

**YANGON UNIVERSITY OF ECONOMICS
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**THE ROLE OF TRUST IN BANKs-SMEs
RELATIONSHIP IN MYANMAR**

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THE ROLE OF TRUST IN BANKs-SMEs RELATIONSHIP IN MYANMAR

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ABSTRACT

The purpose of the study is to explore and how to analyze the role of trust in banks and SMEs in Myanmar. The qualitative research approach is gathered the deep understanding about the situation of banks and SMEs and constructive trust building. The research was analyzed by qualitative method through the interview process in two entities of banks and SMEs. The participants are SMEs from Yangon and Mandalay regions and SME bankers from SME banking industry who are managerial level and above. Semi-structured style of interview questionnaires was conducted during the interview time. Moreover, the empirical analysis was used to find out the research purpose. The purpose of the result sought to understand if the trust were deep in between two entities, can support the decision on loan approval although the applicants are SMEs which are having information asymmetry for the banks are happened to hesitate to give loans because of the possibilities of default. This study reveals the nature of banks and SMEs as well as the business. This study will contribute to the further study in SME industry leads to be more flexible on banks restricted on loan process and decision making. As per the study result, there is already existed the trust between banks and SMEs and they are applying that advantage for their business and other bank's services and products.

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LIST OF ABBREVIATIONS

SMEs	Small and Medium Enterprise
MIS	Management Information System
GDP	Gross Domestic Products
FI	Financial Institution
PRC	People Republic of China
US	United States
M&A	Merger and Acquisition
IFC	International Finance Corporation
TSL	Two Step Loan
JICA	Japan International Cooperation Agency
IMF	International Monetary Fund
MMK	Myanmar Kyat
USD	US Dollar
PFI	Participating Financial Institutions
KYC	Know Your Customer

CHAPTER 1

INTRODUCTION

Small and Medium Enterprises (SMEs) firms play an increasingly important role in a country's economy. The well situation of SMEs is a necessity for a country's future success. SMEs play an essential role in the economic development of South-east Asian countries as per the key role in the development of national economies in both developed and emerging economies (Ackah & Vuvor, 2011). The SME sector is the main driving force behind job creation, poverty reduction, wealth creation, income distribution and reduction in income disparities in a country (Ifeakachukwu & Olasunkanmi, 2013). SMEs create employment opportunities complementing the public sector (Mutuku, 2010).

SME banking is an industry in transition. From a market that was considered too difficult to serve, it has now become a strategic target of banks worldwide. The "*issuing middle*," describing the gap in financial services provided to SMEs. More and more banks are developing strategies and creating SME units in the emerging markets. To effectively serve SMEs, banks have had to change the way they do business, and manage risk and credit assessments. Banks have begun to understand that SME banking more and more and prioritizing unsecured loan based on cash flow analysis products to emerge the customer value. In order to expend bank business in SMEs lending, banks need to develop the capacity to predict risk without completely reliable financial information, by using tools such as credit bureau, credit scoring and monitoring & evaluation on non-financial information, has enabled banks to more effective screening on their potential clients.

Fair access to credit procedures and regulations for the banking services are a ladder to development and poverty reduction world over. Access to a bank account gives an individual greater control and security over their money, and a loan from a credit organization can be vital in promoting enterprise development (Kauffmann, 2010). Banks need to address the needs of these SMEs for them to expand their business forward being a major driver in the growth of the economy. Most commercial banks have been hesitant in credit lending to SMEs due to lack of collateral, credit history, financial statements and banking history. In additional reason is lack of

adequate access to credit because SMEs have little access to finance, which thus prohibit their emergence and eventual growth. This has not been easy for SMEs due to the stringent credit terms and conditions offered by financial institutions.

A theory by- Myers & Majluf (1984) suggested that because of information asymmetries new equity holders require a higher rate of return for their investments. Also, greater information asymmetry leads to higher risk. Thus, Myers & Majluf argue, that firms prefer inside finance to debt, short-term debt over long-term debt and any kind of debt over outside equity. However, the lenders are found having a hard time making a distinction between the “good” entrepreneurs who will repay their loans back and the “bad” entrepreneurs, who will not repay their loans (Diamond, 1984).

Most of the researches on the development and the financing of SMEs talk about a lack of funding as a structural feature, often unavoidable, which must be mitigated by measures going beyond the framework of the market, often through state intervention: government lending programs, grants, guarantees or other favorable fiscal measures. Cassar (2004) found out, that startups with intentions to grow seemed more likely to use bank financing and they wanted to establish strong credit relationships as early as possible. SME banks needs to build the relationship banking in SME access to finance industry. In the relationship building for SMEs, the trust is the essential for both entities; banks and SMEs in order to access the credit. Thus, the trust sought to be built in, so called, relationship banking, in between banks and SMEs.

The present paper is based on the identification of features of the SMEs in the contemporary economy, particularly their role and business, how they come to financing and trust building in banks in order to access the credit to SMEs.

1.1 Rational of the Study

A dynamic small and medium enterprise (SME) sector is acknowledged as a priority amongst economic development goals, in both developed and emerging economies. SMEs are a main tool for job creation and gross domestic product (GDP) growth. They highly contribute to economic diversification and social stability and they play as an important role in private sector development. SME development represents a primary and difficult challenge. SMEs typically face more severe

constraints to growth than large companies due to their lack of critical size resulting in reduced access to markets, skills, structured financial information and capital.

Lack of access to financing is consistently cited by SMEs as one of the main barriers to growth. SMEs are often considered by commercial banks and financial institutions (FIs) as risky and costly to serve of credit and services. SMEs are largely underserved when it comes to basic financial services. SMEs which are with such limited access to financing, SME owners struggle to make the investments as they need to increase productivity and competitiveness of their business, develop new markets, and hire more people. They also often need credit terms for working capital requirements. The reliable information on SMEs is rare made costly for financial intermediaries.

Banks are looking to enter the market or to expand their SME operations will be able to take the lessons of other banks' experience. These lessons can be able apply to operations in five strategic areas: (1) strategy, which is SME focus and execution capabilities; (2) market segmentation, which is for products and services; (3) sales culture and delivery channels; (4) credit risk management; and (5) IT and management information system (MIS). Before putting these lessons to use, banks need to follow a process for market entry that begins with understanding the specific opportunity in the SME sector and ends with developing a strategy and implementation plan. To facilitate the process, there are two tools to be used, such as a market assessment and an operational diagnostic. A market assessment is determining the size and nature of the opportunity as well as the competitive landscape. An operational diagnostic helps highlight a bank's strengths and weakness.

Therefore, trust relationship, so called relationship banking is often considered as the appropriate lending technique. Trust is a complicated matter and it has different basis and different meanings to individual entities. Thus, it is important to understand what trust means for different entities and why does it matter. It is important to find out how increased trust affects the lending process and what other effects it might have. Mutual understanding is also important it would be beneficial for any relationship if the participating entities can perceive each other's needs efficiently and correctly. Additional point to touch is to find out what kind of lending models are used when in the process when an SME is looking for a loan. The basic lending models for SMEs

loan is to access the information on financial and non-financial. In addition, it is important to see what other factors affect the whole lending process. For example, understanding the definitions and roles of so-called soft data and hard data are important and this study touches upon them as well.

1.2 Objectives of the Study

The objectives of the study are:

- (1) To identify the role of banks, SMEs and their situations
- (2) To analyze the trust building, role of trust and existence of trust in banks and SMEs is effective for credit lending in SME Industry

1.3 Method of the study

Both primary and secondary are collected to find out and understand how trust is established between banks and SMEs. To conduct literature review and to collect samples, the secondary data was gathered from reports and guidelines of SME, IMB, GIZ, World bank and JICA and from reference textbooks, relevant articles, journals , previous research papers and internet websites. This study conducted with the interview questionnaires and discussions. The selected groups had given the answers of the discussions by phone calls upon these research topics. The quality research questionnaires were conducted to both parties of banks and SMEs. The research was engaged to 10 SMEs owners who are loan borrowers/customers from the various commercial banks in Myanmar and 3 SME banking officers from the management level from the local commercial banks.

The study aims to examine on finding out how the trust is linked in the banks and SMEs by constructing the relationship building. The variable results are found out upon the questions how much trust can lead to the decision on the SMEs lending in Myanmar. The first questionnaires are to find to understand about trust building is how much constructed between these two parties: the banks and SMEs. The main research question is “How is trust between banks and SMEs which was established and how much it affects the SMEs loan process?”. The research starts from the point when SMEs approach to the banks for loan for the first time they know each other and how

the lending process was proceeded together. By understanding this condition provides a good basic thing to be carried on for the further study could be built on.

1.4 Organizing of the Study

The study is organized into five chapters. The first chapter composed of introduction, the rational of the study, objectives of the study, method of the study and organization of the study. The second chapter presents theoretical background of the related literatures. The third chapter deals with the background of Banks' Business and Situation of SMEs in Myanmar. The fourth chapter is presented in findings upon interviewed of research and relationships between banks and SMEs. In the last chapter of fifth is experimented in research finds out, discussions, suggestions and recommendations and for further study.

