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Owner/Managers' Financing Preferences and the Proportion of Firm's Capital Structure: Evidence from Successful SMEs in Malaysia

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ABSTRACT

The importance of economic contributions of Small and Medium-sized Enterprises (SMEs) around the world particularly in developing countries requires better understanding of financial practices among SMEs. This research investigates the financial practices among SMEs in Malaysia, within the list of Enterprise 50 award winners from 1998 to 2010. Focuses are on SME owner/managers' level of financing preferences towards available sources of financing and also its relationship with the proportion of the firm's capital structure. Electronic surveys were conducted with a response rate of 29.5%. SME managers are found to have a higher preference towards debt financing from banking institutions which is shown by the average debt-to-equity ratio among these SMEs of 57 to 43. Account payable and retained earnings were two types of liabilities with higher proportion in the firm's capital structure. Bivariate analysis reveals that owner/managers' preferences towards internal equity financing, external equity financing and debt financing were found to have a statistically significant relationship with the proportion of firms' short-term financing, long-term financing and also equity financing. This research enhances the existing body of knowledge of financial practices of SMEs, particularly within the context Malaysian SMEs by providing the information on manager's level of financing preferences and its relationship with the proportion of firm's capital structure.

Keywords: Financing Preferences, Capital Structures, SMEs

1. Introduction

Small and Medium Enterprises (SMEs, hereafter) are important to almost all economies in the world, but especially to those of developing countries. SMEs, in total, constitute a large proportion of economic activity, and are considered to be an engine of growth in both developed and developing countries (Boocock and Shariff, 2005). In developing countries, the concern for the role of SMEs in the development process continues to be at the forefront of policy debates (Cook, 2001) as they comprise a majority of the business population in most countries, and therefore play a crucial role in the economy (Mitchell and Reid, 2000). Mac an Bhaird (2010) adds that the realization of the significant economic contribution of SMEs has resulted in increased attention to the sector from policy makers, as well as academics.

Small and medium-sized enterprises (SMEs) potentially constitute the most dynamic firms in an emerging economy. In the case of Malaysia, SMEs play a vital role in the economy, and are considered to be the backbone of industrial development in the country (Saleh and Ndubisi, 2006). As small businesses are the fastest growth segment of all business, the majority of businesses regard financial resources as their most pressing concern (Helms and Renfrow, 1994). The role of finance has been viewed as a critical element for the development of small and medium-sized enterprises (Cook, 2001). The availability of external finance for SMEs is a topic of significant research interest to academics, and an issue of great importance to policy makers around the globe. The conceptual framework to which most of the current research literature adheres has proven to be helpful in advancing an understanding of the markets to provide funds to SMEs in both developed and developing nations. Despite the presence of multiple and often interrelated constraints, based on policies to support SMEs, the lack of finance constitutes the main obstacle to the growth of SMEs. The availability of credit for SMEs depends significantly on the nation's financial structure and its accompanying lending infrastructure and technologies (Wu et al., 2008). To facilitate better financing for SMEs, an understanding of their financing behavior may generate greater awareness of their financing needs.

The structure of this paper starts with a general discussion on SMEs in Malaysia with particular emphasized on the issues and challenges faced by Malaysian SMEs. This is followed by discussion on research aims and objective, and methodology adopted in conducting this study. The next section focuses on results and finding of this study, followed by a discussion of research findings and finally concluded with the recommendations for future research.

2. SMEs in Malaysia: Issues and Challenges

The issue of improved access to finance for SMEs has been recognized as an area of importance in APEC. Anecdotal evidence is often cited to the effect that SMEs are disadvantaged when it comes to accessing finance because of factors such as the relatively higher burden of transaction costs, financing gaps and finance market inefficiencies (APEC, 2002). The issue of entrepreneurship in Malaysia is closely tied to the political economic considerations unique to the Malaysian context, and thus, has its own set of constraints to contend with even while it is being developed.

The availability of funds is no longer an issue. Rather SMEs encounter difficulties in accessing such funds. Part of the problem could be overcome on the part of the SMEs themselves to provide full disclosure as to their financial status, repayment record and management capabilities in order to enable financial institutions to make an objective assessment of loan applications. Therefore, there is a need for SMEs to strengthen their administrative and financial management to ensure a better chance of taking advantage of various financial facilities available (SME Performance Report, 2003). This is in line with the findings by Rozali et.al (2006) that one of the pertinent issues faced by SMEs is lack of accessibility to capital and credit facilities for the purpose of start-up and expansion. SMEs typically faced problems in getting the finance they needed from commercial banks and government support agencies. They failed to obtain finance, mostly due to their failure to provide sufficient business information and financial guarantees, as well as being insufficiently informed or poorly advised about appropriate sources of finance.

