Access to Debt Finance in Sub-Saharan Africa: Redefining the Problem from Risk Perspective and Way Forward

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Abstract

This paper presents critical points of view relating to small and medium-sized enterprises (SMEs) access to debt finance in Sub-Saharan Africa (SSA). Prevailing view suggests that lack of credit information is a fundamental factor that contributes to the constraints faced by SMEs. We challenge this prevailing dominant view and argues that SMEs are constraints in accessing debt finance due to bank's risk assessment strategies. At the same time, suggest that banks modelling credit risk assessment for SMEs in SSA became extremely crucial for determining access to debt finance. This impacts on access to debt finance contrary to popular claim that the opaque nature of SMEs is the major constraint limiting access to debt finance. In such challenging context, SMEs are expected to either provide more information to banks to reduce the problem of information asymmetry as well as provide collateral and guarantees in the absence of reliable information to safeguard against risk of default or maintain a long-term relationship with banks which is expected to result in an increase in debt financing. The authors emphasize the need to redefine the problem of access to debt finance, so that financing obstacles for SMEs can be strengthen. The implications and alternative strategies for SMEs access to debt finance are discussed.

Keywords: Access to debt finance; Financing; Credit risk assessment; SMEs; Sub-Saharan Africa.

1. Introduction

A great deal of research at the intersection of finance and entrepreneurship has focused on challenges facing small and medium-sized enterprises (SMEs) and particularly obstacles in SMEs access to finance (Abereijo and Fayomi, 2005; Agyapong et al., 2011; Beck, 2007; Beck, Demirguc-Kunt, and Peria, 2011a; Behr and Guttler, 2007). Whilst several attempts have been made to resolve this reoccurring phenomenon of access to finance (Bruns and Fletcher, 2008; Calabrese and Osmetti, 2013; Cassar, Ittner, and Cavalluzo, 2015; Krasniqi, 2010; Huang, Liu and Ren, 2018), the problem still persist in Sub-Saharan Africa (SSA) where an estimated 28.3 percent of SMEs are fully credit constrained and only between a third and a fifth of these SMEs have a bank loan or line of credit and recent studies have called for further scrutiny of the phenomenon (Moro, Fink, and Maresch, 2015a; 2015b; OECD, 2018; Zhu et al., 2019; Runde, Savoy, and Staguhn, 2021). In response to such call, this paper examines issue of SMEs access to debt finance in SSA and provides evidence to suggest that the decision to lend to SMEs is significantly constrained by the perception of risk in SMEs lending. In turn, this is a consequent of banks risk assessment strategies used in evaluating such SMEs loans. Therefore, our central claim, which is similar to but extends Palazuelos, Herrero Crespo and Montoya Del Corte (2018) and Moreira (2016), is that the constraint on SMEs access to finance is due to the perceived risks complicated by the banking system of SSA not being able to perform a fair and extensive actual credit risk assessment suitable to SMEs in SSA context. Debt financing of SMEs is a topic of significant interest amongst policymakers and researchers (Berger and Udell, 2006; De La *et al.*, 2008; Kersten et al. 2017). This interest is driven in part by the fact that debt finance from banks is recognized as a major source of external finance for SMEs (Peterson & Rajan, 1994; Cosh & Hughes, 1994) and also because of the important roles SMEs play in the economy.

SMEs are considered a major driver of innovation, employment, economic growth and development. However, recent empirical studies have suggested that the future of small business sector might be threatened due to financial constraints because finance is assessed a major challenge confronting SMEs innovation, growth and development (Beck, Demirgüç-Kunt and Maksimovic, 2005; Aghion, Fally and Scarpetta, 2007; Olufunso Fatoki, Van and Smit, 2011; Ramlee and Berma, 2013). This view is further shared by a number of studies which find that limited access to debt finance is considered a major factor that affects the growth and development of small business worldwide (Beck, Demirgüç-Kunt and Maksimovic, 2005; Beck and Demirguc-Kunt, 2006; Beck *et al.*, 2006; Beck, Demirgüç-kunt and Martinez, 2008; Zhu *et al.*, 2019). This is also an acute problem especially in SSA where SMEs typically refer to limited access to finance as the major obstacle inhibiting growth of the sector (Abor and Biekpe, 2007; World bank, 2006). The literature has identified finance as a major constraint to entrepreneurs in establishing and managing small firms in developing countries (Abereijo and Fayomi, 2005; Beck, 2007; Hoff et al, 2007; Gibson, 2008).

