Analysis of Access to Finance for SMEs in Laos

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Abstract

SMEs in Lao PDR are growing amid global growth, affecting the adjustment of the domestic economy. Laos has a growing number of small and medium-sized businesses every year, meanwhile, entrepreneurs choose to invest in various sectors, especially SMEs. What businesses in Lao PDR are facing right now is the lack of costs and capital to run their business, and many businesses are using their own capital. Therefore, many businesses seek various sources of funding to support their business, such as loans from banks, financial institutions, and loans from government funds. However, these sources still have limitations that make it difficult for SMEs to access them. This study's purpose is to investigate the relationship between the decision to apply for bank loans and the characteristics of the business owner/manager and the characteristics of the business. The results show that more experienced, owner-managers running small-size and corporation type businesses in services or manufacturing are more likely to apply for bank loans.

Keywords: *SMEs, access to finance, apply for bank loans.*

1. Introduction

Small and medium enterprises are the main actors of both national and regional development in many countries according to research about the importance of SMEs in the country's economy (Holmes et al.,). Many countries implemented support for SMEs in various programs and policies and there are many programs that have been implemented to improve the innovation and entrepreneurship of SMEs. Therefore, SMEs are very significant for economic growth, job creation, and economic and social cohesion (Pandula, 2011). The World Bank reports that SMEs represent about 90 percent of businesses and more than 50 percent of employment worldwide and SMEs contribute up to 40 percent of national income (GDP) in developing countries. In emerging markets, most formal jobs are generated by SMEs, which create 7 out of 10 jobs. However, SMEs are facing problems like access to finance, which is a key constraint to SME growth. It is the second most cited obstacle facing SMEs to grow their businesses in developing countries (World Bank, 2022). Based on International Finance Corporation (IFC) 2021 report, SMEs are less able to obtain bank loans than large firms; instead, they rely on internal funds or cash from friends and family to launch and initially run their enterprises. The International Finance Corporation estimated that around 65 million firms, or 40 percent of formal micro, small and medium enterprises (MSMEs) in developing countries, have an unmet financing need of $5.2 trillion every year, which is equivalent to 1.4 times the current level of the global MSME lending (IFC, 2017). Lao PDR is the one which was included by International Finance Corporation (IFC) as well. Laos is Southeast Asia's sole landlocked country. Laos has maintained a medium-to-high rate of economic growth, with investment and private consumption serving as the primary engines of the economy and SMEs are increasing at the same time. However, Lao SMEs still face various financial constraints such as collateral and options for financial sources. Only a small portion of SMEs are able to access finance (Kyophilavong, 2008). Access to finance is very important. However, there is little research on Lao SMEs. Therefore, the purpose of this study is to gain a better understanding of the characteristics of Lao SME's access to finance. The purpose of this study is to investigate the significant of each factor are affect to decision apply for bank loans, and the characteristics of the business.

Access to finance is very important. However, there is little research on Lao SMEs. Therefore, the purpose of this study is to gain a better understanding of the characteristics of Lao SMEs' access to finance. The objective of this thesis is 1) to investigate the finance's situation of SMEs in Laos. 2) The study tests hypotheses on the relationship between certain characteristics of owners/managers and their businesses, as well as their financial requirements, together with the difficulties they face in accessing finance from Laos banks. In this instance, research encompasses SMEs policy and supporting. The following questions were created to guide the research to ensure that the research objectives were met:

1. What financial sources do the SMEs use to start their business?
2. What are some of the obstacles that SMEs face when it comes to receiving funds from banks?
3. What kind of financial bank group did SMEs apply to?
4. What factors have a significant effect on SME's accessing finance from Laos banks?
5. How does the Lao government support SMEs through promotional policy?

2. Materials and Methods

A survey was conducted with a sample of 160 members of Laos SMEs from four different economic sectors; retail, wholesale, service, and manufacturing sectors located in the northern and middle part provinces of Laos (Luang Prabang, Oudomxay, Xieng Khouang, Luang Namtha, Borkeo, Huaphan, Vientaine).

The collected data was analyzed using the Statistical Package for the Social Sciences (SPSS) version 26. Descriptive analyses were undertaken to reduce the raw data into a summary format in the form of simple tabulation of frequency distributions through the calculation of averages, frequencies and percentages. Moreover, the study used chi-square tests to assess the significance of relationships between the access to finance from banks and the characteristics of ownership and business characteristics. The logistic regression was also conducted to analyze the relationship between the access to finance and the characteristics of ownership and business characteristics.