A lack of sufficient finance and access to credit are often cited as major handicaps in the development of SMEs, particularly in their early growth stages. For instance, it is estimated that close to 95 per cent of all SMEs rely on the personal resources of their owners and/or loans from friends and relatives to finance such enterprises. Thus, one of the factors hampering SME growth is access to finance (UNDP, 2007). The reasons why SMEs choose to forego incentive measures established to assist them include: (a) the bureaucratic maze (b) the vast amount of information sought before assistance is given and (c) the slow processing period (UNDP, 2007). For the future, capacity efforts need to focus on raising awareness among SMEs of the range of government services that are available. Still too many SMEs are unaware of grants and programmes and therefore do not apply (UNDP, 2007).

It is also reported that, although micro enterprises formed about 80% of small and medium-sized enterprises in Malaysia, only 13% of micro enterprises received finance from financial institutions (NSDC, 2007). Lack of access to finance is among the challenges faced by SMEs in Malaysia (Ting, 2004; UPS, 2008; Isa, 2008; Saleh and Ndubisi, 2006). Given the high priority accorded to SME development in Malaysia, the Government will continue to put in place various initiatives to strengthen finance providers, widen the avenues of financing and address specific issues faced by SMEs in accessing adequate finance. The ultimate goal is to ensure that SMEs at various stages of their business life-cycle, namely, start-up, business expansion and rehabilitation, have access to the necessary types of finance (SMIDEC, 2007).

The issue of challenges faced by SMEs in Malaysia have been addressed by many studies (Ting, 2004; UPS, 2008; Isa, 2008; Saleh and Ndubisi, 2006; Saleh et al., 2008). Besides lack of finance, other challenges faced by SMEs are the changing international market environment with increased globalization and liberalization; competition from the emerging markets; advancements in technology resulting in the shortening of product life cycle; global business trends of large corporations are to outsource their non-core activities and create opportunities for SMEs; nurturing innovative and resilient SMEs through mergers, consolidations and strategic alliances; access to the market is not only dependent on the domestic market; human resource constraints; a lack of innovation; high levels of bureaucracy in government agencies; lack, and cost, of professional and skilled workers; and limited access to better technology and Information and Communications Technology (ICT).

In 2001-2002, the Central Bank of Malaysia conducted a survey to assess the current situation of the SMEs, their requirements and identified issues that impede their development. In term of the financing of SMEs' operations, more than half, or 62%, had no problems obtaining finance. About 47% of SMEs reported that they borrowed from banking institutions to fund their business, 32.4% are self-financed followed by 11% relying on other sources of finance such as family, friends and supplier credit whilst 4.1% from financial institutions, private sector grants accounted 1.1% and 0.9% venture capital finance. In this study, the problems faced by SMEs according to rank were: (i) competition from bigger players; (ii) not able to obtain loans; (iii) not able to source skilled labour; (iv) competition from new entrants; and (v) lack of government support. The desired forms of government assistance by SMEs are (i) tax incentives; (ii) greater access to finance; (iii) greater technological support; (iv) central body that collates and disseminates information on SMEs; and (v) central training body (Saleh et al., 2008).

A study conducted in 2001 by the Central Bank of Malaysia showed: (i) the low contribution of SMEs to GDP; (ii) their domestic-market orientation; (iii) the constraints they face in terms of capacity, level of technology, access to markets and resources to upgrade skills and production process; and (iv) limited access to finance. As SMEs grow in size, they tend to rely more on financial and commercial institutions as sources of finance. SMEs generally face difficulties in obtaining finance. The most significant problem faced by SMEs in the three sectors was lack of collateral. The other difficulties included insufficient documents to support loan applications, lack of financial track record and viability of businesses. These accounted for more than 80.0 per cent of listed difficulties in all sectors. At the same time, 9.8 per cent of SMEs also reported that the processing time for loan applications was an added constraint (Aris, 2007).

The National SME Development Council (NSDC) in its SME Annual Report for the year 2005 and 2006 revealed the findings of a survey conducted by Bank Negara Malaysia in November 2001. Among others, the surveys reported that accounting, finance and audit are the type of advisory services mostly required by SMEs in Malaysia. The results also highlight that the majority of SMEs did not have access to advisory services, with those who have access mainly relying on advisory services provided by the private sector. The following figure shows the problems in business operations and desired forms of Government assistance among Malaysian SMEs.

