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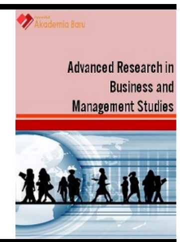

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Revisiting Barriers to External Finance for SMEs

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ABSTRACT

After the Global Financial Crises in 2008, obtaining finance has become more complicated. This study reviews the literature on barriers in accessing external finance given to the importance of availability of finance for all business firms specifically SMEs. Literature over 20 years is searched while reviewing the research question by using Google scholar. Both demand and supply related barriers in accessing external finance has been searched. The study reviewed the factors influencing accessing external finance in the context of developed as well as developing countries with unique conditions and include the issues pre-and post-crises using available literature. The findings of the study discuss the hindrances for SME's financing mentioned in the literature and highlights the frequently mentioned barriers. Moreover, barriers in accessing external finance in developed and developing countries are different depending upon country environment. It also depends on industry specific effects, firm's specific effects, and owner's specific effects. This review provides the problems faced by SME's in obtaining external finance. Key barriers in accessing finance are also highlighted in the light of available studies. Moreover, it will give further insight to the barriers of small sized firms in developed and developing countries. It has practical value for policy makers while addressing the problem. Future research recommendations will contribute to the literature.

1. Introduction

Small and medium sized enterprises (SME's) have always remained the engine for economic growth and development [1]. More than 50% Employment in 48 out of 76 countries is due to SME's [3]. Small and medium enterprises are backbone of any economy. Small and mature firms maintain the highest level of overall employment, while smaller and younger firms are the richest in new job creation [4]. Despite their importance, SME's still faces many problems in accessing external finance. Therefore, to reduce poverty, increase economic growth and development, access to external finance might be alleviated. Because small business has limited resources and need external finance to perform its day-to-day operations smoothly. This review focus mainly three quarries (a) What are barriers for SME's in accessing external finance, (b) What are the key barriers (c) and what are the

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operational definitions of access to finance in the light of available literature. The said phenomenon got greater attention after the global financial crises 2008-09. During the crises which brought business and economic destruction around the world, small business were affected the most, because size is the main factor that influence access to finance [21]. Majority of small firms went bankrupt and cannot maintain their operations A remarkable decrease from 7.4 in 2007 to 3.9 pound in 2009 was observed by the bank of England in credit supply to small businesses [15]. The main reason of failure was barriers in access to external finance because SME's mainly rely on external sources as they have limited internal resources [15].

Finance play a vital role in economic growth and development [10]. Access to finance is termed as the ability of firm or household to obtain financial products and services at reasonable cost [13]. On the other hand firms and household that can't access financial products and services are termed as financially constrained. On the basis of credit constrained status firms are classified in to three groups, firstly the firms having limited cash flow and can't access external finance even at high cost are fully credit constrained on the other hand the firms either have sufficient cash flow or can avail external finance at low cost are unconstrained, while the firms that have limited cash flow but can access finance at relatively high cost are termed as partially credit constrained [21]. Moreover there exist a strong causal relationship among financial system (termed as private credit supply capitalization of market) and investment poverty reduction, growth and total factor productivity [10]. The study aims to investigate barriers in accessing external finance also the key barriers in the light of available literature. Moreover operational definitions different authors have discussed are presented in the later portion.

2. Literature Review

There exist demand and supply side factors that determine access to external finance, and authors have tried to compile both side factors. Analyzing demand side factors a study conducted in 2017 highlighted that collateral requirement, lack of credit worthiness information, lack of insufficient net value of assets, liability and entrepreneurial characteristics were the barriers which stops SME's firms accessing external finance [29]. In accessing financial products and services geographical location of firm and infrastructure play key role. Similarly, studying 11 United Kingdom economic reigns it was concluded that regional specific factors play key role and increasing the distance among bank headquarter and braches constraining effect is exacerbated [34]. After the credit crunch demand for outside finance is higher in older firms having comparatively higher risk rating and the phenomenon is opposite in women owned SME's, more specifically older firms were appreciated in obtaining finance but bank were unwilling to lend finance to risky firms [12]. Information asymmetry and insufficient collateral are the beigest obstacles in case of Cote D'Ivoire SME's, simultaneously the phenomenon of being financially constrained due to information asymmetry and insufficient collateral is more severe in micro firms as compared to small and medium firms [17].