In fact, many of the small businesses in developing countries rate access to finance as a major constraint as a result of high administrative costs, high collateral requirement and lack of experience within financial intermediaries (Dalberg Global Development Advisors, 2001; Onwuegbuchunam and Akujuobi, 2013). It is difficult for small businesses to access finance especially long-term loans from commercial banks for reasons ranging from the lack of collateral, difficulty in proving credit worthiness, inadequate credit history, high transaction costs, small cash flows, etc. (Scholtens, 1999; Schiffer and Weder, 2001; IADB, 2004; Beck and Demirguc-Kunt, 2006). In addition, information asymmetry has been highlighted as a huge constraint limiting access to finance for SMEs and cited as the root cause of SMEs credit risk

(Gong and Cullinane, 2018; Song & Zhang, 2017; Li et al., 2016; Chen et al., 2010; Altman et al., 2010; Altman & Sabato, 2007).

Our review shows that understanding credit risk exposure is a major factor in decision making for banks involved in lending. This is because it influences the probability of banks survival and existence, suggesting that risk is highly prioritised by those banks who engaged in lending to SMEs (Oliyide, 2012; Huang, Liu and Ren, 2018; Palazuelos, Herrero Crespo and Montoya Del Corte, 2018). So when banks decide to extend credit to SMEs, they are particularly concerned with the repayment ability of the SMEs. Stiglitz and Weiss (1981) observed early in the literature that banks are more interested in the risk of default inherent in a borrower when considering a loan application. This reflects in the bank's decision whether to extend loans to SMEs and carefully determine the interest-rate charged for the loan if eventually approved. This interest in the level of risk banks are exposed to is an effect of agency problem arising from information asymmetry (a situation where a borrower in a lending contract has more knowledge and relevant information, which is material to the lending contract but is less known or unknown to the lender). This hinders finance providers from making informed decision as it becomes difficult for the lender to distinguish between high and low risk businesses or good and bad borrowers. In effect, leading to the problems of adverse selection where unless the lender incurs significant transaction costs, bad/high risk borrowers would be granted loans and creditworthy borrowers rejected by the lender, and/or moral hazard where borrowers conceal risky behaviour not specified in the credit contract from the creditor (Stiglitz and Weiss, 1981; Agyapong, Agyapong, Gloria and Darfor, 2011; Beck, Demirgüç-Kunt and Pería, 2011).

Therefore, in an attempt to mitigate lending risk resulting from the absence of information from SMEs, banks adopt various credit screening techniques which may include request for audited financial statements, change in terms of contract, loan covenants, increase in interest rates, increased collateral requirements, and credit rationing (Stiglitz and Weiss, 1981; Beck, 2007; Beck, Demirgüç-Kunt and Pería, 2011a; Olufunso Fatoki, Van and Smit, 2011). Each of these techniques illustrates some of the measures banks used due to risk perception in SMEs lending to guard against risk of default. However, we argue that some of these measures and credit risk assessment strategies are unfit for SMEs in SSA context – suggesting the need to redefine the problem of access to finance and chart new way forward. One motivation for this line of reasoning is to show that bank's credit risk assessment and strategies for SMEs in SSA should be distinct from SMEs in developed countries or for large enterprises. Previous studies that have focused on modelling credit risk particularly for SMEs have been conducted in developed countries. These studies not take into consideration features and finance ecosystems of SMEs in SSA which are markedly different from those of SMEs in developed countries (Altman and Sabato, 2007; Calabrese and Osmetti, 2013).

