An Exploratory Study On Bank Lending To SME Sector In Bhutan

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Abstract : This study examines the factors used by the banks to determine the outcome of loan applications of Small and Medium Enterprises (SMEs) in Bhutan. Inaccessibility to financing is one of the biggest challenges faced by the Bhutanese SMEs. This exploratory study is built on in-depth interview of 6 credit officials to understand the lending behaviour of banks towards SMEs. Thematic Analysis revealed that the bank loan accessibility was a function of firm and owner characteristics. The collateral and internal finance was found to be vital in determining SME's accessibility to bank loans. SMEs' inadequate financial information was a serious problem for the banks. Firm age, size and industry sector had a positive correlation with bank loan accessibility. The age and educational qualification of borrowers were also found to have a positive relationship while the gender of the owner did not have any effect on bank loan accessibility.

Index Terms: SME, Bank Loans, Bhutan, Collateral, Internal Finance

1 INTRODUCTION

The Bhutanese economy is dominated by Small Medium Enterprises (SMEs) inclusive of micro enterprises and family owned firms representing a developing economy (MoEA & ADB, 2012). Bhutanese SMEs plays a crucial role not only in economic growth but also social development through employment generation, poverty reduction and balanced regional development. SMEs in Bhutan are categorized based on the initial cost of investment and number of employees (Table1). The financial market in Bhutan is represented by small banking system made up of five banks and three non-bank financial institutions and the Royal Monetary Authority (RMA), the central bank of Bhutan (RMA, 2015). Due to Bhutan's small and underdeveloped financial market, equity finance and venture capital are less prevalent and thus, the banks remain the dominant source of financing for the Bhutanese SME sector (MoEA & ADB, 2011).

Table 1: *Classification of Bhutanese SMEs*

Firm Size	Employment Size	Investment Size
Large	100+	> Nu. 100 million
Medium	20 – 99	Nu.10 100 million
Small	5 – 19	Nu. 1 – 10 million
Cottage/Micro	1 – 4	< Nu. 1 million

Source: MoEA, 2012

Despite, SME sector being recognised as a poverty alleviation tool, SMEs are financially constrained, hampering their growth and development (Berger & Udell, 2006; Shinozaki, 2014). According to SME's financial growth cycle, inaccessibility to finance in its initial growth stage resulted in the failure of the business and developmental stagnation in the later stages.

SMEs face difficulties in accessing financing from the banks, particularly in developing countries like Bhutan. SMEs in Bhutan start on a small scale and remain small throughout due to lack of finance to grow (MoEA & ADB, 2011). The banks are involved in stable and large commercial transactions and bias towards SME sector due to high risk and cost involved in SME financing.

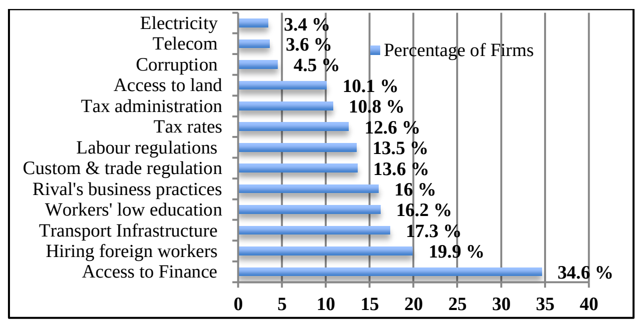

Fig 1: *Major Constraints faced by Bhutanese SMEs*

Source: MoEA & ADB, 2011

In a survey carried out by Ministry of Economic Affairs (MoEA), Bhutan with Asian Development Bank (ADB) on cottage and small industries in Bhutan in 2011, 34.6% firms rated 'access to finance' as the biggest obstacle in comparison to other 12 pre-identified factors, depicted in Figure 1 (MoEA & ADB 2011). Likewise, World Bank (2017) ranked Bhutan 73 out of 190 countries on 'Ease of doing business (SMEs)' and 82 in the sub-area of 'Getting credit to do a business'. The ranking indicates the existence of a higher degree of financing obstacles faced by SMEs operating in an underdeveloped capital and financial market. Furthermore, inaccessibility to finance is more prominent in rural region as indicated by the low penetration financial sector in rural areas of only 5.50% (RMA, 2016). Hence, the key research question of this study is:

1) What are the factors used by the banks in Bhutan to assess and screen SME borrowers?

