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The Impact of the Use of Independent Auditing on Credit Accessibility: The Case of Vietnamese SMEs

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Abstract: Vietnamese small and medium size enterprises (SMEs) are deemed the "backbone" of the economy; they are a key driver for the achievement of sustainable economic development. Access to finance, however, has been consistently identified as a major problem facing many Vietnamese SMEs. That has caused serious setbacks in the sustainable development of Vietnamese SMEs, and has adversely affected their profitability. This raises the question of whether independent auditing of financial statements can be influential in the credit allocation process. The current study developed a model of the influence of independent auditing on credit accessibility by employing a qualitative method to identify the impact of independent auditing on credit accessibility in Vietnamese SMEs. The results of this study reveal that the use of external auditing is one of the key criteria to accessing credit in Vietnamese SMEs.

Keywords: Vietnamese SMEs, independent auditing, accounting, credit accessibility.

1. Introduction

No nation has evolved into a modern, industrialized country without small and medium sized enterprises (SMEs). They are an essential element of a healthy and vibrant economy as a fundamental part of the economy - playing a crucial role in furthering growth, innovation and prosperity [1]. The contribution of SMEs is significant not only in static but also in dynamic terms. In transition economies in particular, the potential of SMEs to promote the domestic and export markets to strengthen the resilience of the economy has been recognized [2].

According to the Asian Development Bank, in ASEAN countries, SMEs are considered to be the backbone of the economy [1], they provide an impetus to sustainable economic development when encouraged to develop. In line with this, SMEs have often been acknowledged in capital raising literature, and generally receive support from their country's policymakers and international agencies. That access to finance not only helps SMEs to grow and prosper, but also promotes innovation and entrepreneurial activity.

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The issue of SMEs' access to bank finance has been on the agenda of policymakers since at least the 1960s [3]. Access to finance is a driving factor of an enabling economic environment, and its importance has been highlighted in various international reports including Darberg Global Development Advisors, 2011 [4], Certified Professional Accountants, 2012 [5], Triodos-Facet, 2013 [6], International Finance Corporation, 2013 [7], Deloitte Access Economics, 2013 [3], Asian Development Bank, 2013 [1], and Organization for Economic Co-operation and Development, 2014 [8]. It has been identified in the literature that in developing countries in particular, financial access of SMEs is a key determinant in their ability to expand employment and a country's development. The issue of SMEs' access to bank finance has been on the agenda of policy makers since at least the 1960s [3].

This study raises the question of whether independent auditing of financial statements can be influential in the credit allocation process. The current study developed a model of the influence of the independent auditing on credit accessibility by employing a qualitative method to identify the impact of independent auditing on credit accessibility in Vietnamese SMEs. The results of this study reveal that the use of external auditing is one of the key criteria to accessing credit in Vietnamese SMEs.

2. Vietnam SME definition

The Vietnamese Government defines SMEs as "small and medium sized enterprises that have registered their business according to the Enterprise Law". The definition is divided into three levels - micro, small and medium scale - of total capital equivalent to the total assets identified in an enterprise's accounting balance sheet or the annual number of employees, as shown in Table 1.

Based on the Vietnam Government's Decree No 56/2009/ND-CP [9], Vietnamese SMEs are divided into three types: micro, small and medium sized firms. Small enterprises in the trade and service sector are defined by registered capital under VND 10 billion (under about US$500,000), with 10-50 employees. Small enterprises in the agriculture, forestry and fishing, and industry and construction sectors are defined as those with registered capital under VND 20 billion (under US$1 million), and a labour force of 10-200 employees.

In the trade and service sector, medium enterprises are defined as having registered capital between VND 10 billion and 50 billion (from US$500,000 to US$2.5 million), and 50-100 employees. The medium enterprises in the other two sectors are defined as those with registered capital between VND 20 billion and 100 billion (from US$ 1 million to US$5 million), with a labour force of around 200-300 employees.

Table 1. Summary of the definition of SMEs in Vietnam

Sector	**Small enterprises**		**Medium enterprises**	
	Capital (C) VND billion	Employees (E)	Capital (C) VND billion	Employees (E)
Agriculture, forestry and fishing	$C \leq 20$	10-200 E	$20 < C \leq 100$	200-300 E
Industry and construction	$C \leq 20$	10-200 E	$20 < C \leq 100$	200-300 E
Trade and service	$C \leq 10$	10-50 E	$10 < C \leq 50$	50-100 E

Source: Vietnam Government Decree No. 56/2009/ND-CP [9].

