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Small Business Financing Initiatives in Ghana[1]

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Abstract

Access to finance has been identified as a dominant constraint facing the Ghanaian Small and Medium Enterprises (SME) sector. This study examines how the finance gap for SMEs might be addressed by means of policies to support other financing initiatives other than commercial finance by the conventional financial institutions. This study through a questionnaire survey investigates the awareness and use of these various financing schemes (quasi-commercial credit) available to the SME sector. The study also ascertains the difficulties SMEs encounter in accessing these financing sources. The results of the study reveal low awareness and usage levels of the various financing initiatives among SMEs. Most of the schemes are perceived as difficult to access. A number of specific action areas have been identified for proactive public policy for small business finance in Ghana.

Key words: financing initiatives, SMEs, policy, Ghana.
JEL Classifications: M13, G30.

1. Introduction

Access to finance has been identified as a dominant constraint facing SMEs (Lader, 1996). A World Bank study found that about 90% of small enterprises surveyed stated that credit was a major constraint to new investment (Parker et al., 1995). Levy (1993) also found that, there is limited access to financial resources available to smaller enterprises compared to larger organizations and the consequences for their low growth and development. This stems from the fact that SMEs have limited access to capital markets partly due to the perception of higher risk, informational barriers, and the higher costs of intermediation for smaller firms. In Sub-Saharan Africa, most small businesses fail in their first year due to lack of support from government and traditional banks (Biekpe, 2004).

In Ghana, the idea that problems in financing small firms have significantly hindered the role they play in the overall macroeconomic performance of the Ghanaian economy is deeply rooted since the overthrow of the first Republic of Dr. Nkrumah (Boapeah, 1993). Previous studies have identified a growing gap in the financial support offered to Ghanaian SMEs. The high interest rates, collateral requirements and the cumbersome processes have often been mentioned as the main impediments to SMEs' access to bank loans in Ghana (see Sowa *et al*., 1992; Aryeetey *et al*., 1994; Bigsten *et al*., 2000; Buatsi, 2002). These studies however focused mainly on the difficulties SMEs face in accessing commercial credit from conventional banks and other financial institutions.

The present study examines how the finance gap for SMEs might be addressed by means of policies to support other financing initiatives other than commercial finance by the conventional financial institutions. The study seeks to investigate the awareness and use of these various financing schemes (quasi-commercial credit) available to SMEs in Ghana. The issue is of critical significance given the important role SMEs play in the Ghanaian economy. SMEs have been noted to contribute about 85% of manufacturing employment (Steel and Webster, 1991). They represent about 80% of the private sector and also account for about 92% of businesses in Ghana. For the current Ghana government's slogan of "Golden Age of Business" to succeed and for the country to reach the per capita income of US $1,000 by 2012, there is the need to steadily increase the rate of economic growth from the present level of 4-5% to 7-10%. Given that SMEs represent a vast portion of the firm tissue in Ghana, they have an important role to play in spurring growth.

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The structure of the remainder of the paper is as follows: The second section provides a review of the literature on small business finance. The following section explains the methodology employed for the study. The empirical results are presented and discussed in the fourth section. The final section concludes the discussion and also provides policy recommendations in addressing the SME finance gap.

1.1. Overview of SME Development in Ghana

The idea of SME promotion has been in existence since 1970 though very little was done at the time. Key institutions were set up to assist SMEs and prominent among them are the Office of Business Promotion and the present Ghana Enterprise Development Commission (GEDC). The main objective of GEDC was to assist Ghanaian businessmen to enter into fields where foreigners mainly operated. It also had packages for strengthening small scale industry in general, both technically and financially (Kayanula and Quartey, 2000).