2 LITERATURE REVIEW

SMEs contribute immensely to the socio-economic development of a country by through job creation, innovation and a wider distribution of wealth and business opportunities

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(Beck, Demirguc-Kunt, & Martinez-Peria, 2008). SMEs contribute more towards employment generation than larger firms due to its labour intensive nature (De Wit & De Kok, 2014). Likewise, Beck, Demirguc-Kunt and Levine (2005) empirically established a positive relationship between SMEs' employment generation and poverty reduction and economic growth. SMEs are therefore, undoubtedly the tool to resolve social issues like unemployment and poverty in developing countries such as Bhutan.

2.1 Theoretical Context

SME financing literature is founded on the theories of Pecking Order of Hierarchy (Myers, 1984), Information Asymmetry (Stiglitz & Weiss, 1981), and Agency Theory (Jensen & Meckling, 1976). The Pecking Order of Hierarchy (PoH) describes a firm's preference for internal finance over external debt based on the cost and accessibility, defining its capital structure (Berger & Udell, 2006; Bahird & Lucey, 2010). Hall, Hutchinson and Michaelas (2004) found that debt proportion was low in SMEs due to their preference for internally available funds. This SME financing preference is linked to limited funding options and difficulty in accessing external financing. SMEs exhibit significantly higher levels of asymmetric information than larger firms deterring external borrowing (Caneghem & Campenhout, 2012; Liu, Margaritis, & Tourani-Rad, 2011). Irwin and Scott (2010) informed that since SMEs are not listed companies and under no obligation for public disclosure, little is known about their financial reporting practices. SMEs inadequate financial information and lack of credit history translated into high risk for finance providers (Allee & Yohn, 2009; Altman, Sabato, & Wilson, 2010). SMEs' information asymmetry is extended into the principal-agent issues of adverse selection, credit rationing and moral hazard. The SMEs (agent) are required to generate return on the loan advanced, which might not meet the expectations of the banks (principal) causing agency issue. The banks adopt adverse selection, making a conscious and calculated decision of not lending to certain borrowers to mitigate the risk caused by information asymmetry (Hyytinen & Vaananen, 2006; Shen & Reuer, 2005). The banks also impose credit limits of smaller loan amounts than required by SMEs either at same or higher interest rates as an integral part of SME credit risk management (Kundid & Ercegovac, 2011; Steijvers, Voordeckers, & Vanhoof, 2010). There is high risk of SMEs diverting bank loans into riskier projects, giving rise to the problem of moral hazard. The issue of moral hazard is associated with the borrower's hidden action, undertaking of high-risk ventures, after a successful loan transaction, while concealing such behaviour from the lenders (St-Pierre & Bahri, 2011).

2.2 Gap in SME Bank Financing

The financial institutions are exposed to high risk caused by SMEs obscure accounting systems and financial opaqueness (Brent & Addo, 2012; Uchida, 2011). The banks consider SMEs not investment ready and hence a high-risk investment due to its inadequate financial information to base their investment decisions on. Okura (2008) argued that SMEs' small firm and loan size hindered financial institutions from achieving economies of scale. The transaction cost for SME loans are costlier than for larger firms because the small size of loans to SMEs increases the average cost incurred by the banks in allocating loans to them, thereby increasing cost per unit (Beck et al., 2008). The degree of credit risk associated with SMEs influences the willingness of the banks to extend credit to the firms (Kundid & Ercegovac, 2011; Steijvers et al., 2010). Therefore, banks adopted stringent lending terms and conditions, such as high collateral and interest (Holmes et al., 2003). Collateralization is a prominent risk management strategy adopted by the banks while lending to SME to address its high information opacity (Steijvers et al., 2010; Uchida, 2011). Hall, et al. (2004) reported that collateral induced positive moral hazard behaviour in SMEs lowering the loan default risk. On the other hand, the stringent lending strategies adopted by the banks made it difficult to access bank loans, increasing cost of borrowing (Beck et al., 2008; Canales & Nanda, 2012). Hence, there is a gap between SMEs' financing needs and the provision of external finance.

