

Aligning Lending Strategies with the Transformation Experiences of SMEs



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Source of Capital



- Own funds : 57.9%
- Family & Friends : 27.5%
- Banks/Credit Union : 25.4%
- Continued use of Personal funds: 53.5%
- Continued use of Family & Friends : 16.5%
- Banks & Credit Union : 18%

Source :IDB Report 2008
Sample of Start up firms

Research Problem



The missing gap:

There is a paucity of literature that examines lending strategies in terms of perceptions and how these perceptions may have implications for the transformation experiences of SMEs operating in small English speaking developing economies (SEDE).

- Paucity of literature that addresses change in small firms in SEDE.
- Limited empirical validation on the change patterns and characteristics of SMEs that takes into account geographic scope and size.
- Lack of consensus in the literature

(Gupta, 2013)

Definition of Terms



What is transformation ?

- Change in the state , size and characteristics of the firm during its life cycle
 - Structure
 - organization situation
 - Strategy

Lending Strategies:

- credit products and processes adopted by financial institutions in anticipation of the needs of SMEs.(Harris & Gibson,2006)

SMEs

- 6-150 employees , revenue US \$ 125,000 –US\$4 ml. (DBJ)

Purpose of Study



This study seeks to understand how SMEs perceive the lending strategies of financial institutions and the alignment of these strategies to their transformation experiences:

- To understand how SMEs change.
- The reason for change
- To identify any general change patterns and characteristics.
- To understand the important concerns with lending strategies and change and how SMEs perceive them.

Research Questions



- 1) What are the most important internal changes made by SMEs?
- 2) What are the characteristics of the internal changes made by SMEs?
- 3) Are there any general change patterns exhibited by SMEs?
- 4) What are the most important reasons for the internal changes made by SMEs?
- 5) What are the important concerns with lending strategies and the ability to make change in SMEs?

Theoretical Perspectives



Organization life cycle theory: the dominant perspective used to explain change in small firms

- Firms undergo predictable patterns of change as they grow and develop over time.
- Firms go through set stages of development identified by distinctive characteristics .
- Each stage manifests increasing complexity and exhibit complimentarity among the variables of structure, strategy and organization situation.

(Quinn and Cameron 1983)

Contemporary Views

Other researchers have argued that:

- No preconfigured path to change. (Brown and Mawson,2013; Levie and Lichtenstein, 2010.)
- Firms may choose or forced to retain current form or adapt to new changes. (Van de Ven and Poole 1995)
- Change and transitional path occur largely on a random basis (Coad and Tamvada,2012).

What drives change:

- Need to respond to external environmental developments
- Market conditions and opportunity creation.
- Knowledge capacity of owners and their perceptions.
- Cataclysmic events that threatens the survival and effectiveness of the firm.

Theoretical Perspectives



- Heterogeneity of transformation experiences and needs.
- Transition influenced by the firms existing resource base and ability to compete for financial resources (Westhead & Cowling,1995)
- Firms have a particular preference order for financing choices (Myers,1984)
- Information asymmetries and transaction costs affects ability to access loans
(Myers,1984; Harris & Raviv,1990).
- Unavailability of capital may compromise changes and emphasis is placed on only those changes with high profit expectations.

Key Research Variables



Organization situation

- Firm growth rate
- Firm size
- Firm age
- Human capacity
- Infrastructural capacity
- Ownership

Structural

- Centralization
- Formalization
- Specialization

Strategic

- Marketing
- Cost Management

Other

- Profitability concerns
- Satisfying requirements
- Unaffordable finance
- Bureaucratic process
- Evaluation process
- Financial illiteracy
- Poor quality banking solutions
- Banking illiteracy

Hypotheses



P1

- High growth firms perceive more difficulty in satisfying requirements of lending institutions.

P2

- The more firms have profitability concerns, the more likely they are to perceive the evaluation process of lending institutions as lengthy .

P3

- Firms that make structural changes will experience less difficulty with the quality of banking solutions.

P4

- Firms that make strategic changes will experience more difficulty with the quality of banking solutions.

Research Methodology



Facilitated through **in depth interviews**.

Sample:

- 24 Jamaican based SMEs in the retail and distribution sector with a minimum of 4 years in existence.

Sampling Technique:

- Judgement sampling.

Sampling Frame:

- Lists from Small Business Ass., JAMPRO, JSE, EXIM.

Unit of Observation:

- Owner-Manager

Research Methodology



Procedures :

Interview guide utilizing three part framework of organization situation, structure and strategy.

Respondents were asked to :

- Describe the important internal change experiences over the life of the firm
- Describe the circumstances surrounding change.
- Rank the most important reasons for change.
- Describe the important concerns with lending strategies and change

Data Analysis



- Ex-post coding of data.
- Descriptive statistics
- Spearman's rank correlation

Findings



Characteristics by Types of Important Changes Made

Strategic(%)	%	Organization situation	%	Structural	%
Marketing	58	Infrastructural cap.	25	Addition specialists	71
Cost management	17	Human capacity	56	Formalized policy/procedure	3
Strategic alliance	1			Concent/decision making	1
Total %	76		81		75

Findings



Most Important Reasons for Change

Reason	Frequency/Reason	Percent/Reason
Growth	16	63
Profitability concerns	7	33
Regulatory requirements	1	4

Findings



Perceptions by SMEs of the Lending Strategies and the Ability to Make Change

Perceptions of Lending Strategies	Percent
Poor quality banking solutions	83
Unaffordable finance	46
Banking illiteracy	34
Unable to satisfy requirements	25
Financial illiteracy	25
Lengthy evaluation process	8
Bureaucratic process	4

Lending Strategies & Change Patterns

P1	High growth firms perceive more difficulty in satisfying requirements of lending institutions.	Supported .516* .010
P2	The more firms have profitability concerns, the more likely they are to perceive the evaluation process of lending institutions as lengthy .	Supported .426* .038
P3	Firms that make structural changes will experience less difficulty with the quality of banking solutions.	Not supported -.365 .393
P4	Firms that make strategic changes will experience more difficulty with the quality of banking solutions.	Not supported -.183 .393

Conclusions



- The transformation experiences of SMEs are not predictable neither was there complementarity among these changes .
- Priority was given to opportunistic changes relevant to growth and profitability issues.
- Minimal changes made to formalization procedures has implications for reducing the high level of information asymmetry.
- Onset of growth and profitability concerns places greater demands on financial capacity of SMEs and requires quicker response time from lending institutions to their requests.

Conclusions



- There is greater demand for creative banking solutions, lower interest and transaction costs, education on financial options and non traditional collateral.
- Lending institutions are perceived as having limited understanding of SMEs
- SMEs are a heterogeneous group with different kinds of expectations and experiences.

Contribution

The findings of this research is  of great value to :

Academic Literature :

- Presents a stronger category of critical change and lending strategy variables for improving the theoretical understanding of transformation experiences and lending strategies relevant to SMEs in small economies.

Policymakers:

- Provides lending institutions with a better understanding of how lending strategies are perceived by small firms allowing for the crafting of more interventional and coherent policies relevant to the transformation of small firms in developing economies.

Contribution



Practitioners :

- Entrepreneurs will benefit from improved insights into critical organizational transitions and perceptions important to their relationship with lending institutions.

Recommendations



- Move aggressively at accepting non traditional collaterals e.g floating assets
- Factoring
- Leasing
- Attach percentage of loans to capacity building
- Relationship based lending in the absence of hard information.
- Financial education programmes for SMEs
- Training on SME behaviours