

# Factors Affecting Libyan SMEs' Selection of Banks as Business Partners

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## Abstract

The aim of the current paper is to investigate the major criteria/factors considered in the process of banking partner choice/selection by SMEs in Libya. For this purpose a sample of more than 200 SMEs was targeted by a survey questionnaire which was prepared based on the relevant literature. The findings reveal that factors such as personal banking relationship with the bank, location convenience, and the credit availability upon competitive prices were considered as the most important. Lower level of attention, however, was given to other factors such as recommendation by others, personal relationships with managers, and friendliness of the staff. No significant differences in these factors were found across business sectors. Considering the fact that the study was conducted within only one region, the findings may lack generalizability. Hence, further research to assess the extent to which these findings can be further generalized across the country is encouraged. The findings can be beneficial for banks in order to be more effective in serving this sector. As a result, it is hoped that SMEs to be better served. The results may also create more business opportunities between banks and SMEs. The study is the first of its kind that investigated the SMEs-banks business relationship in Libya. It, therefore, adds to the existing literature on SMEs-banks relationships in developing economies.

**Keywords:** Bank selection criteria, SMEs, Libya.

## 1. Introduction

In both developed and industrialized countries a robust small and medium-sized enterprise sector (SMEs) is vital for economic development. This is especially true in the case of developing countries where this sector is described as the main “engine growth” (Floyd and McManus, 2005). As a result of the increasing recognition of their central role, SMEs have been the focus of research in the areas of financing (e.g. Berger and Udell, 2006; Tucker and Lean, 2003; Van Auken and Neeley, 1996), innovation (e.g. Rammer and Schmiele, 2008; Zhang, Macpherson and Jones, 2006), and management (e.g. Hutchinson and Quintas, 2008; Ghobadian and Gallea, 1996). A common conclusion of these studies is that access to finance is crucial for SMEs' growth and banks are major providers.

In the commercial banking industry there is a growing recognition that SMEs not only represent a viable market segment and an opportunity to make a good rate of return (Keasey and McGuinness, 1990) but that their needs are different (Ali and Raza, 2015; Gidhagen and Thunman, 1999; Kolari, Berney and Ou 1997; Nielsen, Trayler and Brown, 1995; File and Prince, 1992) and frequently underserved and unmet (Chaston, 1994; Edwards and Turnbull, 1994). According to Nielsen *et al.* (1995) commercial banks that once relied on the highly profitable corporate market will find it increasingly necessary to tailor their services to the SMEs sector market.

In the same vein, for SMEs, banks represent an important and almost indispensable business partners as they facilitate numerous functions that are necessary for their viability and growth. For instance, banks

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provide cash management services, arrange letters of credit, and facilitate both domestic and foreign exchange transactions. More importantly, it is well documented in the literature that banks are critical sources of SMEs' credit needs (e.g. Raza et al., 2015; Adair, Ammous and Fhima, 2010; Vera and Onji, 2010; Viducic, Viducic, and Boras, 2010; Le and Nguyen, 2009; Ono and Uesugi, 2009; OECD, 2006; Ayadi, 2005; Carey and Flynn, 2005; Lund and Wright, 1999; Berger and Udell, 1995; Cole and Wolken, 1995).

Based on the above, for SMEs to survive and thrive, they will need a banking partner that not only understands their business, but also one who stands ready and willing to meet their ever expanding service requirements. Surprisingly, however, despite this importance of banks to SMEs and vice versa little is known about the characteristics of their relationships with each other. Research on bank selection criteria has mainly focused and mostly targeted the general population with little attention being paid to SMEs. Some researchers believed that bank selection criteria in many countries are the same: price, reputation and service. Nevertheless, due to differences in cultural, political, economic and legal environments it can be argued that some differences may exist not only from country to country but also from one region to another within the same country.

The literature has shown that studies related to bank selection criteria conducted elsewhere other than the USA and Europe are quite rare (Gerrard and Cunningham, 2001). Therefore, this paper is an attempt to enhance the understanding of bank selection criteria in the context of SMEs sector in developing countries. As such, this study aims to explore the factors that SMEs consider important in their selection of main banking partners in a developing country which is Libya. The study also examines any differences in these factors among SMEs operating in the three main economic sectors which are; trade, services, and manufacturing.