2.3 SME Financing Factors

A strong association has been observed between factors endogenous to SMEs (firm and owner characteristics) and it accessibility to external financing. Factors used by the banks to evaluate loan applications are strongly related to the 5 Cs of Credit Criteria - character, capital, capacity, condition and collateral (Altman et al., 2008; Canales & Nanda, 2012).

Firm Characteristics

The debt proportion is determined by firm characteristics, where larger and older firms have a better accessibility to debt (Kira & He, 2012; Holmes et al., 2003). Smaller and younger firms with higher information opacity lack of credit history and tangible assets are associated with higher risk and face more difficulty in accessing external finance (Brent & Addo, 2012; Okura, 2008). Due to difficult borrowing conditions, young firms are more dependent on internal finance and less on external financing (Mateev, Poutziouris, & Ivanov, 2013). A firm's financial status in terms of liquidity, profitability and assets influenced accessibility to external financing (Caneghem & Campenhout, 2012). As a firm grows and garners credit reputation based on its performance, there is reduction in information asymmetry, adverse selection and credit rationing, easing access to external financing (Mateev et al., 2013). Similarly, Irwin and Scott (2010) associated older and larger firms with information transparency and retained earnings, resulting in higher financial credibility and easier loan accessibility. A firm with more tangible assets created higher value for the firm and was subjected to lower level of adverse selection and credit rationing by the lenders. Debt accessibility was also influenced by firm sector (industries) and its level of competition and profitability in the market (Degryse, de Goeij, & Kappert, 2012). Firms belonging industries with highest asset structure and value had highest debt levels owing to easy access to external funds (Johnsen & McMahon, 2005).

Owner's Characteristics

The owner, who is also the manager of the SMEs, is responsible for all business operations and thus plays a dominant role in determining the firm's path of growth, including its financing (Holmes et al., 2003). A positive association of owner's age to the firm's financial credibility, thereby positively influencing financial accessibility has been indicated (Coleman, 2000; Neeley & Auken, 2009). The bank's confidence was higher in older SME owners and more likely to gain bank loans in comparison to younger ones.

Higher educational qualification was associated with the capacity to understand the loan repayment terms and conditions, thereby increasing the probability of successfully availing bank loans (Neeley & Auken, 2009). Literature strongly upholds the existence of gender disparity in SME lending, where female owners were more credit constrained than male owners (Bellucci, Borisov, & Zazzaro, 2010; Storey, 2004). Carter, Shaw, Lam and Wilson (2007) concluded that female entrepreneurs were less likely to get bank financing compelling them to rely more on internal finance. Moreover, female owners who were successful in getting external finance were charged higher interest rates by the banks (Muravyev, Talavera, & Schafer, 2009). Many studies have indicated that men received higher loan amount to invest in the business than their female counterparts.

3 RESEARCH METHODOLOGY

Qualitative method was employed to gain an in depth understanding of the research issue. The qualitative research generates a comprehensive in depth description of collected data by establishing relationships among different categories within the data (Creswell, 2013). The data was collected through semi-structured interviews of six credit officers, identified through purposive sampling (Punch, 2014), each representing a bank in Bhutan. The credit officers worked directly with loan appraisal process and their work experience ranging from 3 to 17 years generated the required information for data analysis. The open-ended questions allowed the researcher to probe and control the line of questions, while also giving enough scope to the respondents to share their opinions on the issue, upholding the validity and reliability of the interview. Qualitative software QSR NVivo 10 was used for sorting, storing and retrieval of the transcribed interview data. Thematic analysis enabled the interview data to be analysed in terms themes identified from the interview data. The principle of thematic analysis lies in identifying patterns (themes) in the data and then analysing and reporting the findings (Creswell, 2013). Underlying themes within the interview data were identified and interpreted through critical review of the themes. The comments were interpreted using cross-case analysis, enabling comparison of each respondent's view on the identified themes.

4 FINDINGS AND DISCUSSIONS

The interview revealed that none of the banks had separate SME departments, different from the World Bank findings, which reported existence of separate departments catering to the SME sector (Beck et al., 2008). The absence of SME credit units reflects a gap between the SME financing needs and the existing loan products offered by the banks; reinforcing financing difficulties faced by SMEs in Bhutan. Five themes emerged from the interviews with credit officers: loan repayment capacity; financial information; loan characteristics; firms' characteristics and owner's characteristics. The discussion explores these factors as eligibility criteria used by the banks to SME loan applications.

