

Problems and Prospects of SMES Loan Management: Case of Lesotho

¹Leseko Makhetha, ²Polasi Sebolelo

^{1,2}Department of Economics National University of Lesotho P.O. Roma 180, Maseru, Lesotho

Abstract: Small and medium enterprises play a fundamental role in economic growth and developments. The economies of all market-oriented nations depend on the efficient operation of complex and delicately balanced indispensable element in these systems - systems of money and credit. However, historically SMEs financing remains as major challenge to the growth of SME. This paper therefore tries to identify some underlying problems from the banks perspective. This study is based on primary data which is collected through personal interview with structured questionnaire and direct observations. Findings indicate that banks appear to be facing serious challenges of high cost of gathering information and collateral. Both high costs to gather reliable information on SMEs and high administration costs on loans made to SMEs were found to have fundamental impact on SME lending. Though lack of finance appears to be a major challenge hindering SMEs growth, this hindrance may be mostly enhanced by constraints that are within SMEs themselves.

Keywords: Bank Financing, FNB, Lesotho, Nedbank, SMEs, Standard Lesotho Bank.

1. INTRODUCTION

The relevance of banks in financing small and medium enterprises (SMEs) of any nation cannot be overemphasized. The economies of all market-oriented nations depend on the efficient operation of complex and delicately balanced indispensable element in these systems - systems of money and credit. Banks provide the bulk of the money supply as well as the primary means of facilitating the flow of credit. Consequently, it is submitted that the wellbeing of SMEs of a nation is a function of advancement and development of her banking industry. Akterujjaman (2010) posits that SMEs provide profound foundations for a sustained growth and development of developing countries and transitional economies as they create large scale, low-cost employment opportunities, use locally available inputs and technologies, mobilize small and scattered private savings, develop entrepreneurship, and correct the regional imbalance in development within the developing economies. Nonetheless, despite all these potentials, in Lesotho, there are lot of the impediments to SMEs development, which include but not limited to lack of clear policy framework, absence of enabling environment, unfavorable monetary and credit policies, inefficient and fragmented education and training programs, lack of supportive legal frame work and small claim courts, lack of holistic and comprehensive programs on exports development.

This paper therefore tries to identify some underlying banks' problems in designing proper financial products such as Overdraft, Time loan, and Term Loan for the SMEs sector. In Lesotho, commercial banks generally seem to be reluctant in financing SMEs, perhaps due to high risk and high supervision cost associated with this type of financing. Thus the objective of this study is to find out the major problems and prospects of SME loan management of Lesotho commercial banks. The specific objects are thus to find out the bank's reasons for reluctance to provide loans to the SMEs as well as to find out the banks problems and prospects in designing proper financial products for the SMEs. This study will contribute to the empirical literature of the problems and prospects of SMEs loan management as well as helping policy makers with policy formulation associated with SMEs loan management.

1.1. SMEs Background in Lesotho:

Lesotho had over 125,000 SMEs providing employment for approximately 200,000 workers in 1999. About three quarters of SMEs were headed by women and concentrated mainly in straw work, garments, brewing, vending and retail

wholesaling. The labor statistics bulleting as presented by Ministry of Labor and Employment 2008 shows a decrease in female unemployment from 33.1% to 25.3%. In line with provision of vision 2020, the Government of Lesotho (GoL) attaches great importance to development of SMEs and informal sector. Recent estimates by Maxine *et al* (2011) reveal that SME sector employs over 130,000 people (approximately 200,000 including the informal sector) making it the largest employer after the government.

GoL is looking for ways to improve access and affordability of finance for small scale entrepreneurs and the youth in the informal and rural sector. An important component of World Bank assisted private sector competitiveness (PSC) and Economic Diversification Project entails addressing issues of limited access to finance by Small, Medium and Micro-Enterprises (SMMEs) commercial banks through the establishment of an enterprise development facility which will provide guarantee to SMMEs to access funds from commercial banks. M50 million partial grant has been set aside in the 2010 budget to create guarantee facility which is being set up to give Small Medium and Micro Enterprises access to credit and training. The fund was however not utilized. In addition, export financing scheme and loan guarantee scheme offered by the Central Bank of Lesotho (CBL), according to CBL both failed due to the limited capabilities of small businesses and exporters which were too low to fulfill the requirements of the scheme.