Therefore, our work extends the growing literature on SMEs access to finance by rethinking the phenomenon around bank's credit risk assessment and strategies as partly responsible for low access to finance in SSA. Moreover, we also build on extensive research which has been conducted on the use of credit ratings and scores and other quantitative information based on publicly available information on financial ratios and other indicators from annual reports (Altman and Sabato, 2007; Fantazzini and Figini, 2009; Calabrese and Osmetti, 2013) by acknowledging that qualitative information based on subjective evaluations of the borrower also play crucial role when granting loans to SMEs (Figini and Giudici, 2011). As such, the study reviews the criteria used by banks to assess SME loans, its practicability and its implications for SMEs in SSA context. We note that an insight into the SMEs loan application and the decision-making process lenders adopt in granting loans to SMEs would

help address the problem of access to finance for SMEs in SSA context. The rest of the paper is organized as follows: Section 2 provides an examination of access to debt finance for SMEs in SSA. Section 3 describes the SMEs credit risk influencing factors. Section 4 discusses the main findings and considers the implication and alternative strategies for SMEs credit risk assessment. The last section concludes the study and offers suggestion for future direction.

2. Access to Debt Finance for SMEs in Sub-Saharan Africa

The definition of the term small and medium-sized enterprises (SMEs) is said to be idiosyncratic to an environment, this implies that the concept varies from one country or context to the other (Oliyide, 2012). However, exploring the diverse definition of SMEs both in Africa and worldwide, the term is generally defined along the parameters of turnover, number of employees and asset. For example, in Nigeria, small enterprises are those enterprises employing between 6-29 employees with a fixed assets of $100,000 why medium enterprises are enterprises employ between 30-99 employees with fixed assets of up to $1million (Mensah, 2004). A survey conducted in 2010 by the National Micro, Small and Medium Enterprise (MSMEs) revealed that the total number of enterprises in Nigeria stood at 17,284,671 (micro 17,261,753, small 21,264, and medium 1,654) and the total number of persons employed by this sector as at December, 2010 stood at 32,414,884. In other words, although there are about 18 million enterprises in Nigeria with small firms representing 99 per cent of the total number of enterprises and like most other African developing countries employing the largest number of workers, the large size of micro-sector in Nigeria could reflect the possibility that certain unfavourable economic and financial conditions forced small and medium enterprises to become micro enterprises.

There is no doubt that SMEs operations are crucial to the growth, development and economy of Sub-Saharan Africa (SSA). It is estimated that more than 95% of enterprises across the world are SMEs and they account for more than 60% of private sector employment (Ayyagari et al., 2011). In SSA, SMEs account for a greater proportion of businesses in Ghana, Nigeria, and South Africa and their contributions to GDP and poverty reduction are substantial. The SMEs are facing numerous challenges in SSA because most countries within the sub-region have shallow financial markets and interest rates have lagged behind rising inflation. Under these circumstances, SMEs require substantial finance to invest in research and development, innovation, new products development, and market expansion. In context, previous research has identified that SMEs in Africa lack of access to finance is due to two high risk characteristics. First, the provision of finance for Africa is generally rated as riskier than for other regions. Second, the provision of finance for small firms is globally rated as riskier than for large firms (Collier, 2009). In fact, around one-quarter of firms (23 to 25%) in Sub-Saharan Africa are classified as fully credit constrained (Thornsten and Cull, 2014). It was noted that SMEs are unable to obtain external debt financing despite actively seeking credit or were discouraged from seeking credit due to the unfavourable terms and conditions of a proposed loan. SMEs in SSA are 19% less likely to obtain a loan than in other regions of the developing world (Thornsten and Cull, 2014).