For SMEs, this study is particularly appropriate as the decision of choosing banking partner is typically exclusively controlled by the owner-manager of the firm unlike the situation in large companies where such decisions are usually made by multiple decision makers and following a complicated process. In addition, the study is important in the sense that it is the first of its kind targeting SMEs in Libya which means it will constitute a stepping stone for further studies to determine bank selection criteria in the country across different segmentations. Moreover, the study also provides bank executives and senior officers with better understanding of SMEs banking needs so they are better informed when designing products and services to satisfy SMEs market.

The remainder of the paper is structured as follows: the next section briefly reviews the relevant literature. Thereafter, the methodology of the study is discussed. The results of the empirical study are reported in the following section. The final section provides the conclusion of the study with its implications, limitations and venues for further research.

## **2. Literature Review**

Bank choice behaviour in the business environment has been an area of academic interest. Numerous studies have been conducted on the bank selection process around the world. Most of these studies are geographically focussed, market segment focussed or product focussed. Generally, customers employ a number of processes for product/service evaluation which will eventually leads to the choice and/or preference of a particular product or service provider. Previous research has indicated some important factors influencing customer choice of banks in areas like bank personnel, the organisation and structure of banks, pricing policy, and product offerings.

Previous studies suggest that bank selection decisions were significantly different across different market segments (e.g. Decker and Khazeh, 1992; Kaynak and Kucukemiroglu, 1992; Laroche, Rosenblatt and Manning, 1986). While large firms are interested in price of the service or the product (Turnbull and Gibbs, 1989), SMEs are more interested in the quality of the relationship with the service or the product provider which is in most cases commercial banks. Furthermore, social exchange was found more important

for large companies than for SMEs (Zineldin, 1995). According to File and Prince (1992) SMEs require greater interaction and, moreover, in the case of family business the decision of choosing banking partner is more emotion-based (Dreux and Brown, 1994).

In fact, multiple factors for bank selection are used by SMEs (Lindstrand and Lindbergh, 2011). Ennew and Binks (1996) provided evidence that the provision of quality bank service positively influences SMEs in their choice of a banking partner. Their findings suggest that the quality of the advice offered by bank staff, personalization in the service delivery process, provision of credit, and competitive rates and fees are the key characteristics of service quality that SMEs are eager to seek in their choice and retention of a banking partner.

In an attempt to understand bank selection decision in this sector an earlier study by Buerger and Ulrich (1986) surveyed 475 SMEs in Pennsylvania. The results revealed that the prices of services offered were very important factors in selecting a bank. A year later, Schlesinger, Unsal and Zaman (1987) confirmed this as the findings of their study showed that lending rates were among the three most important factors in selecting a bank for a sample of 174 SMEs in New York. Other factors were found important included ease of borrowing and the full service offered by the bank. However, recommendations of others and local ownership of the bank were the least important. Still in the US, two later studies by Prince and Schultz (1990), and Freeman and Turner (1990) found SMEs owners were primarily more interested in issues related to confidentiality and professional personnel.

A study comparing the factors that SMEs in the United States and those in Australia consider when selecting their main banking partners was conducted by Trayler, Nielson and Harrison (2000). The study concluded that in both nations SMEs ranked the bank's willingness to accommodate their credit needs as being important. However, other factors such as the range of products and services and convenient location were rated more important by US firms. On the other hand, Australian SMEs placed more emphasis on long-term relationships, day-to-day efficiency and competitive prices. Another Australian-based study qualitatively investigated the service quality attributes which SMEs desire in their choice and retention of banks (Jobling, Walker and Heffernan, 2009). The study found that the qualities that Australian SMEs desire in their banks can be categorised under five broad themes or dimensions namely; employee capabilities, credit accommodation, price competitiveness, accessibility and internet banking.