The government is not the only estate concerned about ways to improve access and affordability of finance for SMEs. The banking sector is making an initiative, though reluctantly. The banking sector in Lesotho is considered to be very conservative when it comes to financing of SMEs projects. The sector currently comprises of three commercial banks [Standard Lesotho Bank, Ned Bank Lesotho and First National Bank (FNB)]. All the banks recognize that future growth will only come from SME sector and are adapting their strategies to address this market. Although commercial banks in Lesotho are very liquid, they do not extend credit to local private sector as they should due to the commonly cited problems with the banks that there are no bankable projects due to high risk and administration.

In response to the problem of financial constrain which lead to hindrance of SME growth, Standard Lesotho Bank developed a new approach to SME lending in 2010 which included deploying innovative technology to overcome the challenge of assessing risk in SME market. Short term working capital facility called Quick loan was launched. It is aimed at serving unbanked SMEs, undeserved SMEs - in particular female entrepreneurs. In so doing, loan disbursement process was reduced from several weeks to three days, reduced application forms from nineteen pages to two pages. Thus show that even though the perception that SMEs fail to obtain loans due to their failure to meet bank requirement, Standard Lesotho Bank in particular identified the need to provide adequate conditions for SMEs so as to ease the access of SMEs to loans. In addition, the special concentration to female entrepreneurs is very crucial due to the fact that unlike in many developing economies, in Lesotho most SMEs are owned by men.

Ned Bank also implemented a “potential supplier” database, consisting of primarily potential SMEs who approach the bank for business, there are however no specific set-aside policy by commodities that exist but measures are in place to ensure all new black or black owned suppliers engaged are empowered. In addition, Ned Bank is assisting several in house black SMEs in setting up and then accessing Ned bank procurement or Ned bank staff as their clients as part of its entrepreneur. FNB SME Business unit offers both standardized financing packages and financing for more complex buy-in and buy-out transactions. Financing is usually provided in a form of term loans, asset based finance and or overdraft facilities.

2. LITERATURE REVIEW

2.1 Theoretical Literature:

The significance of SMEs for economic growth is underlined by their contribution in developed and developing countries. The advantages claimed for SMEs are various, including; the entrepreneurship, the greater likelihood that SMEs will utilize labor intensive technologies and have immediate impact on employment generation. Cook and Nixso (2000) similarly postulates that SMEs play a major role in economic development in every economy, including African economies, as studies indicate that in both advanced economies and developing countries SMEs contribute to average of 60% of total formal employment in the manufacturing sector. The truism of this perception is practical in Lesotho as the findings of the survey carried out by Maxine *et al* (2011) in Lesotho show that SME sector employs over 130,000 people (approximately 200, 000 including the informal sector) making it the largest employer.

However Akterujjaman (2010) and Bayene (2002) argue that, despite all the potentials of SMEs, SMEs are disappearing and abandoning the potential role they could have played in economic development. They emphasize that major several studies have identified the major obstacles including infrastructure facilities, taxes and regulations and stability of policies. They further postulate that infrastructure is another area where SMEs encounter formidable problems, good infrastructure is critical for fostering economic performance and competitiveness of SMEs. They add that optimal physical and telecommunication infrastructure comprised of, among other things, a good, well maintained network of roads, airport and ports, a stable power supply and an extensive telecommunication network, are vital for the effective function of enterprises.

Rosen (2003) indicated that the entrepreneurs behind SMEs could and should play a much larger role in development but too often are held by lack of ready access financing from local formal sector financial institutions just as Akterujjaman (2010) posits that lack of SMEs financing has been identified as a major obstacle to SMEs. Although most often SME entrepreneurs acquire their capital from family members, they also resort to traditional banking services. However because of their weak financial base SMEs are regarded as high risk areas and as such do not succeed in attracting enough loans. Bayene's (2000) point of view in this regard is no exception in Lesotho.

2.2 Empirical Literature:

With regard to the internal and external challenges associated with SMEs, Akterujjaman (2006) carried out the study on 'Problems and prospects of SMEs loan management in Mercantile Bank Limited, Khulna Branch in Bangladesh. The study was based on both secondary and primary data. The results revealed that SMEs are not preparing proper financial statement which create problem for the banks in judging financial standings, profitability and credibility. In addition, it was also observed that SMEs are not monitoring proper licensing. This study shows that problems associated with SMEs growth are both internal, that is they are within SMEs themselves.