Small and medium sized businesses seem to be underutilizing financial products and services. Like a study found that only 50% firms are using banks in dealing, as these firms faces many barriers in accessing finance. Furthermore legal form, economic activity, labor, capital and sales turnover are the factors that stops SME's from banking services, moreover small business are more constrained [14]. In same line firm's profile influence SME's access to finance, like ownership structure, size and type of business strongly effect access to financial products and services [26]. Regarding access to finance firm specific factors like ability of owner to access various sources of finance, risk management, keep liquidity & solvency optimum, and hiring efficient workers including experienced managers play a vital role to minimize the hurdles. In Asian context recognition of proper type of finance, proper financial institution, credit rationing, and risk premium imposed by lender agency are the features which facilitate Small businesses in this regard [19]. Enterprise survey suggested that small size firms are either partially constrained or fully constrained compared to larger firms, similarly they finance their working capital and investment through trade credit or informal finance [21].

On the basis of performance firms whose labor productivity is high are less probable to be credit constrained and age of the firms is not important in this regard while size significantly affect credit constraining phenomenon [19]. A study in 2011 found that SME's obtain only 30% of finance from external sources. Majority of SME's use friend and family Finance to start business and overdrafts are used for working capital requirement the reason is that they face problems in obtaining external finance, the barrier in external finance are information asymmetry, insufficient collateral, complexity in loan application process and less experience in the industry [31]. Charilaos in 2017 conducted a study and found that firm specific and country specific factors matter a lot in Islamic country because Islamic countries do not deviate their norms [24].

As stated earlier that small businesses are constrained due supply side factors also. Those factors are beyond the control of owners and only could be alleviated by policy makers, government policies, and public support. In the later Para, supply side barriers are discussed. Banks are institutions that help SME's around the world in financial issues but small businesses are still unable to take full advantage of banks. Interestingly it was found that small businesses are constrained due to institutional factors, and weaknesses in financial system of developing countries [6]. SME's is the most profitable segment for banks but in developing countries they are unable to access, due to macroeconomic instability and in developed countries banks competition stops SME's in accessing bank loan and services, simultaneously loan rejection, acceptance and recovery power is still centralized which is again hurdle for SME's [7]. Highlighting importance of banks and other financial institutions it was concluded that dominance of banks in financial system reduce the use of financial services by all size firms and low end financial institution make easy access to finance for all firms. Secondly there exists no such evidence which shows that smaller institutions are better in providing finance [8]. In European context small firms also contribute largely but as they have different needs, different challenges and more specifically due to limited equity financing they rely more on bank lending and other types of finances [32]. Bank funding cost and borrower leverage explain firms access to finance, more clearly increasing bank funding cost and liquidity ratios are significant predictors of bank access to finance, subsidiary creation also helps in easing the barrier [30]. Role of government and macroeconomic factors can't be ignored while focusing on barriers for SME's while accessing finance. Effect of sovereign stress and unconventional monetary policy was studied and the authors came to the conclusion that in euro area during the crises the firms in stress countries were more credit rationed comparatively both in price and quantity, they also found that after implementing Outright Monetary Transaction program the number of credit rationed were decreased, similarly firms with rich credit history and better outlook were taking advantages of the program [16].

Now when firms fail to access external finance they try to find alternative sources. In same line a study shaded light on the evidence that credit constrained firms try to tackle the problems by obtaining finance through trade credit, not by banks and the dependence increases during the financial crises in contrast unconstrained firms depends on banks [9]. On the other hand a study found that credit constrained SME's rely more on bank loan, trade credit and other types of financial products [32].

