

VARIATION IN PERCEPTIONS BETWEEN MANAGERS AND LOAN OFFICERS TOWARDS SMALL BUSINESS LOANS: A CASE STUDY OF MALAYSIAN BANKS¹

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ABSTRACT

This paper investigates the problems faced by commercial banks while dealing with loan requests from small businesses. The study is survey based, and reports on the perceptions of 84 bank managers and 49 loan officers. Having highlighted the major problems faced by small business in securing bank loans the paper differentiates the views of bank managers from the views of loan officers (components of the sample) with respect to the mentioned problems. Interestingly the perceptions of these two parties with respect to the financial problems of small businesses seems to differ significantly. Whether this is a contributory factor to the limited accessibility of loans to small businesses is a question that requires further research.

INTRODUCTION

For most small businesses, getting loans from banks has been an uphill task even when they are established customers. This problem is more serious for those beyond the perimeter of the big-city money centres and those who want to explore overseas markets (McDermont, 1993). The hard reality is that commercial banks are not willing to take on much risk, and beginners normally have the slimmest chance of obtaining financial assistance from a bank (Brown, 1994). In some instances, because of the difficulties in obtaining bank financing, many small business are now turning to finance companies or even 'loan sharks'. Getting loans from the finance companies is much easier than from banks. However, interest charges at finance companies tend to be slightly higher (a difference of 1 to 2 percent) than those imposed by the commercial banks (Szabo, 1992).

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Obtaining loans during a recession is even harder for small business. In the United Kingdom, for example, the difficulties faced by the small and medium-size businesses during the recession have produced a controversy over the role and conduct of commercial banks. During this period, banks perceived a steeper increase in the risks of financing small and medium-size businesses relative to large businesses (Hutchinson and McKillop, 1992). Similarly in the United States, both banks and other lenders significantly reduce commitments to small and medium-size businesses. Such a credit squeeze tends to create problem for these companies, which depend on loans for growth and survival (Szabo, 1990). Because of such difficulties, special institutions or agencies have been established in some countries by the government with the objective of assisting this sector with their financing needs. For example, in Malaysia, Credit Guarantee Corporation was established on July 5, 1972 by the government with the objective of assisting small enterprises in obtaining credit facilities from commercial banks at a reasonable cost. As of 31 December, 1991, 47,152 small enterprise loans valued at RM 1,170.2 million (exchange rate US\$1.00 = RM 2.50) were guaranteed by this corporation.

Insufficient capital has been found to be the main cause for small business failure (Fredland, 1976, Dipietro, 1977, Peterson et. al., 1983, Dennis Jr., 1993). For many Malaysian small businesses, the lack of capital is highly correlated with their difficulty in obtaining bank loans (Chee, 1986). Small business entrepreneurs claim that it is very difficult to get loans especially from the commercial banks. These small businesses even feel that commercial banks are not sympathetic to their needs. Generally, commercial banks pay more attention towards their corporate customers. This is because corporate customers tend to bring more income to the bank and often carry less risk (Turnbull and Gibbs, 1987).

To improve the chances of getting loans from commercial banks, small business should first make sure they understand how the credit appraisal process works. Questions such as: How much money is needed? How will the loan help the business? How will the money be repaid? How will the loan be repaid if the business is unsuccessful? will be asked by the banker upon receiving the loan application (Brown, 1994). In most cases, potential borrowers are unable to supply the banker with appropriate answers. Bankers have identified some of the obstacles that small businesses have to overcome in order to obtain loans. They are: (i) better projections, (ii) a closer review of financial statements, (iii) more frequent financial reports, (iv) additional collateral, and (v) a closer review of personal income statement (Nichols, 1991).

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Because of their dependence on commercial banks for both working and fixed capital financing, it is essential for small business entrepreneurs to be aware of the common problems faced by the bankers when dealing with small business loans. Such an understanding will assist both bankers and the entrepreneurs to appreciate the difficulties faced by each other and would also eliminate any misconception held by all parties concerned.

The purpose of this study was to collect information on the perceptions of commercial bank branch managers and loan officers towards lending to the small business sector. Both managers and loan officers were used as samples as they are directly involved in the lending process. For many commercial banks in Malaysia, the basic function of loan officers is to process the application and provide recommendations on the applications. The branch manager will then have the final say either to approve or reject the application. Based on this assumption, aspects such as common problems when dealing with this sector, preferable methods of initial contact and the factors considered while appraising creditworthiness by these officers were examined. This study also explored the significance of each problem in influencing the branch managers' and loan officers' decision making during the loan appraisal process. A wide variation in views between managers and loan officers on what constitutes a good loan application is expected to further reduce the chances of small businesses in obtaining loans.