Addotei (2012) also carried out the study on the "Challenges of financing small and medium enterprises (SMEs)", in the Ashanti region (A case study of Stanbic Bank ((GH) LTD) Ghana. Data was also collected from both primary and secondary sources. Primary data were captured through the use of questionnaires and personal interviews. Secondary data was collected using journals, textbooks and manuals, review articles and editorials, literature review informal discussion with expert colleagues, seminars and conferences as well as published guides. The results obtained were similar to those of Akterujjaman (2006) in a sense that, Addotei (2012) also showed that staff respondents have been on the SME banking for 4 years where majority having been with the unit for three years period. However, it was found that several SMEs have had their loan applications rejected before and reasons assigned to the rejection to the rejection of the loan application or in other words major problems faced by SMEs in securing funds were, not to mention others lack of collateral/guarantee, inadequate compiled financial records and accounts, poor credit experience or history, inexperienced management team or lack of professionalism, inadequate technologies and limited knowledge of opportunities.

In addition, there was a study undertaken by Small Business Prospects (SBP) in Lesotho for the Ministry of Trade and Industry, Cooperatives and Marketing (MITCM) in 2008 on the state of small enterprises in Lesotho to examine business activities and operating environment in a range of setting and geographical locations across the country. The study was based on both the primary and the secondary data. According to the findings, the tendency for small business to focus on lack of demand was a fairly common response in this survey. Competition from other business was also common response (15% of respondents) suggesting lack of differentiation of products and services of these respondents who identified competition as a challenge, 30% referred specifically to competition from Chinese or Indian businesses and resentment of Chinese-owned business was common theme throughout the survey. Other key challenges identified by businesses included high operational costs, inadequate infrastructure and/or unsuitable premises and cash flow problem caused by customers buying on credit and paying late, inadequate infrastructure was raised explicitly by 13% of respondents as a key challenge for their businesses.

3. METHODOLOGY OF THE STUDY

3.1. Sources of Data:

This study is based on primary data which is collected through personal interview with structured questionnaire (*see appendix 1*) and direct observations. Employees of Standard Lesotho Bank, Ned bank Lesotho and First National Bank

will be used as respondents and the sample units will be drawn through convenience sampling method. Respondents will be assured of anonymity by asking them not to reveal their identity anywhere in the survey instrument. They were also told that neither their immediate supervisors nor their headquarters officials will have access to the individual questionnaire. The questionnaire distribution would be drop-and-pick-later; ten questionnaires were dropped to each of the three banks and were picked few days later.

3.2. Data Analysis Methods:

An analysis will be generated from questionnaire to fulfill the objective of the study. The analysis will be the convenience of analysis percentage of the responses will be calculated and for the ease of better understanding descriptive which means that it will be using cross tabulation method which involves graphical presentation, charts and tables. For the information of percentages will be presented on charts and tables.

3.3. Hypothetical Formulation:

According to Alam and Neger (2009), research hypothesis is an unproven statement, which helps the researcher to make discretion on his hypothetical assumption whether it is true or false based on some specific statistical tests. For this study, the following hypotheses (at 95% confidence level) are developed, which are also to be tested.

Hypothesis 1

H_0 : Banks are not very experienced in dealing with SMEs

H_1 : Banks are very experienced in dealing with SMEs

Hypothesis 2

H_0 : Banks regard large enterprises to be more important than SMEs

H_1 : Banks regard SMEs to be more important than large enterprises

Hypothesis 3

H_0 : Banks do not adapt strategies to address SME sector

H_1 : Banks adapt strategies to address SME sector

Hypothesis 4

H_0 : Lending obstacles are internal (i.e. are within SMEs themselves)

H_1 : Lending obstacles are not internal

4. DATA ANALYSIS

An analysis is generated from the questionnaire to fulfill the objective of the study. Ten questionnaires were administered to each of the three banks (Standard Lesotho Bank, Ned Bank and First National Bank), total of 30 questionnaires. The study has taken the highly affecting responses and tries to find out the bank's problem in designing proper financial products such as Overdraft, Time loan, and Term Loan for the SMEs sector. For the convenience of analysis the study has calculated percentages of response. For the easy comprehension, the study presented the information under four headings (very experienced, experienced, not much and not all) where appropriate. And (strongly agree, agree, disagree and strongly disagree) where appropriate.