CHAPTER 2

THEORETICAL BACKGROUND

This chapter is about the definition of banks, SMEs and the “Trust”. It includes about SMEs and its businesses. The study is presented by using “Agency Theory” and discussion of why this paper linked with this theory.

2.1 The Definition of SMEs

Definitions of SMEs differ between countries, not only as a common indicator, such as employment, but also in the types of indicators used, such as turnover and capital investment. Along with employment, the common criteria are assets or capital and revenue, which is the definition being sales or turnover. Many economies set SME definition is with two criteria, one is being employment and the other is being assets or capital and revenue. For example, Malaysia considers manufacturing firms to be SMEs with the workers fewer than 200 or revenue of less than RM50 million (about \$12 million). There may also be different criteria for different sectors. The People Republic of China (PRC) has 15 sector definitions, Japan has 4, and Singapore has 1. Some government agencies within the same country may use different definitions. A ministry may use one definition while the national statistics office uses another, and a priority lending policy may adopt yet another (Yoshino and Taghizadeh Hesary 2018).

Fig. 2.1 The World Bank’s MSME definition (2015)

Category	Headcount	Assets	Annual Sales
Micro Small	< 10	< 100,000	< 100,000
Medium	< 50	< USD 3m	< USD 3m
	< 300	< USD 15m	< USD 15m

Source: GIZ SME training

Figure 2.1 shows the definition of Myanmar SMEs by World Bank in 2015. In category, Micro and Small business are defined by having fewer 10 employees or Assets is lesser than 100,000 or annual sales is lesser than 100,000. In a same meaning, Medium sized business are categorized by having between 50 to 300

employees or Assets are from 3 million to 15 million USD or annual sales are from USD 3 million to 15 million.

2.1.1 Role of SMEs

SMEs are key engines of job creation and economic growth in developing countries.” (IFC- International Finance Corporation- The World Bank Group) The importance of SMEs has attracted a lot of international attention in recent past due to their significant contributions to the economies of both the developed and developing countries (Asiedu, 2006). In Europe, SMEs are the backbone and engine of the European economy as they play as a central role. In the European Union, almost 85% of net new jobs from 2002-2010 were created by SMEs (European Union, 2012 European Commission, 2011; Abouzeedan, 2011; and Muhammad et al, 2010). In 2004, SMEs in the U.S. employed about 25 million people and their gross product was about 20 percent of the gross domestic product of private industries in the U.S. (Kozlow, 2006; BEA, 2006). Present time in Africa, SMEs are small and growing businesses which create around 80% of the region’s employment, establishing a new middle class and fueling demand for new goods and services (World Economic Forum-2015).

2.1.2 Role of SMEs in Asia

Asia has been growing continuously since the Asian financial crisis, and this growth has mitigated poverty and increased the number of middle-income countries in the region. However, several factors caused the recent regional and global economic slowdown, including the limited access of small and SMEs to bank credit. New and sustainable models are necessary to ease the access of SMEs to finance and boost the economic growth and job creation. In the region. A survey that the Asian Development Bank (Asia SME Finance Monitor (ASM)) carried out on 20 countries from 5 ADB regions¹ showed that SMEs accounted for an average of 96% of all enterprises and 62% of the national labor forces across the ASM countries. These countries cover Central Asia, East Asia, South Asia, Southeast Asia, and the Pacific. Meanwhile, the latest data reveal that SMEs contributed an average of 42% of the gross domestic product (GDP) or manufacturing value added in ASM countries (ADB 2015). SMEs have continued to influence trade. The latest data indicate that SMEs in

the People's Republic of China (PRC) and India accounted for more than 40% of the total export values, followed by 26% in Thailand, 19% in the Republic of Korea, and 16% in Indonesia (ADB 2015).

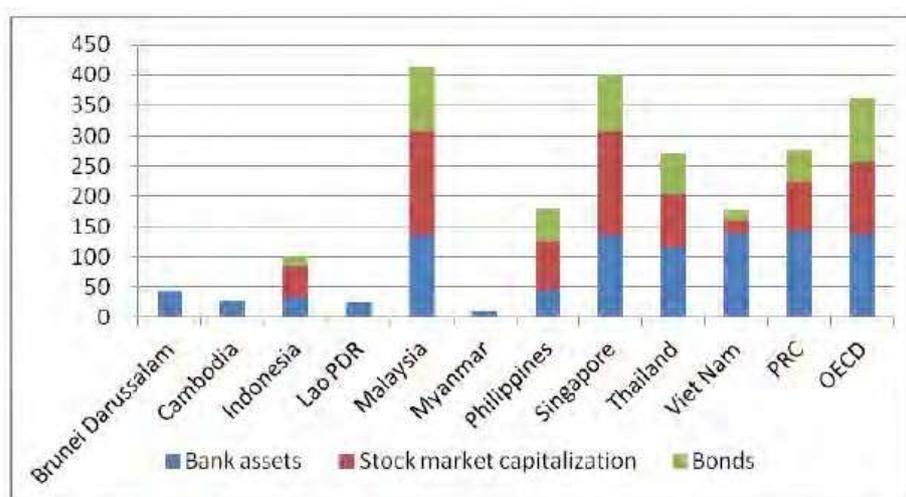
In Asia, SMEs are very important for employment creation and are sources of economic growth and foreign currencies. In Indonesia, SMEs are valued for their potential to create employment, to generate foreign currencies through export, and their potential to grow into larger enterprises (Tumbunan, 2012). In India SMEs constitute over 90% of total enterprise in most of the economy, generating the highest rate of employment growth and account for a major share of industrial production and exports (Kumar, and Sardar, 2011).

Small and Medium Enterprises (SMEs) play an essential role in the economic development of South-east Asian countries as per a key role in the development of national economies in both developed and emerging economies (Ackah & Vuvor, 2011). The SME sector is the main driving force behind job creation, poverty reduction, wealth creation, income distribution and reduction in income disparities in a country (Ifeakachukwu & Olasunkanmi, 2013). SMEs create employment opportunities complementing the public sector (Mutuku, 2010).

2.2 The Definition of Banks and Its Role

A bank is a financial institution licensed to receive deposits and make loans. Banks may also provide financial services, such as wealth management, currency exchange, and saving deposits. There are two types of banks: commercial/retail banks and investment banks. In most countries, banks are regulated by the national government or central bank.

Fig. 2.2 Total Financial Assets in ASEAN Economies, 2010 (% of GDP)



Notes: bank assets (claims on the domestic real nonfinancial sector by deposit money banks) come from IMF/IFS, lines 22, a-d; stock market capitalization is from the World Bank database; bonds (sum of local currency and foreign currency bonds) are from ADB's Asian Bond Online database.

Sources: IMF, International Financial Statistics database, www.imf.org; World Bank, database, <http://data.worldbank.org>; and ADB, Asian Bond Online, <http://asianbondsonline.adb.org/index.php>

Figure 2.2 shows the total financial assets in ASEAN Economic 2010 showing with the percentage of gross domestic product (GDP).

2.2.1 Types of Banks

(a) Commercial Banks

Commercial banks are typically concerned with managing withdrawals and receiving deposits. It is also supplying short-term loans to individuals and small businesses. Consumers mainly use these banks for basic checking and savings accounts. Examples of commercial banks include JPMorgan Chase & Co. and Bank of America Corp.

(b) Investment Banks

Investment banks focus on providing corporate clients with services such as underwriting and assisting with merger and acquisition (M&A) activity. Morgan Stanley and Goldman Sachs Group Inc. are examples of U.S. investment banks.

(c) Central Bank

Central banks are chiefly responsible for currency stability, controlling inflation and monetary policy, and overseeing money supply. Some of the

world's major central banks include the U.S. Federal Reserve Bank, the European Central Bank, the Bank of England, the Bank of Japan, the Swiss National Bank and the People's Bank of China.

2.2.2 Role of Banks

The banking system plays an important role in the modern economic world. Banks collect the savings of the individuals and lend them out to business, people and manufacturers. Manufacturers borrow from banks the money needed for the purchase of raw materials and to meet other requirements such as working capital. It is safe to keep money in banks. Interest is also earned thereby. Thus, the desire to save is stimulated and the volume of savings increases. The savings can be utilized to produce new capital assets. Thus, the banks play an important role in the creation of new capital in a country and thus help the growth process.

Banks arrange for the sale of shares and debentures. Thus, business houses and manufacturers can get fixed capital with the aid of banks. There are banks known as industrial banks, which assist the formation of new companies and new industrial enterprises and give long-term loans to manufacturers.