METHODOLOGY

Currently there are 37 commercial banks (21 domestic and 16 foreign banks) operating in Malaysia. For this pilot project, questionnaires were mailed to branch managers and to the loan officers of 150 selected branches of five domestic commercial banks. The five domestic banks consist of one of the big four banks and four other medium-sized banks. Selection of banks was based on convenience. The selection of branches were based on a systematic random sampling (branches positioned at the odd number in the sampling frame list were taken as samples). Of the 300 questionnaires distributed to managers and loan officers, 84 managers and 49 loan officers replied to the questionnaire giving a response rate of 56 percent and 33 percent for managers and loan officers respectively.

The questionnaire contained two sections. The first section gathered information about the respondent's personal background. The characteristics of the respondent are presented in Table 1. A total of 86.9 percent of the branch managers were above 35 years old, whereas 65.3 percent of the loan officers were below 35 year old. This was in line with the length of their service with the bank. Eighty-two percent of the branch managers have been

working in the bank for more than ten years, whereas 63.2 percent of the loan officers were with the bank for less than ten years. Only 20.2 percent of the branch managers possessed either degrees or professional qualifications; 69.6 percent had majored in business, accounting or economics. For loan officers the proportion of degree or professional qualification holders was 38.8 percent while 58.1 percent were from the business, accounting or economics disciplines. In terms of involvement in credit work, 65.3 percent of the loan officers had working experience of less than five years and about 80 percent of the managers had been dealing with credit work for more than five years.

Table 1: Respondent's Characteristics

	Manager		Loan Officer	
	Number	Percent	Number	Percent
Age:				
Less than 29 years	-	-	17	34.7
30 - 34	11	13.1	15	30.6
35 - 39	41	48.8	14	28.6
40 years and above	32	38.1	3	6.1
	84	100	49	100
Highest academic qualification:				
High school or diploma	67	79.8	30	61.2
Degree or professional	17	20.2	19	41.9
	84	100	49	100
Discipline:				
Business, accounting or economics	48	69.6	25	58.1
Arts, engineering or science	21	30.4	18	41.9
	69	100	43	100
Length of service with the bank:				
Less than 5 years	-	-	11	22.4
5 - 9	10	11.9	20	40.8
10 - 14	35	41.7	8	16.3
15 - 19	26	31.0	8	16.3
20 years or more	13	15.5	2	4.1
	84	100	49	100
Involvement in credit work:				
Less than 5 years	15	18.3	32	65.3
5 - 9	41	50.0	14	28.6
10 - 14	17	20.7	3	6.1
15 - 19	9	11.0	-	-
20 years or more	-	-	-	-
	82	100	49	100

** Variation in total is due to omission by respondents

The second concerning the applications made to indicate the scale ranging from 1 to 5 were also asked to indicate factors influencing the

Univariate and *t*-test were used for most appropriate samples and variables.

In this study, Bank Negara Malaysia is classifying the credit of RM500,000 and above (traders) with the shareholder's

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The second part of the questionnaire was designed to generate data concerning the problems faced by the bankers when dealing with loan applications made by the small business persons. The respondents were asked to indicate the frequency of the occurrence of the problems on a five point scale ranging from 'never occurred' to 'occurred all the time'. The respondents were also asked to indicate the degree of importance of those variables in influencing their recommendations for approval of the loan applications.

Univariate statistics consisting of arithmetic mean, standard deviation, and *t*-test were used in the data analysis. These tools were thought to be the most appropriate in a study of this nature which presented characteristics of samples and variations in perceptions.

In this study, the definition of small business is in congruence with that of Bank Negara Malaysia, which is also adopted by all commercial banks in classifying their small business loan. A loan to small business is defined as a credit of RM500,000 or less, granted to a registered business (including petty traders) with net assets of up to RM500,000, or in the case of corporations, shareholder's funds of up to RM500,000.

FINDINGS

Under normal circumstances, banks will give loans to profitable or potentially viable businesses. After all, banking is largely a lending business and its main source of income is the interest received from the loans granted. To ensure that loans are given to assist business persons in their ventures, bank officers give their customers the right facility, disbursed at the right time, and the adequate amount. Generally factors such as character, capacity, capital, collateral and condition would be taken into consideration while appraising the loan application. Basically, a loan application goes through the following stages:

- preliminary interview;
- second interview;
- pre-sanction visit;
- loan decision;
- loan documentation; and
- disbursement.