The Economic Recovery Programme (ERP) instituted in 1983 has broadened the institutional support for SMEs. The National Board for Small Scale Industries (NBSSI) was also established within the Ministry of Industry, Science and Technology to address the needs of small businesses. The NBSSI established an Entrepreneurial Development Programme, intended to train and assist persons with entrepreneurial abilities into self employment. In 1987, the industrial sector also witnessed the coming into operation of the Ghana Appropriate Technology Industrial Service (GRATIS). It was to supervise the operations of Intermediate Technology Transfer Units (ITTUs) in the country. GRATIS aims at upgrading small scale industrial concerns by transferring appropriate technology to small scale and informal industries at the grass root level. ITTUs in the regions are intended to develop the engineering abilities of small scale manufacturing and service industries engaged in vehicle repairs and other related trades. They are also to address the needs of non-engineering industries (Kayanula and Quartey, 2000). The setting up of the new Ministry for Private Sector Development by the current government is also an attempt to focus on the development of the SME sector.

The most significant institutional weakness facing dynamic SMEs is their lack of access to external finance. Repressive financial policies in the past, especially low interest, and a monopolistic banking system minimized the interest of banks in developing this market. To reverse the consequences of these practices, a combination of financial liberalization and institutional reform was in order (Aryeetey et al., 1994).

In view of the relatively low level of response from the private sector to early ERP reform measures the focus was on the liberalization of various sectors, including the financial sector under the Financial Sector Adjustment Programme (FINSAP). Under the FINSAP, direct institutional measures aimed at supporting small enterprises were also been put in place. With World Bank assistance, the Programme of Action to Mitigate the Social Costs of Adjustment (PAMSCAD) created a special fund to assist microenterprises, and the Fund for Small and Medium Enterprises Development (FUSMED) was initiated to increase the amount of credit available to SMEs through commercial and development banks. This was based on the presumption that poor availability of credit from formal sources was one of the major reasons why the private sector investment had not grown as expected. A major argument was that small firms with good growth potential were being discriminated against (Aryeetey et al., 1994). At the same time, however, the effectiveness of many similar SME credit was being called in question (Webster, 1991).

There are currently a number of financing schemes set up by government and the donor agencies available to the SME sector, including Private Enterprises and Export Development Fund, Export Development and Investment Fund, Deutsche Gesellschaft Fuer Technische Zusammenarbeit (GTZ), Business Assistance Fund, Ghana Investment Fund, Trade and Investment Programme, Africa Project Development Facility, Support for Private Enterprise Expansion and Development, Promotion of Small and Micro Enterprise Fund, Business Sector Programme Support, Revolving

Loan Fund, Ghana Private Sector Development Fund etc. Inspite of these developments, the finance gap continues to be a major problem to SME development in Ghana.

2. Literature on Small Business Financing

The extant literature is clear on the fact that small businesses mostly have problems accessing funds from finance providers to finance fixed assets and working capital for their operations (Tucker and Lean, 2003). The presence and nature of a 'finance gap' for small firms has been debated for decades, ever since the Macmillan Report (Macmillan, 1931). According to Blanton and Dorman (1994), small firms are frequently under-capitalized. That is, the term structure of loans granted to SMEs does not suit their needs. Blanton and Dorman (1994) argue that even when SMEs are given credit, they are often granted short-term loans and therefore they have no option but to depend on short-term and informal credits in financing their long-term needs such as acquiring new equipments (Riding and Short, 1987).

The presence of the 'finance gap' is mainly a result of the existence of information asymmetries between finance providers and borrowers. Information asymmetries refer to the disparity between the information available to businesses seeking capital and suppliers of capital who are typically assumed to be at an informational disadvantage with respect to insiders of the business (Stiglitz and Weiss, 1981; Bester, 1987). Privately held firms do not publish the same quantity or quality of financial information that publicly held firms are required to produce. As a result, information on their financial condition, earnings, and earnings prospects may be incomplete or inaccurate. Faced with this type of uncertainty, a lender may deny credit, sometimes to firms that are creditworthy but unable to document it (Coleman, 2000). In a perfect markets setting, with perfect and costless information available to both the small firm (i.e. the agent) and the finance provider (i.e. the principal), and no uncertainties regarding present and future trading conditions, the principal-agent relationship does not suffer from the market failure of information asymmetry. However, information in the real world is neither perfect nor costless, and additionally the small business finance market is characterized by risk and uncertainty regarding future conditions. Information is distributed asymmetrically between the bank or finance provider and the firm (Tucker and Lean, 2003).