4.1 Loan Repayment Capacity

For this study, the loan repayment capacity of SMEs is measured in terms of the size internal finance and the size of the collateral (Steijvers et al., 2010).

4.1.1 Internal Finance

The interview revealed that owner's equity was a mandatory requirement for SMEs to avail bank loans. A certain percentage of the total project cost had to be injected by the owner to be eligible for bank loans as reflected in the following statements made by the respondents:

'…as for owner's equity contribution of the owner, they have to by any means make some sort of equity contribution because we do not finance total project cost'. (R1).

'…we want the borrower to be serious enough to realize that at least some portion of his equity has also been ploughed in and if his business performs badly then he is also going to lose on his equity share'. (R4)

The required percentage of owner's equity ranged from 25% to 50% as reported by credit officers:

'...we prefer 50:50 ratio between owner's equity and loan amount approved by bank'. (R6).

'…minimum of 25% of project cost must come from owners, and 75% is sponsored by the bank'. (R1).

4.1.2 Collateral

Collateral was precondition imposed by all banks on SMEs to be eligible for bank loans. It was required to recover the loan amount in event of loan default and bankruptcy. The respondents stated:

'…collateral will cover our losses in case a borrower fails to repay the loan…that's why collateral keeps banks on safer side'. (R6)

'…in a case where the project is viable but does not have enough collateral, we have to reject the proposal'. (R5)

The banks preferred fixed assets (land and buildings) to business assets (machinery and equipment). Owing to the smallness of SMEs, the value of business assets was low, which was not enough to offset the risk of SME loans and recover its investments. The credit officials stated:

'…land, building and vehicle are the most common collateral used, which are all personal assets…we don't finance against business assets'. (R2)

The collateral required was a minimum of 1.5 times and a maximum value of 2 times the size of the loan amount. The collateral value provided bank with indemnity to offset the SME loan default risk, as specified in the following statements:

'…the value of collateral should be at least two times or sometimes three times the loan amount'. (R5)

4.1.3 Loan Repayment Capacity Discussion

Table 2: *Influence of SMEs' Repayment Capacity on Loan Accessibility*

Interview Respondent (R)	Theme: Influence of SMEs' Loan Repayment Capacity on Loan Accessibility	
	Collateral	Internal Finance
R1	Collateral value required - 1.5 times the loan amount.	Minimum 25% owner's equity is required.
R2	Collateral value required - 2 times the loan amount.	Minimum 40% owner's equity is required.
R3	Collateral value required - 2 times the loan amount.	Certain percentage owner's equity required.
	Collateral value required -	Certain percentage

R4	half of the loan amount.	owner's equity required.
R5	Collateral value required - 2 times the loan amount.	Certain percentage owner equity required.
R6	Collateral value required - 2 times the loan amount.	Minimum 50% owner's equity is required.

The data analysis revealed that a firm's repayment capacity represented by collateral and internal finance was vital in determining SME's accessibility to bank loans. Higher the value of collateral and internal finance, higher was the chance to secure bank loans. Collateral and owner's equity minimised the risk associated with SMEs information asymmetry. The equity and collateral were equated to owner's commitment and motivation inducing positive moral hazard behaviour in SMEs as reported in literature (Behr, Norden, & Noth, 2013). SMEs' financial stake in the business increased the confidence level of banks in financing SMEs. As a part of risk management strategy, banks preferred to use tangible fixed assets, like land and real estate due to their high value in the market (Bhaird & Lucey, 2010). The value of collateral was also important for the banks where it had to a minimum of two times the loan amount. SMEs with fewer assets are faced with more difficulties in securing loans from the banks. Thus, a positive relationship between the size of internal finance and collateral and access to bank loans was established.

