposits and capital are likely to be less cautious. Some explanation for this is provided in section 7 below.

6.0 Perceptions about *existing* borrowers

Preliminary observations

Overall, the average scores here are higher, indicating that lenders may be more comfortable in financing customers they have already developed a relationship with (existing) compared to those they don’t know well (prospective). For *business* borrowers, the aggregate average increased from 4.12 to 4.61 and for *household* borrowers from 3.84 to 4.55 (table 5). In terms of overall worst perceived obstacle, for *business* borrowers it is ‘collateral repossession’ (RCOLL; 4.24) and for *household* borrowers, COMPL and LEGAL; both at 4.39. Taken together, it appears that lenders are not too concerned about any of the identified factors being a major obstacle in financing existing and/or would-be borrowers; a score of 1, 2 or even 3 do not emerge in the averages across different categories, the lowest average is 3.47, associated with prospective *household* CREDIT.

10 The ordered probit results are consistent with the simple correlation test results above, confirming the Makridakis and Hibon (2000) claim that simple analytical tools are as effective, if not more, than the more complex methods of analysis.

Table 5: Overall perceptions

This table compares the average perceptions of respondents across the four groups of borrowers: (P_PB = perception on *prospective business* borrower; P_PH = perception on *prospective household* borrower; P_EB = perception on *existing business* borrower; P_EH = perception on *existing household* borrower. As the table shows, the averages exceed a value of 3, indicating that lenders may not have any major problems with any of variables with respect to any borrower type.

	P_PB	P_PH	P_EB	P_EH
KNOW	4.23	3.76		
COLL	4.10	3.89	4.95	4.75
CAP	3.89	3.96	4.45	4.57
FINR	4.14	3.69	4.52	4.45
ODOC	4.63	3.83	5.02	4.70
COMPL	4.92	3.93	4.65	4.39
CREDIT	4.00	3.47	4.78	4.57
REP	3.95	4.04	4.56	4.52
RCOLL	3.82	3.88	4.24	4.58
LEGAL	3.55	3.98	4.33	4.39
Avg.	4.12	3.84	4.61	4.55

Simple correlations

As in the case of prospective borrowers, the correlations here too are generally weak. And again, if at all, it is the institution type that may have some influence; while less stronger than in the case of prospective borrowers, at 0.14 and 0.42 for business and household borrowers, respectively, this correlation remains the highest across the identified factors (table 3). If this does indicate anything, in case of both prospective and existing borrowers, banks appear to be more watchful compared to non-banks, and within the banking sector, larger banks appear to be more careful than smaller banks.

Interestingly, the signs of some correlations shown to be negative regarding perceptions about prospective borrowers, change to positive in the case of *existing business* borrowers but they remain negative in the case of *household* borrowers. This appears to indicate that only in the case of *existing business* borrowers, might the size of an institution, its deposit base, liquidity, and number of branches, positively influence the perception of lenders regarding the identified factors, i.e. larger institutions, with more deposits, liquid assets and outlets, may have fewer problems in financing the business borrowers they have built a relationship with. While weak, these results do raise a number of questions, which we discuss in section 7.

Regression results

With respect to *business* borrowers, in contrast to the prospective group, only one variable—liquid assets—in one combination, appears to significantly but negatively influence perceptions (model 1, table 6). When ‘institution type’ is introduced in the model, the relationship remains negative but the

significance disappears. While insignificant, the relationship with total assets and total capital are also negative suggesting that, if anything, larger, more liquid and better capitalised institutions are inclined to be more cautious. On the other hand, however, while also insignificant, the relationship with deposits is positive.

Table 6: Perceptions about *existing* borrowers: ordered probit regressions

This table presents the more meaningful results of the ordered-probit regressions between perceptions about *existing* borrowers and selected independent variables. As the table shows, only occasionally are the correlations significant (denoted by *). That is, the selected independent variables do not appear to strongly influence granting further credit to existing private sector clients. Also, some correlations are unexpectedly negative. Results are generally consistent with simple correlation tests (table 3).

Dependent Variable:	Business (P_EB)		Household (P_EH)	
Independent Variables	Model 1	Model 2	Model 1	Model 2
Total assets	-73.24	-89.79	133.87	71.23
	(0.6334)	(0.6285)	(0.7165)	(0.0456)*
Total capital	-10.97	-11.08	-91.16	-76.15
	(0.8106)	(0.8085)	(0.3920)	(0.1583)
Total deposits	84.03	101.18	-54.91	
	(0.5345)	(0.5591)	(0.8635)	
Liquid assets	-16.34	-18.29	-27.53	-28.69
	(0.0240)*	(0.2012)	(0.1261)	(0.0814)*
Net profit (before tax)	11.51	11.92	28.67	22.87
	(0.5762)	(0.5652)	(0.5009)	(0.3610)
Institution type		-0.17	2.07	1.82
		(0.8742)	(0.2419)	(0.0554)*
Pseudo R squared	0.1220	0.1222	0.3001	0.2998

p-values are given in parenthesis under the coefficients; individual coefficients are statistically significant at the *5% level.