Hypothesis 1:

TABLE 4.1: the level of experience in dealing with SMEs FNB

Rating	Frequency	%
Very experienced	2	25
Experienced	4	50
Not much	2	25
Not at all	0	0
Total	8	100

Source: own-computation

Of the ten questionnaires that were dropped at FNB only eight were answered, with regard to the level of experience. Table 4.1 indicates that the FNB is generally experienced in dealing with SMEs, and 25% of the respondents indicated the level as “very experienced” whereas 50% of respondents showed their level as “experienced” while the last 25% of respondents indicated the level of experience as “Not much”.

TABLE 4.2: The level of experience in dealing with SMEs Standard Lesotho Bank

Rating	Frequency	%
Very experienced	5	50
Experienced	5	50
Not much	0	0
Not at all	0	0
Total	10	100

Source: own-computation

Ten questionnaires dropped at Standard Lesotho Bank were all answered and 50% of the respondents showed that they are “very experienced” in dealing with SMEs while another five (50%) indicated it as just “experienced”.

TABLE 4.3: The level of experience in dealing with SMEs Ned Bank Lesotho

Rating	Frequency	%
Very experienced	2	50
Experienced	1	25
Not much	1	25
Not at all	0	0
Total	4	100

Source: own-computation

Out of ten questionnaires dropped at Ned Bank Lesotho branch, only four were answered, of the four respondents two (50%) indicated that the level of experience is “very experienced”, one respondent (25%) showed that it is “not much” while another one (25%) indicated it as “experienced”.

Hypothesis 2: Customer base

The banks were asked which segment of their customer base between SMEs and large enterprises they regard as more important. In this case the general responses vary from one bank to another. Responses from FNB indicate preference for large enterprises; this is supported by large enterprises registering 75% while SMEs have 0%. The Standard Lesotho Bank however has 50% for SMEs and 10% for large enterprises. The Ned Bank Lesotho responses indicate 50% for large enterprises and 0% for SMEs. The details are shown in figure 5.4. The literature posits that in some cases banks prefer large enterprises to SMEs because they have collateral, keep accounting records, they are comparatively less costly to administer and their relatively long period of their existence serve as an advantage. In some cases there is equal preference due to the ability of the banks to adopt strategies that accommodate both large enterprises and SMEs.