However, these definitions do not fully reflect the characteristics of SMEs in each sector; and the capital threshold does not signify the real scale of an enterprise, because during its operations an enterprise's capital, especially working capital, regularly fluctuates subject to the demands of production and business. Thus, it might be hard to target the appropriate policies to relevant groups of SMEs based on the overall definition.

3. Overview of development of SMEs in Vietnam

Vietnam has come a long way since the *Doi Moi* reform process was initiated in 1986. The past 30 years have seen Vietnam enjoy one of the world's best performances in terms of both economic growth and poverty reduction - living standards have improved significantly. Political and economic reforms have transformed Vietnam from one of the poorest countries in the world to a lower middle income country. The percentage of people living in poverty has dropped from almost 60% in the 1990s to less than 3% today [10]. The country has attained remarkable achievements, with a gross domestic product (GDP) that reached an average growth rate of 8.4% in the 2005-2011 period, lifting GDP per capita from US$642 in 2005 to US$1,411 in 2011 [7]. Such results stem from the significant efforts of hundreds of thousands of SMEs, and micro enterprises nationwide [11].

Along with the rapid growth of the national economy, Vietnamese SMEs have significantly developed. In 2010, the enterprises included micro, small and medium sized enterprises (MSMEs) making up the largest proportion of 98.54%; while large enterprises only accounted for 1.46% [11]. There were only 47,158 registered enterprises in the previous period 1991-1999 under the Private Enterprise Law (1991). In contrast, nearly 500,000 registered enterprises were established nationwide in the period 2000-2010, encouraged by the passing of the Enterprise Law (1999), and the updated version of the Enterprise Law (2005). The annual registered numbers of SMEs during 1991-2010 are shown in Table 2.

After integrating into the global economy, in spite of significant economic difficulties, the number of registered enterprises has continued to rise in Vietnam. It is estimated that there were 84,000 newly registered SMEs in 2010, increasing the overall number up to around half a million SMEs. The significant increasing trend in the number of SMEs reflects the reality of their development. However, there were a total of 238,804 active SMEs as at January 2010, accounting for only about 51.6% of total registered SMEs.

Table 2. Vietnamese SMEs registered in 1991-2010

Year	Registered no.	Accumulated no.
1991-1999		47,158
2000	14,453	61,611
2001	19,642	81,253
2002	21,668	102,921
2003	27,774	130,695
2004	37,306	168,001
2005	39,958	207,959
2006	46,744	254,703
2007	58,196	312,899
2008	65,319	378,218
2009	84,531	462,749
2010	84,000	546,749
2011	-	-
2012	-	-

Sources: Ministry of Planning and Investment, 2012 [11]; General Statistics Office, 2010 [12].

The number of active SMEs remained low because their finance may not be fully dependent on bank loans, and their businesses are led by a cohort of experienced managers [11]. These figures indicate approximately 48.4% of the SMEs could go bankrupt, be dissolved or shut down, or have stopped paying taxes.

In Vietnam, SMEs are seen as key to developing a resilient, inclusive economy, and as a source of job creation.

In 2012, there were 333,835 enterprises active as MSMEs in which the trade and service sector was dominant, accounting for 60.30% of total active MSMEs, followed by the manufacturing sector at 15.7%. The MSMEs sector employed 5.1 million people, which accounted for 46.8% of total employees in 2012 [1]. In the recent years, SME have achieved a significant growth rate both in terms of production and investment. The private sector, represented by SMEs, contributing the most to GDP, is considered as one of the driving forces of the economy. Up to now, SMEs make up for more than 95% in the number of enterprises nationwide, contributing to 48% of the GDP and presently is the fastest growing sector of the economy [11].