With respect to *household* borrowers, when all variables are included in the model (model 1), none are significant, however, when deposits are excluded from the model, surprisingly three of the variables become significant—total assets, liquid assets, and institution type.

7.0 Implications of the results

Lenders in Fiji, particularly banks, have often used the notion ‘lack of bankable projects’ to justify the relatively lower credit levels to the private sector (e.g. ADB, 2001), meaning that proposals do not adequately satisfy a number of lending criteria, such as collateral and capital contribution. However, the analysis presented in this study shows that such claims may be tenuous. We say this because, it appears that lenders may actually be indifferent towards the wider community and perhaps focussed on a small group of firms and/or generating significant revenues from sources other than loans. If this approach allows a lender to generate relatively high profits while prudently managing credit, capital

and other risks (Sharma and Brimble, 2010), then allocating resources to the wider community may not seem a good business strategy; both the profit and risk profiles could change adversely. Moreover, in a heavily bank-dominated, competition-averse credit market, smaller, profit-generating, and risk-mitigating lending portfolios make good business sense.

The 80-20 strategy

It is possible, as de la Torre et al. (2008) note, that the lenders in Fiji are systematically seeking potential business through existing (and perhaps large and profitable) clients. The practice generally involves institutions asking existing clients for references on their best clients and suppliers. With a list of potential clients in hand, institutions contact these companies with the intention of converting them into clients as well by offering attractive (even if only initially) tailor-made, credit and non-credit services and products. Apart from additional revenues, this approach enables institutions to obtain an assessment of the quality of potential clients from established and reliable sources, who may also provide any required guarantees. This networking strategy would be useful in managing the otherwise usually suspicious but vital 'soft' information required in relationship lending; institutions are able to not only substantially reduce the risks involved in seeking new, unfamiliar clients but also reduce the time required for developing a relationship.

Moreover, lenders may also systematically seek out large companies with extensive network of branches and subsidiaries of its own; the idea would be to serve the entire chain of business and, not only in one country but possibly across the region. Take for example the case of Punja's Group. The group is one of the many well-established, family-owned, profitable business enterprises in Fiji. It has a total of 19 related companies; 11 of which operate in Fiji and the rest across the South Pacific, including in Samoa, Tonga, Vanuatu, Kiribati, Solomon Islands and Papua New Guinea¹¹, basically in all economies of the region. Similarly, a giant in general building, home furnishing and gardening supplies, Vinod Patel Limited, has branches in all towns and cities in the country. A number of such groups of companies operate in Fiji with branches across the country and the South Pacific region.

The lack of competition in the financial sector—financial markets are either virtually non-existent or awfully shallow and inactive, and a few of banks control the dominant forms of funding and lending—is likely to give rise to 'price leadership' or 'signalling' opportunities. In fact, there is a strong perception that the practice, at least in Fiji, may be real (CIFS, 1999); such practices are believed to be prevalent in other countries as well, e.g. Argentina, Australia and the UK (de la Torre et al., 2008). . An implication of this practice is that price competition may not be an option for smaller institutions, which may otherwise be willing to provide credit at lower rates; following the 'leader' may be a wiser strategy.

¹¹ <http://www.punjas.com/achievements.htm>

If networking is indeed a primary business strategy for lenders in Fiji, then lending portfolios are likely to be skewed towards a relatively small group of clients i.e. Pareto's 80–20 rule may well be the practice (see e.g. Sanders, 1987; Mandelbrot and Hudson, 2006; and Orrell, 2010 for some discussion and application of the rule). If a lender is able to generate most of the revenues from a small group of the customers then this is the group likely to receive most attention; the rest may not count much, which may partly explain the general indifference of the lenders towards both existing and prospective borrowers, the lack of robust correlations.

Rent protection

Borrowers too may benefit from such a network strategy. Firms in Fiji generally, and the larger particularly, appear to be secretive about their business activities, as ADB (2001; p29) notes, in explaining the reasons for the rather small number of firms listed on the stock exchange: 'companies are mostly family businesses to whom disclosure requirements seem intrusive and rather threatening'; a very large number of these multi-million dollar, family-owned and-run businesses remain unlisted (Chand, 2002; Sharma, 2009). While debt-financiers would also require confidential information for the purposes of credit granting, such information remains private, contrary to its publicity in the case of a listed firm, a comfortable outcome for the 'secretive' firms. Moreover, to retain this important group of clients, lenders may offer incentives such as discounted lending rates; any foregone revenues would well be compensated by the very cheap deposit funding, use of which by even the providers incurs a service charge—banks raise revenues not only via a margin on the deposit-lending activity but also on borrowed funds (deposits).