Our review of the finance and entrepreneurship literature shows that problems with access to finance or inadequate financial support have been identified as the main cause of small enterprise failure in SSA (Abereijo and Fayomi, 2005; Okpara, John O; Wynn, 2007; Ihua, 2009). This has hindered small businesses in SSA from having significant contributions to national output compared to other nations (Eriki and Inegbenebor, 2009). This further explains why although small enterprises in SSA represent about 99 per cent of firms, they only

contribute a low percentage to GDP compared with empirical studies which show that small and medium enterprises contribute over 55% of GDP and over 65% of total employment in high income countries, over 60% of GDP and over 70% of total employment in low-income countries, 70% of GDP and 95% of total employment in middle income countries (National MSMEs collaborative survey, 2010). Specifically, recent research found that there are over 44 million SMEs in SSA which provide an estimated 80% of jobs on the continent (Runde, Savoy, and Staguhn, 2021). Our review also uncovers that almost all of the SMEs in SSA are micro businesses and more than half of SMEs (51%) require more funding than they currently access (cf. Runde et al., 2021). In this view, we argue that lack of access to credit facilities hindered small business contributions to growth and development as well as limit SMEs ability to meet their expectation of accelerating job creation, facilitate technology transfer, increase production of goods and services and create further opportunities for entrepreneurs (Eriki and Inegbenebor, 2009; Runde et al., 2021).

It is important to note that access to finance is essential at all stages of a firm's life cycle as it helps it in fulfilling small enterprise roles of employment creation, poverty reduction and eradication, growth and development of any economy. Bank lending is recognised in the literature as the most common source of external finance for SMEs and most SMEs are heavily reliant on it for reasons ranging from size of funds being relatively small compared to the criteria for equity finance and the need to minimize intrusion into the business for fear of losing control or ownership. For SMEs in more developed countries, finance is noted to be relatively faster and easier to access because the financial markets are more developed, there is an enhanced risks management and information sharing system and resources are better allocated (Giovannini et al., 2013; Rajan & Zingales, 1996). On the contrary, in most countries of SSA constraints on access to finance is more pronounced and often highlighted among the main obstacles preventing SMEs development (Dinh et al., 2010; Stein et al., 2013). Factors such as asymmetric information, agency problems, high transaction costs, SME opacity, limited credit history, lack of collateral are often cited as causes that limit access to debt finance for SMEs in developing countries.

In sum, the literature suggests that a high proportion of SMEs still encounter substantial difficulties in accessing debt finance particularly as a result of higher interest rates and lack of assets to serve as collaterals to banks. Although banks claim credit is made available for SMEs and different resources are provided to increase access to finance for SMEs. But, there is evidence to suggest that banks have become more risk adverse with evaluating SME credit thereby enhancing financing constraints of SMEs. In recognition of banks inability to reliably assess risks and potential benefits in lending to SMEs as a result of information deficiencies, a report by (OECD, 2018) maintain that the difficulties faced by SMEs in assessing debt finance and the higher cost typically associated with SMEs can be reduced in the presence of a more reliable information about risks because it reduces the high risks banks perceive when SMEs approach them for debt finance. This information can be provided by infrastructure for credit risk assessment such as credit bureaus and registries among others.

3. SMEs Credit Risk Influencing Factors

Agyapong et al. (2011) in their study of criteria for assessing SMEs loan in Ghana revealed that lenders perception of risk significantly shapes their lending decision as they dealt with SMEs. In deciding whether to lend to SMEs, the lenders ranked highest the following factors for consideration: purpose of loan, credit history, repayment schedule, type of business activity, size of loan relative to size of business and availability of security. Banks adopt a number of systems to identify risks and probability of default in their lending decision, this assessment influences their decision on whether to extend credit or not to grant credit and if debt is granted;

the terms and condition attached to the lending relationship ; Bruns and Fletcher, 2008; Moro, Fink and Maresch, 2015). These systems include either the bank's internal credit risk evaluation criteria or external credit rating and scores from credit bureaus. These are used to assess the credit worthiness of borrowers before a credit decision is made. Our review shows that three main factors; information, interest rate, and collateral influence banks credit risk decision regarding SMEs debt financing in SSA. We elaborate upon these factors in the following sub-sections.