Despite this impressive achievement, Vietnam's SMEs remain weak in terms of business management, competitiveness, innovation, human resources, the accessing of financial sources, and technology. The common characteristics of Vietnamese SMEs are that they are small in scale, with limited capital, lack knowledge of capital management, are passive in the application of technology, and have limited human resources capability. Taking a closer look at the SME sector of Vietnam, it can be seen that one of its major limitations in development relates to management capacity. It has also been observed that SMEs are growing in quantity but not in quality; the internal management capabilities in most Vietnamese SMEs are unprofessional and weak [11, 13], and the lack of management capability of owner-managers often leads to poor business performance, including not being able to forecast global economic fluctuations. Particularly, access to finance has been consistently identified as a major problem facing many Vietnamese SMEs - given that about 75% of them have had to borrow from unofficial funding sources at an interest rate of up to 5 to 6% per month [11]. Such unfavorable factors have exacerbated the development of the Vietnamese SME sector in terms of globalization [12, 14, 15].

The contribution of SMEs to economic fundamentals varies substantially across countries. In light of the substantial economic and social contribution of SMEs, policymakers are understandably keen to explore how the SME sector's potential can be maximised (Association of Chartered Certified Accountants, 2010 [2]). In accord with this, SMEs' ability to access credit generally reflects the institutional development in their nation's economy (Certified Professional Accountants, 2012 [5]; Darberg Global Development Advisors, 2011 [4]; Triodos-Facet, 2013 [6]). In its latest report, Deloitte Access Economics (2013) noted that difficulty gaining capital access can be attributed to a range of factors that can be roughly categorised as follows: (1) regulatory environment; (2) lenders' decision-making processes; and (3) challenges faced by borrowers. Because of the significance of SMEs and the perception that these firms are financially constrained, their financial capability has been a subject of significant interest to numerous policymakers and researchers [3]. The following subsection presents some of the previous studies related to access to finance among SMEs.

4. Theoretical foundation

The nature of small business often means limited access to long-term capital; most SMEs rely on trade credit and short-term bank loans. Therefore, most SMEs' assets are in the form of current assets and current liabilities, which are main sources of external finance

[16, 17]. Most SMEs have to rely on short-term debts from trade credit, short-term loans from credit providers, bank overdrafts, tax provisions and other current liabilities [18] - financial characteristics that are often less productive at attracting new owner equity or for raising loan capital.

Access to finance is widely examined by policy makers and government authorities such as Darberg Global Development Advisors (2011), Certified Professional Accountants (2012), Triodos-Facet (2013), Deloitte Access Economics (2013), Asian Development Bank (2013), and Organisation for Economic Cooperation and Development (2014). Some of the initial studies relating to SMEs were conducted by Pace and Collin (1976), and Berger and Udell (1998); and were continued by the following: Beck, Kunt, Laeven and Maksimovic (2006); Beck and Kunt (2006); Canovas and Solano (2010); Beck, Kunt and Peria (2011); Barth, Lin and Yost (2011); Padachi et al. (2008); and Rand (2007).

Existing empirical evidence by Canovas and Solano (2010) [19], and Malesky and Taussig (2008) [20] indicated that if SMEs strengthen their banking relationships, they are likely to experience less credit rationing, and are thus more likely to be granted a loan. Association of Chartered Certified Accountants (2010) [2], and Australian Centre for Financial Studies (2015) [21] suggested that to be successful in credit access, the SME owner-manager should: (1) understand the decision-making structure within the bank; (2) develop a holistic relationship with a number of staff in the bank, including the credit manager, regional manager and front-line staff; (3) be open and upfront in all dealings with the 'relationship manager' in particular; and (4) keep internal reporting current. These recommendations were further confirmed in a study by Deloitte Access Economics (2013) [3], which identified that SMEs without an established banking relationship are likely to spend more time trying to access credit. Another method for gaining access to credit, as highlighted in previous studies [22], is business networking. The more SME owner-managers interact with other firms and associations, the higher the opportunity of extending their production reach and reputation. Such networks can even offer additional support to new entrants, enabling more immediate access to credit suppliers, without having to build up a reputation and relationships [22].