In the context of developing countries, a bi-dimensional study conducted by Abdulrahman, Mahmood and Abdulrahman (n.d.) in Malaysia. The study surveyed local bank managers and SMEs owners regarding their understanding of bank selection criteria among domestic SMEs. Surprisingly, the top six factors identified by bankers were also among the top factors ranked by SMEs owners. However, SMEs owners tend to place greater emphasis on the financial health of the bank and on the ability of the bank to provide personal banking relationship. A more recent study by Narteh (2013) surveyed more than 500 Ghanaian SMEs with the aim to identify their determinants of bank selection and other patronage factors. The study found that price competitiveness, credit availability, perceived service quality, staff attributes and bank attributes are the determinants of SMEs' selection of banks in Ghana.

Abou Aish, Ennew and McKechnie (2003) compared bank selection decisions in the SMEs market across UK and Egypt. The results advocated various similarities and provided evidence to suggest that reputation of the bank plays a major role in the bank selection decisions by SMEs in both countries. The study reinforces the opinion that technical quality (quality of service itself) is more important than functional quality (quality of the service provider) in bank selection decisions. More specifically both Egyptian and UK SMEs customers consider financial items (fees, interest rates and credit availability) as the most important factors in bank selection decisions.

Other studies found different criteria to be important. A study by Lam and Burton (2006) identified the quality of perceived service as the major selection criterion by SMEs in Hong Kong. The ability of banks to accommodate the credit needs of SMEs was an important determinant for SMEs in their bank selection decisions (Nielsen, Terry and Trayler, 1998). Other studies in the literature suggest that convenience of bank

location is significantly important (e.g. Nielsen *et al.*, 1995). In addition, high trust and high ability of adaptation were among the top three factors in SMEs' choice of principal bank in Sweden (Zineldin, 1995).

### 3. Methodology

To restate, it is the objective of this study to identify the most important criteria of bank selection considered by Libyan SMEs' owner-managers when choosing banking partners for their businesses. The current study took place in June-August 2013 in the city of Benghazi the second most populous city in the country, yet, it has the highest informal economic and commercial activities. All banks operating in the country have at least one branch office in this city which can be an indicator of highly competitive banking environment where clients have a wide range of banks from which to choose a banking partner.

In order to achieve its objective, the study adopted a survey questionnaire as the data collection instrument. Such approach has been widely used in similar studies and provided an efficient and effective means of collecting the necessary data (e.g. Sayani and Miniaoui, 2013; Kamakodi and Khan, 2008; Devlin and Gerrard, 2005). The questionnaire covered different attributes that banks customers perceive as important when selecting which bank to choose as business partner. Those attributes and factors were derived from the relevant literature. They were then revised and adapted to the local banking system. As such, all factors that are believed to be relevant to the Libyan business and banking environment were covered. Therefore, factors such as extensive automated teller machines services (ATMs), availability of Internet banking as well as high incidence of advertising campaigns since they are either in their infancy or non-existent in the country's banking system were not included. Finally, prior to being employed the questionnaire was pre-tested and alternations and amendments where appropriate were made.

The questionnaire was self-administered by the researcher and two field assistants. The sample employed by the study comprised of small and medium-sized firms operating within the city of Benghazi. The selection of SMEs in the sample was based on the requirements established by the National Council for Economic Development's recommendation (NCED, 2008) regarding the definition of small and medium-sized enterprises whereby these businesses are defined according to the number of employees ( $SMEs \leq 50$ ). Both small and medium enterprises were targeted. Although firms were randomly selected, the lists were stratified to include firms in all the three main industries namely; trade, services, and manufacturing.

In order to improve the quality of the data, only owner-managers who are primarily responsible for selecting currently patronised bank were asked to complete the questionnaire. Each respondent was provided with a list of possible criteria and asked to rank the three most important ones he/she considered in selecting his/her firm's banking partner. Each approached respondent was given a simple briefing about the study and a time frame for the completion of answering the questionnaire. A total of 280 questionnaires were distributed. 213 questionnaires were received of which only 202 were usable leading to a response rate of (72.6%). Such a response rate was considered sufficient for statistical reliability and generalizability.

In the light of the study's objectives data were analysed using Statistical Package for Social Sciences SPSS version 22. In order to determine which of the various factors SMEs consider most important in the process of bank selection, weighted average rank scores were derived for all listed factors. Moreover, bank selection criteria were compared using a one-way ANOVA test to determine if there were any significant differences across business sectors.