3.1 Role of Information in Lending

Banks critically take into considerations information from the financial statements in assessing the risk in a borrower as the analysis of this information enable them determine capability and repayment abilities of the borrower. Recent theoretical literatures have stressed the role that information plays in a lending relationship (Gong and Cullinane, 2018; Song & Zhang, 2017; Li et al., 2016; Chen et al., 2010; Altman et al., 2010; Altman & Sabato, 2007). They have outlined the role of information in accessing credit worthiness as banks are better able to evaluate a borrower and make informed lending decisions based on how much information it possesses about the borrower (Fredriksson and Moro, 2014; Moro, Fink and Maresch, 2015a). Zairani and Zaimah (2013) demonstrates that banks are unlikely to lend in the absence of verifiable information.

The lack of a reliable information often make it difficult for lenders to distinguish between credit worthy and unworthy borrower leading to the problem of adverse selection and moral hazards (Agyapong et al., 2011; Beck, Demirgüç-Kunt and Pería, 2011b). Although using hard information or transaction-based lending default prediction models are easy to use in risk assessment in practical sense because it has better predictability and less time is required for quantification of the risk, it is not applicable to many SMEs in developing countries for unavailability of required information (Andrikopoulos and Khorasgani, 2018). This technique is not desirable in the context of SMEs because they easily lead to the exclusion of small businesses from having access to debt finance (Behr, Entzian and Güttler, 2011), especially SMEs in developing countries that are characterised by inability to provide robust information resulting in information asymmetry.

3.2 Role of Interest rate and determinants of Loan pricing

In a situation where banks cannot evaluate the risks in lending to small enterprises due to information asymmetry, and consequent problems of adverse selection and moral hazards, they adopt different strategies to protect themselves from the potential risk of failure which may result in credit rationing (Abor and Biekpe, 2006). Banks tend to adopt increased interest rates to reflect the associated risk in the lending. In SSA, local interest rates from banks are largely in double digits in the range of 20 – 25 percent in some SSA countries (Runde et al., 2021). In perspective, Krasniqi (2010) pointed out that when rates are increased, enterprises with lower tendencies to succeed would usually be willing to pay the increased interest rate thereby signalling high risks. On the other hand, when interest rates are increased by banks because of uncertainty surrounding the borrowing small enterprises, credit worthy borrowing small enterprises would consider the increased rates too high and would choose not to borrow even though they have viable projects.

This reflects the work of George Akerlof "Market for Lemons" which shows how information asymmetry can result in adverse selection and a situation where bad business drives out good business that now have to raise debt at the cost of the associated exaggerated risk. Akerlof's work adopted the market for used cars as an example of the problem of uncertainty. So, supposing that there are two types of cars: the peaches (good used cars) and

the lemons (defective used cars) but the buyer of a car does not know beforehand whether it is a peach or a lemon as a result of several not-always-traceable variables and other elements hidden from view as well as not easily accessible for inspection, the buyer's best guess for a given used car is that the car is of average quality; accordingly, he/she will be willing to offer only the price of a car of known average quality. Consequently, the owner of a carefully maintained, never-abused, good used car will be unable to get a complementary price offer to make selling his car worthwhile, the owners of good cars will therefore not place their cars in the market or would withdraw the sales of their good cars which will resultantly reduce the average quality of cars on the market causing buyers to revise downward their expectations of any given car whether good or bad because of perception of risk.

Therefore, the side effect of the cost of dishonesty in the market not only lies in the amount a buyer is cheated but also include the loss incurred from driving legitimate business out of existence. According to Akerlof (1970), when making business decision, there is an inherent difficulty in distinguishing between good and bad quality in an uncertain situation; therefore, considering that small enterprises are perceived to be highly risky, the level of risk associated to the riskiest small enterprise tends to be applied to all other small business which reflects in how the loans extended to them is priced. In sum, high interest rates usually deter SMEs from accessing finance in SSA.