The banking system can create money. When business expands, more money is needed for exchange transactions. The legal tender money of a country cannot usually be expanded quickly. Bank money can be increased quickly and used when there is need of more money. In a developing economy (like that of India) banks play an important part as supplier of money. The banking system facilitates internal and international trade. A large part of trade is done on credit. Banks provide references and guarantees, on behalf of their customers, on the basis of which sellers can supply goods on credit. This is particularly important in international trade when the parties reside in different countries and are very often unknown to one another. Trade is also assisted by the grant of loans by discounting bills of exchange and in other ways. Foreign exchange transactions (the exchange of one currency for another) are also done through banks.

Finally, banks act as advisers, counsellors and agents of business and industrial organizations. They help the development of trade and industry. There are special types of banks which provide facilities to different kinds of economic activities. Now-a-days in every country there is a central bank which controls the

activities of all other banks, endeavors to keep the price level steady, and controls the rates of foreign exchange.

2.3 SMEs' Difficulties in Accessing Finance from Financial Institutions

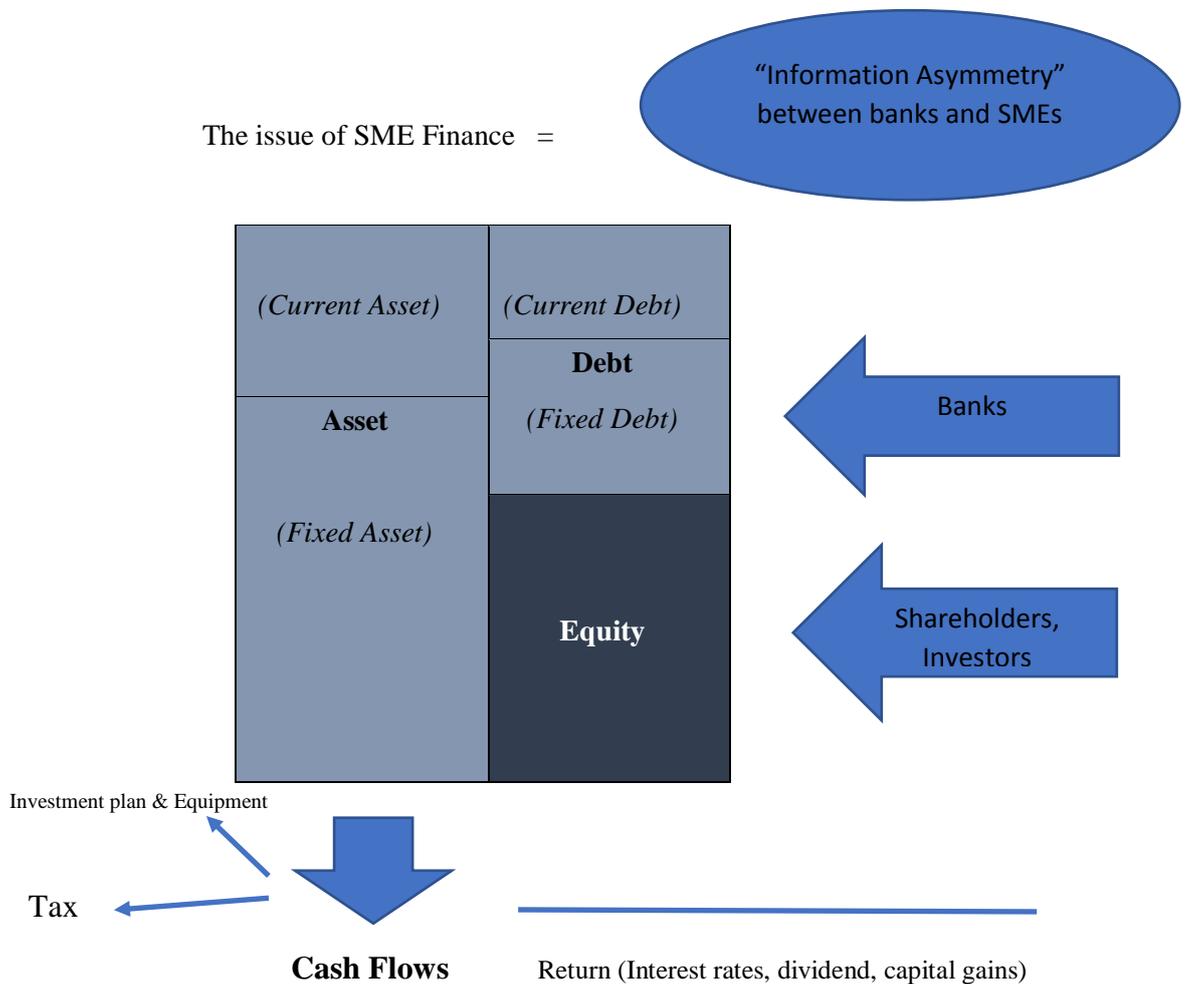
Almost 70% of the Indian, 80% of the Chinese, and 90% of the Malaysian financial system consists of bank loans (Yoshino and Taghizadeh-Hesary 2015). Researchers often characterize Asian economies as having bank-dominated financial markets and underdeveloped capital markets, in particular venture capital. This is even true for Japan and the Republic of Korea, where the venture capital market is not developed. This means that banks are the main source of financing. Although the soundness of the banking system has improved significantly since the Asian crisis, banks have been cautious about lending to SMEs, even though such enterprises account for a large share of the economic activity. Start-up companies, in particular, are finding it increasingly difficult to borrow money from banks because of strict Basel capital requirements. Riskier SMEs also face difficulty in borrowing money from banks. It is difficult for banks to evaluate SMEs, since they often do not have solid accounting systems. Many SMEs in Asia borrow money by paying high rates of interest or offering costly collateral. Many banks prefer to lend to large enterprises rather than SMEs.

2.3.1 Why it is so difficult financing in SMEs?

Cash flow is defined as the movement of cash into or out of an SME. For a health, financial status an SMEs cash inflow should be more than cash outflows at any given time. Net working capital is the difference between the SME's current assets and the SME's current liabilities. According to Mugo (2014), working capital refers to a firm's short-term assets or current assets necessary for the day-to-day smooth running of the firm. The cash flow of SMEs can be affected by overcapitalization and overtrading. Overcapitalization occurs where the SME has excessive stocks, debtors, and cash balance and very few creditors. Overcapitalization lowers rate of return on investments for SMEs. Overtrading occurs when an SME does much volume of trade too quickly with little long-term capital. Uwonda et. al. (2013), state that cash flow management is concerned with cash payment, collection of management and liquidity management that involves

acquisition and disposal of assets in SMEs. Inadequate cash flow management is the main reason for failure of many SMEs (Uwonda et. al. 2013). Adequate management of cash flow by SMEs is therefore key for the survival of SMEs in any developing economy. To get to know the actual financial stability and cash flow for the SMEs are very difficult caused the unsuccessful on the credit decision. The Figure (2.3) shows how and why SMEs are so difficult to get financing from the banks.