Figure-2.1. Problems in Business Operations and Desired Forms of Government Assistance.

Rank	Problem		Rank	Desired Forms of Government Assistance
1	Competition from bigger players		1	Tax incentives
2	Not able to obtain loans		2	Greater access to finance
3	Not able to source skilled labour		3	Greater technological support
4	Competition from new entrants		4	Central body that collates and disseminates info on SMEs
5	Lack of Government support		5	Central training body

Source: SME Annual Report, 2005

A recent survey by UPS Asia Business Monitor (ABM) in 2008 on SMEs in Asia found that lack of innovation, availability of a qualified workforce and inadequate government support continue to impede the competitiveness of SMEs in Malaysia. Fifty-eight per cent of the SMEs (including Malaysian SMEs) still experienced difficulties in financing their businesses. Of those that did face problems, the majority cited bureaucracy and red tape as the biggest setback and were found in markets where insufficient government support was also cited. Furthermore, the survey found that only 8% of SMEs polled believe the initiatives to improve access to business finance have been highly effective while the majority (86%) is ambivalent about the effectiveness of the initiatives.

Domestic and external challenges in an increasingly borderless world economy may indeed hinder SMEs' resilience and competitiveness. The growing competition in the world's business and trade landscape forces greater challenges for SMEs in Malaysia to seek opportunities in the global marketplace (UNDP, 2007). These challenges are addressed by strengthening the enabling infrastructure, building the capacity of SMEs, enhancing access to finance, increasing market access and enhancing growth and competitiveness. These measures are believed to help build resilient Malaysian SMEs in a competitive world. The comprehensive studies of the relevant literature on the challenges faced by Malaysian SMEs by Salleh and Ndubisi in 2006 list these challenges as follows:

1. Difficulties in obtaining funds from financial institutions and the government. Interest charged by financial institutions is deemed to be high.
2. Lack of human capital.
3. High level of international competition.
4. Lack of access to better technology and ICT.
5. High level of bureaucracy in Government agencies.
6. Low level of Research and Development (R&D).
7. Substantial orientation for the domestic markets.

Within all the findings reported by many studies relating to constraints and challenges faced by SMEs around the world and particularly in Malaysia, the lack of access to finance is one of those challenges widely cited. Wang (2003) has cited the lack of finance as one of many challenges facing SMEs, quoting the main issues regarding SME financing thus: (1) Financial institutions assess SMEs as being inherently high-risk borrowers, owing to their low capitalization and limited assets, vulnerability to market fluctuations and high mortality rates, (2) While large firms comply to a large extent with high standards of disclosure requirements, most SMEs do not, and (3) The significant administrative and transactions costs associated with lending or investing small amounts do not make financing for SME as a profitable business for private commercial banks.

A further study by APEC in 2002 also highlights the difficulties in accessing loans and other forms of financial assistance as one of many challenges faced by SMEs in Malaysia. In addition, limited access to finance and capital, and the infancy of venture funds is also reported as one of many issues confronted by Malaysian SMEs which affecting their competitiveness, efficiency and resilience (SMIDEC, 2002). Market studies by United Parcel Services (UPS) in 2005 among decision makers in several Asian SMEs also revealed that access to funding and capital are among the biggest challenges for Asian SMEs.

Given the existence of the financing-related challenges faced among SMEs in general and in particular Malaysian SMEs, there is an avenue for further studies on financial practices among SMEs in Malaysia to enhance better understanding of their financial behavior. It is hoped that this will add to existing knowledge of financial practices among SMEs in general, especially within the context of Malaysia.

3. Research Aims and Objectives

The importance of SMEs to the Malaysian economy and the existence of financing related issues and challenges discussed in the previous sections clearly indicate the need to conduct a study of financial practices and behavior among Malaysian SMEs, so as to:

1. Increase the level of understanding of financial practices among SMEs in Malaysia. The existence of financing-related issues among SMEs in Malaysia, especially ones that involved SME access to funds reflects the lack of understanding of how SMEs are making their capital structure decisions. These decisions are closely related to owner/manager's preference of financing, and their firm's capital structure. It is hoped that a better understanding of this issue will reduce the financing gaps that currently exist.
2. Add to the body of knowledge, particularly on the topic of financing preferences and firm's capital structure among small businesses in Malaysia. This is important as academic papers were found to have a lack of focus on these topics. The existence of knowledge gaps within the general topic of SME financing, particularly in regards to the manager's preferences and firm's capital

structure will be reduced, and it is hoped that this will result in a better financing environment made accessible to Malaysian SMEs.