3.3 The Role of Collateral in a Loan Contract

Collateral is also said to play an important role in the lending behaviour of many banks. In the face of information asymmetry, collateral enables banks to militate against the event of project failure by limiting the potentials of losses with the provided assets which can be used as substitute for the loan loss thereby shifting risk from lenders back to the borrower (Storey, 1994, p.210; Elsas and Krahnen, 2000; Manove, Padilla and Pagano, 2001). Although based on conventional wisdom, the request for collateral corresponds with how risky a loan or borrower is predicted, it is viewed as an instrument to lower risk exposure of a bank (Berger and Udell, 1990; Cowling and Westhead, 1996). Some models interpret collateral to be a signalling device which allows banks to militate against the problem of adverse selection common with financing debt under a situation of information asymmetry (Bester, 1985; Chan and Kanatas, 1985; Besanko and Thakor, 1987a, 1987b).

According to Bester (1985) and Besanko and Thakor (1987) cited in Elsas and Krahnen (2000), under a signalling model a negative correlation is predicted to exist between risk and collateral as high levels of collateral is generally linked to low risk borrowers as they offer large amounts of collateral to signal their quality why high risk borrowers prefer no collateral at all attached to their loans. This argument follows logic that a borrower that is low risk has more reasons to pledge collateral than a high-risk borrower because the borrower has a less likelihood of failure and loss of the pledged collateral than a high-risk borrower. The provision of collateral also helps prevent borrowers from behaving in an opportunistic manner because they have investment at stake which might be lost if the project fails, so it makes them commit to the success of the project (Abor & Biekpe, 2006; Storey 1994, p210).

Furthermore, the provision of something of value by the borrower in form of collateral serves as a signal to the bank that the small enterprise borrower believe the project would succeed (Abor and Biekpe, 2006). Other aspects of collateral existing studies have examined relates with how the request for collateral in a lending relationship depends on the length of relationship between lender and borrower. This is because rather than request for collateral to mitigate against the problems associated with information asymmetry, this may be resolved

through relationship lending where the lender through continuous contact with the borrower overtime will learn about the borrowers credit behaviour (Behr et al., 2011; Berger and Frame, 2007; Moro and Fink, 2013; Ferri *et al.*, 2019). The findings of Berger and Udell, (1995) analysis of the relationship between collateral and length of relationship imply decreasing collateral requirements where bank-borrower relationship has bought about information intensity. Therefore, the provision of the bank's required collateral helps banks to screen out high risks from low risk borrowers (Krasniqi, 2010). However, where the enterprises are characterised by a lack of collateral, the financing constraint that small enterprises encounter would still persist as is the case with SMEs in Sub Sahara Africa.

4. Discussion

From a theoretical point of view, this paper reaches three major findings. Firstly, we find that past experience of loan loss or uncertainty regarding debt are extended to SMEs because of information asymmetry make banks to be risk averse; this affects bank's willingness to grant credit to SMEs and in such situations where debt is extended, it is done employing various strategies to either cover for the risk perceived or to shift the risk to the borrower. This finding gives the idea of an appropriate credit assessment strategy in the absence of bank required information. This is because on one hand, the tendency to place greater attention to risk by banks has affected how a loan is assessed and the risk control measures put in place. While these risk control measures allow the avoidance of credit losses (i.e. Type 11 errors) similar to Dietsch and Petey (2002), Type 1 errors (i.e. a situation where credit worthy borrowers are denied credit) becomes difficult to overcome as the lenders are particular on risk reduction (Deakins and Hussain, 1994; Nilsson and Öhman, 2012). This strategy of mitigating or shifting risk currently adopted by banks eliminate Type 1 error, however Type 2 error is created where credit worthy borrowers would have been denied access to debt for their lack of collateral or information or acceptance of high loan pricing.

