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ASYMMETRY INFORMATION PROBLEM BETWEEN COLLATERALS REQUIREMENT AND FIRM –BANK RELATIONSHIP: A CASE OF HARARE SMALL TO MEDIUM ENTREPRISES MANUFACTURING ENTITIES, ZIMBABWE

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Moses, Z., Njaya, T. & Mazhambe, Z. (2023). Asymmetry Information Problem Between Collaterals Requirement and Firm –Bank Relationship: A Case of Harare Small to Medium Entreprises Manufacturing Entities, Zimbabwe. *Indiana Journal of Economics and Business Management, 3*(4), 29-34.

Abstract: *Small business owners are not transparent and do not give the true information about their assets, liabilities, profits and others to tax collectors, their employees and outsiders. Thus, this study examined asymmetry information problem between collaterals requirement and firm –bank relationship. The research adopted the mixed research methodology. The objective of the study was to assess asymmetry information practices and their effects on financial performance of SMEs Manufacturing Entities. The research design was a descriptive survey. The study used interviews and surveys as data collection tools. The study' findings revealed that Banks are the main providers of financing to firms and have the capacity to generate higher and better information than other financial intermediaries. Therefore, firm-bank relationship is a useful tool in resolving problems associated with asymmetric information in business and lending Moreover, players in SMEs were not willing to provide right information when applying for loans. The study recommended that Small to Medium Manufacturing Enterprises Entities in Zimbabwe must give right information about their business to banks in order to get appropriate financial support.*

Keywords: perceived risk, book keeping records, asymmetry information, collateral, right information.

INTRODUCTION

Shinozaki, S. (2012) explains asymmetry information as defining characteristic of credit markets. He further said that banks offering credit to borrowers face uncertainty about their credit worthiness to the extent that they cannot observe some of the borrowers' characteristics and actions. Shinozaki, S. (2012) assertion was supported by Sachs, J. & Larraine, F. (2016) who define asymmetry as a measurement used by banks to assess creditworthiness of borrower. These informational asymmetries may lead to credit rationing and may invalidate other standard results of competitive markets. Moreover, in the process of lending, banks gather some proprietary information about borrowers' creditworthiness, so that over time they may partially resolve the problems associated with informational asymmetries. Furthermore, with such information banks acquire some degree of monopoly power over their clients and an advantage over their competitors. As a document used by banks to assess whether borrowers qualify for loan applied, asymmetry information document shows actual credit risks and the perceived risks of lending to SMEs. This have led lenders to require borrowers to use their physical properties as collateral to reduce potential losses from loan defaults. However, many SMEs do not possess valuable fixed assets, such as land and buildings, to pledge as security for loans. Instead, they own "movable" collateral, such as equipment and machinery, livestock, accounts receivables, intellectual property and inventories. Thus the issue of asymmetry information requirement is a tropical issue that can cause the relationship between borrower and the bank being sour. Having a secured transactions framework that provides adequate protection to lenders allows SMEs to leverage these types of assets and secure loans to grow their businesses. Moreover, integrated legal framework for secured transactions needs to be accompanied by a modern collateral registry for movable and intangible assets. Such registries allow a lender to take security rights in an asset without having to take physical custody of it.

The theory of social capital underscores the importance of trust in social networks at both individual and organizational level (Shinozaki, S. 2012). Thus banks and borrowers must consider relationship lending. The problem in evaluating the creditworthiness of the borrower is that small business owners are not transparent and do not give the true information about their assets, liabilities, profits and others to tax collectors, their employees and outsiders (Mishkin, F.S. 2020). This poses the information asymmetry problems. With access to external finance depending on an open

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trade of information between the SME and the financiers, the problem of asymmetry information will not be a challenge. More transparency and better dialogue between SMEs and financial institutions can help to solve some of the challenges SMEs face in accessing loans (Sachs, J. & Larraine, F. 2016).

The refusal of small business owners to give right information about their business to outsiders make it difficult to assess creditworthiness and also difficult to lend (Sachs, J. & Larraine, F. 2016). Shinozaki, S. (2012) suggests two ways in which SMEs can neutralize the challenge of informational asymmetry. Firstly, the can explore relationship lending which is enhanced by social networks because it relies primarily on soft information gathered by the loan officer through continuous, personalized, direct contacts with SMEs, their owners and managers, and the local community in which they operate (Shinozaki, S., 2012). Secondly, by adopting clear accounting standards, setting up independent, competent and reputable accounting firms and creating more credit bureau supplying data on the solvency of firms, banks can able to obtain relevant information from SMEs without having first to hustle with them (Shinozaki, S. 2012).