4.2 Financial Information

All respondents agreed that a firm with higher quality and quantity of information had better chances of accessing bank loans in comparison to ones without any information to share with the banks. The following statements affirming the importance of the financial information in SME loan decisions:
'…firms should maintain good financial records and come up with good project report with sound financial projections'. (R2)
'…if they have been performing well over the years with proof of financial statement, the banks considers such cases'. (R5)

However, the interview revealed SME business proposals and financial information were unreliable. It was also established that Bhutanese SMEs had low financial literacy including basic book keeping. The credit officers stated:
'…it is rare that SMEs come up with true financial projections'. (R3)
'…SME clients do not maintain any kind of financial information'. (R2)

4.2.1 Financial Information Discussion

Table 3: *Influence of SMEs' Financial Information on Loan Accessibility*

Interview Respondent (R)	Theme: Influence of SME financial Information on Loan Accessibility	
	Financial Information	SMEs' Financial Management
R1	Information has positive effect on loan approval.	Low financial literacy amongst Bhutanese SMEs.
R2	Information has positive effect on loan approval.	Low financial literacy amongst Bhutanese SMEs.
R3	Information has positive effect on loan approval.	Low financial literacy amongst Bhutanese SMEs.
R4	Information has positive effect on loan approval.	Low financial literacy amongst Bhutanese SMEs.
R5	Information has positive effect on loan approval.	Low financial literacy amongst Bhutanese SMEs.
R6	Information has positive effect on loan approval.	Low financial literacy amongst Bhutanese SMEs.

The analysis supported a positive relationship between SME's information level and its accessibility to banks loans, consistent with the literature (Moro, Fink, & Kautonen, 2014). However, the credit officers reported that the financial literacy within the Bhutanese SME sector was very low. The SMEs lacked reliable financial information that was required for evaluation of the businesses' financial prospects. The inadequacy of financial information hindered SMEs' chances of accessing debt from the banks, consistent with the Information Asymmetry theory (Allee & Yohn, 2009). The findings affirmed that banks consider SMEs not ready for formal debt financing due to inadequate financial information management. In the absence of financial information, the banks resorted to asset based lending mechanisms to assess SMEs' financial credibility (Caneghem & Campenhout, 2012). When the information is reliable and tangible, the banks are able to determine the credit worthiness of the firm and its capacity to repay the loan amount.

4.3 Loan Characteristics

Loan interest rate and loan term were identified as factors that determined the SME loan accessibility (Uchida, 2011).

4.3.1 Loan Interest

All the respondents stated that SME loan approval was not influenced by the loan interest rate, differing from the literature. The base interest rate was set in accordance to the RMA regulations, upon which the banks built interest rates for different loan products. The banks could not charge higher interest rate even if the borrower was willing to pay higher interest rate. The following statements from credit officers emphasize the central bank's role in determining the loan interest, rather than the banks:
'…interest rate is uniform and we do not charge different rates to different clients. We have to follow terms and conditions circulated by RMA regarding setting interest rates'. (R2)
'…there are different loan schemes. If construction scheme interest rate is 13%, we cannot charge 16% interest rate even if the applicants are willing'. (R5)
'…based on RMA base interest rate, each bank charges interest rate according to their own policies. There might be difference of about 1 to 1.5 % on same loan products between different banks'. (R1)

4.3.2 Loan Term

The analysis revealed that the SME loan approval was not determined by the loan term differing from the literature. The loan term for each loan products was predetermined and fixed for each loan schemes. The following statements highlights irrelevance of loan term on loan accessibility
'…we carry out appraisal of the project; we are not concerned with loan term'. (R1).
'…If the borrowers have enough source of income after availing loan, they can even clear loans with all interest earlier than term period'. (R1)

Nonetheless, some respondents hinted their preference for short-term loans to long-term loans, based on their organizations' liquidity gap, as indicated in following statements:
'…we prefer short-term to long-term loans but there is no hard and fast restriction levied by our loan committee'. (R2)
'…loans are based on our deposit portfolio. Large money is usually deposited with banks for shorter term. So, shorter-term loans are preferred to offset our asset and liability gap'. (R4)

4.3.3 Loan Characteristics Discussion

Table 4: *Influence of Loan Characteristics on Loan Accessibility*

Interview Respondent (R)	Theme: Influence of Loan Characteristics on Loan Accessibility	
	Loan Interest Rate	**Loan Term**
R1	Interest rate not determining factor.	Loan term not determining factor
R2	Interest rate not determining factor.	Not important but prefer long-term loans.
R3	Interest rate not determining factor.	Not important but prefer long-term loans.
R4	Interest rate not determining factor.	Not important but prefer long-term loans.
R5	Interest rate not determining factor.	Loan term not determining factor
R6	Interest rate not determining factor.	Loan term not determining factor

