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SPOTLIGHT

GOVERNMENT SHOULD CONSIDER REMOVING BARRIERS THAT RESTRICT SMALL AND MEDIUM-SIZED ENTERPRISES TO ACCESS BANK LOANS

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Key Points

- Access to finance (bank loan) is one of the main obstacles that stifle the growth and development of Small and Medium-sized Enterprises (SMEs) in Papua New Guinea (PNG).
- Cost of borrowing is the main barrier for SMEs to access bank loans in PNG; and in most instances, SMEs are confronted with short-term loan repayment periods .
- Since finance is vital for the creation, survival and growth of SMEs, barriers that hinder SMEs to access bank loan need to be removed in order to achieve the aim of the SME policy in PNG.
- The intent to facilitate adequate government funding by creating credit facilities with banks should be fast-tracked to help mitigate the impact of COVID-19 pandemic on the country's SME sector.

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GOVERNMENT SHOULD CONSIDER REMOVING BARRIERS THAT RESTRICT SMALL AND MEDIUM-SIZED ENTERPRISES TO ACCESS BANK LOANS

By Wendy Morona and Francis Odhuno

Small and Medium-sized Enterprises (SMEs) have been recognised as a major source of employment and economic development across the globe, especially in the developing countries. SMEs contribute over 70 percent of GDP and 95 percent of total employment in the middle-income countries while they contribute over 60 percent of GDP and over 70 percent of total employment in the low-income countries, (Hidayet et al., 2010).

Comparative statistics for PNG are currently hard to come by, but can be inferred from the country's ambitious SME Policy targets which is, to support and facilitate the growth of SMEs from the current 49,500 to 500,000 SMEs that will employ two million people and contribute 50 percent of the country's GDP by 2050 (Ministry of Commerce, Trade and Industry, 2016). To do this, SME operators need finance to survive and grow. However, they often find it difficult to meet the stringent lending requirements of commercial banks.

Indeed, access to finance is vital, especially, at this time when most SMEs are struggling after being hurt by the COVID-19 pandemic which is currently ravaging businesses and individuals across the globe. At times like this, access to finance is vital for the SMEs not just for the growth, but also for the creation and retention of jobs, survival and rebuilding and expansion of their businesses.

Yet, in PNG, what is not in question is that lack of access to business finance, including government-backed loans, continue to be a major constraint for SMEs. The purpose of this paper is to identify, based on existing studies and data, the key demand-side barriers that PNG SMEs face when accessing bank loans. It also suggests some policy interventions to address these barriers.

Sources of SMEs Financing

SME business finance or capital can be acquired as debt (loan) financing or equity (personal) financing. Personal finance, that is, funds from the family, clans or friends, may be limited due to the high unemployment and low wages prevalent in PNG. Thus, for the majority of SMEs, the most likely suppliers of business finance are banks and non-bank financial institutions. However, in PNG, access to private debt finance or loans is among a host of impediments that continue to stifle the growth, development and performance of SME sector (Mishra and Smyth, 2016). For this reason, successive governments in PNG have often initiated measures, programs and projects with the hope of creating opportunities for the SMEs to access business finance.

To continue the quest to grow the SME sector, the current government allocated K100 million in the 2019 supplementary budget, and K200 million in the 2020 National Budget to the SME sector (The National, 2019). This money is yet to be distributed to commercial banks for onward lending to SMEs. Aware of the subtle difficulties of dealing with banks, the GoPNG has recently released an additional K165 million to all districts and provinces to progress development of agriculture and SMEs (The National, 2020). It is most likely that this money, too, will be channelled to SME borrowers through commercial banks and financial intermediaries.

The role of PNG banks in providing finance to SMEs

The Small and Medium Enterprise Corporation (SMEC), the government agency mandated to promote the development of SMEs in PNG, has established credit guarantee schemes with banks and non-bank financial institutions such as Bank of South Pacific (BSP), National Development Bank (NDB) and Micro-finances. While SMEC's role is indirect, it is these financial institutions that directly perform a vital role in providing business finance to support SMEs in the country. Apart from taking deposits from the customers, they provide business finance (loans) to SMEs. Details available on their respective websites indicated that each bank imposes varied terms and conditions for providing bank loans to SMEs.

BSP usually provide short-term loans to SMEs that have the annual turnover of less than K1,000,000. The loans range from K5,000 to K250,000 and can be repaid within six months to five years on a monthly repayment basis. NDB also provides several loan products to fill the gap of financing for urban and rural SMEs in PNG.