In South Africa, Banks like FNB have partnered with SMEs with Pastel Accounting software to manage all their accounting and management using internet banking. However, this has opened these SMEs to electronic frauds but it has proved to be an effective way to earn the banks' trust. This has resulted in the SMEs on these programs getting loan from the banks due to the transparency of the program. Using the accounting software makes it easier for the SMEs to present financial statements and also pay their VAT and tax returns effectively. Given the reduced information risk arising from audited financial statements, potential lending institutions may offer low interest rates as well. In other words, audited financial statements improve borrower's credibility and therefore reduce risk for lenders (Sachs, J. & Larraine, F. 2016).

Policy Guidelines

A modern, secured transactions system will have the following elements: a) A stand-alone law (e.g. secured transactions law or personal property law) to regulate all aspects of security interests in movable property rather than revising existing provisions in multiple laws, such as commercial and civil codes. b) Broad scope of secured transactions law by allowing: i. All types of assets (both tangible and intangible, present and future) to be used as collateral for loans; ii. Broad pools of assets (revolving assets) with a generic description of the assets to be accepted as collateral to facilitate the use of credit revolving facilities; iii. Equal treatment of all transactions secured by movable property regardless of their contractual nature (financial leases, consignments, assignment of receivables, secured sales contracts, loans secured with movable property, retention of title, etc.); and iv. Automatic extension of security interests to products and proceeds of the collateral to protect the value of the security interest. c) Simple procedures for creating and enforcing security interests in movable property. d) Movable collateral registries to notify parties about the existence of a security interest in movable property and to establish the priority of creditors visà-vis third parties, comprising of: Single and centralized data source registry for all security interests, including non-consensual liens; ii. Web-based electronic system accessible 24/7; iii. Registrations performed by creditors or their legal representatives directly in the system; iv. Information available to the public for searches; v. Search criteria that includes, at least, a debtor identifier and serial numbered collateral; vi. Flat and reasonable fees for registrations and searches; vii. Registrar role limited to management, not to verify and modify information in the registry; viii. Non-cash payments (debit/credit cards, electronic transfers, or pre-paid accounts); ix. Defined liability of the registry for errors; and x. Secured and protected registry data, with established disaster recovery sites. e) Priority schemes for creditors to determine the sequence in which competing claims to the collateral will be satisfied when the debtor defaults. f) Speedy and inexpensive enforcement mechanisms to satisfy security interests. Enforcement is most effective when parties can agree on rights and remedies upon default, including seizure and sale of the collateral outside the judicial process. Banks can mitigate information asymmetry from the demand side and provide better information and advice to their SME customers on available services, products and schemes. Banks are the main providers of financing to firms and have the capacity to generate higher and better information than other financial intermediaries. Therefore, firm-bank relationship is a useful tool in resolving problems associated with asymmetric information in business and lending. Sachs, J. & Larraine, F. (2016) find that collateral requirements decrease with increasing bank-borrower relationships. Borrowers with more concentrated and long-lasting bank relationships have less stringent collateral requirements. Therefore, a strong firm bank relationship will increase the willingness of owner manager to apply for bank loans. Nyoni, T. & Bonga, W. G. (2017) indicate that firms with previous relationships with banks can regain access to such banks. Mishkin, F.S. (2020) mentions that firms that use short-term debt also employ long-term debt, and firms that do not use short term debt do not use long term dept. firms that have relationships with banks are able to apply both short and long term debt, whereas firms that do not have such a relationship are not capable of applying and accessing any form of funds from banks. The following hypotheses on firm-bank relationships and bank loan applications is proposed on the basis of the arguments between asymmetry information and collaterals:

Human capital theory and SME financing

Human capital includes knowledge, skills, competencies, abilities, attitude, talents and experiences that are used by an individual to provide value to a firm achieve the goals of a firm and support the success of a firm (Mishkin F.S. 2020). Human capital is defined as a key element in improving firm assets and employees, increasing productivity and sustaining competitive advantage. Florin (2013) finds that human capital is a significant source of success in entrepreneurial firms. The human resources of a business venture act as a surrogate indicator of the competence and credibility of a firm and confidence level of external and internal stakeholders. The owner manager is one of the most common components of SMEs. The majority of SMEs are owned and managed by the same individuals. By contrast, large firms are normally managed by a team of professionals appointed by the shareholders of the firms. Therefore, the characteristics of owner managers such as levels of education and experience affect firm survival and access to external financing. Thus, highly educated entrepreneurs will choose to dissolve their firms and seek lucrative employment opportunities. Mishkin, F.S. (2020) suggests that ownership experiences play an important role in explaining differences in external financing. Mishkin, F.S. (2020) examines education, years of experience, and access to external finance. He finds some evidence that education is positively related to access to external loans. Sachs, J. & Larraine, F. (2016) explores some of the barriers that increase the bank finance problems faced by SMEs. They found that educational level does not have a significant impact to finance sources, except those with advanced level of education who frequently used friends and family and remortgaged their homes.