The study findings were in contradiction to the literature supporting financial institutions levying higher interest rates and shorter loan terms to minimise the SME credit risk (Berger & Udell, 2006; Ma et al., 2013). Beck et al. (2008) inferred that due to the high prevalence of non-performing loans in the SME sector in comparison to larger firms, the banks charged SMEs higher fees and interest rates to mitigate the risk of SME lending. Empirical studies showed banks favouring loan applicants seeking short-term over long-term loans (Mudd, 2013; St-Pierre & Bahri, 2011). However, the accessibility to bank loans was influenced neither by interest rates or loan duration in case of Bhutan. The interest rate and loan term was uniform for each type of loan product and regulated by the central bank. Nonetheless, the credit officers hinted their preference for short-term loans and higher interest rates for its cost effectiveness and return in investment. However, in case of Bhutan, the SME loan accessibility was not function of loan characteristics.

4.4 Firm Characteristics

The endogenous factors of the firms (age, size and sector) were taken into consideration during the loan appraisal process, influencing the final outcome of the loan application.

4.4.1 Firm Age

Majority respondents (83.33%) said that they financed both young and established firms, but indicated a preference for older firms based on banks' bad experience in SME loan repayment. Only one respondent was absolute in stating that his bank financed only established firms and did not finance start-up businesses due to the high risk, no financial history, inadequate collateral and unpredictable performance.

'…we lend to both new start-up businesses and established businesses….obviously, all the banks would prefer already established businesses that are doing well'. (R4)

The new and younger firms were required to provide collateral to offset the risk associated with SME lending. The following statements explain the basis for lending to new and younger firms:
'…firm age is important to get business loan from the banks. Yes, we do finance new firms but they have to provide the bank with collateral security by any means. That is the first criteria'. (R3)
'…they also have option of providing with a good guarantor, who has taken loan from our banks and with good repayment. The banks will check if the guarantor has enough collateral and security'. (R5)

4.4.2 Firm Size

Four respondents (66.67%) stated that firm size was not a factor considered during the loan appraisal process but had to be backed by sufficient collateral. Though these respondents said that the firm size was not a determining factor for financing SMEs, an inclination towards bigger firms within the SME sector was indicated during the course of the interview. One of the respondents said,
'...depending on the viability of the businesses, we take up all, small, micro, medium irrespective of the size'. (R4).

The remaining two respondents (33.33%) stated that the size of the firm played a critical role in the outcome of SME loan applications. The bigger firms were associated with higher return on their investment as reflected in following statements:
'…bigger firm take bigger loan and is more beneficial to the banks'. (R6)
'…It is cost effective for banks to give loan to one big firm than to 10 smaller firms and generate more income'. (R5)

4.4.3 Firm Sector

66.6% of respondents reported that their SME loan approval decision was influenced by the sector of the firm. The manufacturing sector was preferred to the retail and service sectors because of it investment size and the possibility of generating bigger returns. One respondent said:
'…in the case of manufacturing, they have already invested huge amount, they will try their best to perform well and generate more profit'. (R5)

On the other hand, Bhutanese market is saturated with retail units characterized by high competition and lower returns for the banks. Hence, the banks are cautious about lending to the retail sector:
'…we do not like to lend to retail businesses because a retail firm would be competing with already established business houses and will face more problems than making profit'. (R4)
The remaining two respondents (33.3%) said loan was given to all sectors as long as it was backed by collateral: '…*as long* as the project proposal is good; we support financing of all sectors. It also has to be backed by collateral'. (R1)

4.4.4 Firm Characteristics Discussion

Table 5: *Influence of SME Characteristics on Loan Accessibility*

Interview Respondent (R)	Theme: Influence of Firm Characteristics on Loan Accessibility		
	Firm Age	Firm Size	Firm Sector
R1	Finance all ages of firms.	Finance all firm sizes.	Finance all firm sectors
R2	Finance only established firms.	Finance all but prefers bigger firms.	Finance only retail sector.
R3	Finance all but prefers older firms.	Finance all but prefers bigger firms.	Prefer manufacturing sector.
R4	Finance all but prefers older firms.	Finance all but prefers bigger firms.	Prefer manufacturing sector.
R5	Finance all but prefers older firms.	Firm size is important.	Prefer manufacturing.
R6	Finance all but prefers older firms.	Firm size is important.	Finance all firm sectors