Current paper is an attempt to revisit the barriers small businesses face in accessing external finance so the rest of the paper is designed that part 2 covers methodology. Part 3 comprises of results and discussions. It is followed by part 4 which is composed of conclusion in the light of earlier studies.

3. Methodology

As this is a systematic review in which we have tried to find answers of some queries in the light of existing literature. In order to answer these queries we started sorting literature on the barriers faced by SME's in accessing finance. Initially 20 years' literature was sort out by title i.e. access to finance and list of more than hundred papers was created. After sorting out literature paper from 2002 to 2017 are cited as no paper relevant to our interest before 2002 was found. Papers for this review were downloaded from the journals (Small business economics, international of finance, journal of economic geography, international journal of entrepreneurial behavioral and research, international journal of entrepreneurship and small businesses, Asian economic and financial review, European journal business and social science, journal of money credit and banking, Scottish journal of political economy, world bank, journal of financial economy, international small business journal, and journal of applied economics) using google scholar. Further, we screen out paper by matching the most relevant articles to topic of interest. In next step, articles were screen out by abstract, and it made our task easy in finding the most appropriate articles. After assembling articles for 20 years (1996 to 2017), we than prepared a fact sheet/analysis sheet, in fact sheet dependent and independent variables were place in separate columns followed by next column of research questions. It helps us in highlighting the barriers in SME's financing. Moreover, results discussion portion comprises of tables, which show a clearer picture of SME's challenges in accessing finance.

To the best of authors knowledge the term "access to finance" is used first time in 1976 by N.Hood studying the effect of US investment in Scotland [20]. Before this no detail, study is available.

4. Results and Discussions

The results include revisiting latest definitions of the concept "accessing external finance", tabulating the barriers to external finance, and highlighting frequently considered barriers to external finance.

4.1 Revisiting the Latest Definitions

The term access to finance refers to condition in which business firms can get financial products and services at reasonable cost. Services mean all type of insurances and equity while products mean all types of deposits and loans [28]. The term access to finance is defined by different authors based on time dimensions. The latest definitions are presented in the **Error! Reference source not found.**.

4.2 Barriers to External Financing

Like access to finance, access to credit also mean approach to financial products and services at reasonable cost. In case of need for external finance, Pecking Order Theory presented by Myers and Majluf [27], suggest that firms when needs external funds to complements for financial deficiency it must Search for internal funds first like cash flow, if can't complement than go for debt financing, if still deficit than go for equity financing. Small businesses need external finance because their resources are limited and cannot run the business smoothly by owner equity. Simultaneously they cannot obtain external finance easily due to multiple factors and prefer informal finance like friends and family (informal debt). Equity financing is also a challenge because SME's either do not want to dilute the ownership or do not have access to equity market. In case of private SME's they cannot obtain equity from public by law [2]. The barriers can be placed under demand and supply side barriers.

Table 1
Definitions of Access to Finance

Author (Year)	Definition
Veselin et al [21]	Firms are said to unconstrained or having fully access to finance if applied to external credit in the past twelve month and had acquired the needed funds from external sources
Charles et al [19]	Used dummy variable, which takes the value of 1 if the firm have obtained at least 2 types of finance from external sources otherwise 0. And the firm is said to be having access to finance.
Annalisa et al. [16]	The firms are termed as having access to credit if apply for loan within past 6 months and have received 75% loan they had applied at reasonable cost.