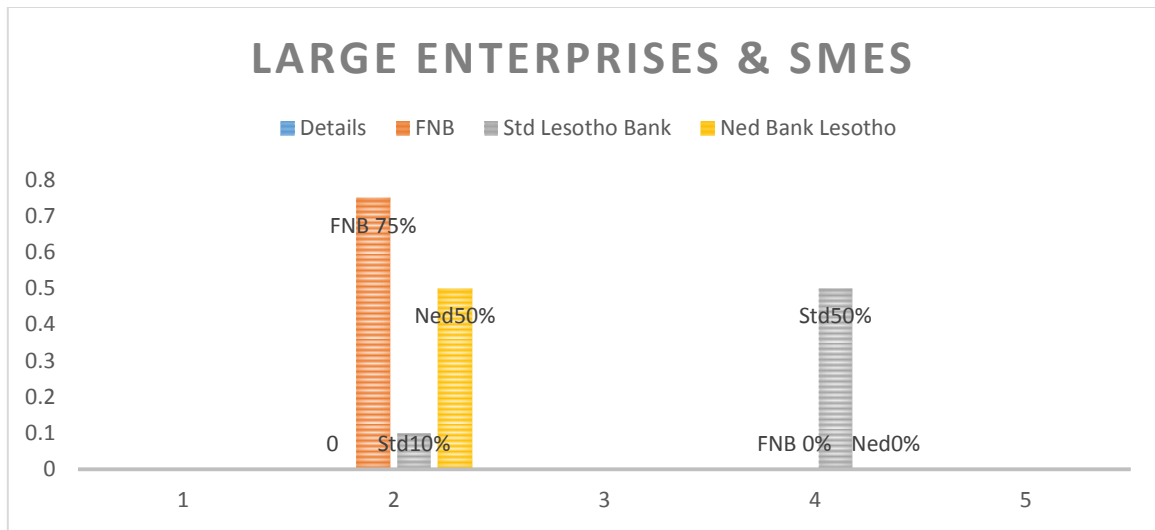


Fig. 4.4; Bank's customer base

Source: own-computation

Hypothesis 3: The banks' involvement with SMEs

According to findings of this study, all the banks in the sample have SMEs among their clients, and they all do have greater than 10% of their share of loans that has been made to the SMEs. In addition all these banks in sample adopt strategies to address SME sector, this is presented by table 4.5.

TABLE 4.5; Bank adapt strategies to address SME sector

Rating	FNB		STD BANK		NEDBANK	
	Frequency	(%)	Frequency	(%)	Frequency	(%)
Strongly Disagree	1	12.5	0	0	0	0
Total	8	100	10	100	4	100

Source: own-computation

Given the four classes of rating, Table 4.5 shows the response of each bank's respondent when they were whether the banks adapt strategies to address SME sector. The extent of each category of rating varies from one bank to another as shown by the table.

Hypothesis 4: Obstacles to SME lending

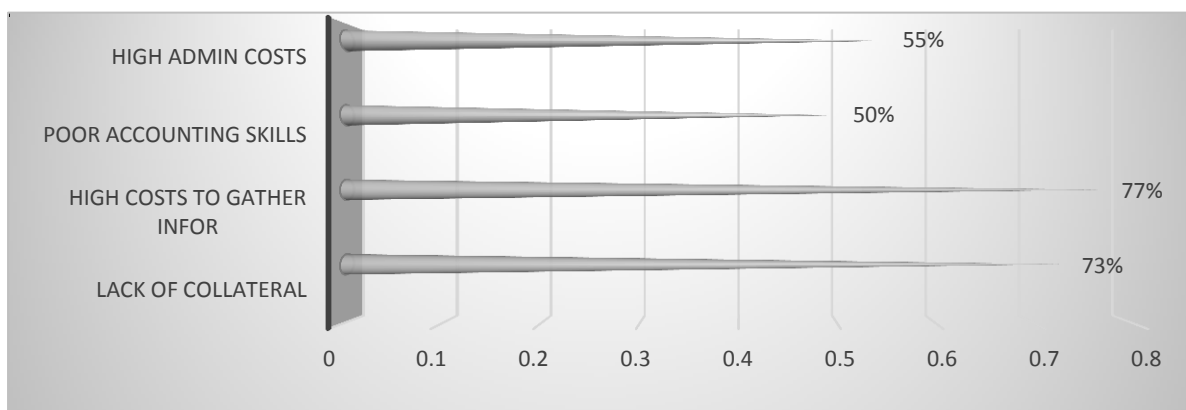


Figure 4.1. Obstacles to SME lending

Source: own-computation

It is a pandemic perception that lack of finance is a major challenge that prohibits the growth of SMEs. This study does however finds that some of the problems that enhance this prohibition are internal; thus within SMEs themselves. Banks were asked to indicate whether the SME specific factors observed in the figure below are important obstacles to their exposure to SMEs. The figure 4.1 shows the response in percentages of all the banks in the sample since they all consider each factor significant. Figure 4.1 reveal percentages of banks responses with regard to the extent to which they find obstacles. High cost of gathering information seems to be the major obstacle, followed by lack of collateral. However, poor accounting skills seem not to be a major obstacle to SMEs lending.

5. CONCLUSION AND RECOMMENDATIONS

Contrary to the general perception that financial institutions are averse to the SME segment, all commercial banks in Lesotho have SMEs among their clients as well as experience in dealing with them. However, these banks appear to be facing similar challenges of high cost of gathering information and collateral. Both high costs to gather reliable information on SMEs and high administration costs on loans made to SMEs were found to have fundamental impact on SME lending. Though lack of finance appears to be a major challenge hindering SMEs growth, this hindrance may be mostly enhanced by constraints that are within SMEs themselves. As result, in order to exploit the potential of the SME segment as engine of growth, these internal constraints which are actually obstacles for the banks to finance SMEs should be dealt with accordingly. Banks should not only have SME Banking Unit but they should also adapt strategies to identify and address constraints of SMEs and financial challenges, this could be achieved by establishing educational workshops and training for SMEs to equip them with skills that will make them eligible to meet banks' requirements. Government should provide resources to create an incentive scheme for financial institutions to make flexible loans available to SME.