Apart from focusing on the financial practices among SMEs, this particular study also focused on successful SMEs in Malaysia. The financial practices of this particular group of SMEs are still very much unknown. For this reason, it is also an aim of this study to explore the financial practice of successful SMEs in Malaysia. It is hoped that the findings of this study will provide some significant explanation as to the financing practices of these successful SMEs. These significant details will ultimately help to establish a supportive financing environment for SMEs in Malaysia.

These aims were then translated into the following research objectives:

1. To investigate the owner/managers' level of preferences towards different sources of financing.
2. To investigate the proportion of firms' capital structure.
3. To determine if there is any association between owner/managers' level of financing preferences and the proportion of their firm's capital structure

4. Methodology

The methodology applied in this study was mainly determined by the need to accomplish the research aims and objectives listed in the previous sections. Academic studies of SME financing usually involve conducting multivariate regression analysis by employing panel data sets consisting of accounting and finance data (Mac an Bhaird, 2010). Within this particular study, this panel data set was found to be incomplete and unavailable, due to the lack of track records among SMEs in Malaysia. The lack of track records proves to be one of the difficulties faced by Malaysian SMEs in accessing finance, as reported in the Census of Establishment and Enterprises, conducted by Department of Statistics in 2005. Mac an Bhaird (2010) points out that the lack of comprehensive databases containing complete data is a significant impediment to researching the topic of SME financing. Existing databases are either incomplete or are not representative of the total population. As there is a significant increase in academic research on SME financing over the past two decades, he suggested that this issue may be overcome by employing methodologies such as questionnaire and interview data collection.

As mentioned earlier, most studies of SME financing incorporated panel data analysis in generating their findings. In this study, due to the fact that the panel data was incomplete and unavailable, a questionnaire was developed based on previous academic and institutional studies, incorporating the use of a questionnaire to capture financial practices among SMEs and large companies in Malaysia (see Graham and Harvey, 2001; Bancel and Mittoo, 2004; Brounen et al, 2006; Pinegar and Wilbricht, 1989; Department of Statistics, various years; The Associated Chinese Chambers of Commerce and Industry of Malaysia (ACCCIM) SMEs Survey II, 2007; Zhang, 2008; Ab. Wahab, 1996; Buferna, 2005; S M Zain, 2003; SME Corporation Malaysia (SME Corp), 2010, Small and Medium-sized Industries Development Corporation (SMIDEC), 2009). Other than this, publications such as financial reports and textbooks were also used in developing this data collection instrument. Upon its completion, the questionnaire was then pre- and pilot-tested before being used as the survey instrument.

Online surveys were chosen as the best approach to conduct data collection, primarily after considering the costs involved in postal surveys and also the availability of access to the internet among SMEs in this study. The lists of winners of the Enterprise 50 award from 1998 to 2010 were chosen as the best available databases for SMEs which fit into the pre-determined criteria for this study. The actual surveys resulted in a total of 120 responses received out of 444 total SMEs. This figure was used to determine the response rate received for this survey. 21 SMEs were not able to be contacted while 17 SMEs were contacted but not interested and refused to participate. After all these were taken into consideration, the overall response rate for this study was 29.5%.

Survey methods applied in this study is closely associated to the positivistic paradigm. This paradigm basically involved the collection of numerical data which were then quantitatively verified, and appropriately analyzed using both parametric and non-parametric tests. Although parametric tests were believed to be superior to their counterparts, both tests were mainly conducted depending on the type of data and level of measurement involved. All the tests were believed to be appropriately performed to represent valid results, and were used to support the overall finding and conclusions made in terms of accomplishing the research objectives.

5. Results and Findings

Results and findings of this study are discussed as follows, classified into few subsections to capture the three research objectives which are owner/manager's level of financing preferences towards different sources of financing, the proportion of firm's capital structure and finally, the association between these two.