Therefore, education and experience are significant in applying for external formal financing. However, some studies suggest that the benefits of this knowledge are limited to the managerial roles and not the operational roles of business owners (Sachs, J. & Larraine, F,. 2016). Mishkin, F.S. (2020) mentions that experience should not be equated with knowledge because experience may or may not lead to increased knowledge. Mishkin, F.S. (2020) uses Spearman's correlation analysis to find any association between the level of education of owner-managers and application for financing. Earlier studies find that the influence of human capital to firm performance and the education of owner-manager are not related to the success of a firm. Mishkin, F.S. (2020) discovers a negative relationship between bank financing and owner experience.

However, SME owners and works in developing countries often have relatively low levels of education than employees in large firms (Sachs, J. & Larraine, F. 2016). Human capital theory states that the education and experience of owner –manager influence the access of firms to external financing.

Theory of the firm and SME financing

The determination of firm size may be based on the value of capital investments or the number of employees, which are input measures of firm size because they are the internal factors of the firm (Mishkin, F.S. 2020). Firm size has received limited attention in the empirical tests of asymmetry and simultaneity hypotheses because differences in size reflect differences in other variables such as age (Mishkin, F.S. 2020). Sachs, J. & Larraine, F. (2016) cite that size theories on firm size can be classified into four approaches, namely the conventional microeconomic approach (or the technological approach), transaction cost approach (or the institutional approach), industrial organization approach, and dynamic model f size distribution approach. The dynamic model of firm size and distribution includes stochastic, life cycle, and evolutionary models. The primary source of innovation in this approach is research and development. In pursuing this activity, larger and more established firms have an advantage than smaller and newer firms. These models correlate the size of the firm to its age and growth, (Nyoni, T. & Bonga, W. G. 2017). Mishkin, F.S. (2020) suggests that the firms enter the market as small firms and grow through learning. A small and young firm faces greater risks and turbulence than a big firm. Small firms also encounter difficulties in obtaining credit. Thus, Mishkin, F.S. (2020) indicates that the interactions between outside / inside financing and firm size are important and should be controlled when examining such financing relationships. Firms that seek growth are more likely to apply for external equity and debt capital than firms that do not exhibit growth (Mishkin, F.S. 2020). Mishkin, F.S. (2020) finds that firm size plays an important role in the way financial structure affects the growth process. Mishkin, F.S. (2020) states that firm size is positively related to external financing application. Mishkin, F.S. (2020) discovers that firm size is significantly associated with debt. New and younger firms use fewer banks and other finance institutions than older firms. On the other hand, Nyoni, T. & Bonga, W. G. (2017) find that new and young firms are likely to apply for external resources than older firms. Mishkin, F.S. (2020) studies the choice of formal or informal financing in China and finds that firm size has a significant negative correlation with formal financing. Mishkin, F.S. (2020) find that younger firms usually lack sufficient internal funds and do not have easy access to external equity. Thus, these firms are more reliant on external debt sources. Mishkin, F.S. (2020) find that older firms have less loan applications than younger firms. They also indicate that firm size is not a determinant of the propensity to apply for loans. Larger firms are more likely to receive approval but do not apply more or less often. Furthermore, the paramount issue of informal sector and enterprises "full recognition" as economic actors is very fundamental for policy makers, development agencies and formal credit financiers who normally

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consider them as rather marginal and with a skewed negative perception of the formal sector (Floridi *et al.*, 2014). The informal sector and enterprises should instead be perceived (Floridi *et al.*, 2014) as a phenomenon encompassed with its own conceptual and theoretical frameworks. Collaborations and recognition of SMEs as important economic players is essential for speaking with a unified voice, negotiation and advocacy for multiple benefits that can be negotiated with the Government, Financial institutions and Investor community, hence this study placed greater emphasis on this concept.

Access to formal credit from financial institutions

A survey by Kitindi *et al.*, (2017) of 1710 registered SMEs in Nigeria revealed that there is no significant relationship between formal credit and SME size, SME collateral, SME ownership structure and SME entrepreneur educational level. Traditionally banks are reluctant to issue formal credit to SMEs mainly due to their high associated costs and risk in servicing of the loans (Kitindi *et al.*, 2017).