REFERENCES

- [1] Addotei (2012) The challenges of financing small and medium scale enterprises (SMEs) in the Ashanti Region -A Case Study of Stanbic Bank (Gh) Ltd.
- [2] Akterkujjaman , S M. 2010.,Problems and Prospects of SMEs loan management; A study on mercantile Bank limited Khulnu Branch.
- [3] Akterkujjaman (2006). Economies of Scale in Banking Bank Parikrama, Vol. 30 & 31, pp. 91-113.
- [4] Alam, M. J. and Meher.Neger. (2009) "Measuring Consumer Attitude towards Beautification Products: A Study on Some Selected Brands in Bangladesh." Journal of Business and Technology (Dhaka), 4(2): 61.
- [5] Bayene, A. (2002). "Enhancing the competitiveness and productivity of small and medium scale Enterprises (SMEs) in Africa: Analysis of Different Roles of National Government through improved support services.
- [6] Cook, P and Nixon, F. (2000). "Finance and Small and Medium sized Enterprises Development" IDPM University Manchester, Finance and Development Research program working paper, series paper No 14.
- [7] Mexine, L, et al (2011). An assessment of enabling environment for women's Enterprises in Lesotho.
- [8] Ministry of Trade and Industry, Cooperative and Marketing, (MTICM), 2008.
- [9] Rosen, H. (2003). "Improved Access to Finance: A key to SME Growth" World Bank Institute.

APPENDIX- A

Questionnaire to the Commercial Banks:

1. Which of the following best describe your bank?

- State owned privately owned shareholding bank with predominantly domestic shareholders
 foreign owned

2. Level of experience of the bank in dealing with SME loan request

- Very experienced Experienced Not much Not at all

3. Which do you regard as more important segment of your customer base?
 SMEs Large enterprises They are equal
4. Share of loans your bank has made to SMEs in total credit
 <10% 10%-20% 20%-30% 30%-50% >50%
5. In recent period (say2007-2012), this share is
 Increasing Almost unchanged Decreasing
6. Of total loans to SMEs, long-term lending (defined as over 2 years) account for:
 <10% 10%-20% 20%-30% 30%-50% >50%
7. Rate of default on loans made to SMEs as compared to large enterprises is
 Very high High low Very low
8. In comparison with large enterprises, ratios of non performing debts on SMEs are
 Very high High low Very low
9. SMEs lack assets to meet collateral requirement
 Strongly agree Agree Disagree Strongly disagree
10. It is more costly to gather reliable information on SMEs
 Strongly agree Agree Disagree Strongly disagree
11. Accounting skills and standards applied in SMEs do not meet your bank's requirement
 Strongly agree Agree Disagree strongly disagree
12. In general, average administration costs on loans made to SMEs are high
 Strongly agree Agree Disagree Strongly disagree
13. Projects proposed by SMEs are less reliable due to their low capacity of analyzing projects
 Strongly agree Agree Disagree Strongly disagree
14. Number of years of survival of an SME is an important factor in deciding whether or not to make loans to that enterprise
 Strongly agree Agree Disagree Strongly disagree
15. What is your opinion about usefulness of government facilitation in supporting SMEs access to commercial banking sources?
 Very useful Of some use Not useful
16. Does financial regulatory environment helps facilitate commercial financing available to SMEs
 Strongly agree Agree Disagree Strongly disagree
17. It is socially and politically more difficult to enforce repayment of loans or to cover assets in cases of default by SME
 Strongly agree Agree Disagree Strongly disagree
18. In general, do government policies and incentives to facilitate access to commercial finance favor large enterprises more than SMEs?
 Strongly agree Agree Disagree Strongly disagree
19. Lack of access to finance is major challenge that prohibit SMEs growth
 Strongly agree Agree Disagree Strongly disagree
20. Does the bank adapt strategies to address SME sector?
 Strongly agree Agree Disagree Strongly disagree