5.1.Owner/manager's level of preferences towards different sources of financing

The results from the univariate analysis revealed that retained earnings were the most preferred source of internal financing among SME managers, followed by shareholders' own contribution and funds from related companies (parents, subsidiaries or associate companies). When it comes to external funding, banking institutions, trade/supplier credit and government funds were found to be the most preferred sources of financing. Other sources of financing (DFIs, cooperative financing, leasing and factoring) were found to be the least preferred by the SMEs managers with equity investments being the least preferred sources of financing. In regards to the term of financing, long-term financing was found to be the most preferred term of financing among respondents.

By comparing both the descriptive results for manager's level of financing preference for different internal and external sources of financing, a conclusion can be made as to the five most preferred sources of financing, as presented in the following table:

Table-5.1. Five most preferred source of financing

Rank	Source of financing	Internal/External
1	Banking Institutions	External
2	Retained Earnings (*Net Income Retained for Reinvestment*)	Internal
3	Shareholder's Own Fund/Contribution	Internal
4	Trade/Supplier Credit	External
5	Government Funds/Schemes	External

The table above indicates that the most preferred sources of financing among SME managers are a mixed of external and internal sources of financing. This list provides a clearer insight into the level of financing preferences for various sources and types of financing available for small businesses particularly in the case of Malaysian SMEs. Managers of SMEs appear to find external funding most possibly from banking institutions, suppliers and also from the Government. Otherwise, they would use internal sources of financing from retained earnings or provide their own funds to accomplish much needed funding.

5.2.Proportions of SMEs Capital Structure

Univariate analysis indicates that generally SMEs depend more on debt over equity-sources of financing. This is proven by the descriptive results, which shows that overall Debt-to-Equity ratio (DER) was found to be approximately 57 to 43. This figure proves that firms mainly seek external debt-sources of financing over internal funds. The proportion of debt financing was also found to be equally divided into short and long-term debt financing which shows that firms generally use both types of debts in financing their business activity. The following eight items were found to have the highest proportion in the firm's liability and equity. These items are presented as follows:

Table-5.2. Type of financing with the highest proportion in the firm's liability and equity

Types of financing	Debt/Equity
Account Payable	Debt
Retained Earnings (Net Income Retained for Reinvestment)	Equity
Shareholder's Own Fund/Contribution	Equity
Trade/Supplier Credit	Debt
Share Capital	Equity
Capital Reserved	Equity
Bank Overdraft	Debt
Long-term Debt	Debt

The results presented in table 5.2 show that firms get their funding from debt-sources of financing in the form of account payable, trade/supplier credit, bank overdraft and long-term debt. Other forms of debt financing were found to be least used by the SMEs, which supports the previous results regarding the manager's level of financing preferences for various sources of financing. Other possible ways of funding come from internally-sought funds, mainly from retained earnings.

5.3. Association between owner/managers' level of financing preference with the proportions of firm's capital structure

This particular part of the analysis aims to establish whether there is any statistically significant relationship between manager's preferences for IEF, DF and EEF and the proportion of firm's capital structure which are grouped into three different categories, namely Short Term Financing (STF), Long Term Financing (LTF) and Equity Financing (EF). The financing preferences were later tested and reported within 9 sub-hypotheses, to assess the relationship between manager's levels of financing preferences and the proportion of the firm's capital structure

The variables used to study the relationship between these two are described in the following table 5.3, followed by discussion of the test results on each sub-hypothesis accordingly.

Table-5.3. Summary of Dependent and Independent Variables

Dependent variable	**Description of variable (Level of Measurement)**
Proportion of firm's Short-term Financing (STF)	Summated score of responses on level of proportion of four types/sources of financing (5-points Likert scale)
Proportion of firm's Long-term Financing (LTF)	Summated score of responses on level of proportion of four types/sources of financing (5-points Likert scale)
Proportion of firm's Equity Financing (EF)	Summated score of response on level of proportion of five types/sources of financing (5-points Likert scale)
Independent variable	**Description of variable (Level of Measurement)**
Manager's preference on Internal Equity Financing (IEF)	Summated score of responses on level of preference on three types of internal equity financing (5-points Likert scale)
Manager's preference on Debt Financing (DF)	Summated score of responses on level of preference on seven types of debt financing (5-points Likert scale)
Manager's preference on External Equity Financing (EEF)	Summated score of responses on level of preference on four types of external equity financing (5-points Likert scale)

Some indicators were primarily used to measure managers' level of preferences and proportions of firm's capital structure. The responses received for each individual indicator were then added, to create fewer variables which contain the summated scores of all indicators. The summated scores for the variables concerning manager's level of preferences were already discussed in the previous section. In this particular section, indicators regarding the proportions of firms' capital structure originally contained 14 different types of financing, which were then summated into three different variables, namely STF, LTF and EF.