The first three stages are the more important stages in the lending process. To some extent, the mode of introduction between the bank officers and the potential customers will carry some impact in the decision making process for the officers who process the loan. Table 2 indicates the reaction of officers

when first meeting with potential borrowers, relative to the type of introducer and this can be used as a guide for small business persons who wish to establish relationships with banks. Both branch managers and loan officers were not happy when potential borrowers seek assistance from politicians in the introduction process (common in the Malaysian context). The most preferred method by both branch managers and credit officers was the establishment of relationship as a result of the banks' marketing efforts. The second preferred method perceived by both branch managers and loan officers was when prospective customers were introduced to the bank by existing customers. The *t*-test indicated that there was a similarity in opinion between the managers and the officers.

Table 2: Response to the Mode of Introduction

	Manager		Loan Officer		t	p
	Mean	SD	Mean	SD		
Introducer:						
1. Political figure	1.99	1.02	2.04	0.93	-0.297	0.767
2. Friends and fellow bankers	3.21	0.78	3.24	0.75	-0.290	0.772
3. Superior at bank	3.08	0.74	3.22	0.59	-1.204	0.231
4. Own marketing	4.34	0.99	4.33	0.75	0.071	0.943
5. Existing customer	3.76	0.81	3.57	0.65	1.469	0.145
6. Applicant's own initiative	3.21	0.97	3.43	0.76	-1.497	0.137

Scale: 1: dislike very much; 2: dislike; 3: neutral; 4: like; 5: like very much.

During the preliminary interview, apart from the purpose of the loan and the source of repayment, many questions were asked by officers especially in the area of management, finance, and marketing. The borrower must therefore be able to convince the bank officer that he/she was a capable and knowledgeable business person and that the loan granted would be used for the intended purpose only and consequently to generate more profit. However many officers encountered numerous problems when dealing with small business persons. The list of problems and the frequency of occurrence is listed in Table 3.

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Table 3: The Frequency of Occurrence of Major Problems Faced by Bankers When Dealing With Small Business Persons (in descending order for manager)

		Manager		Loan Officer	
		Mean	SD	Mean	SD
1.	Lack of knowledge in accounting	4.42	0.68	3.95	0.77
2.	Total dependence on business income as a source of loan repayment. No other source of income to support the application	4.14	0.77	3.75	0.81
3.	Own contribution relatively small compared to loan requested	3.98	0.82	3.56	0.82
4.	Insufficient information on the working paper given to the bank	3.96	0.84	3.73	0.76
5.	Business is a one-man show	3.92	0.92	3.40	0.94
6.	No proper business plan	3.89	0.96	3.31	0.99
7.	Lack of knowledge in working capital management	3.84	0.90	3.41	0.86
8.	Unable to provide collateral as requested to support the loan application	3.77	0.80	3.38	0.96
9.	Unable to determine actual amount of finance or loan required for the business	3.73	0.97	3.33	0.90
10.	Lack of knowledge about banking facilities available to them	3.72	0.83	3.48	0.68
11.	Great urgency for loan	3.71	1.30	3.63	1.20
12.	Unable to explain financial problem professionally	3.67	0.87	3.50	0.68
13.	Lack of knowledge in overall business management	3.64	0.87	3.15	0.85
14.	Lack of knowledge in marketing	3.63	0.93	3.23	0.66
15.	Total dependence on officer to determine the amount required and other terms for the loan	3.50	1.00	3.06	0.88
16.	Entering into competitive business	3.44	1.00	3.39	0.73
17.	Fail to impress banker with appearance or personality during the first interview	3.32	0.96	3.12	0.73
18.	Unable to decide the appropriate banking facilities for their business	3.32	0.93	3.10	0.94
19.	Unclear about the future of their business	3.30	0.93	2.85	0.86
20.	Newcomer to the venture	3.24	0.86	2.94	0.72
21.	Lack of confidence. Always relying on others to help them in the loan application	3.17	1.00	2.90	0.99
22.	Having an attitude that he/she the only one who knows all aspects of his business	3.05	0.99	2.94	0.72
23.	Constantly disturbing banker by phone or other means to know the fate of their application	3.04	1.04	3.16	0.87
24.	Maintaining no account with the branch(bank)	3.01	1.07	2.88	0.86
25.	Entering into an unprofitable business	2.83	0.85	2.71	0.84
26.	Entering into business because of political reasons or reasons other than own interest	2.46	1.10	1.99	0.81