The data analysis established that the age, size and sector of the firm determined SME's accessibility to bank loans. It was easier for larger and older firms to access bank loans compared to smaller and younger counterparts, in line with prior studies (Caneghem & Campenhout, 2012). Firm's age and size is associated financial history and serves as a proxy for firm reputation and firm risk. Larger firms are associated with more assets and increased loan repayment capacity, the banks prefer to lend to bigger firms within SME sector (Brent & Addo, 2012; Mateev et al., 2013). The bank's concern in lending to smaller and younger firms was high transaction cost and their ability to recover their investments. The firm's sector might indirectly translate into its business risk based on the market status, and thus influence debt accessibility (Degryse et al., 2012; Kira & He, 2012). The findings revealed that firm sector was one of the factors for loan approval, with banks inclined towards manufacturing sector. A firm's loan accessibility is influenced by sector risk and sector returns.

4.5 Owner Characteristics

The owner's characteristics (age, gender and educational qualification) were factors that influenced the outcome of SME loan applications.

4.5.1 Owner's Age

83.33% respondents voiced their strong preference for older loan applicants because of their association with maturity and responsibility towards loan repayment. The banks had more confidence in older borrowers to make timely loan repayments:

'… we make sure that the borrower is old and wise enough to understand the loan transaction and loan repayment. Therefore, we do prefer older borrowers over younger ones'. (R5)

'…the bank prefers to finance older applicants with good track record. They are more responsible and they have tendency to pay off the loans as fast as they can'. (R3)

Only one respondent considered age as a secondary factor since the loan approval was based on the business feasibility and financial projections:

'…we just investigate their project, how is their cash flow, income flow and financial information…for example, if a person who is 19 comes with a promising project, we don't hesitate giving loan for the business'. (R1)

4.5.2 Owner's Gender

All the respondents agreed that they did not differentiate between male and female borrowers, attributing it to Bhutan's cultural setting and gender equality in the Bhutanese society. Stressing on the irrelevance of gender during loan appraisal, respondents stated:

'...there is no differentiation between male and female borrowers. This could be because of our overall perception that anything a man can do; a woman can do that as well'. (R2)

'…the loan appraisal process does not take into account gender. This could be because of our social background…we as a society think that man and woman are equal in every field'. (R1)

The respondents rather preferred female borrowers to their male counterparts based on their business performance and loan repayment history as reflected in following statements:

'…we have in fact realised that in many cases woman are better in doing business'. (R4)

'...in Bhutan women are performing well. They are smart, confident, forward looking'. (R5)

4.5.3 Owner's Educational Qualification

66.67% respondents emphasized the importance of educational qualification in the SME loan appraisal process. Higher qualification was equated to knowledge and capacity of owners to manage the business operations as reflected in the following statements:

'…we look at educational qualification because we want the entrepreneurs to be at least able to maintain their own books of account'. (R4)

'…we have a minimum criterion for educational qualification, at least they should be class 8 passed and above'. (R4)

The remaining two respondents (33.33%) considered educational qualification irrelevant, since most of the people in the SME sector seeking bank loans are not highly qualified:

'…we don't differentiate between people based on their educational qualification. Almost 70-80% of our clients are rural population and uneducated'. (R1)

4.5.4 Owner Characteristics Discussion

Table 6: *Influence of SME Owner Characteristics on Loan Accessibility*

Interview Respondent	Theme: Influence of Owner Characteristics on Loan Accessibility		
	Owner's Age	Owner's Gender	Owner's Education
R1	Owner's Age is irrelevant.	Gender is irrelevant.	Qualification is not important.
R2	Finance Older applicants.	Gender is irrelevant.	Qualification is not important.
R3	Finance Older applicants.	Gender is irrelevant.	Qualification is important factor.