Padachi & Howorth (2013) [23] stressed that SMEs using transparent accounting standards and external auditing are more likely to access external credit from foreign banks and domestic bank loans, compared with those that fail to disclose such information [24]. Incompetence and unbalanced experience, and a lack of managerial experience often lead to business failure [25]. The existence of asymmetric information, such as a lack of adequate financial statements, often makes it difficult for lenders to assess the creditworthiness of potential SME proposals. Once lenders cannot differentiate between potential and high-risk borrowers, or it becomes costly to evaluate the quality of a firm's investment opportunities, lenders generally ration their credit or simply charge higher prices [19, 26, 27]. In order, therefore, to overcome obstacles in accessing credit, the potential borrower should provide accurate financial statements to demonstrate a reasonable performance. Independent auditing of these financial statements will further validate this financial information, helping to overcome any problems relating to a perceived lack of high-quality accounting data for an SME [24]. In the case of Vietnamese SMEs, a lack of transparency in financial management is quite common - their financial reports are mostly prepared for the tax agencies [28].

According to the Ministry of Planning and Investment (2012), Vietnamese SMEs tend to operate in a unique environment where the dual role of owner and manager exists, which implies that the SME owner or manager is personally independent in making decisions [11]. Their internal management is often unprofessional and weak, and mainly based on the limited personal experience of their owner-managers. In most of these SMEs, their assets are not clearly separated between the firm as a legal entity and the owner-manager's personal assets. In addition, when an SME owner-manager runs the business based on his or her personal interest and experience with minimal capital, it often lacks a business development strategy. In such situations, the owner-manager only strives to maintain their business with the minimum number of customers and suppliers required. Effective capital management ensuring an optimum return will hardly ever be achieved. Moreover, when based on accounting standards and usage of auditing statements limited to the Vietnamese SMEs, they will struggle to overcome obstacles in a global business environment, and are generally unable to operate and develop in the competitive global context. This study raises the question of whether the use of independent auditing can be influential on credit accessibility in Vietnamese SMEs.

5. Research question

Information asymmetry often arises from SMEs' lack of accounting records of good quality due to them not using accurate accounting techniques, including in the publishing of their balance sheets. Thus, inadequate financial statements make it difficult to assess the creditworthiness of these SMEs [17]. Meanwhile, independent auditing can improve the firm's financial verifiability, by providing more reliable data that convinces lenders they are worthy of credit access [23].

SMEs that use transparent accounting standards and independent auditors generally have greater access to external credit, and as well often achieve a higher number of bank loans for fixed investments and working capital compared with those that fail to adequately disclose such information. It seems the use of independent auditing can be positively influential on obtaining credit access. These ideas were highlighted in the research by Barth, Lin and Yost, 2011 [24], Padachi and Howorth, 2013 [23].

Based on the literature and the empirical evidence presented, this study has formulated a theoretical model on the impacts of the use of independent auditing on credit accessibility in Vietnamese SMEs. The discussions above raise the question of whether the use of auditing of financial statements can influence the credit allocation process in Vietnamese SMEs. Hence, in this study it is questioned that: *Does the use of independent auditing have an influence on credit accessibility in Vietnamese SMEs?*

6. Qualitative methodology

Testing the relationship between SMEs and banks has previously been done by Canova and Martinez Solano (2010) [19], where a combination of qualitative and quantitative methods was used. In their model, cost of debt was employed as the dependent variable against key independent variables of firm size (net turnover), age of firm (number of years since its foundation), and solvency (ratio of cash flow to total assets), to measure the firm's capacity to finance itself and pay off loans; another independent variable, leverage (ratio of liabilities to total assets), was also employed.

An approach to determining financial access was used by Rand (2007) [29], following Fazzari, Hubbard and Petersen (1988) [26], which categorized firms as credit constrained or unconstrained. In Rand's model, variables related to credit access such as revenue, firm age, gender and education against total debt were employed to directly identify the determinants of credit access in Vietnamese SMEs. This current study has maintained consistency with the previous research methods by developing a similar empirical framework to Rand (2007) [29], Barth, Lin and Yost (2011) [24], and Canovas and Solano (2010) [19], where the impact of the use of auditing on credit access in Vietnamese SMEs has been focused on. To achieve the research objective, the researchers have used surveying instruments in terms of a questionnaire to obtain accurate information from the research participants. Thus, the qualitative method is suitable for gaining further insights into these research problems.