The proportions of firms' STF were summated from the response received in terms of proportion of Account payable, Bank overdraft, Trade credit, and Accrued expense. Summated responses received for the proportions of firms' Notes payable, Long-term debt, Leasing and Factoring were then used to measure the overall proportion of a firm's LTF. Finally, firms' proportion of EF were aggregated from the responses received on proportion of Retained earnings, Shareholder's Own Contribution, Share capital, Capital reserved, Funds from Parent/Subsidiaries/Associate Companies in the company's balance sheet concerning types/sources of financing which falls under equity-type financing.

As mentioned earlier, the level of financing preferences among managers were measured using an interval scale, with 1 denoting Very Low Preferences and 5 representing Very High Preferences for the source of financing under study. The same type of scale/level of measurement was used to gauge the proportion of firms' capital structure, with a five point Likert scale being used, with 1 representing Very Low Proportion and 5 signifying a Very High Proportion. As both variables were measured on an interval scale, Pearson's correlation coefficient was used to test the relationship between manager's financing preferences and the proportion of a firm's capital structure categorized as STF, LTF and EF. 9 sub-hypotheses were developed to guide the analysis.

A summary of test results for Pearson's correlation coefficient are presented in the following table.

Table-5.4. Pearson's correlation coefficients test results for relationship between manager's financing preferences and proportion of firm's capital structure.

	IEF (Sig.)	DF (Sig.)	EEF (Sig.)
STF	-0.005 (0.956)	0.192* (0.036)	-0.130 (0.081)
LTF	0.033 (0.722)	0.294** (0.001)	0.198* (0.030)
EF	0.388** (0.000)	0.337** (0.000)	0.444** (0.000)

**Correlation is statistically significant at the 99% level of confidence (2-tailed)
*Correlation is statistically significant at the 95% level of confidence (2-tailed)

The following first three sub-hypotheses (H_{2-1} - H_{2-3}) were developed to guide tests of the relationship between manager's preferences for IEF with proportion of firm's capital structure, accordingly.

The results of the test, as presented in Table 5.4, show that out of three sources of financing, managers' preferences for IEF have a statistically significant positive relationship with the proportion of firm's EF at Sig=0.000 and r=0.388. Therefore H_{2-3} is accepted, indicating that there is a statistically significant medium positive relationship between managers' preferences for IEF and proportion of firm's EF. This indicates that an increase in manager's level of financing preferences for IEF will also increase the proportion of EF in their capital structure. Managers who have higher preferences for IEF seem to prefer EF over STF and LTF to fulfill their firm's financing need. This is proved by the statistically significant evidence of no relationship between manager's preferences for IEF on proportion of firm's STF and LTF.

The next three sub-hypotheses are developed to represent hypothesis testing the relationship between manager's preferences for DF and the proportion of firm's capital structure.

The results in Table 5.4 shows that all sub-hypotheses are accepted to indicate a statistically significant positive relationship between manager's preference for DF and the proportions of the firm's STF, LTF and EF. Evidence shows a small (medium) relationship between preferences for DF and the proportion of firm's STF and LTF (EF), indicating that an increase in manager's preferences for DF as a source of financing results in an increase in a firm's use of STF, LTF and EF accordingly. A close to medium and medium relationship between manager's preferences for DF and proportion of firm's LTF and EF shows that managers would prefer to use LTF and EF over STF in a condition where extra funding is needed.

Finally, the remaining three sub-hypotheses (H_{2-7} - H_{2-9}) were developed to guide the analysis of association between manager's preferences for EEF with the proportion of firm's capital structure.

Manager's preferences for EEF have a statistically significant relationship with the proportion of firm's LTF and EF with an r of 0.198 and 0.444 respectively. These results indicate that an increase in manager's preferences for EEF will also increase the proportion of firm's LTF and EF respectively. A medium correlation between the proportion of a firm's EF and manager's preference for EEF shows that managers may opt for equity financing over long-term debt financing. There was no evidence to support the existence of a relationship between manager's preferences for EEF and the proportion of firms' STF, hence H_{2-7} is rejected.