Limited domestic savings and high financial services costs coupled with tight regulation framework are the primary justifications for poor access to formal credit in developing countries. (Hong, S. & Gu, X. 2014). Accounting information and record keeping is vital for determination of profits and taxation purposes, since they provide management of all organisations regardless of its size with useful information for decision making and also for outside stakeholders like financial institutions who require the information for access to credit and loan facilities and also tax authority for Income tax purposes (European Commission (EC), 2018). Since there is currently no established correlation between SME size, management, physical assets, collateral or age of establishment, this study therefore sought to evaluate any causal linkage on asymmetry information requirement and collaterals. Moreover, the challenges of SMEs include, the inability of SMEs to provide collateral and other information needed by banks such as audited financial statements coupled with the high cost of loans in terms of high interest rates making it extremely difficult to access bank loans (Stiglitz, J. & Weiss, A. 2017). SMEs have fewer collateral sable assets than large firms. Another reason why small firms have a smaller proportion of fixed assets is the capital constraints faced by them. Because of the need to raise large amounts of capital, it becomes difficult for them to acquire substantial fixed assets. Access to formal finance is also poor because of the high risk of default among SMEs due to inadequate financial facilities, (Shinozaki, S. 2012).

Maintenance of books of accounts is important in any business, whether it is small or large sized. Sad to say, most of the small and medium business entrepreneurs often neglect this process, which has a direct adverse effect on the business. In fact, some SMEs failed in financial management due to weak or no accounting records (Stiglitz, J. & Weiss, A., 2017). They do not maintain their books of account, because they think maintenance of books of account for their small business is worthless yet it is part of asymmetry information requirement. Thus this study focused on the asymmetry procedure practices and their effects of firm-bank relationship.

Experimental Section/ Material and Methods

Statement of the Problem

Asymmetry information requirement about actual risks and the perceived risks of lending to SMEs has resulted in lenders requiring borrowers to use their physical properties as collateral to reduce potential losses from loan defaults. Thus, led to the wrong assumption that there was no social network trust between SMEs and the banks. What is the relevance of trust in social networks at both individual and organisational level when borrowers were required to use their physical property as collateral?

Objectives of the Study

To assess asymmetry information procedure practices and their effects on firm-bank relationship based on a study of sixty (60) SMEs Manufacturing Entities staff, in Harare**.**

Research Question

Do the issue of asymmetry information procedure on SMEs Manufacturing Entities have an impact on their financial statement performance?

Methodology

The population of the study consisted of 60 (sixty) members from Harare, SMEs Manufacturing Entities. A mixed method approach was used to examine the major causes of non-funding by banks and attachment of physical property in the event of loan defaults.

A purposive approach to select 20 (twenty) SMEs Manufacturing members was used for the study as it enabled the researcher to consciously select a sample appropriate for the Study Interviews that allowed respondents to answer certain questions in order to secure desired information and questionnaires were used as the data collection tools.

RESULTS AND DISCUSSION

The study wanted to find out effects of failing to adhere to asymmetry information procedure requirement by SMEs Manufacturing Entities when borrowing loans from the banks.

The following results were obtained

Table 1: Effects of Failing to Adhere to Asymmetry Information Requirement by SMEs Manufacturing Entities When Assessing Loans.

Issues:	**Agree**	**Not Sure**	**Disagree**
1. Do you encounter any problem in completing asymmetry information form?	90%	5%	5%
2. Do you give right information?	85%	5%	15%
3. Is there inadequate knowledge by SMEs Manufacturing staff on asymmetry information requirement form?	90%	5%	5%
4. Do you encounter liquidation problems in the day to day running of your firms?	80%	2%	18%
5. Attachment of property by banks in the event of defaults common?	90%	5%	5%
6. Does non- funding by banks has an effect on financial performance of your entities?	80	5%	15%