Scale: 1: Never occurred, 2: Not often, 3: Sometimes, 4: Often, 5: Occurred all the time

The findings in Table 3 show that the five most common problems faced by the managers when dealing with small business persons were the applicant's lack of knowledge in accounting, limited sources of income for loan repayment, insufficient personal contribution as compared to the loan amount requested, the working paper (a write-up explaining the feasibility of

the business) for the loan application submitted to the bank is incomplete, and the applicant is a one-man show (absolute reliance on a single person constitutes a very high credit risk) in running his business. The factors which were considered to be least problematic were as follows: entering into business because of political reasons or reasons other than their own interest, entering into an unprofitable business, non-maintenance of an account with the branch, eagerness in wanting to know the loan decision, and finally having an attitude that he/she is the only one who knows all aspects of his/her business. There was a similarity in terms of the five most common problems faced by the managers and the loan officers. Except for the problem regarding the smaller amount of own capital contributed by the applicant which was placed third by the managers, and fourth by the loan officers, most other factors were considered equally by both groups. Such similarities were also observed at the other end of the scale i.e. the factors which were ranked to be least problematic.

There was, however, much variation in perceptions in term of frequency of occurrence of problems faced by the managers and loan officers when dealing with small businesses. Table 4 summarises these variations. There were two likely reasons for these variations; first, both managers and credit officers had differing experiences, qualifications, and backgrounds. These factors could have led to the different perceptions towards small business customers. Second, both managers and loan officers were approached by a different profile of small business customers. There was a possibility that small business customers who were new to the bank or who lacked confidence preferred to see the loan officer rather than the manager. Small business customers who tend to be familiar with the bank, would certainly prefer to see the manager rather than loan officer.

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	t	P-value
1. Lack of knowledge in accounting	3.546	0.001
2. Total dependence on business income as a source of loan repayment. No other source of income to support the application	2.776	0.006
3. Own contribution relatively small compared to loan requested	2.783	0.006
4. Business is one-man show	3.186	0.002
5. No proper business plan	3.306	0.001
6. Lack of knowledge in working capital management	2.744	0.007
7. Unable to provide collateral as requested to support the loan application	2.533	0.012
8. Unable to determine actual amount of finance or loan required for the business	2.328	0.021
9. Lack of knowledge in overall business management	3.176	0.002
10. Lack of knowledge in marketing	2.889	0.005
11. Total dependence on officer to determine the amount required and other terms of loan	2.505	0.014
12. Unclear about the future of the business	2.695	0.008
13. Newcomer to the venture	2.079	0.039
14. Entering into business because of political reasons or reasons other than own interest	2.866	0.005

Table 5 illustrates the level of importance associated with the different variables which tend to influence the final decision on loan recommendation or approval. The variable which loan officers perceived to be the most important in adversely affecting the decision making process was the applicant's lack of knowledge in working capital management. The second most important variable perceived by loan officers was total dependence on business income as a source of loan repayment and the third important factor was insufficient information in the working paper and/or the loan application, prepared by the customers for the bank. Although, in most cases there were similarities in opinion between the officers and the managers, there were differences in the order of importance of the profitability of the applicant's business. Managers perceived that profitability was the second most important factor in their loan evaluation, whereas loan officers perceived profitability as the sixth most important factor. There were not many differences in the variation of opinion between the managers and loan officers regarding the importance of variables. The only two variables which were significant at 5 percent were 'entering into an unprofitable business' ($t = 2.297$, $p\text{-value} = 0.024$) and 'lack of knowledge in working capital management' ($t = 2.272$, $p\text{-value} = 0.025$). A clear understanding of the bank's lending policy could be the reason for the similarities in perceptions of the importance of variables in making decisions among managers and loan officers.