These hypotheses will explain the relationship between the gender, amount of education and training, and business experience of SMEs' owners/managers and their decision to apply for bank loans.

H1: The level of SME owner/manager education has a significant effect on the decision to apply for finance.

H2: SME owner/manager experience has a significant effect on their decision to apply for finance.

H3: SME owner/manager gender has a significant effect on their decision to apply for finance.

H4: Business size has a significant association with the decision to apply for finance.

H5: Business ownership type is significantly associated with the decision to apply for finance.

H6: Business type has a significant effect on the decision to apply for finance.

3. Results

3.1 Descriptive Analysis

This study was investigated the operation of business as small and medium enterprise in Laos. The results show that the majority of enterprises invested 48.9percent of their own capital (own savings) and 27.8percent of their entire family capital (family assistance) for their investments. Entrepreneurs are investing 76percent of their own funds (internal sources). The majority had start-up expenses of less than $25,000, and 56.9percent did not have access to bank loans. SMEs seek finance for several reasons including expanding their business (n = 68, 22.4 percent), purchasing equipment or vehicles (n = 56, 18.5 percent) and working capital (n = 57, 18.8 percent). Out of 160 respondents, 69 respondents had applied for bank loans in Lao PDR. The majority borrowings are from the state-owned commercial bank or Banque Pour Le Commerce Exterieur Lao Public (n = 28, 40.58 percent), which is a convenient and popular bank for entrepreneurs in Laos. Most of them were faced complexity of application and loan procedures (n = 27, 19.7 percent), which is one of the main obstacles that make it difficult for borrowers. The next problem was high interest rates (n = 26, 19 percent). Most entrepreneurs use the land as collateral (n = 55, 59.1 percent), because land is an asset that the bank sees as a valuable asset and its value will increase in the future.

3.2 Chi-Square Analysis

This study conducted chi-square tests of independence between the owner/manager/business characteristics and decision to apply for bank loans. The test results show that owner/manager experience, business size, ownership type, and business type are related to the decision to apply for bank loans. The test results show that the more experienced owners/managers with bigger business size, joint ventures or corporations in services or manufacturing sectors are more likely to apply for bank loans.

- This study was conducted to examine the relationship between the education level of SME owners/managers and their decision to seek financing. The relationship between these variables is not statistically significant ($x^2_{(1,n=160)}$= 0.59, P = 0.80).
- The relationship between owner/ manager experience and the decision to apply for finance was examined using a chi-square test of independence, the relationship between these variables is statistically significant ($x^2_{(1,n=160)}$= 5.97, P = 0.01).
- The relationship between the gender of business owners/managers and their decision to seek financing, this association is not statistically significant ($x^2_{(1,n=160)}$= 0.44, P = 0.50).
- The relationship between the number of employees in the company, the results shows that the relationship between these two variables statistically significant ($x^2_{(1,n=160)}$= 3.96, P = 0.04).
- This study was conducted to examine the relationship between business ownership type and the decision to apply for finance, the relationship between these two variables is significant ($x^2_{(1,n=160)}$= 3.71, P = 0.05).
- The test of independence was conducted to examine the relationship between the business type and the decision to apply for finance, the relationship between these two variables is significant ($x^2_{(1,n=160)}$= 3.67, P = 0.05).

3.3 Logistic Regression Analysis

The dependent variable in the model is a decision to apply for bank loans, which is binary, with a value of 1 if the enterprise has applied for bank loans and a value of 0 if the enterprise has not applied for bank loans. According to the estimation results, among the owner/manager characteristics including owner/manager education, experience, and gender, only owner/manager experience is statistically significant at 1percent level. However, all business characteristics; business size, business ownership structure, and business type are statistically significant at 5percent or 1percent level.

In more detail, the fact that the P-value of gender is greater than alpha (P-value = 0.34 > 0.05) indicates that gender has no effect on the decision to apply for bank loans or that there is no correlation between gender and the decision to apply for bank loans. Due to the fact that banks currently have no gender restrictions, banks have made it possible for all entrepreneurs, male or female, to obtain bank loans if they are qualified.

The fact that the P-value of owner/manager’s education is greater than alpha (P-value = 0.85 > 0.05), demonstrates that the level of education of the business owner does not influence the likelihood of applying for a loan from the bank. This is because the bank may look for and check other requirements rather than the business owner's level of education. Studies have shown that a number of respondents have degrees lower than a bachelor's, but that does not rule out the possibility that they have access to funding. The fact that the P-value of owner/manager’s experience is less than alpha (P-value = 0.01 < 0.05) demonstrates that entrepreneur experience is relevant to decision to apply for bank loans. Experience is crucial because entrepreneurs with business experience will be familiar with the various funding options available to their company, specifically, the procedures and methods for applying for bank loans.