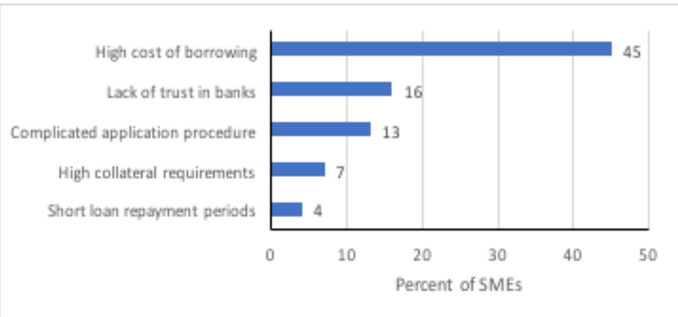
Financial institutions such as PNG Microfinance, People's Micro Bank, Nationwide Microbank and Women's Micro Bank also provide loans to businesses including SMEs. PNG Microfinance Limited (PML), for example, provide SME loan amount above K15,000 with an interest rate of 24 percent paid annually. Its maximum loan term is 36 months. Still, even with the financial institutions willing to provide loans, the barriers of accessing loans by SMEs are still there.

The COVID-19 pandemic has given the opportunity to the government to work in partnership with the local financial institutions. As noted above, the GoPNG plans to support SMEs by putting money into the banks for SMEs to borrow at lower interest rates. BSP has agreed to provide loan to SMEs at the interest rate of 5 percent with the repayment period of 15 years. Kina Bank and NDB also indicated that they will provide loans for SMEs at the interest rate of 4.7 percent and 4 percent for 20 years respectively. Are these terms favourable enough to mitigate the impact of COVID-19 pandemic on the country's SME sector?

Demand-side barriers restricting SMEs from accessing bank loans in PNG

The nation-wide SME Baseline Survey conducted by Tebbutt Research (2014) highlights why SMEs still have difficulties in accessing investment funds from the lenders. According to the survey, 81 percent of the 1,117 SMEs surveyed across the country were unable to access loans from the commercial banks and microfinance institutions. In fact, 59 percent of the respondents rated access to finance as difficult – with 26 percent indicating that accessing finance was very difficult, while 33 percent said it was somewhat difficult. Factors affecting SMEs from accessing bank loans are presented in Figure 1.

Figure 1: Demand-side barriers affecting SMEs from accessing bank loans in PNG



Both supply-side and demand-side barriers continue to limit SMEs from accessing finance (loans) from the banks in PNG. This study focuses only on the demand-side barriers because it does not appear that there is a shortage of private money in PNG that can be lent to SMEs. Yet it is very difficult for SMEs to access loans from the financial institutions such as commercial banks due to the reasons depicted in Figure 1. Yet, access to commercial business finance is often considered the source of strength for SMEs to grow. These demand-side barriers that make it difficult for SMEs to access finance from the banks are discussed below, followed by policy recommendations to address these barriers.

- ***High cost of borrowing***

From the Tebbutt Research (2014) nation-wide survey, about 45 percent of respondents consisting of either SME owners or managers stated that due to the high cost of borrowing, they were unable to borrow loans from the banks. As shown in Figure 1, the cost of borrowing is the major barrier that holds back SMEs from accessing bank loans. The response by relatively new SMEs (not shown in Figure 1) suggested that majority of people who may be willing to start up businesses cannot access loans from the banks due to the high cost of borrowing. Also, those that are already in the business hardly survive due to not having access to bank loans since the cost of borrowing is very high. SMEs who have been in business for some time require finance to maintain and expand their operations.

- ***Lack of trust towards banks***

From the Tebbutt Research (2014) survey, about 16 percent of SMEs stated that they never trust the banks generally. For such lack of trust, SMEs are sometimes unwilling to provide business financial information to the banks, even when such information is needed to evaluate their viability and ability to repay loans. It is not entirely clear why SMEs do not trust commercial banks and financial institutions in PNG. Their (SMEs) lack of trust towards the banks has led them to not accessing the finance (bank loans) from the banks. It is probable that the inhibiting effect of the perceived subtle difficulty of dealing with banks, which is symptomatic of bad SME-bank relationships, could be blocking their access to finance. Nevertheless, the closer understanding and the exclusive relationship between the banks and the SMEs can build the trust between the two parties.

