

Asymmetric Information and SME Financing: A Case Study of Homagama Divisional Secretariat

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Many experts argue that small and medium enterprises play a significant role in the economy irrespective of the status of the development. According to the Sri Lankan context, SME contribution is 52 - 53 percent to GDP. Since majority of SMEs themselves unable to finance on their own requirements, many move towards the external financial sources. SME financing is a challenging task for lenders and obtaining credit facilities from financial institutions is also challenging for SMEs. Irregularity of SMEs, specially in reporting transactions, fund management, lack of innovation and asymmetry of information are common issues that inherent to SME industry. This study is based on asymmetric information related to SMEs. During the process of a credit facility, asymmetry of information creates a great influence. When it comes to SME lending there is a gap between borrower and the lender regarding both financial and non-financial information which is resultant in adverse selection and moral hazard. The main objective of the study was to observe how asymmetric information affects in SME financing. Both private sector and state banks have the issue of asymmetric information in lending for SMEs. SME borrowers faced obstacles when obtaining credit facilities from banks and banks have a greater amount of default credit facilities in SME lending. The study realized that majority of default credit facilities fell under sole proprietorships and the least were in limited liability concerns. Banks follow a rigid procedure to facilitate SMEs having a strict way of analyzing financials where it has become an obstacle for to obtain credit facilities from formal financial industry. Many tend to provide favourable information with the view of obtaining the credit facilities. If banks inject their loan funds majorly into existing good payers, how do new born SMEs survive and develop?

Keywords : asymmetric information; credit facilities; external financial resources; SME financing