### 4. Findings

As stated earlier in this paper the three main sectors of the economy in which SMEs are substantially engaged namely; trade, services and manufacturing were targeted by the questionnaire. The analysis was based on usable responses received from 202 respondents. Table 1 below shows the distributions of the participated SMEs between these three sectors.

**Table 1: The Distribution of the Sample**

Business sector	Frequency	%
Trade	61	30.2
Services	46	22.8
Manufacturing	95	47.0
<b>Total</b>	<b>202</b>	<b>100</b>

The table shows that 30.2 percent of the businesses surveyed were operating in the trade sector. The larger number of businesses was more likely to be in the manufacturing sector constituted about half the sample (47.0 per cent). The group of enterprises operating in the services sector represented 22.8 per cent of the whole sample.

After indicating the business sector to which the firm belongs, each respondent was provided with a list of some factors which reflect possible bank selection criteria and asked to indicate in order the most three important ones considered in the process of selecting the current main banking partner of his/her firm. Table 2 below illustrates the responses for the whole sample as for the main factors for choosing their banking partner. Those criteria are sorted in a descending order according to the calculated weighted average ranking scores.

**Table 2: Bank Selection Criteria**

Rank	Bank selection criteria	Weighted average rank score
1	Already had my private account with this bank/ salary account	1.80
2	Convenient location/ nearest/ only bank in the locality/many branches	1.41
3	Willingness to accommodate SMEs' credit needs (loans, overdrafts)	1.12
4	Offers the best terms and conditions for SMEs (low/reasonable interest charges on loans)	1.06
5	Recommended by business associate/friend	0.23
6	Friendliness of bank personnel/staff	0.09
7	Bank is efficient in its day-to-day operations	0.04
8	Relationship with bank manager/easy to contact	0.03

First of all, it is interesting to note that all of the respondents stating having especial bank accounts for their firms. This suggests that they regularly use the services of banks. This is consistent with observation of Nasr and Pearce (2012) who reported that although SMEs in MENA region have low rates of credit usage from banks, they are better served with bank accounts.

As for the criteria indicated by the respondents, when asked why they had chosen the banks which their firms currently deal with, respondents gave different answers. Of the criteria listed in the questionnaire, the most important factor for SMEs across the sample, according to the figures in the table, was that the owner-manager already had a personal bank account with the selected bank. This factor had a weighted average score of (1.80) the greatest of all. The bank's location was the second most endorsed criterion. Where the bank is located, how close it is to their firms/homes, as well as the number of branches through which the bank serves its customers as important criteria of bank selection received the second highest weighted average rank score (1.41). Unexpectedly, third and fourth in order of importance were the factors related to the bank' services offered and oriented mainly to SMEs in terms of loans, price and cost, and service-charge policy. Those two factors had weighted average rank scores of (1.12) and (1.06) respectively.

The results also revealed that among the least important bank selection criteria for Libyan SMEs were the factor of recommendation from others (a friend or a business associate) and the friendliness of bank personnel/staff. The former received a weighted average rank score of (0.23) while the figure for the latter was (0.09). However, surprisingly factors relating to banks' efficiency in day-to-day operations and relationships with the bank manager were named by none as the first and the most important in the process of selecting a bank. With weighted average rank scores did not exceed (0.04) both factors were the least important bank selection criteria for Libyan SMEs.

Although each participant was given the opportunity to add other selecting factors in case that some other important factors, in their opinion, were not included within the ones listed in the questionnaire none had done so which suggests that all the factors examined in the study are the most common and the most relevant to the Libyan banking environment at least at the time of the current study.