R4	Finance Older applicants.	Gender is irrelevant.	Qualification is important factor.
R5	Finance Older applicants.	Gender is irrelevant.	Qualification is important factor.
R6	Finance Older applicants.	Gender is irrelevant.	Qualification is important factor.

The owner's age was found to positively influence SMEs' debt accessibility consistent with the prior studies (Kira & He, 2012; Neeley & Auken, 2009). Owner's age is directly associated with an established track record and reputation, in particular an ability to meet their financial obligations. Older applicant's maturity increased the bank's confidence to lend to SMEs. Likewise, the educational qualification of SME owners also had positive effect on bank loan accessibility, as predicted by the literature (Holmes et al., 2003; Neeley & Auken, 2009). Higher the educational qualification of a borrower, the higher was their ability to gain access to bank loans. The educational level of SME owners adds value and credibility to the firm. The gender of the loan applicant did not play role in bank loan accessibility, in total contradiction to past studies where gender was identified as one of the key factors that determined the SME's accessibility to external financing (Coleman, 2000; Storey, 2004). Studies have reported that female owners were more credit constrained than male counterparts (Carer et al., 2007). However, there was no gender discrimination in SMEs' accessibility to bank financing in Bhutan, unlike in other developing countries. The finding is socio-economically important as it reveals the equal position of women with men in Bhutanese society in accessing bank loans. Bhutan's cultural context plays an important role in defining the relationship between gender and financial accessibility.

5 CONCLUSION

Table 7: *Summary of Effect of Factors on SME Loan Applications*

Factors (Themes)	Effect of Factors on SME Loan Applications					
	R 1	R 2	R 3	R 4	R 5	R 6
Internal Finance	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Collateral	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Financial Information	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Loan Interest	*No*	*No*	*No*	*No*	*No*	*No*
Loan Term	*No*	*Yes*	*Yes*	*Yes*	*No*	*No*
Firm Size	*No*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Firm Age	*No*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Firm Sector	*No*	*Yes*	*Yes*	*Yes*	*Yes*	*No*
Owner Age	*No*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Owner Gender	*No*	*No*	*No*	*No*	*No*	*No*
Owner Education	*No*	*No*	*Yes*	*Yes*	*Yes*	*Yes*

The key finding of the study was requirement of collateral and internal finance to be eligible for bank loans, limiting the flow of credit to the SMEs. Bank loan accessibility was found to be a function of firm and owner characteristics and loan characteristics: smaller and younger firms faced more difficulties in gaining bank loans in comparison to their larger and older counterparts. Industry sector had a moderate effect on accessibility to bank loans while the age and educational qualification of borrowers was found to have a positive relationship to debt accessibility. The gender of the owner did not have a substantial effect on a firm's debt accessibility. This study on bank's lending behaviour towards SMEs holds both theoretical and practical implications.

6 IMPLICATIONS AND LIMITATIONS

Theoretical Contribution

Most of the studies on SME financing constraints based in industrialized and matured economies may not be applicable to developing countries like Bhutan. There are fewer academic works available in reference to developing economies like Bhutan creating a gap of knowledge. The information available on the Bhutanese SME sector is limited to government reports focused on the general constraints of the SME sector and not specifically on SME financing constraints. To the knowledge of the researcher, this is the first explorative academic study providing theoretical insights to SMEs' accessibility to bank loans. Therefore, the study expands on the existing literature on SME financing constraints in developing countries like Bhutan.

Practical Implications

This study exploring the factors influencing SMEs' loan approval from the banks bears a huge practical significance. Understanding the factors used by the banks in assessing SMEs will be beneficial in developing remedial action at policy level to influence a positive outcome of SME loan applications. The emphasis of banks in Bhutan on collateral and owner's equity as prerequisite condition of lending seems to be out of line with international practice, which places greater weightage on the financial assessment and credit history of the business. It limits the flow of credit to SMEs and also penalizes the banks in missing out on a profitable SME lending. An independent review of the SME lending practice of the banks is recommended, with the view to introduce change to these practices to facilitate sustainable access to bank loans. Since the banks did not have SME credit units and financial products suited to the needs of the SME sector, banks need to establish SME focused department and expand into innovative SME financial products to take advantage of the large SME market.

Limitation

The study maybe limited by the small sample size and the level of statistical analysis, without undermining the contribution of the research outcomes.

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