Fig. 2.3 Why so difficult in SME lending



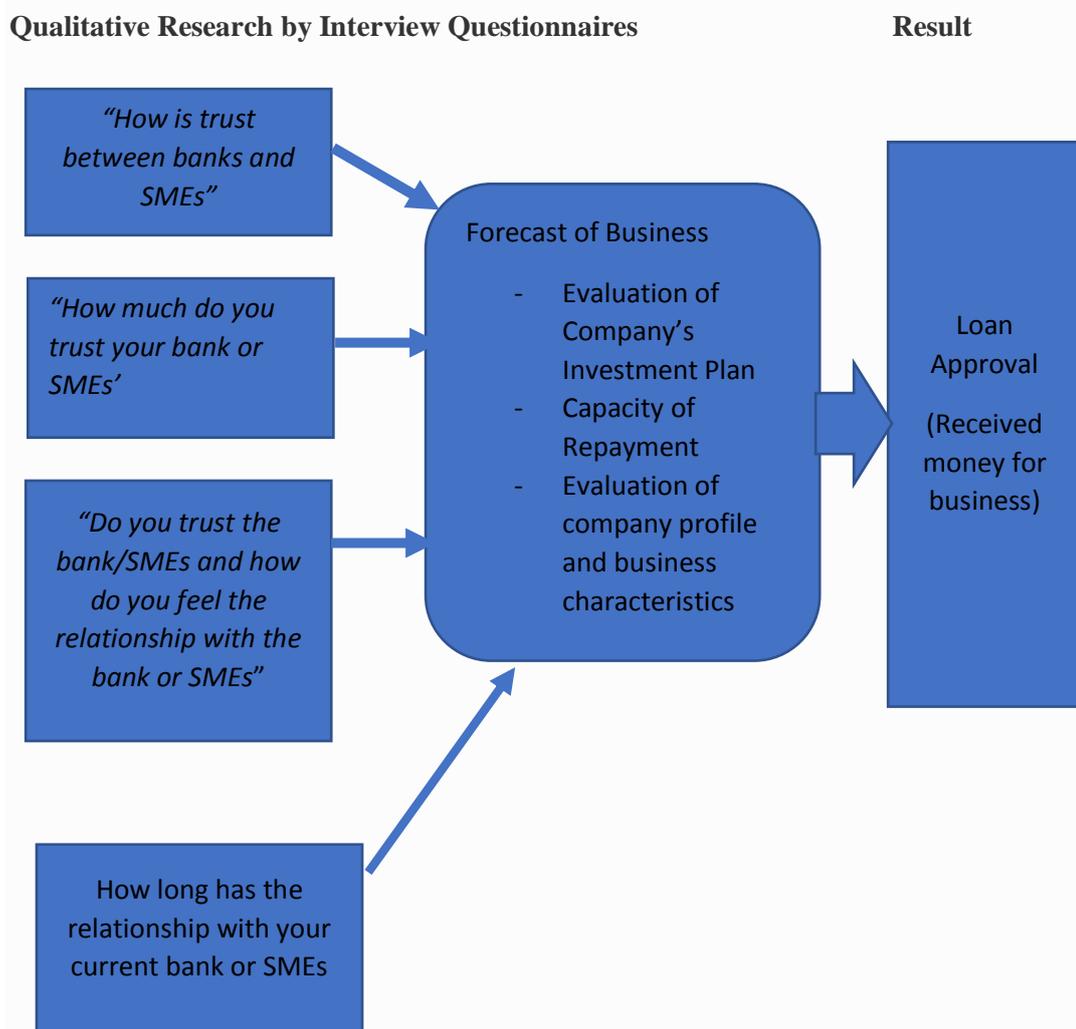
Source: JICA SME-TSL project training

2.4. Conceptual Framework of the Research

The conceptual framework, the framework for this study is developed according to the local bank practicing into access to finance shown in figure (2.4).

The conceptual framework of this research shows how linked of trust in between banks and SMEs leads to SME's lending. The approach of this research is to engage the questionnaires to both entities: banks and SMEs. As per information asymmetry of SMEs, banks need the reliable information for their decision making. If the banks have been making relationship with the SMEs and getting the information of financial and non-financial completely, it helps banks to access the credit assessment which forecast on the capacity of loan repayment and risk possibility. The framework is modified into qualitative research on relationship banking or trust building.

Fig. 2.4 The Conceptual Frame Work



Source: Experience on SME lending

2.5 Agency Theory

Principal-agent theory is not so commonly used in trust research. Agency theory is a principle that is used to explain and resolve issues in the relationship between business principals and their agents. Most commonly, that relationship is the one between shareholders, as principals, and company executive, as agents. An agency, in broad terms, is any relationship between two parties in which one, the agent, represents the other, the principal, in day-to-day transactions. The principal or principals have hired the agent to perform a service on their behalf.

Principals delegate decision-making authority to agents. Because many decisions that affect the principal financially are made by the agent, differences of opinion and even differences in priorities and interests can arise. This is sometimes referred to as the principal-agent problem.

By definition, an agent is using the resources of a principal. The principal has entrusted money but has little or no day-to-day input. The agent is the decision-maker but is incurring little or no risk because any losses will be borne by the principal. Agency theory addresses disputes that arise primarily in two key areas: A difference in goals or a difference in risk aversion. For example, company executives may decide to expand a business into new markets. This will sacrifice the short-term profitability of the company in the expectation of growth and higher earnings in the future. However, shareholders may place a priority on short-term capital growth and oppose the company decision.

Another central issue often addressed by agency theory involves incompatible levels of risk tolerance between a principal and an agent. For example, shareholders in a bank may object that management has set the bar too low on loan approvals, thus taking on too great a risk of defaults.

A re-phrased version of the question is that what it takes for an agent to appear trustworthy to the principal so that the principal would be willing to hire him? There is a similar setting in this study. However, in this study the focus is in how does the SME representative appear trustworthy so that the bank is willing to give the SME funding.

2.6 Types of Lending on SMEs

Moro & Fink (2013) argue, that research on SMEs divides the lending techniques into four main categories, which are financial statement lending, asset-based lending, credit-scoring lending and relationship lending. Financial statement lending is based on the information found in the financial statements. Asset-based lending is based on provisions of collateral and its quality. Credit-scoring lending is based on statistical techniques, mostly hard information, but also information about the SMEs owner and information of the firm itself (Berger & Udell, 2006). This information might also include assessments of the future of the SME gathered from past communications with such entities as SMEs suppliers, customers or neighboring businesses. (Berger & Udell, 1995; Degryse & Cayseele, 2000; Petersen & Rajan, 1994). In relationship lending the financial institutions rely mostly on the soft information that has been gathered over time during the relationship with an SME, its owner and the local community (Berger & Udell, 2006). However, Moro & Fink (2013) argue, that the first three lending techniques are usually grouped together and labelled under “transaction lending”, because the risk evaluation is based on the public (factual) information available that it is independent of the quality and the length of the relationship and these loans are mainly used for serving non-recurrent needs. Berger & Udell (1995) argue, that in relationship lending the information gathering goes beyond the relatively transparent data that can be found in official documents. Previous studies argue, that SME financing does not rely on a single model at a time, but more likely a combination of different models with difference in the weighing of them are used.

Based on earlier research a common finding is that in large companies have advantage in lending transactions that are based on “hard” quantitative data and small institutions benefit have advantage in transactions that are based on “soft” and more qualitative information (Berger & Udell, 2006). As the soft information might be harder to communicate inside a large organization the small institutions with less layers in management might have an advantage in relationship lending (Berger & Udell, 2002). Soft information accumulates over time and it can be measured by the length and strength of the relationship between a bank and an SME (Moro et al. 2014). Berger & Udell (2000) even suggest, that soft data might even contain information about the character and the reliability of the firm’s owner. However, soft

information is hard to communicate within the financial institutions and it is often rather in the loan officers' minds than in the company's databases (Berger & Udell, 2006). Scott J. (2004) argues, that soft information is more qualitative and is subject to interpretation of the gatherer. Thus, it is not so easily transmitted inside the organization as hard quantitative data.

Previous research also suggests, that larger banks allocate less loans to SMEs than small banks (Cole et al., 2004). Also, Alessandrini, Presbitero & Zazzaro (2009) found out, that the geographic distance between the bank and the borrower affects the lending process so that with distant customers the banks tend to rely more on the hard information. However, the effect of this could be decreasing over time, as information technology gets better and better and increasing amount of loan discussions are conducted online instead of having a meeting at the bank premises. But in Myanmar, although big local banks are using the ICT technologies but still SME banking needs to access the credit appraisal at the client business and location.

2.7 Trust in Banks and SMEs

“What is trust and how effects the lending process”

A trust is a fiduciary relationship in which one party, known as a trustor, gives another party, the trustee, the right to hold title to property or assets for the benefit of a third party, the beneficiary. Trusts are established to provide legal protection for the trustor's assets, to make sure those assets are distributed according to the wishes of the trustor, and to save time, reduce paperwork and, in some cases, avoid or reduce inheritance or estate taxes. In finance, a trust can also be a type of closed-end fund built as a public limited company. The actors in any trust-related relationship are the trustor (one who has expectations of another) and the trustee (one who is the object of trust), from whom the trustor expects favorable intentions and actions based on the level of trust.

The trust between the SMEs and banks is extremely important when using the relationship lending technique. In 1995 Mayer, Davis & Schoorman suggested, that trustworthiness is based on three factors, which are ability, benevolence and integrity. Ability focuses on such aspects as skills and competence. Thus, it is domain-specific, and it might not be able to generalize it to other situations. Benevolence is relationship-specific, and it means the extent of a trustee would voluntarily do good to

the bank or other trusting party. Integrity relies on the trustor's perception of the trustee adhering to a set of principles that the trustor has considered applicable. In conclusion Moro & Fink (2013) found out, that when a loan manager scores a customer highly on trust and the components of it (ability, benevolence and integrity) their access to credit improves. In addition, their econometric findings underline, that relationship lending cannot be simplified to facts and figures. They also argue, that the role of trust might even be greater and more important to very small firms that are unable to provide the hard data required by banks.

Their study also indicates, that trust plays a far more important role in relationship lending than it has been acknowledged so far. Moro, Fink & Maresch (2015) also argue, that reduction in information asymmetry has a positive effect, such as getting a higher amount of short-term credit, in the lending process. The empirical results from a study by Moro et al. (2014) point out, that the voluntarily disclosed information is assigned a significant role. They argue, that when entrepreneurs disclose information, the loan managers reciprocate by allowing more flexible banking relationships. Thus, the loan managers give the entrepreneurs some incentives to disclose additional information.

According to Nooteboom (2002, 2) "Trust can have extrinsic value, as a basis for achieving social or economic goals. It can also have intrinsic value, as a dimension of relations that is valued for itself, as a part of a broader notion of well being or the quality of life.". When talking about the intrinsic value of trust Nooteboom argued, that it can be based on hedonism or self- respect, as people often prefer trust-based relationships over relationships that are based on suspicion and opportunism. Nooteboom divided behavioral trust to different forms, of which I believe intentional trust and competence trust to be the most important forms in bank-SME relationships. Relationship lending requires more authority given to the loan officer that has the greatest access to the soft information. Moro et al. (2014) argue, previous research suggests, that high level of trust could lead to an even higher risk of fraud. On the other hand, disclosing less information might lead to having worse terms on the loan, so it might not be the best idea to try to disclose as little information as possible.