Source: Primary data 2023

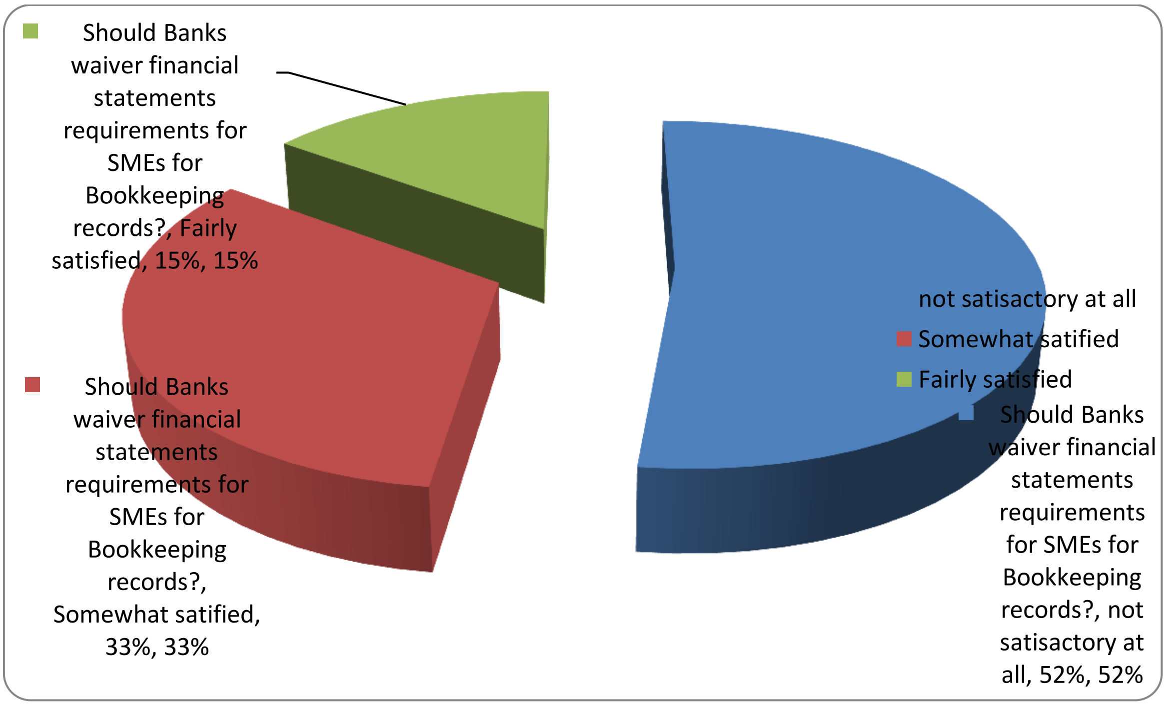
The majority of respondents agreed (85%) that there do not give right information to the banks when applying for a loan, with a minority in disagreement (15%) and (5%) not sure.

Asymmetry information problem procedure requirement in- depth understanding , in Harare Manufacturing entities, Zimbabwe and impact on financial performance provided by the respondents included, loss of customers, financial loss, liquidation of entities, attachment of physical property as a result of failing to provide right information.

The research intended to establish whether asymmetry information has a relationship with other factors such as booking records . The following results were obtained.

Do the issue asymmetry information requirement has a relationship with other factors such as bookkeeping records?

Should Banks waiver financial statements requirements for SMEs Manufacturing Entities Bookkeeping records?



Source: Primary data 2023

The interviews data gathered with the SMEs Manufacturing Entities indicated that there is a link (52%) between asymmetry information requirement and SMEs bookkeeping records and no need to waiver provision of record keeping records. It would be difficult for banks to waiver this requirement because

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there is no way banks can dish out money to businesses that have no evidence of existence. Therefore, financial statements will be very difficult to do away with. The interviews gathered also showed that Members of SMEs Manufacturing Entities interviewed indicated that they were aware of the obligation of giving right information about their business to banks when applying for loans, and requirement that the banks must meet their other side of the agreement by giving them loans.

Furthermore, data gathered through questionnaires concurs with data collected from interviews. Thus, this shows that the respondents were aware of major effects of failing to provide right information when applying for loans.

Findings

The study's findings revealed that asymmetry information problem requirement and firm-bank relationship procedure require banks to use it when assessing bank loans, thus it complies with the understanding at the continental level. The Small to Medium Enterprises were not able to provide right information to the banks thus actual credit risks and the perceived risks could not be determined by the banks. This had led Banks requiring borrowers to use their physical properties as collateral to reduce potential losses from loan defaults.

CONCLUSIONS

Small to Medium Manufacturing Enterprises in Zimbabwe should ensure right information is given as part of agreement of obtaining funding. Furthermore financial profitability of these Small to Medium Enterprises must not hindered by failure to adhere to asymmetry information problem requirement procedure on firm –bank relationship. Banks failed to assess credit worthiness of Small to Medium Manufacturing Enterprises clients because right information was not provided.

Recommendations

The study recommended that Small to Medium Manufacturing Enterprises in Zimbabwe must give right information about their business to banks in order to get appropriate financial support.

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