Table-5.5. Summary of test results

Dependent Variable	Independent Variable	Reject/Accept H_0
Proportion of firm's Short-term Financing	IEF(H_{2-1}), EEF(H_{2-7})	Accept H_0
(STF)	DF (H_{2-4}),	Reject H_0
Proportion of firm's Long-term Financing	IEF(H_{2-2}),	Accept H_0
(LTF)	DF(H_{2-5}), EEF (H_{2-8})	Reject H_0
Proportion of firm's Equity Financing	None	Accept H_0
(EF)	IEF (H_{2-3}), DF(H_{2-6}), EEF (H_{2-9})	Reject H_0

The summary of test results presented in Table 5.5 shows that of the nine possible sub-hypotheses, six of them (H_{2-3}, H_{2-4}, H_{2-5}, H_{2-6}, H_{2-8}, and H_{2-9}) are accepted. These acceptances of alternative hypotheses indicate that there are statistically significant relationships between these variables at different levels of r. Other alternative hypotheses were rejected, as there was no proof of the existence of any statistically significant relationship between the variables under study. Overall, results indicate that manager's level of preferences for DF have a statistically significant relationship with the proportion of firm's capital structure, whereas their preferences for IEF and EFF have a statistically significant relationship only with proportion of firm's EF, and LTF and EF respectively.

6. Discussions

This section discusses the findings of this study of owner/manager's level of financing preferences towards different sources of financing and its association with the proportions of firm's capital structure.

6.1. Owner/manager's level of financing preferences

Managers' level of financing preferences for various types of finance (classified into internal and external sources of financing) was investigated, and the results show that in general, most of them prefer both sources of financing. Three types of internal financing and 11 types of external financing were included in this study. External financing was then classified into Debt Financing (DF) and External Equity Financing (EEF), while internal financing was labeled as Internal Equity Financing (IEF) and each of these sources of financing contained seven, four and three types of financing respectively.

Retained earnings, with 60% of respondents indicating high and very high preference for this type of finance, were found to be the most preferred internally generated fund among managers. This was followed by shareholder's own funds (45.8%). Funds from parents, subsidiaries or associate companies were the least preferred type of internally generated funds among managers, with 63.3% of respondents indicating very low and low preference for this particular type of finance. Within the external sources of finance, debt financing was found to be the most preferred source of finance in comparison to external equity financing. Debt financing from banking institutions, supplier credit and government funds was found to be the most preferred types of external debt financing among owner-manager of SMEs. These were followed by funding from Development Financial Institutions (DFIs), Cooperative financing, leasing and finally, factoring companies. More than half of the respondents were found to have lower preferences for funding from Cooperative financing, leasing and factoring companies. External equity financing which consists of four different types of financing (venture capital, business angel, friends and family, unrelated companies) were found to be the least preferred sources of external financing among managers of successful SMEs in Malaysia. Results show that more that 60% of respondents indicated lower preferences for these types of financing.

The Census of Establishment and Enterprise 2005, conducted by Department of Statistics of Malaysia, shows that generally SME's in Malaysia use their own funds to finance their business activities (NSDC, 2006). This contrasts somewhat with the findings of this particular study, in which debt financing from banking institutions, supplier credit and government funds are found to be the most preferred sources of external financing among managers of successful SMEs in Malaysia. However, this result is anticipated, as the majority of SMEs in this study are SMEs (i.e. small and medium-sized enterprises). These findings shed light on the importance of these sources of finance to successful SMEs and need to be highlighted and taken into consideration particularly in developing accessible funds for this group of SMEs. Particular attention must also be given to other sources which are least preferred by the managers of successful SMEs. Further investigation needs to be conducted to find out ways of increasing their level of preference for these sources of debt financing (DFIs, cooperative financing, leasing and factoring).

6.2. Association between owner/managers' level of financing preference with the proportions of firm's capital structure

The proportions of a firm's capital structure are found to be associated with managers' level of financing preferences for internal equity, debt and external equity financing. Managers' level of financing preferences for debt financing is found to be positively and significantly associated with the proportions of their firm's short-term financing. There are no associations to be found between their level of financing preferences for internal equity and external equity financing with the proportions of their firm's short-term financing. These associations indicate that when it comes to seeking short-term financing, managers would prefer to use debt over equity financing. They are believed to seek this short-term financing mainly from banking institutions, supplier credit or in the form of Government funds, as shown in the results of the descriptive analysis (on their level of financing preferences for different types of debt financing).