P-value of business characteristic as business size is less than alpha (P-value = 0.00 < 0.05). The results indicate that the size of the business and the decision to apply for bank loans are highly correlated and that the scale of the business, as measured by the number of employees, is crucial to decision to apply for bank loans. Banks may determine that having employees reflects the structure and system of the business in accordance with government-mandated business requirements. In addition, banks examine the organizational structure of the business, looking for the presence of departments or even divisions.

P-value of business characteristic as a business ownership type is less than alpha (P-value = 0.00 < 0.05). This indicates that the business ownership type affects the decision to apply for bank loans. This study focuses on the types of business ownership, which include sole proprietorship, partnership, and corporation as a possible factor to affect the decision to apply for bank loans. The empirical test supports the relationship between business ownership type and the decision to apply for bank loans. When the business ownership type is partnership or corporation the owner is more likely to apply for bank loans. In the case of joint ventures and corporations, applying for bank loans may be easier due to the large number of entrepreneurs who can assist one another.

The fact that the P-value of business type is less than alpha (P-value = 0.03 < 0.05) indicates that if the business type is services or manufacturing, owner is more likely to apply for bank loans. Because most banks in the Lao People's Democratic Republic have guidelines to support SMEs in accordance with government policy, manufacturing businesses account for 64 percent of total loans to the private sector.

In summary, the group of owners/ managers with more than 5 years of experience are more likely to apply for bank loans than the group with less than or equal to 5 years of experience. Moreover, the group with less than or equal to twenty employees are more likely to apply for bank loans than the group with twenty or more employees. Small businesses may be viewed as less risky by banks compared to larger businesses. The test also reveals that if the type of owner or manager is a joint venture or a corporation, owners are more likely to apply for bank loans as compared to sole proprietorships. Finally, services and manufacturing businesses will be more likely to apply for bank loans than retail and wholesale businesses.

4. Discussion

The findings of this study show that some variables have the same impact as those found in earlier studies, while other variables produce distinct outcomes. In actuality, numerous studies that have been previously investigated and reviewed on the basis of numerous pertinent theories have been used to determine the variables or factors influencing the access to capital of SMEs. According to the research by Waked findings the source of finance for business Start-up, which indicate that almost half (n=265, 47.71 percent) of the respondents had used personal resources to finance the commencement of their business (47.71 percent). The reasons for finance show that the main purpose for seeking finance was to increase their working capital to prevent liquidity problems (22.28 percent). The applying for bank finance they had applied for a bank loan (58.89 percent). the majority of respondents indicated that they had (Waked, 2016). Furthermore, Chironga founds the most important source of funding for between 75-90 percent of SMEs are internally generated funds such as own savings and borrowing from family and friends (Chironga, 2012). According to Phouphet's research identified four variables, food/beverage, domestic firm, management experience and experience in other business that positively impact firm performance. However, the overall source of financial operating was found to have a negative impact. The study also categorized firm size into five employment-based categories, with varying access to finance, loan sizes, interest rates, and periods. Large companies were found to have larger loan quantities compared to smaller firms (Kyophilavong, 2011). Additionally, lack of prior experience for an SME owner/manager, can put the company at risk, limiting access to external financing (Beck and Demirguc-Kunt, 2006). Entrepreneurs with less expertise are less likely to acquire external financing. Some studies report that experience of the majority owner, business size, and export status are insignificant determinants of the need for capital (Thanh et al., 2011).