Table 5: The Importance of Variables in Influencing Final Decision on Loan (in descending order for managers only)

	Manager		Loan Officer	
	Mean	SD	Mean	SD
1. Lack of knowledge in working capital management	4.51	0.72	4.21	0.77
2. Entering into an unprofitable business	4.44	0.88	4.00	1.15
3. Insufficient information on the working paper given to the bank	4.33	0.83	4.17	0.90
4. Lack of knowledge in overall business management	4.24	0.72	4.04	0.71
5. Newcomer to the venture	4.20	0.89	3.93	1.03
6. No proper business plan	4.19	0.92	4.13	0.77
7. Lack of knowledge in marketing	4.18	0.79	3.91	0.70
8. Own contribution relatively small compared to loan requested	4.06	0.89	3.75	0.89
9. Total dependence on business income as a source of loan repayment. No other source of income to support the application	4.05	0.95	4.18	0.77
10. Unclear about the future of their business	4.04	0.86	3.87	0.87
11. Lack of knowledge in accounting	4.02	1.03	3.89	0.88
12. Unable to determine actual amount of finance or loan required for the business	3.85	0.90	3.69	0.90
13. Unable to explain financial problem professionally	3.81	0.94	3.60	0.84
14. Unable to decide the appropriate banking facilities for their business	3.76	1.04	3.61	1.05
15. Unable to provide collateral as requested to support the loan application	3.65	1.01	3.98	0.99
16. Maintaining no account with the branch(bank)	3.63	1.32	3.58	1.22
17. Entering into competitive business	3.63	0.91	3.36	1.02
18. Business is a one-man show	3.61	1.06	3.25	1.01
19. Lack of knowledge about banking facilities available to them	3.52	1.02	3.37	1.02
20. Total dependence on officer to determine the amount required and other terms for the loan.	3.37	1.06	3.18	0.91
21. Fail to impress banker with appearance or personality during the first interview	3.36	1.15	3.08	0.98
22. Lack of confidence. Always relying on others to help them in the loan application	3.34	1.01	3.53	0.99
23. Great urgency for loan	3.10	1.36	2.86	1.13
24. Entering into business because of political reasons or reasons other than own interest	2.95	1.29	3.09	1.29
25. Having an attitude that he/she the only one who knows all aspects of his business	2.92	0.94	3.09	0.98
26. Constantly disturbing banker by phone or other means to know the fate of their application	2.74	1.01	2.80	1.06

Scale: 1: Not important at all, 2: Not important, 3: Slightly important, 4: Important, 5: Very important

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CONCLUDING REMARKS

This paper sought to highlight the problems associated with lending to small businesses, as perceived by 133 bankers. Apart from highlighting the problems generally associated with small business loans, the paper divided the sample (133 respondents) into two groups, that is managers (84) and loan officers (49). Using the responses from each of the groups, a comparative study was undertaken to determine the variation in perceptions between the groups. Interestingly it was found that their views on various factors relating to the sanctioning of small business loans tended to vary. While it cannot be categorically ascertained if this variation in views makes the sanctioning of such loans difficult, a logical extension to our finding is that one of the contributory factors to the problems encountered by small business persons in acquiring loans, may be due to this variation in views.

Another variation of view was observed with respect to perceptions in terms of frequency of occurrence of a number of problems faced by bankers dealing with small business persons. Variations in perceptions were observed for factors such as 'lack of accounting knowledge', 'no proper business plan', 'lack of knowledge in overall business management', 'business is a one man show', and 'lack of knowledge in marketing'. In all cases the mean score for managers were higher than those of loan officers. With respect to the importance (weighting) given to different factors related to the sanctioning of loans, there were more similarities than differences.

Now that the common problems faced by the bankers have been made public, small businesses can prepare their loan applications accordingly. It is important for small businesses to establish a relationship by opening and maintaining an account with commercial banks. The operations of accounts is one of the key indicators used by bankers in evaluating the business performance and the character of the customer. The small business owners should have self-confidence while submitting their loan applications. Seeking assistance from political connections could jeopardise the application. Small business owners should be able to convince the loan officers that they have adequate knowledge in business management, especially in the area of accounting, finance and marketing. Those who feel that they have insufficient knowledge in those areas should make full use of the training and consultancy assistance provided by centres of entrepreneurship which are available at most universities. A brief and concise business plan which consists of the company's objectives, history, management, finance, market analysis, financial statements, and future plans of the company would be considered essential and should be submitted to bankers to further assist in assessing the loan application.

This study also found that there was a variation in perceptions among their managers and loan officers. This indicates that an information gap exists at their frontage. In order to narrow this gap, a well streamlined and clear policy should be introduced. While ensuring the bank's lending policies and guidelines remain as priority, the bank could grant some leeway to these "starters". Additionally banks themselves could establish an advisory cell to assist small business in preparing more appropriate applications. These measures would certainly enhance the quality of services provided to this small but important sector of the economy.

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