It is often difficult to gather financial information from Vietnamese SMEs based on their cultural beliefs and confidentiality concerns, although most seem more willing to provide what they deem as less sensitive information relating to their firm's managerial competency and general business performance. The technique used in this qualitative analysis ensured that participants understood that their answers would be treated confidentially, allowing the researcher to obtain more accurate and reliable information.

The first set of items identified whether they applied auditing to their SME, and if so, whether they used independent or internal auditing, or both. The experience of owner-managers in conducting financial statement auditing was measured by 10 items they were asked to answer. The starting point was to ask respondents to choose the one closest based on their own experience.

A basic questionnaire structure was also considered most relevant for this study, in both English and Vietnamese languages. In the questionnaire, responses were based on a five-point scale ranging from 1 (strongly disagree) to 5 (strongly agree). The questionnaire consisted of 30 straightforward questions mainly focused on capital raising including capital management of the SMEs.

7. Primary data collection procedure

In this study, a sample was drawn from manufacturing SMEs located in Vietnam, and potential participants and respondents were selected from public listings of local SME membership associations. The mail survey method was employed at this data collection stage, in which questionnaires were sent to participants. The survey was a mailed questionnaire that also contained a postage paid return envelope. Techniques suggested by scholars to increase response rates to mail surveys were employed, including a cover letter, follow-up mail or postcard reminder, and a stamped return envelope [30, 31]. Questionnaire packages were then sent to potential Vietnamese SME owner-manager participants, which were translated into Vietnamese.

8. The sample

In the qualitative analysis, this study examines such issues by exploring the nuances as to why access to credit is particularly difficult for Vietnamese SMEs, and how this situation has developed. This study suggest that where asymmetric information exists - often relevant in SMEs that are known for their lack of high-quality accounting data - the use of accounting standards and independent auditing are beneficial for accessing external credit. It is expected that the results of this study are of value to contribute to the existing literature on capital raising among Vietnamese SMEs.

This subsection provides a description of the primary data collected from this study's survey. The sample comprises Vietnamese small and medium sized enterprises in the 2010-2012 period. The sample was carried out according to the requirements established by Decree No. 56/2009/ND-CP issued on 30 June 2009 by the Vietnam Government [9]. As part of this selection, large firms with capital over VND 100 billion were excluded. In addition, firms that did not satisfy the Vietnamese SME definition - those with registered capital less than VND 10 billion, and firms in the services, banking and finance, insurance, education, and foreign investments industries - were all excluded from the sample. SME owner-managers of private, collective, partnered, private limited and joint-stock enterprises were involved in this survey mail-out, the questionnaires randomly sent to Hanoi and Bac

Ninh in the north, Da Nang and Nha Trang in the middle, and Ho Chi Minh and Binh Duong in the south. As a result, approximately 110 of the 400 postal questionnaires were returned to the researcher. Copies of the relevant questionnaire are attached in this paper.

Unlike in previous studies that inferred financing access was based on firm age and capital structure, this study measured the determinants of credit accessibility based on the use of independent auditing. From the qualitative information collected in this study, use of external auditing, was deemed as one of the most relevant drivers of the determinants of credit access in Vietnamese SMEs.

The research question addressed focuses on the use of independent auditing conducted within their business as well as owner-managers' education, network, and banking relationship which can impact on their firm's credit access. The use of independent auditing is further examined in the following subsections of this study.

9. Qualitative analysis and results

Where asymmetric information exists, where lenders cannot differentiate between high-potential borrowers and high-risk borrowers, or it is costly to evaluate the quality of investment opportunities, lenders generally ration credit to what they deem as high-risk borrowers, or simply charge them higher prices. When the cost of obtaining borrower information is high, borrowers can reduce such costs by providing accurate financial statements audited by independent auditors. Independent auditing will further validate the financial information and can help overcome any asymmetric information problems, particularly for SMEs where a lack of high-quality financial information is commonplace.

To measure the professional competency of SME owner-managers in understanding the use of accounting standards and independent auditing on credit access in Vietnamese SMEs, the questions were designed based on the items the participants most agreed with. In this study those aspects were measured via simple items, which enabled an avoidance of more direct questions that might deter responses. The first set of items identified which accounting standards they use for capital management: (1) Vietnam accounting standards; or (2) international accounting standards.