2.7.1 Sources of trust and role of trust in Banks-SMEs relationships

Nooteboom (2002) argues, that having the distinction between the trustor and the trustee is especially important, when thinking about the foundations of trust, which can be further on split to reasons for trustworthiness and sources of trust. Nooteboom (2002) divided building trust in three major stages, which were 1. control in the absence of trust, 2. assessing trustworthiness and developing tolerance levels of trust and 3. widening these tolerance levels.

In the first stage there are no basis for trust, so trustworthiness must be demonstrated in some way. For example, Williams (1998) divided sources of trust to “macro” sources which have institutional origins and are general and impersonal, and “micro” sources, that are personal and arise in specific relations. Nooteboom argues, that at this point the trustor must think about opportunism and possible lack of competence. He suggests, that one way move further in this situation is to proceed with small steps without having a lot of risk. Demonstrating trustworthiness could, for example, include discussions and providing information.

According to Moro et al. (2014) soft information accumulates over time in a relationship, but disclosing additional information voluntarily is influential in lending relationships between banks and SMEs. A logical conclusion from this is, that increased trust leads to a setting where information is shared with less friction, which ultimately leads to lower amount of information asymmetry between banks and SMEs.

Also, Moro & Fink (2013) argue, that if banks rely solely on transaction lending they cannot evaluate SME managers properly, which leaves out many good SMEs. They argue, that by relying on trust and perceived ability plus benevolence and integrity the loan managers can more effectively make a distinction between good and bad customers. They also argue, that role of trust might be greater and more important in the case of very small firms which lack the potential to provide banks with all the facts and figures they require. Finally, they conclude, that when thinking about accessing bank finance it is not the best strategy to refrain from disclosing information and altogether reduced information asymmetry is associated with more credit.

2.8 Financial Regulation and SMEs in Myanmar

The banking sector of Myanmar has been severely restricted by various kinds of regulations. In 2005, just after the banking crisis, MOF, the Banks Supervision Committee and CBM issued an instruction which prohibited banks from making loans without sufficient collateral, and banks were required not to lend medium-term or long-term loan and not to lend more than 20% of the combination of paid-up capital and special monetary fund (CBM instruction No1/2005) to a single party. This instruction was intended to keep financial stability, fearing bank runs and bankruptcies like those which happened in 2003. As a result of these regulations, banks cannot lend their funds without immovable collateral, or for more than one year except for some policy loans such as the term loan of MADB. Consequently, Myanmar banks have not offered sufficient financial services for their clients. Borrowers must prepare many kinds of certificates and papers in order to make the lending application form, and provide immovable collateral, normally 30 to 50% of the forced sale value (FSV). Depositors must wait for a long time to just withdraw their deposits and pay charges when they use ATMs, most of which act as no more than cash dispensers. In other words, the banking sector does not need to recognize itself as a service sector providing services to its clients.

Due to less borrower friendly banking regulations and practices as mentioned above, the banking sector is playing only a limited role in economic development in Myanmar. A report issued by the Asian Development Bank Institute (ADBI) points out that the total financial assets of Myanmar, in terms of ratio to GDP, are by far the lowest in the ASEAN economies² According to an ADBI working paper, the ratio of bank assets to GDP in Myanmar was 10% in 2010, while those for the second lowest, Lao PDR, was 27% and the third largest, Cambodia, was 28%. Compared to Thailand or Malaysia, size relative to GDP is less than one tenth.

Problem with financial regulation and resolutions are: (1) Restriction on the length of loans (one-year rule) (2) Collateral requirement (3) Regulation on interest rate.

Chapter 3

Background Information of Banks and SMEs in Myanmar

This chapter presented banking business in Myanmar with the situation of SME in Myanmar. It includes “Trust” between banks and SMEs in Myanmar.

3.1 Banking Business in Myanmar

Myanmar’s banking sector today consists of four state-owned banks, 27 domestic private banks and 13 foreign bank branches. In addition, there are 49 representative offices of foreign banks listed on the website of the CBM. As of December 2017, total bank assets amounted to 56.12 trillion MMK. Private banks accounted for roughly 55% of total bank assets, 66% of deposits and 82% of loans.

The amount of bank branches in relation to the population is still low in Myanmar, reflecting the low access of people to formal financial services. In 2016, there were 3.41 bank branches per 100,000 people, compared to 3.9 in Vietnam, 8.8 in the Philippines and 11.5 in Malaysia. In addition, branch coverage is very uneven across regions, leaving especially rural populations widely unserved by private banks, although they keep increasing their branch numbers. Total loans of private banks amounted to 18.5 trillion MMK (approx.. 13.48 billion USD) in December 2017. Between March 2012 and March 2017, the amount increased almost sevenfold. The trading sector accounts for the largest share of loans from private banks, followed by construction and services.

In December 2017, 88% of collateral used to secure loans in Myanmar were land and buildings. As banks tend to only lend a maximum amount of 50 to 70 percent of the collateral value, this may however not be a major concern in the short and medium term. Secondly, high collateral requirements make it especially hard for smaller borrowers that do not own adequate collateral, such as SMEs and private households to access bank loans. A directive issued by CBM in November 2017 stated that banks are encouraged to develop new loan products assessing client creditworthiness through cash-flow and business cycle analysis. Banks are required to submit the proposed loan products with the corresponding credit risk analysis to CBM on a no-objection basis. However, CBM procedures for new product approvals are not

standardized and approval period is not yet clearly defined. In addition, banks face limitations on developing new loan products based on borrower's cash flow since CBM has capped annual effective lending interest rates at 13%, which is lower than the perceived market lending interest rate based on credit risks associated with most businesses. Regardless, local banks price regular term-loans at up to 13% annual interest rate and other refinancing and subsidized loans at around 8.5%.

3.1.1. Commercial and Consumer Loans

All banks in Myanmar offer similar commercial loans which can be generally categorized into three types.

- a. Term loans with mostly full principal payment at the end of the loan term (usually 1-3 years) and quarterly interest payments with up to 13% annual interest rate;
- b. Hire-purchase loans for the financing of vehicles, heavy machineries, etc, where the wholesaler carries major part of the repayment risk; and
- c. One-year overdraft facilities where interest is only payable on the actually outstanding loan amount.

3.2 Situation of SME in Myanmar

According to a research conducted by Central Statistics Organization, 98 percent of the more than 120,000 businesses registered in Myanmar are SMEs. In the employment sector, of the 21.9 million workers, 83 percent are working in un-registered SMEs.

SMEs play a crucial role in the economic well-being of developed and developing countries alike. 126,237 or approximately 99.4% of all businesses in Myanmar are classified as SMEs. On average, SMEs in Myanmar account for 50-95% of employment and contribute 30-53% of GDP in ASEAN member states. The Government recognizes that SME entrepreneurship will define the country's future national economic development. However, international isolation and a lack of private sector investment, among other factors, have left Myanmar playing catch-up with its regional neighbors.

Promoting sustainable private-sector-led growth with the aim of creating more and better jobs is one of the key pathways to eliminating poverty. Encouraging the

growth of small and medium sized enterprises (SMEs) is therefore one crucial element of the development strategy put forth by Myanmar's government. Myanmar is opening up and integrating with the outside world in terms of trade and investment. The country also actively encourages greater private but also financial sector Development.

Today, less than 30 % of the population has access to formal financial services and credit in rural areas; particularly in the agricultural sector this is severely constrained. Further, current banking practices severely limit access to loans for SMEs. SMEs without the currently acceptable types of collateral have no access. Those with acceptable collateral and financial statements are only offered the standard repayment options and loan maturity not addressing specific financing and investment needs. SME development therefore not only means the provision of funding but also requires capacity building on micro, meso and macro level.

Myanmar government recognizes SMEs as important sector for Myanmar economy. Thus, Myanmar Economic growth is totally dependent on the development of SMEs in private sector. The Government of Myanmar places SME development as a high priority policy issue and launched the Central Committee for Development of SMEs chaired by the President and the Work Committee for Development of SMEs with the aim of achieving inclusive economic growth led by private enterprises. In the national economy of Myanmar, the role of small and medium-sized enterprises (SMEs) is significant, as 99.4% of the registered companies and 87.2% of the manufacturing companies are SMEs according to Ministry of Industry.

SME development has been the top-priority issue for the Myanmar government. As the rapid economic growth is gaining momentum in Myanmar, funding needs for capital investment by SMEs have been increasing. However, the supply of medium/long-term funding by banks has been extremely limited as a negative legacy of the strict regulations on loan terms by the central bank, which was relaxed only recently. As a result, many SMEs have to rely on their own funding sources for capital investment. For SMEs to aim for stabilized and expansive business management with medium/long-term perspective, it is necessary to expand the supply of medium/long-term loans made by financial institutions.