Secondly, regarding the characteristics of SMEs in developing countries, we find that the problem of information asymmetry is not necessarily because SMEs have refused to share information about their businesses or provide collateral as a signal of their low risk and credit worthiness, but the main issue is that SMEs in developing countries are very opaque in nature. As such, it is very common to find that these enterprises are unable to provide lending requirements imposed on them by banks and are essentially exempted from the possibility of accessing debt based on those requirements (Palazuelos, Herrero Crespo and Montoya Del Corte 2018; Bruns et al., 2008). Thirdly, banks do not have factual evidence of an assessment of risk of default in SMEs considering their opaque characteristics in SSA and they also do not have a basis for assuming a risk of default is inherent in the lending. Altman and Sabato (2013) maintain that from a credit risk perspective, risk is perceived to be higher in SMEs compared to larger enterprises. This has been partly attributed to the fact that the default prediction model developed for large enterprises when applied to SMEs shows a poorer performance resulting from the lower prediction power of the model. This is because SMEs have different characteristics from large enterprises.

Furthermore, the finding is consistent with a similar study by Uchida et al. (2008) where they investigated the importance of bank size and relationship in Japanese SMEs in relation to the availability of audited financial statements. Uchida et al. (2008) maintain that the identification of whether the relevant SMEs studied have audited financial statements would help determine whether an SME can receive loans from a bank whose lending technology is transaction/financial statement lending-based and also permit a more penetrating interpretation of the gap. While the work of Uchilda et al. (2008) examined SMEs of developed countries

who often can provide audited accounts. Our research, nevertheless, extends recent literature at the intersection of SMEs access to finance and entrepreneurship in SSA showing that most SMEs especially micro businesses do not have audited accounts and that banks (lenders) need creative approach to evaluate SMEs loan approval (cf. Runde, Savoy, and Staguhn, 2021; Moyo & Sibindi, 2022). Therefore, it is very important for banks to make accurate judgement and assessment of risks or probability of default in lending to SMEs. This is not just because of the losses that can result from underestimating risks when debt is extended to SMEs but also because of loss of opportunities and gains that may result from not extending credit to SMEs due to wrong risk assessment. Thus, the importance of an appropriate credit risk assessment for SMEs in SSA should not be underestimated.

4.1 Implication of Assessment Strategies on SME Access to Finance

If the financial intermediation role which involves channeling funds from the surplus sector to the deficit sector in the economy of every nation is successfully performed by banks, as noted by Oliyide (2012) it will be instrumental to SMEs discharging its roles in economic growth and development. However, bank's decision to grant loans to businesses and the determination of the interest rates is based on the evaluation of the business information to determine borrower's ability to repay (Cassar et al., 2015). Nonetheless, using the evidence of the assessment and eligibility criteria that banks adopt to review SMEs loans, this study in agreement with Lefilleur (2008, 2009) argued that banks are biased against SMEs, which results from the perceived risks associated with small firms which makes banks very overcautious in SMEs credit review and often reluctant to extend credit to them. Lefilleur (2009) further argued that the problems of information asymmetry and SMEs inability to provide required security is the reason risk in SMEs lending are overestimated.

The inability of SMEs that are informationally opaque to provide security for their loans result into: firstly, an increase in transaction cost derived from risk assessment and supervision; secondly, inaccurate and overestimated risk assessment by banks. These two factors make banks avoid extending credit to SMEs and in the event, they extend, it is at a very high interest rate (Lefilleur, 2009). In Sub-Saharan Africa, while there have been many models developed and adopted by practitioners for large enterprises to predict probability of default, none have been developed specifically for SMEs in developing countries putting into consideration its unique characteristics. We are not suggesting the need for a generalised or one size fits all approach to credit lending to SMEs. Instead, we are acknowledging that there are unique characteristics of SMEs in SSA that make them vulnerable in accessing finance from banks and call for redefining the problem. Our review also found that the SMEs ecosystem which affects SMEs in SSA countries differ substantially from that of developed countries and credit risk assessment should equally take this feature into consideration. In sum, our overarching claim is that there is no one size fits approach to SMEs access to finance in SSA but that each bank requires unique credit risk tool kits when dealing with the specific issue that each SME exhibits in SSA.