Moreover, some results of findings the relationship between owner/manager experience and financial access was significant (P=0.03), which is consistent with our study's findings that owner/manager experience was highly significant. Owner and manager experience is crucial for financial access because it gives them the skills and resources necessary to successfully apply for bank loans (Ung, 2010). Further research has demonstrated that the level of experience possessed by the majority owner is a crucial factor in determining the necessity of capital. This finding is particularly relevant in situations where the business owner has limited experience in managing financial matters, as they may be less aware of how to effectively manage their finances and may require greater assistance in procuring the necessary funds. Conversely, business owners who possess a greater level of experience are often able to identify and address issues related to cash flow and capital needs more effectively, resulting in a reduced need for external financing. Therefore, it is important for entrepreneurs to recognize the impact of their experience on their business operations, and to take proactive steps to improve their financial management skills as needed (Thanh et al., 2011). Contrarily, some variables were not statistically significant. Waked noted in his thesis that the association the gender of the owner/manager was not statistically significant ($p = 0.68$), since banks today do not care whether a person is a man or a woman, its accessing finance is based on the personal abilities of each entrepreneur, such as their determination and adaptability, and how they apply these skills to their business endeavors. Also the results owner/manager's education show that the association between these variables was not significant ($p = 0.45$). In today's world, education has become a crucial element for successful business ventures. However, it is also true that there are instances when one can apply for a bank loan without the need for fulfilling this criterion. This has resulted in a scenario where many entrepreneurs, who do not possess a high level of formal education, have been able to secure funds and launch their business ideas (Waked, 2016). Although some research findings suggest that education significantly impacts business manager's performance and aids in firm's growth and development, highly educated managers are better at analyzing complex problems, developing innovative solutions, and making informed decisions. Education also equips managers with team management, communication, and business landscape navigation skills. Investing in business manager's education yields significant benefits for firms pursuing sustainable growth and success (Pelts et al., 1998). The fact (business size) that the results showed that the number of employees was not significant ($p = 0.45$) (Waked, 2016), these findings contradict our own, as our results were significant. Large companies with more significant loan quantities are viewed as financially stable and creditworthy by lenders, giving them better access to financing at favorable terms and interest rates. Their size and bargaining power may enable them to negotiate better loan terms. However, lenders consider other factors like cash flow, collateral and credit history when evaluating loan applications (Gamage, 2013) and The research conducted by Charles Harvie has revealed that factors such as the type of business and the nature of ownership play a crucial role in determining the likelihood of entrepreneurs to apply for bank loans. Our own research findings corroborate this argument, lending support to the notion that these factors must be taken into account when assessing the creditworthiness of business ventures (Harvie et al., 2010).

5. Conclusion

This study conducted chi-square tests of independence between the owner/manager/ business characteristics and decision to apply for bank loans. The test results show that owner/manager experience, business size, ownership type, and business type are related to the decision to apply for bank loans. Lastly logistic regression tests were performed to investigate the relationship between the owner/manager/business characteristics and the decision to apply for bank loans after controlling for the effects of other dependent variables. The test results show that the more experienced owners/managers with bigger business size, joint ventures or corporations in services or manufacturing sectors are more likely to apply for bank loans.

An examination of the policies and support provided by the Government of the Lao PDR reveals that the government is devoted to supervising and pushing the expansion of SMEs in the country. In addition, the government has established offices and institutions near the business unit to provide assistance and provide direction. However, there is still a difficulty in getting government loans through financial institutions such as banks. Lenders and banks themselves impose stringent restrictions on lending to small and medium-sized enterprises and most small and medium-sized enterprises (SMEs) lack the conditions to access capital sources due to the lack of systematization, weakness, and absence of a solid business plan. Consequently, this is one of the reasons why access to loans remains a significant issue for SMEs.

SMEs must strengthen themselves, have a solid system or business plan, have a clear goal and vision, and build the best experience and credibility for their business in order to solve this issue. To obtain a loan for their business, they demonstrate a willingness and a sense of responsibility for the impending debt. For banks to provide underprivileged individuals with access to funding, it is necessary to plan long-term policies and seek out appropriate solutions. As previously stated, many young entrepreneurs are interested in starting a business, but financial constraints prevent them from doing so. Maybe we will miss seeing young entrepreneurs with innovative ideas and creative concepts who will develop our SMEs.

6. Conflict of Interest

We certify that there is no conflict of interest with any financial organization regarding the material discussed in the manuscript.

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Table 1. Logit Regression Test for the Determinants of the Decision to Apply for Finance

Independent Variables	*B*	*S.E.*	*Wald*	*df*	*Sig.*	*Exp(B)*
Gender	-.341	.359	.903	1	.342	.711
Education	-.074	.390	.036	1	.850	.929

Business type	-.814**	.391	4.334	1	.037	.443
Business size	1.309***	.420	9.718	1	.002	3.703
Ownership type	-1.428***	.468	9.301	1	.002	.240
Experience	-.931***	.359	6.724	1	.010	.394
Constant	1.055	.561	3.540	1	.060	2.873
Observation	160					
-2 Log-likelihood	193.512					
R Square	0.146 (Cox & Snell)				0.196 (Nagelkerke)	

Source: Author's calculations from the SPSS 26.