The government announced SME Law in 2017 which sought to provide a new window of opportunity for SMEs to explore their full potential. Under

Notification No. 7/2017 issued by the Central Bank of Myanmar last November 24, banks were instructed to give out more loans based on the cash flow system, depending on the borrower's nature of business and historical cash flow patterns. The new Myanmar Financial Institutions, Law allows banks to provide unsecured loans (without collateral) and leaves it to the CBM to rule on lending terms and define eligible collateral. Then some private banks focus on serving small-and medium-sized enterprises (SMEs) which are the major derivative to growth of economy and have worked with the International Finance Corporation (IFC) to extend new loans to SMEs. Thus, credit guarantee insurance was introduced firstly by CB banks and now many of the banks are accessing CGI with the cash flow analysis on credit risk management which is less or without collateral. It provides SMEs loan with no collateral or less collateral with the bearing interest rate at 13% p.a, plus insurance premium fees where goes to Myanma Insurance according to the year of loan tenor. In August 2018, the Ministry of Planning and Finance published the Myanmar Sustainable Development Plan (2018-2030). In the plan, it was given the structure of economy, agriculture and small and medium enterprises are priority of where the government will facilitate growth in these sectors by improving access to finance and markets, security of land tenure and access to machinery and technologies.

3.2.1 Definition of SMEs in Myanmar

Small and medium enterprises (SMEs) are decided by the number of employees and or revenues they have. To be considered a small and medium enterprise, these two determinants must fall under a certain standard held by the respective country. Different countries have varying standards to qualify for this identification.

While the existing definition of Industry Law covers only small and medium industries (SMI) under the supervision of MOI, the new definition is designed to cover various sectors including service, trading and tourism (hotel and restaurant) under MOC, Ministry of Hotel and Tourism or some other ministries. Details of definition of each sector are modified to fit better to the current economic situation. SME defined by industrial type according to new SME law in 2017 shown in table (3.1).

Table: 3.1 SME defined by Industrial Type

Definition	No.	Category	Number of Employees (regular basis)	Capital Investment (Kyats)	Turnover of previous year (Kyats)
Small Enterprise	(1)	Manufacturing business	Up to 50	Up to 500 million	
	(2)	Labour intensive or mainly works for piecework business	Up to 300	Up to 500 million	
	(3)	Wholesale business	Up to 30		Up to 100 million
	(4)	Retail business	Up to 30		Up to 50 million
	(5)	Service business	Up to 30		Up to 100 million
	(6)	Except from above business	Up to 30		Up to 50 million
Medium Enterprise	(1)	Manufacturing business	More than 50, up to 300	More than 500 million, up to 1,000 million	
	(2)	Labour intensive or mainly works for piecework business	More than 300, up to 600	More than 500 million, up to 1,000 million	
	(3)	Wholesale business	More than 30, up to 60		More than 100 million, up to 300 million
	(4)	Retail business	More than 30, up to 60		More than 50 million, up to 100 million
	(5)	Service business	More than 30, up to 100		More than 100 million, up to 200 million
	(6)	Except from above business	More than 30, up to 60		More than 50 million, up to 100 million

(Note) Capital investment doesn't include the value of land.

(Source) SME Development Law (Law No.23, 9 April 2015) Chapter 1 Article 2 (A), (B).

source: JICA SME-TSL project

Figure 3.1 shows the definition of SME in Myanmar by industrial type in terms of (1) numbers of employees (2) capital investment (Kyats) and (3) turnover or previous. It was categorized by 6 business types for small and medium enterprises, such as (1) manufacturing business (2) labor intensive or mainly works for piecework business (3) wholesales business (4) retail business (5) service business (6) except from above business.

3.2.3 Financing Services for SMEs in Myanmar

(a) JICA SME Two-Step Loan Project

SME-TSL is a SME policy-based loan scheme funded by JICA. In Myanmar, the TSL Project aims at serving as a catalyst to stimulate SMEs which would like to borrow money for capital investment by 1) offering low-interest (8.5%) and mid-to long-term loans (exceed 1 year and maximum 5 years); 2) removing non-transparent banking practices; 3) improving banking practices through capacity development of Participating Financial Institutions (PFIs); 4) improving the financial intermediation function for SMEs, and 5) increasing the production and investments of SMEs in Myanmar.

The objectives are to be fulfilled by providing medium to long-term (MLT) funds through PFIs and by strengthening PFIs' capacity, thereby contributing to inclusive development of the country's industry and economy, as well as creation of employment.

To realize these objectives the Government of Myanmar had implemented "Project for the Development of Finance for Small and Medium-sized Enterprises" (the Project Phase 1) since 2015 by using Japanese ODA loan. The Loan Agreement of the amount of JPY 5,033 million was concluded in June 2015, and the loan funds were distributed through Project Management Unit (PMU) to six Participated Financial Institutions-PFIs (AYA bank, CB bank, KBZ bank, Myanmar Apex bank (MAB), Myanmar Citizens bank (MCB), and Small & Medium Industrial Development Bank (SMIDB). The PFIs then provided capital investments loans to SMEs (end-borrowers). During the first three years of the project, JICA provided K60 billion (US\$37.6 million) for loans and it will provide another K200 billion starting from fiscal 2018-2019 with the interest rate of 8.5% through 3 to 5 years of loan tenor.

(b) KfW (German Federal Government) Project

On behalf of the German Federal Government, KfW resumed cooperation with Myanmar in 2013. The Ministry of Planning and Finance (MoPF) is responsible for financial sector development projects in the realm of development cooperation. It is the project partner of KfW Development Bank for the SME Lending Programme (SELP). The Myanma Economic Bank (MEB) acts thereby as the Paying Agent. SELP aims to provide access to financial services for SMEs tailored to their investment needs, to build capacity of financial institutions and to raise awareness on best SME banking practices.

In the first phase KfW finances a refinancing facility to Co-Operative Bank Ltd. (CB Bank), which has its headquarters in Yangon and 162 branches throughout the country. As the first participating bank CB Bank is supported in providing sustainable and needs-based financing to SMEs and in developing a SME lending segment. The project is closely coordinated with GIZ, who is also engaged in the financial sector as well as SME development in Myanmar.

A loan agreement to extend USD 13.22 million to finance SME in Myanmar was signed between KfW Development Bank (KfW) and two local banks; CB and MAB. This is the second round of loans provided by Berlin for Myanmar's SMEs and is based on a bilateral government-to-government agreement. CB bank is recipient of a loan amounting to €3 million, while MAB receives the remaining, which is more than €6 million. The first grant totaled €4.45 million. Business financing loan powered by KfW to SMEs are for financing the fixed assets purchase. The invested fixed assets can also be pledged as collateral with the interest rate between 10%-20% of the total investment value.

(c) Medium Term Loan of Myanma Economic Bank (MEB) to SMEs

The State-owned Myanma Economic Bank (MEB) will disburse loans to entrepreneurs who are actually running the businesses and in need of capital investments under the special program. According to local state-owned bank, MEB began extending loans to business from a wider range of sectors such as production, trading, export, import substitution, recycling, energy and technology. Loans to the relevant business will be capped at 300 million MMK with the interest of 9% per annum with the tenures of three to five years.

(d) Loans from Local Commercial Banks to SMEs

Financial Sector of Myanmar is dominated primarily by commercial banks. The sector struggles to fulfill its role as a fully-fledged financial intermediary. In March 2016, the banking sector still held 92% of total financial sector assets (about 42.4 trillion MMK). The remaining 8% was comprised of Insurance, Securities, Finance Companies and Micro Finance Institutions. Banks have grown rapidly in size in the last decade; both deposit and loan as a ratio of GDP increased approximately 3 times within the last 6 years (Ref: GIZ 2016 and IMF 2018). Ministry of Industry (now it is under Ministry of Planning, Finance and Industry- MOPFI), showed that of 73,085 SMEs registered with it, only 2,207 businesses or 3 percent of the total have received funding from Financial Institutions (FIs).

Banks in Myanmar offer SME loans with their own fund by bearing the interest rate at 13% while they changed significant milestone as they opened SME centers which to provide one stop service of SME financing to SME industry.

Moreover, fixed assets are required as collateral for the loans and some SME loans are set more flexible on collateral requirement. In commercial banking sector, recently some of the banks enlarged their operation in financing of SMEs loan by opening the SMEs service centers in the main area of states and regions, even some top banks provide one-stop SME services. The SME service center are opened by AYA bank, CB bank, KBZ bank, UAB bank, MCB bank and Yoma bank.

3.2.4 Types of SMEs business loan in Myanmar

There are four common types of SMEs business loans available: (1) Long-Term Loans which is most recent implementing in firstly by JICA SME financing then KFW's Loan and MEB (2) short-term loans, which is one year loan but it mostly is extendable traditionally contributed by local private banks (3) lines of credit and (4) alternative financing, which is not very popular and still in progress in local banking industry.