4.3 Demand Side Barriers

Error! Reference source not found. show access to finance as dependent variable and the barriers as independent variables in the light of earlier studies. The results indicate that there was no evidence of loan rejection before the credit crunch in 2008 but after the crunch, loan application of many SME's was rejected. It indicates that along with other barriers rate of loan rejection also discourage applicants to apply for loan and the same is justified by many studies [17, 34]. As discussed earlier that both demand and supply side factors are responsible for barriers, among demand side factors industry play vital rule as if it is difficult for high technology industry to obtain external finance compared to other industries. The reason is that lender prefers relatively smooth cash flow and tries to avoid risky investment moreover business model of such industry is hard to predict [7, 25]. Similarly, firm's specific factors are also most important determinants of access to finance. Contrary to the above a study conducted by world bank explained that firm age is not important for accessing loan or simply newly establish firm are not constrained due to age, but due to other factors [21]. SME's assets tangibility are also main drivers that helps loan approval, because firms having more tangible assets can meet basic requirements of collateral of all lending institutions and individual lenders [7, 31]. Among barriers education, experience and formal education about the same industry as suggested by Human Capital Theory are the key factors that ease access to External finance [33]. Another important aspect of demand side barriers is ownership structure, the firms having international owners in ownership structure can access international markets for finance, and thus they have an edge over other firms [23]. Similarly some studies have also shown that female owned SME's are more constrained financially as compared to male owned [11, 12].

4.4 Supply Side Barriers

Focusing supply side barriers, that hinders small businesses from accessing finance, macroeconomic variables are responsible to facilitate or exacerbate the barriers. GDP (Gross Domestic Product) growth facilitates SME's in loan acceptance or more specifically positively and significantly affect loan application acceptance [9]. Country specific factors contribute to greater extant in loan acceptance or rejection. Development of financial markets and property right protection in developed countries ease access to finance, while contrarily underdeveloped financial markets and weak protection of property rights are exacerbating the phenomenon of loan rejection [5]. Transaction cost which mean loan assessment cost decrease with increase in loan size, but as loan size of SME's are small so it also hampers small businesses from external finance [5]. In summary, there are many factors like firm specific, country; entrepreneurial and financial institution related which are responsible for loan rejection and acceptance.

4.5 Key Barriers to Finance

To meet third objective frequency graph focuses key barriers in accessing finance. Among the barriers firm specific factors e.g. age, size, sector are the key factors (having the highest frequency in literature) that effect access to finance the most as shown in the above graph [12]. Similarly, industry (in which firm is operating) is also a key determinant which effect access to finance. Like it is difficult for high technology industry to find loan from the market as compared to other industries [22].

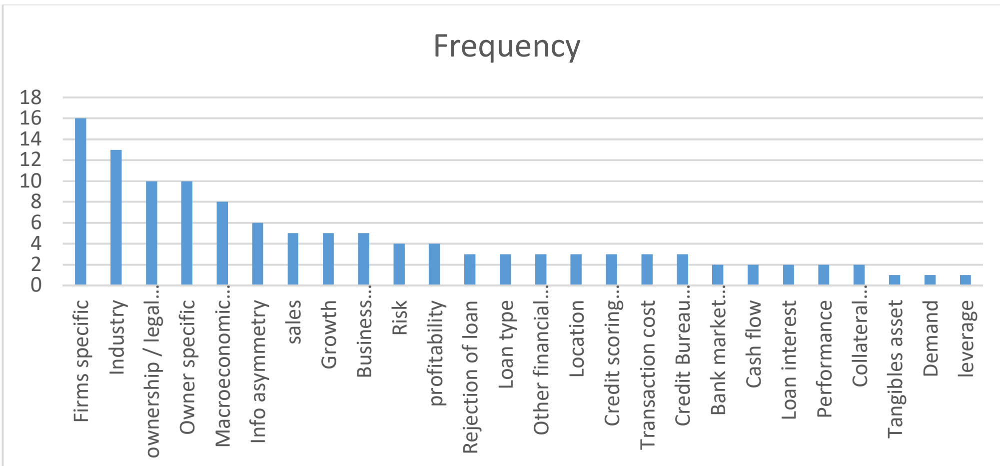

Fig. 1. Frequency of Barriers to Finance

Ownership structure, legal status and owner age, experience, education etc. are the significant determinants of access to finance for SME's [12, 32]. In the same way macroeconomic factors and information asymmetry stops small business from accessing finance [6, 7, 17]. Growth, sales and business environment also significantly affect the phenomenon of accessing external finance [18, 33].