The results showed that 100% of the participants use a computerized accounting system based on Vietnamese accounting standards, indicating that significant numbers of Vietnamese SMEs use fully or partially computerized accounting systems to produce management accounts. There was a need to know how often owner-managers' firms prepare their financial statements, and who physically prepares them. Such aspects raise the question of how it is best to test the SME owner-manager's managerial competency in terms of use of accounting and external auditing standards.

In this study, 100% of the participants noted that they prepare annual financial statements, all via their computerized accounting systems. As this financial statement preparation mostly relates to tax purposes, it signifies that their understanding of accounting standards is not particularly high. These items enabled a closer examination of the role of owner-managers towards financial statement preparation, which is one of the most important criteria to be considered for credit. Across this study's sample, all financial statements were prepared by an accountant. As a further breakdown, 35% of them use an internal accountant, and the other 65% use external accountants.

The research question raises the concern whether the use of independent auditing has a significant influence on credit accessibility in Vietnamese SMEs. Overall, the responses reflected SME owner-managers' managerial competency in terms of the use of audits. From the sample of 43 responses, 5% use independent auditing, 46% use internal auditing, while 49% do not use either auditing type.

By distinguishing these factors, in this study's sample, results show that SME owner-managers' understanding of the importance of auditing activities is mostly weak. It was found that within the 43 responses, 9% were refused credit access, 51% were given credit access with very small loans, while 40% had never applied for credit.

Among those who were refused or never applied for bank credit, most had also never conducted external auditing of financial statements. This study's results indicate that the managerial competency of these Vietnamese SME owner-managers in terms of auditing activity is low. This supports the hypothesis that the use of independent auditing of financial statements has a significant influence on credit access in Vietnamese SMEs, which is also consistent with the findings of Barth, Lin and Yost (2011) [24], and Certified Professional Accountants (2012) [5].

10. Summary and conclusion

Given that the empirical evidence has highlighted the use of independent auditing as one of the key criteria for banks granting loans, those with more sophisticated knowledge in accounting standards and financial management will be more likely to achieve credit access.

Where asymmetric information exists, making it difficult for the lender to assess the potential borrower, or costly to evaluate the quality of their investment opportunities, most lenders ration credit or charge higher prices. With regard to the high cost of obtaining borrower information, lenders can reduce this expense by providing accurate financial statements that have been audited by an external auditor. This independent auditing will validate the firm's financial information, overcoming asymmetric information problems that are often prevalent in SMEs. This study's results indicate that the managerial competency of these Vietnamese SME owner-managers in terms of auditing activity is low. This supports to complete the answer to the research question that: the use of independent auditing of financial statements has a significant influence on credit access in Vietnamese SMEs, which is also consistent with the findings of Barth, Lin and Yost (2011) [24], and Certified Professional Accountants (2012a) [5].

It is also worth noting that most SMEs in this study's qualitative sample do not use independent auditing to validate their financial statements (95%), which also means if the owner-manager lacks auditing knowledge, it will probably be more difficult to evaluate and provide relevant financial information to achieve credit access.

11. Limitations and further study

The research questionnaire was well-designed with readily understandable words to ensure that participants understood what was being asked, and they felt free and the questions were easy to answer. However, due to the small size of the qualitative sample, the findings of the determinants of credit access reported here may not be generalizable.

The technique used in this qualitative analysis ensured that participants understood that their answers would be treated confidentially, allowing the researcher to obtain more accurate and reliable information. However, the nature of the data could be manipulated or limited to what the SME owner-manager wants to answer.

The focus of the study was manufacturing SMEs and was time specific. This study was conducted in 2010-2012, and it does not cover the 2007-2009 Global Financial Crisis, so may not be comparable with the influence of this special period on businesses including Vietnamese SMEs. In addition, as the data collected was focused on a subset of Vietnamese manufacturing SMEs, it may not fully support SMEs in other industries.

This study's findings of the determinants of SME owner-managers' managerial competency relating to credit access via the use of independent auditing could provide the foundation for future research on the sourcing of such knowledge. In addition, further study may enhance this study by including other factors influencing credit accessibility in SMEs, such as the owner-manager's capacity to assess and approach the credit sources available of the banks, formal credit institutions and government funds.

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