- ***Application procedure is too complicated***

About 13 percent of the SME owners and managers who responded to the Tebbutt Research (2014) survey stated that due to complicated application procedures and too much requirements, they were unable to borrow loans from the banks. It is possible that majority of these SMEs owners and managers have not reached higher level of education. So, complicated loan applications and lengthy terms and conditions become very difficult for them to comprehend. And perhaps, because of cost constraints and/or lack of trust, these SMEs are not able to pay professional business advisers for assistance. It may therefore, not entirely be a coincidence that 15 percent of the SME owners and managers admitted to Tebbutt Research (2014) survey that accessing professional services such as accountants, lawyers and business advisers is a major hinderance to their operations.

- ***Unavailable collateral requirements***

Due to high collateral requirements, many SMEs in PNG are financially constrained, even though only about 7 percent of the Tebbutt Survey (2014) respondents reported that banks' collateral requirement for lending was a hinderance for them to access loans. Financial institutions demand high collaterals as a way of mitigating the risk of SMEs not repaying loans. SMEs might not have required collaterals, and this instigate the financial banks to refuse bank loan applications. Still, banks and non-bank financial institutions in PNG lack proper tracking system so it is very difficult to monitor SMEs. There is, therefore, no choice but to impose high collateral requirement as a way of protecting loans. On average, most financial institutions require 30 percent equity from SMEs as the collateral requirement. Cash deposit, motor vehicle, land and building with titles are accepted by most financial institutions as the collateral requirement. Most SMEs in PNG face problems with the land and property titles. Almost 97 percent of lands in PNG are customary-owned and it is difficult to transfer land titles to SME owners if it is under communal ownership. The title transmission issue affects SMEs to use land as their asset for the collateral requirements by the banks for loans.

Short-term loan repayment periods

The short-term periods for loan repayments is also a hinderance for some SMEs to access finance from the banks in PNG. Given the short-term periods, many SMEs will not complete or achieve certain investment projects. So, it is less important for SMEs to borrow from banks to finance their projects. For instances, BSP loan repayment periods range from six months to five years, while NDB loan repayment term is two years to five years. Under such short periods, SMEs are usually reluctant to borrow loans from the banks.

- ***Potential Policy intervention***

SMEs are vital if PNG realises sustainable development. Policy interventions are needed to achieve this dream. It is not a new issue – nearly every other government planning document has a line or two about it. It would seem, therefore, that the problem in PNG is non-implementation of the policy prescriptions. A re-emphasis of the potential policies that could improve SME access to finance is, therefore, necessary.

- PNG government must continue to support and fund SMEs. Indeed, in the SME Policy, the GoPNG promises to facilitate adequate government funding and resourcing support to grow the SME sector.

- There is a need to fast track the Access to Finance project that begun in 2011 to start guaranteeing loans from commercial banks to SMEs. This will enable the banks to charge lower cost of borrowing and more SMEs will be encouraged to seek and have access to bank finance.

- GoPNG should ensure that customary land administration system is effective so that there will be less title transmission issues on customary land and so, land can be viable to be used as collateral by SMEs.

- Provide financial literacy programs and financial inclusion awareness for the SMEs owners, managers and interested citizens so that they will fully understand the responsibilities of financial institutions and may build trust towards the banks.

- Financial institutions need better understanding of each types of SMEs in PNG and how their requirements for investment finance varies. There should be different repayment periods depending on the type of SME businesses. Currently, the repayment period is fixed.

- SMEC and financial institutions should provide more advisory services, either free of charge or at an affordable price. The financial institutions should be able to serve SMEs efficiently and ensure that they provide simplified loan application procedures on loan applications when issuing the loan application forms to SMEs.

Conclusion

Access to finance is a vital tool for the growth of SMEs in PNG. A World Bank-supported SME Access to Finance Project that started in 2011 was intended to provide sustainable credit to support the growth in SME employment and incomes. The project will close in the next four years (i.e. in 2024). Despite sufficient liquidity in the PNG banking sector, SMEs are still finding it difficult to access commercial lending. Barriers such as cost of borrowing, lack of trust towards banks, complicated application procedures, high collateral requirements, and short-term loan repayment periods affect the demanders of finance from borrowing commercial bank loans in PNG. Government's intervention and collaboration with banks or financial institutions in policy-making and implementation is of great importance to SMEs, especially for borrowings. It is necessary for GoPNG to continue to fund SMEs.

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Authors Contribution

Wendy Morona analysed the SME baseline survey data and wrote the original draft. Dr Francis Odhuno revised and edited the original draft.

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