Chapter 4

The Role of Trust in Banks and SMEs Relationship

In this chapter present analysis upon the finding and interviews from the two entities; banks and SMEs. The finding and interviews are one-by-one discussion via phone call interview and coded into specific themes. And this chapter also includes the interview to acquire empirical research data in a qualitative manner.

4.1 Research Design

The research design is a framework that has been created to find answers to research questions. It includes procedures used in collecting and analyzing measures of variables in the research problem, which is a trust building between banks and SMEs. Research design deals with a logical problem and not a logistical problem (Yin, 1989). The research approaches to experience of the subject matter before us. Trust finding between banks and SMEs is the analyzing philosophy of communication, understood as qualitative research in action, inquiry on questioning and interpretations upon the results. Thus, is how qualitative research was used in this study to find out

4.2 Research Method

According to Creswell (2013, 44) “Qualitative research begins with assumptions and the use of interpretive/theoretical frameworks that inform the study of research problems addressing the meaning individuals or groups ascribe to a social or human problem. To study this problem, qualitative researchers use an emerging qualitative approach to inquiry and the collection of data.

In this study, qualitative research approach is used. Primary and Secondary data were collected while interviewing and observing from the references of reports, journals, articles. Primary data were gathered from direct interview to banks and SMEs and secondary data were from references. The interviews were conducted many times to targeted bankers and SME owners upon the questionnaires of trust building with WH questions (what, when, why and how) as well as the SME lending practices

in Myanmar. The data gathered were analyzed the role trust of banks and SMEs on the lending process in Myanmar.

4.3 Population and Sample

This research used interview approaches to participants whom were selected based on the criteria suitable with the research purpose and questionnaires. It was interviewed to two entities: 3 SME bankers out of 5 as per targeted whom are the managerial level and 10 SME owners out of 20 as per the target from of area of Yangon and Mandalay regions.

4.4 Tools of Research Questionnaires

In this research, the interviews were developed to collect qualitative result. In that kind of a research, the interviewer does not so much focus on information, but on, e.g., people's perceptions, viewpoints and emotions. The research was conducted with all the important research questions are answered and at the same time the interviewees can tell anything else they have in mind about the subject.

According to Brinkmann (2013) semi-structured interviews enable the interviewer to become a visible and a knowledge-producing participant in the interviewing process. Brinkmann also says, that semi-structured interviews give the interviewer a greater saying in focus of the conversation so that it focuses in the issues that are considered important or closely related to the research project.

4.5 Analyzing and Presenting the Role of Trust in Banks and SMEs

The study coded the answers two different main groups, which were quotes related to relationship quality and soft information inside the bank-SME relationship and quotes related to trust. Without soft information there is no loan process and without a certain level of trust the process of transmitting soft information might become inconvenient, which would cause information asymmetries. Three main themes that came up in the interviews were role relationship quality, role of soft information and thoughts related to trust, but not always exactly about trust.

4.6 Empirical Result

According to Fauchart & Gruber (2011), social identity theory concerns the structure and function of identity as they relate to an individual's social relationships and their membership in groups or social categories. Prior studies have emphasized on key social aspects of self-concept, for example basic social motivations which shape the behavior of individuals when they engage with others. (Brewer & Gardner, 1996). When analyzing interview data, the study was focused on information related to relationship quality and soft information inside the relationship, because acting consistently in a certain way leads to a certain kind of identity which develops over time. It found out a link between the actions of the trustees and the perception of trustworthiness from the trustors side. Another theme in my data analysis was information related to trust itself.

4.6.1 Relationship with the SME Interview

The average relationship between interviewed SMEs are on-going SME loan customers to their banks. SMEs are also having the potential to be the banks' repeated customers. The study found that SMEs are banks' customers not only for the purpose of SME financing but also for using the other bank products and found that SMEs are convenience with their current banks.

(a) Relationship quality with the contact person

On average the relationship quality with the contact person were described as good or excellent. SMEs agree that their contact persons are good by giving them the prompt customer service. Some banks even came down to their work place to give the service, thus, the SMEs do not need to go to their banks for some services. It seems that the SMEs are convenient using their selective banks and its services.

All of the interviewees said, that they would hope to be always able to do business with the same contact person. "*I wish, that I could always deal with the same contact person.*" This is building trust and getting to know each other takes time. Most of the interviewees (8/10) said "*We do not know the contact person outside the professional relationship*".

About the bank contact person knowing the SME (their business) outside the professional relationship half of the interviewees said, “*we do not know the company outside the professional relationship*”. Knowing the company makes the loan process faster and more convenient which to lead to an even more deep understanding of the SME.

(b) Thoughts on trust

During the interviews I found out, that none of the interviewees were worried over how banks use the information they receive from their clients. This seemed like a standard, which seemed to be based on Myanmar society being a society where trust is generally high. Also, the bank requirements make people trust the banks and banks as institutions have a long history of being trustworthy when it comes to information secrecy. Banks very much aware on the customer’s information has to be kept is their number one responsibility. Thus, being trustworthy is the cornerstone of banking business and the information.

4.6.2 Relationship with the Banker Interview

All the interviewees said, that the quality and the length of the relationship affect the lending process so, that in long relationships it is easier and faster to deal with the financing needs. In long relationships the SMEs and banks know each other well. Thus, less discussion and less background research are needed and in the best cases individual (additional) loan discussions can be as short as one phone call. Also, all the interviewees said, that the quality of the relationship has a major role in the process. Nooteboom (2002) argues, that recognizing the two-sidedness of trust is the most basic point for analyzing trust.

In the study of interviews, the bank representatives stated, that if the relationship is good and the trust goes both ways, the lending process is much more convenient. This finding is similar to the literature review in this study as well as the findings from the SME interviews. However, if the bank requests some information and the company does not provide the information it lowers the trust, or even stops the lending process completely. Banks request for information they perceive

important and if they do not receive this information the loan process simply cannot be taken further.

Banks have their KYC (know your customer), they have high cautious on non-KYC for the first time applying the loan from banks. And the bank understood that financial statement problems of the SMEs and they give light advice on what they need to do before applying the financing. Banks take good care of the customer data because of the bank secrecy requirements.

(a) Thoughts on trust

About trust the bank representatives said, that increased trust leads to a more convenient lending process. Also, the interviewees said, that trust has an important role in the process. Neither did I find any information that would support the hypothesis from my literature review. About trust between banks and SMEs the interviewees “I learned that is based on relationship matter. Financial statement information is not enough for the banks to decide for the first time they met with SME clients. They need the non-financial information to evaluate their business, repayment capacity and avoidable credit default”.

4.7 Relationship Engaged Growth in SMEs

SME banks are now putting the “Relationship Managers” who are doing the communicated relationship between banks and SMEs specially to collect the data, information and giving bank services directly to SME. Some of the banks attempt to access credit assessment based on cash flow lending which released less collateral or without collateral. Although the interest rate is still at 13%, some of the subsidized financing rate at lesser than 13% and also some banks attempt lower than 13% based on the business performance of SMEs. When the banks are upgrading their service and products, mutual-communication is more important between banks and SMEs. Presently, SMEs are getting to know more and more how importance of trust building (relationship banking) is effective on their business growth and its need to be built. Nowadays, more and more SMEs are interested into collaboration with the banks and SMEs development organizations, also more open-up to present about their business and goal of the business.

Chapter 5

Conclusion

This chapter is conclusion chapter by summarized the finding from qualitative research interviews along with the presenting some suggestions, recommendations discussed for further step into the research in the future. This study is only focus on trust building between banks and SMEs and how much trust existence is effective for credit lending in SMEs banking and industry.

5.1 Findings and Discussions

This study is based on the concept and role of trust building which constructive in banks and SMEs, how well it is going for convenience in credit assessment and bank decision making. During the interviews I did not find any major differences between different interviewees and their thoughts. The size or the location of the SME did not seem to have an effect on the bank-SME relationships. However, my study included only SMEs and no large companies from the trustee side were interviewed.