The results from the study indicate that SMEs in Libya use various factors in their bank selection decisions. This is in line with the results of some earlier studies such as Lam and Burton (2005) who found that SMEs employ multiple bank selection criteria. Moreover, with the exception of the factor of having chosen the banking partner because it is the same one where the owner-manager had opened his/her own which seems to be specific to the Libyan context, otherwise, the ranking of the top criteria in this study is, to a large extent, comparable with other studies. Other top criteria identified by this study; convenient location of bank branches, availability of finance, and offering best terms and conditions to serve SMEs, were also found by other studies in both developed as well as developing countries as essential bank selection factors used by SMEs (e.g. Narteh, 2013; Abou Aish et al., 2003; Edris and Almahmeed, 1997; Nielsen et al., 1995; Turnbull and Gibbs 1989; Buerger and Ulrich, 1986).

Among the top four factors which were found significant in SMEs' bank decision making process in this study, one can observe that "personal relationship with banks and convenient location" can be considered external to the bank. The other two factors "quality of service and availability of funds" are internal to the bank. This suggests that Libyan SMEs employ a mix of external and internal bank-related factors in choosing their banking partners with external factors seem to be more important.

Interestingly, from a different angle, using the terms used by Abou Aish et al. (2003), when choosing a banking partner SMEs in Libya seem to be more interested in the functional quality (quality of the service provider), which are banks in the case of this study, more than the technical quality (quality of service itself) offered by the service provider.

Finally, it was also among the aims of this study to detect any possible significant differences in the criteria employed by firms according to their sector of business. Since the variable of business sector contains more than two sub-samples; trade, services, and manufacturing one-way ANOVA test was considered appropriate and thus was computed. Results show that overall bank selection criteria used by firms operating in these three sectors do not statistically differ ( $F = .979$ ;  $p = .377$ ). In other words, no evidence was found to suggest that bank selection criteria in the case of Libyan SMEs statistically differ across business sectors.

## 5. Summary and Conclusion

Gaining an insight into SMEs' usage of services of banks is an important link to better understanding this sector of the economy. Yet, there has been, in general, relatively little research conducted into the unique SMEs-banks business relationships. This trend is more noticeable, in particular, in the case of developing countries. Consequently, this study sought to address these deficiencies by exploring criteria used by SMEs in selecting their banking partners in a developing country which is Libya. The results are based on questionnaire responses from a total of 202 SMEs operating within the city of Benghazi. Results showed that personal relationship with the bank appears to be the most important driver for SMEs' owners in choosing a banking partner for their firms. Locational convenience, accommodation of credit needs, and price competitiveness (including charges, fees, and credit interest rates) were also found to be important. In

contrast, other factors such as day-to-day efficiency, recommendations from business associate or friend, kindness of the bank's staff, and having a relationship or close contacts with the bank manager appeared to have much less influence on Libyan SMEs' selection of banks. No significant differences in selecting factors between SMEs operating in different business sectors were detected.

In theory, this study is in response to the call for more studies on how SMEs interact with banks in emergent economies. Therefore, it contributes to the body of literature on SMEs banking relationships in developing countries with special reference to Libya. In practice, the current study provides information on the key factors in choosing banks as business partners from the point of view of SMEs clients. Such a closer insight into SMEs-banks partnership has the potential to provide banks, practitioners, policymakers as well as researchers with the much-needed understanding of the environment in which these firms operate and also offers a better overview of these businesses' needs and viability. Additionally, the study may have marketing implications for banks or other financial services providers' involved or planning to involve in serving this market which may be applicable not only to Libya but also elsewhere in developing countries.

The study took place in only one city. Therefore, in fact, the results can be considered city-specific. Arguably, SMEs operating in other regions and cities may employ different selection criteria. As such, in order to be able to make further interpretations and generalisations from the results of this study similar studies to assess the extent to which these findings can be generalised across other regions and diverse customer groups in Libya and beyond are needed. Large-scale qualitative and quantitative studies would be valuable.

This study is the first to examine the factors shaping Libyan SMEs decision of choosing banking partners. To gain more comprehensive understanding of this area of investigation there is still an opportunity to extend the research. It is evidenced in the literature that other SMEs characteristics such as age, family involvement and ownership type, among others as well as personal characteristics of owner-managers have an impact on SMEs decisions. These were not explored in this study. Therefore, exploring the relative importance of these variables in the SMEs bank selection process provides a fertile area of further investigations. Finally, since this study is limited to the demand side, adding the bankers' supply perspective would be a natural extension of this study.

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