If indeed the network strategy is mutually beneficial, then it could be a case of mutual 'rent protection', as suggested by Rajan and Zingales (2003). The argument, in relation to financial development, is that industrial incumbents (established large industrial firms) have the ability to finance new projects out of earnings and/or borrow on collateral and reputation. Such privileged access to finance endows the incumbent with positional rents, which is likely to be impaired if financial institutions provided credit to a wider group of borrowers, thus the interest of industrial incumbents to oppose competition in the business and financial sectors. Similarly, more competition in the financial sector may compete away the powers and positional rents of incumbent financiers and thus the interest of incumbent financiers as well to oppose financial development. The mutual 'rent protection' objectives enable financiers to solicit the support of firms in return for privileged access to finance and protection of confidentiality. These incumbents have large economic power to collectively determine competition and the development of the financial sector through political influence.

SMEs and households

There appears to be some evidence to support the above contentions and explanations. In addition to the capital and asset quality regulations mentioned earlier, commercial banks in Fiji have, since

2009, also been required to provide a broad range of financial services, including loans, to small and medium enterprises and households¹², where a ‘small enterprise’ is defined as one with a turnover or total assets between \$30,000 and \$100,000 and employs between 6 and 20 employees, and a ‘medium enterprise’ is one with a turnover or total assets between \$100,000 and \$500,000 and employs between 21 and 50 employees. Moreover, the RBF separately and independently monitors the allocation of credit by banks to these enterprises. These actions of the RBF seem to suggest that banks in Fiji may indeed have had little interest in SMEs and the wider household sector.

With respect to SMEs, if indeed the 80/20 rule is being practiced, these would be enterprises that fall outside the 20% group. In that case, in relation to the business borrowers, the perceptions of the respondents in our survey may well relate to these SMEs—indifferent—granting credit to firms not already in or connected to the 20% group would not be an issue. For a number of reasons, banks and other financial institutions may indeed become uninterested in financing SMEs. For example, SMEs may be relatively more opaque i.e. it may be more difficult to ascertain if these enterprises have the capacity (viability of projects) and/or willingness (moral hazard) to repay (Berger and Udell, 1998; Cole, et al. 2004).

SMEs are also more likely to be informal, particularly in developing economies like the South Pacific, which not only exacerbates the ‘opaqueness’ problem but also poses additional obstacles and risks in lending to these enterprises (Gatti and Honorati, 2007); lack of reliable and complete financials, for example, would make it difficult for financial institutions to lend, especially if lenders are subject to regulatory guidelines such as the ‘Loan Classification and Provisioning for Impaired Assets’ and ‘Capital Adequacy Requirements’ in Fiji. Moreover, the expected high cost associated with the labour-intensive process of collecting soft information is likely to create added deterrents. A similar situation is likely to exist with respect to the wider household sector.

8.0 Conclusion

In light of the growing finance–private sector–economic growth findings, this article examines, from a *supply-side* perspective, obstacles to private sector financing in Fiji, a representative South Pacific small island, growth deprived, vulnerable economy; also a relatively understudied region with respect to the finance–growth literature.

A survey of 80 percent of the suppliers reveals that financing the private sector may not be a major problem; analysis of the data shows that lenders may be rather indifferent about the prospect. On one hand, lenders are expected to operate within the confines of the regulatory framework i.e. safe, sound and stable operations, and on the other, accomplish business goals, including shareholder

12 Banking supervision Policy Statement no. 14:
<http://www.reservebank.gov.fj/docs/Banking%20Supervision%20Policy%202014.pdf>

wealth maximisation. Add to this, the widespread practice of, and problems associated with 'relationship lending', the lack of competition in the supply of credit to the private sector, and a bank-dominated financial sector, and Pareto's 80/20 business strategy naturally springs to mind. This strategy appears likely to be the practice in Fiji, explaining thus the 'indifferent' perceptions of respondents regarding to obstacles to private sector financing. This practice is likely to be prevalent across the South Pacific since the same major banks operate across the region.

While these results provide useful insight into the supply-side perspective, policy formulation should only proceed once the views of other stakeholders have also been obtained. For example, the views of the *demanders* of credit (firms), especially the SMEs, appear equally, if not more important, and requires research. With respect to the suppliers as well, further research, e.g. in-depth interviews with senior executives and better understanding of business strategies would be useful. In the meantime, policy makers in the South Pacific would be encouraged to know that the supply-side component of the finance-private sector-economic growth link may not be a major concern.

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