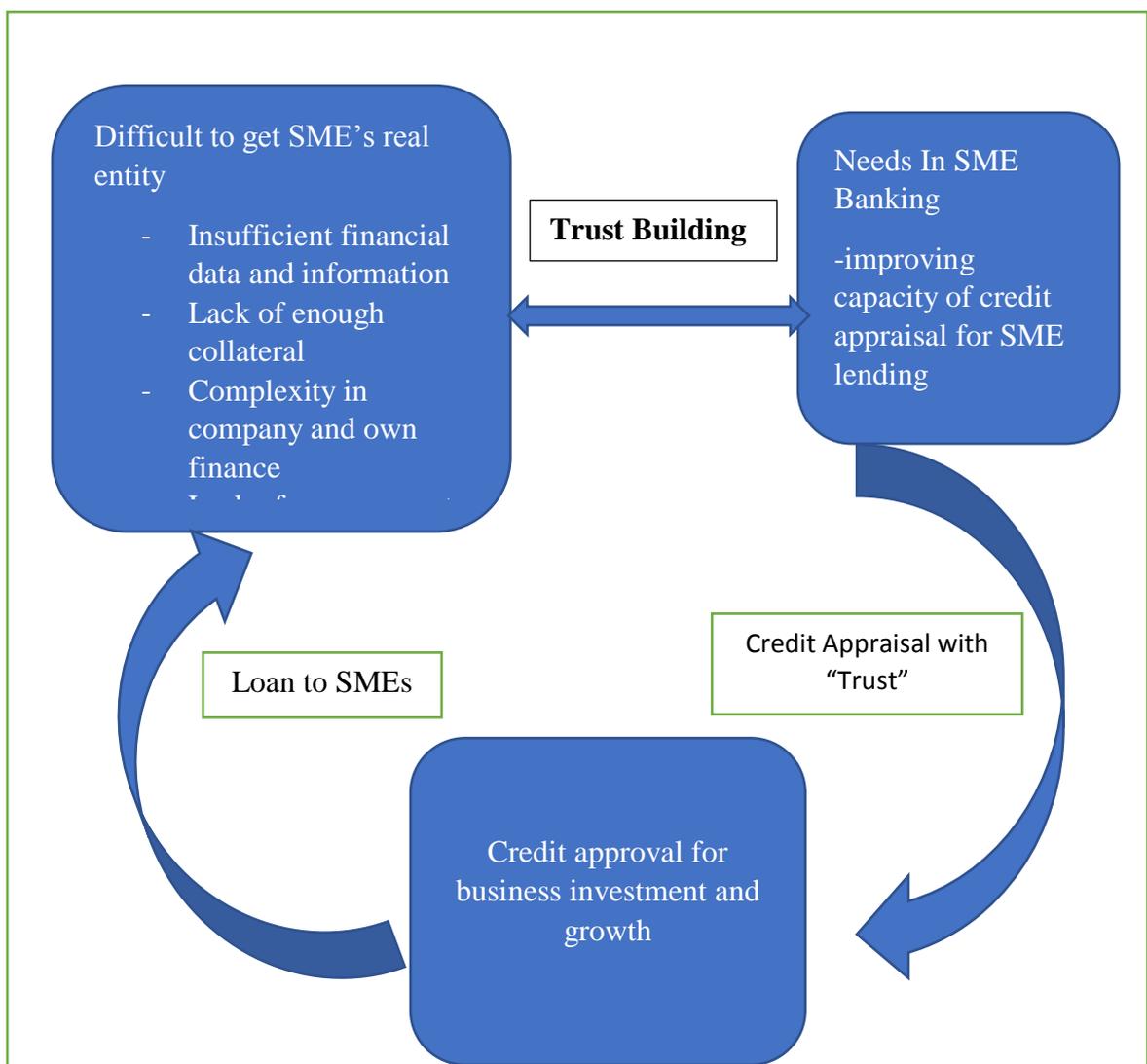
Based on earlier research it seemed clear, that strong bank-SME -relationships take time to build up, lead into more trust and more information disclosed. When developing the relationship and establishing the foundations for trust from the bank-perspective it seemed, based on the interviews, that in the beginning of a new relationship intuition (e.g. trusting one's competence, ability trust) has a big role and it would rise from the free form discussions. Thus, building or disassembling trust is based on consecutive actions in the same direction. From SMEs perspective trust was mainly based on institutional trust and the history of banks as trustworthy institutions.

5.2 Suggestions and Recommendations

When thinking about bank SME relationships and the lending processes related to them it is certain, that financial numbers and other hard data are mandatory information in any lending process. However, it is important to acknowledge, that trust and soft information shared in free form discussions are in the center of the

whole process. Without trust and soft information, the relationship- based lending processes would not be possible in the first place. In some cases, it might be hard to figure out whether a new SME whose looking for a loan is actually able to pay the loan back. Based on the interviews conducted during this study one could argue, that information asymmetry in bank SME relationships is skewed towards the banks. This is true, of course. However, it is a natural consequence of the fact that banks are the actor who are giving out loans and it resembles a classical principal-agent problem. If banks make bad decisions when giving out loans they experience credit defaults. On the other hand it is in the intentions of the SMEs, that they pay back their loans, keep the business running and have the option for further loans if needed.

Fig. 5.2 Trust Building Impact on Loan Decision



Source: Concept of SME Lending

5.3 Further research

Reducing information asymmetry would benefit both the banks and the (good) SMEs. Furthermore, it would be useful to conduct more research of the area so that companies on the both banks and SMEs would be able to use the information and adapt their processes if needed. Also, more research is needed in order to understand, whether the reduced information asymmetry has a large effect on the terms of the loans, or is speeding up the lending process the main effect of it.

It has been argued in some previous studies, that some SMEs might not be so keen to send sensitive information to banks because lack of trust. However, the SMEs I interviewed during this study did not worry about sending sensitive information to banks. Thus, interviewing SMEs who have had some trust issues with banks would be another area for further research. At least I would like to know why they do not trust banks with the information, are they familiar with bank secrecy requirements and what should banks do to gain their trust. Another research subject related to bank-SME trust would be to find out if there are cases, in which SME's have been opportunistic in a way that they have received larger loans than they should receive based on the real status of the company.

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Annex A

Questionnaire for SMEs

1. Relationship with the bank

- 1.1 How long has the relationship lasted with your current bank?
- 1.2 How long has the relationship lasted with your current loan officer?
- 1.3 How would you describe the relationship with the loan officer?
- 1.4 How would you describe the relationship with the bank in general?
- 1.5 Do you know the loan officer in any other way but as a representative of the bank?
- 1.6 Do you wish, that you could always deal with the same loan officer?
- 1.7 Have you had any positive or negative (trust-related) experiences with the bank?

2. Lending process

- 2.1 How often have you applied for a loan?
- 2.2 How do you proceed when you need a loan from a bank?
- 2.3 Do you first contact the contact person or send the loan application straight ahead?
- 2.4 Have you had any problems with your loan applications? If yes, what?
- 2.5 What materials have you needed when you have applied for a loan?
- 2.6 What information do you deliver to the bank? Just what they request, or?
- 2.7 Would you provide additional information in order to get better terms for the loan?
- 2.8 Do you think that providing additional information would improve your chances on getting a loan?
- 2.9 Are you worried how the bank uses the information they receive from you or are you worried, that the information could end up in the wrong hands?

3. Free form discussions

- 3.1 Does the lending process include any free form discussions?
- 3.2 If yes, what role have these discussions had?
- 3.3 What kind of information have you shared in these discussions?
- 3.4 How do you decide what information do you provide to the banks?

- 3.5 Does the loan officer know your company from outside of the professional relationship?
- 3.6 If yes, does it have any effect on the lending process?

Questionnaire for banks

1. General information

- 1.1 Could you briefly describe how the lending process goes in this bank?
- 1.2 Does the length or quality of the relationship affect the process?
- 1.3 How do SMEs contact you usually? (phone, email, what?)
- 1.4 Do the customers ever contact you in unofficial ways? If yes, how?
- 1.5 Does the way of contacting depend on the type of the customer?
- 1.6 Are there any cases where the bank would be the proactive entity in the lending process, e.g. based on earlier unofficial discussions?
- 1.7 Do you think that the level of trust between the bank and a SME has an effect on how much and what kind of information the SME is willing to provide to the bank?

2 Information on the relationships

- 2.1 How often do you meet your typical SME customers?
- 2.2 Do you aim to have the same person dealing with the same customer every time?
- 2.3 What makes you trust an SME?
- 2.4 What actions lead to decreased trust?
- 2.5 Do you know your clients outside the professional relationship?
- 2.6 Does the bank always organize official meetings, or unofficial meetings as well?
- 2.7 Do the clients organize events where a bank representative is present?

3 Information needed in the lending process

- 3.1 What kind of information do you need in order to go through the lending process?
- 3.2 Have you asked for any additional information? What?
- 3.3 Is there any information that is not so easy to communicate on paper?
- 3.4 How do you make sure, that the customer information does not end up in the wrong hands?

4 Further questions about the additional information

- 4.1 What role does the additional information have in the lending process?
- 4.2 How important is the additional information in the lending process?
- 4.3 Does it affect the lending process, that on what does the SME intend to use the money on?
- 4.4 How do you think, that how does a SME decide what information to share with the bank?
- 4.5 If it is not possible to get a clear image of the SME from financial statements and such, what role has the additional information have at this point?
- 4.6 Could the lending process be made more transparent for the customer?
- 4.7 What kind of effect does it have, if the customer does not provide the requested information?

5 Information needed in the lending process

- 5.1 If you have requested for additional information, how have the SMEs delivered this information to you?
- 5.2 Has this additional information affected the lending process?
- 5.3 Do you think that providing additional information helps the SME to get the loan they are looking for?
- 5.4 Does the provided additional information have a straight effect on the result of the lending process?