4.2 Alternative Strategies for SME credit Assessment

Although Erdogan (2018) argue that the lack of proper accounting records and reliable financial statements to reflect the financial situation of the small enterprise borrowers is a constraining factor limiting access to finance from banks, in a developing country situation where a lack of reliable information is an inherent characteristic of small enterprises. However, the assessment of an enterprise true financial position cannot be limited to statements provided by the enterprises. Furthermore, with the understanding that it is important for banks to quantitatively

analyze the financial condition of a borrower (Erdogan, 2018), we found that lenders can achieve same aim by adopting strategies to obtain additional reliable information that properly suits the borrower's characteristics in making informed lending decisions (Moro, Fink and Maresch, 2015). For example, since small enterprises primarily use short tenured loans to finance its operating capital, the bank can as an alternative to relying on accounting records or proper financial statements; assess the cash conversion cycle and inventory holding period of the borrowing small enterprise. The relationship between the borrowing enterprise trade receivables and payable collection and maturity period alongside the proposed loan application can be considered to ensure the enterprises does not encounter difficulty in the repayment of the loan.

Also, since credit track record is usually a criteria considered in assessing the risk of lending to a small enterprise borrower (Bruns and Fletcher, 2008) and with the understanding that most small enterprises in developing countries do not always have a formal credit track record to justify that credit worthiness, as an alternative, the bank can consider the borrowers indebtedness to its suppliers for example and assess whether the borrowing small enterprise have experienced difficulties in the repayment of its trade payables within specified periods. This also applies to longer term loans which are tailored towards investment and capital projects of the small enterprises adopting alternative mechanics to access the viability of the project and its repayment capabilities. On the contrary, to deal with this potential problem of default, banks have mostly concentrated on the Type 2 errors. They have developed measures to mitigate the chances of a loss and also attempted to shift risk from the banks to the borrowers (Bruns and Fletcher, 2008). This explains the use of formal guidelines and assessment criteria for credit decision making by banks. This adoption limits the influence of branch managers and relationship officers who have direct relationship with the borrower and who in the absence of formal information provision can informally signal and rate risk in the borrower. So, although the relationship officers and bank branch managers attempt to determine the repayment capabilities of the borrowing small enterprises and help to support the credit decision process, the explicit assessment criteria set by the bank are the essential factors that sum up risk in the credit decision process.

5. Conclusion

This paper is an additional step forward in research into the role perceived risks plays in lending relationship of SMEs. It shows that it is very important for banks to make accurate judgement and assessment of risks or probability of default in lending in lending to SMEs, not just because of the losses that can result from under estimating risks when debt is extended to credit unworthy borrowers but also because of losses of opportunities and gains that may result from not extending credit to worthy borrowers for wrong risk assessment reasons; hence the importance of an appropriate credit risk assessment for small and medium enterprises in developing countries should not be underestimated. Therefore, an understanding of the peculiar characteristics of a small enterprise in an ecosystem is beneficial in helping to design a risk assessment theoretical framework to address the problem of limited access to debt finance of small enterprise in developing countries. More so, our suggestion will entail more bank involvement and less algorithmic decision-making in credit risk assessment of SMEs. The study suggests that bank's risk adverse policy to supply loans to small businesses, which results from the highly perceived risky nature of small enterprises, is responsible for the financial constraints confronting small businesses. This research therefore concludes that the risk assessment and management strategies adopted by banks considering the peculiarity of SMEs in developing business environment impact the supply of credit and therefore merit particular attention.

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