Literature also highlight risk, profitability and loan rejection as the key driver for accessing external finance. High risk or risk of default determine the extent to which accessing loan is affected by firm profile [9]. Profitable position define the accessibility of firms to access loan [33]. Loan rejection rate discourage the owner to apply for loan [34] Location of business firm, type of loan, and transaction cost are significant determinates of accessing loan [12, 14, 16]. Studies also reveal that collateral requirement is key determinant of accessing finance for SME's [17].

1. Conclusions

Access to finance for small businesses (SME's) has always remained an area of interest both for practitioner and academic as finance affects its operations in all aspects. As discussed earlier access to finance mean access to financial products and services at market price [19]. Studies show that access to finance is determined by various factors like firm specific, industry specific, and country specific business specific factors. All these factors are categorized in two groups i.e. either demand side or supply side factors. Among the barriers discussed earlier, the key barriers are collateral requirement, information asymmetry, credit worthiness history, institutional development, government policies, lake of formal education, weak property right protection, and less developed financial markets. Barriers in access to finance vary from country to country, as in countries that are less developed SME's are more constrained than in developed countries whose financial markets are well developed and where political instability is minimum. Moreover, educated and well-experienced owners can also minimize the problem of credit access. Public support and government-subsidized loan are also helpful in reducing SME's problems regarding access to finance.

Finally, we came to know that access to finance has not been used as moderating or mediating variable. For future research, access to finance as moderating or mediating variable is suggested, as it might facilitate small as well large firms in different aspects.

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Table 1 Factors Influencing Access to Finance for SME

Authors (year)	Info asymmetry	Credit Bureau regulations	Credit scoring system	Location	Firms specific	Profitability	Industry	Rejection of loan	Growth	sales	Cash flow	Loan interest	Tangibles asset	Risk	Bank market power	Ownership/Legal status	Performance	Loan type	Demand	leverage	Other financial sources	Owner specific	Collateral requirements	Macroeconomic env.	Business environment	Transaction cost
Charilaos M 2017 [23]					✓		✓																			
Michael & Marion 2017 [29]	✓	✓	✓																							
Tianshu& Dylan 2016 [34]				✓	✓	✓	✓	✓	✓							✓						✓				
Santiago et al 2016 [9]					✓					✓	✓	✓	✓	✓	✓									✓		
Marc Cowling et al 2016 [12]			✓		✓		✓							✓		✓	✓					✓				
Ferrando & U dell 2015 [16]		✓			✓		✓	✓								✓		✓	✓	✓	✓	✓				✓
Matteo 2014 [32]					✓		✓											✓			✓	✓				
Thorsten 2013 [8]					✓		✓									✓		✓			✓			✓		
Binam& Rodrigue2013 [17]	✓			✓			✓	✓								✓						✓	✓			
Hala et al 2013 [14]				✓	✓		✓			✓						✓										
Martin et al 2013 [26]					✓		✓									✓										
Charles et al 2013 [19]	✓				✓	✓	✓		✓	✓	✓					✓	✓					✓				
Veselin 2012 [21]					✓		✓									✓						✓				
Chaiyuth 2011 [31]					✓	✓			✓	✓												✓				
Jonathan 2009 [10]																						✓				
Thorsten et al 2008 [7]	✓				✓									✓										✓	✓	
Thorsten 2007 [6]	✓				✓							✓												✓	✓	✓
Thorsten 2004 [3]					✓		✓		✓							✓								✓	✓	
David et al 2003 [33]						✓	✓		✓	✓												✓				
Holger 2003 [11]	✓				✓		✓																	✓	✓	✓
Yibin 2002 [12]		✓	✓											✓	✓								✓	✓	✓	