Additional analysis was also performed to enhance the understanding of the cumulative influence of manager's level of financing preferences for debt financing, internal equity and external equity financing on the proportions of firm's capital structure. The results revealed that manager's level of preference for debt and external equity financing are significant predictors of the proportion of a firm's short-term financing. This indicates that managers will consider these two sources of financing when it comes to making related decision regarding the level of their firm's short-term financing. Their preferences for debt and external equity financing will have an effect of the choice of financing used to fulfil their firm's short-term financing needs. Their preferences for internal equity financing do not have any influence on the proportion of their firm's short term financing. This indicates that when it comes to short-term financing, managers will not consider covering the financing needs through the use of internal equity.

Managers' financing preferences for debt and external equity financing are significantly and positively associated with the proportion of their firm's long-term financing. There is no proof to be found as to the relationship between managers' level of financing preferences for internal equity financing and the proportions of their firm's long-term financing. The association between managers' preferences for debt and external equity financing and the proportions of their firm's long-term financing indicates that firm's long-term financing would be achieved from either debt sources of financing (mainly from banking institutions) and also from externally-generated equity financing, either a private equity investment or equity investment from friends and family, business angels, venture capital companies or from unrelated companies.

The proportion of a firm's long-term financing is found to be significantly predicted only by managers' level of financing preferences for debt financing. This result indicates that the proportions of a firm's long-term financing are fulfilled from debt-sources of financing. Managers are believed to fulfill the need for long-term financing through debt sources of financing and their decision will never influenced by their level of preferences for equity financing. In other words, although equity-sources of financing are available, managers will only seek debt-sources of financing in satisfying their firm's need for long-term financing.

Finally, manager's preferences for all sources of financing are found to be significantly and positively related to the proportions of their firm's equity financing. This indicates that when it comes to making decisions about a firm's level of equity financing, managers are believed to consider it from different sources of financing available and are not limited to any particular sources of financing as in the proportions of the firm's short and long-term financing. Managers will consider seeking all the financing needed after considering the different sources of financing available. Multivariate analysis performed also found that manager's levels of preferences for internal and external equity are significant predictors for the proportions of a firm's equity financing. This is relatively straightforward, as a firm's proportions of equity financing is only influenced by the managers' level of financing preferences for internal or external equity financing. Managers will seek equity-types of financing to fulfil their firm's need for equity financing, either from internally-generated equity in the form of retained earnings, shareholder's own funds or funds from parent, subsidiaries and associate companies, or externally-generated equity financing in the form of private equity investment from friends, family or unrelated companies, or equity investment from venture capital or business angels.

7. Conclusions

Managers' of successful SMEs in Malaysia are found to have preferences for different sources of financing. An internal source of funds preferred by them is retained earnings, while banking institutions are the most preferred sources of external financing. Successful SMEs in Malaysia use more debt than equity-sources of financing. This is proven by the average Debt-to-Equity ratio of 57 to 43. This result shows that in general, successful SMEs in Malaysia rely on debt-sources of financing for their business. Evidence also shows that there is a significant association between managers' financing preferences and the proportion of their firm's capital structure.

These findings offer some recent and useful knowledge on the theme of financing preferences and capital structure among SMEs in Malaysia, with particular emphasis on successful SMEs. The significant contributions of SMEs in general and successful SMEs in particular, validate the need for better awareness and understanding of financial practices among these SMEs. In addition to that, evidence of a financing gap in developing countries and a lack of literature on financial practices among successful SMEs in Malaysia also validate the significance of this study. Emphasis on successful SMEs was motivated by the reality that the financial practices of these SMEs are still unidentified, and need to be explored to offer useful information to provide solid financial environment for SMEs in the ever challenging global economy

8. Recommendations for future research

The results of this research raise several issues that warrant future research. First, the sample of micro and small enterprises should be extended. This would enable differences based upon size to be clearly identified and to highlight the form of financing preference and capital structure in different contexts. However, this may prove difficult as there must be the possibility that these firms will be much less likely to be in the list of successful SMEs and also to complete the questionnaire, and this will thus lead to bias in responses. Second, it might be advantageous to focus on a sample from one particular sector such as the manufacturing or service sector by focusing on a specific industry such as the electric and electronics industry. This means that the sample would be more homogeneous and might result in having a certain financing behavior and type of capital structure. This might also make the factors that explain financing preferences more distinct. Alternatively, a case study approach might be employed to highlight the reasons for different types of capital structure and financing preference in a more detailed context. Lastly, research in this area can be developed by conducting a comparative study of the Malaysian situation on financing behavior among SMEs in other developing countries, in order to explore differences in terms of cultural and other contributory factors.

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