Important issues identified within the context of informational asymmetry are adverse selection and moral hazard. Under adverse selection, theoretical models often assume that an entrepreneur has private knowledge about the success probability of a project or expected profits that are not shared with the financier. Consequently, suppliers of capital cannot differentiate between a high-quality business and a low-quality business and adverse selection can result. Moral hazard refers to the inability of the finance provider to control fully how the entrepreneur uses funds provided. Owners can conceivably benefit economically by, for example, redirecting borrowed funds to invest in higher risk projects than those approved by the lender (Stiglitz and Weiss, 1981; Bester, 1987; Bester and Hellwig, 1989; Binks and Ennew, 1996). To avoid this situation, financiers can implement contract provisions that discourage borrowers from acting against the interests of investor or lender, and these precautionary actions can lead to credit rationing. Certain types of moral hazard play a role in the costly monitoring problem, but these moral hazard problems do not affect the outcome of the entrepreneur's projects. Instead, moral hazard affects costly monitoring problems by adding the risk that entrepreneurs will lie about their returns and profit at the expense of the finance provider (Stiglitz and Weiss, 1981; Binks and Ennew, 1996).

The provision of collateral and reputation (track record) can lessen the problem of adverse selection and moral hazard. Low risk borrowers (who would otherwise leave the market due to high interest rates) can signal their status through the provision of adequate collateral and good reputation. With their assets at stake as collateral, firms will be motivated to perform to the best of their abilities. In this context, lack of collateral and reputation may lead to a firm being denied credit. To the extent that small firms possess less collateral and reputation than large firms, they may face yet greater difficulty raising capital than do large firms. Worse still, since there is considerable uncertainty surrounding the survival and growth of SMEs, their asset-backed collateral are usually valued at 'carcass value' to ensure that the loan is realistically covered in case of default and immediate realization (Binks *et al.,* 1992). This implies that the already disadvantaged small firms may even need proportionately more collateral than do large firms.

It is also important to note that the motives and objectives of the owner-manager can greatly influence an SME's ability to secure external finance. Owner-managers are often unwilling to provide their personal assets as collateral. Besides, many SMEs have objectives other than growth as a priority (Tucker and Lean, 2003). Binks and Ennew (1996) however argue that many small firms will be forced to provide yield expansion to protect their limited liability status (which would otherwise be eroded by the provision of personal assets as loan collateral). One main motive for starting a small business is to maintain greater control over the operation of the business and to internalize the benefits of personal effort and risk-taking. In this regard, then, it is understandable that many SME managers would not tolerate any dilution of this control through the introduction of outside equity. Thus, the motives of owner-managers of SMEs may constitute a major constraint on the range of external financing sources available to the firm (Tucker and Lean, 2003).

3. Research Methodology

In order to ascertain the potential role of government policy to support other financing initiatives, it is imperative to determine the use and awareness of the various financing sources available to the SME sector and also to investigate issues that are of importance to SME financing. A questionnaire survey was carried out based on a sample of 200 firms drawn from the database of the National Board for Small Scale Industries and that of the Association of Ghana Industries. The sample selection was based on criteria set by Regional Project on Enterprise Development (RPED) for SMEs in Ghana. That means firms with employee size of less than 100 were included in the study sample. The firms were also drawn from all industrial sectors in Ghana. Pre-testing exercises were done to inform the shaping of the final field questionnaire. This was particularly important given the often sensitive nature of such questions.

The field survey was carried out between January 2005 and September 2005. Out of the total of 200 questionnaires, 125 were received from respondents representing a response rate of 62.5%. The resulting response rate is high for a survey of this type considering that empirical studies involving SMEs have been known to generate far lesser percentage response rates. In order to determine the perception of ease of accessing the financing schemes, responses were measured with a five-point Likert rating scale where very difficult = 1 and very easy = 5. Data obtained from respondents was entered into an "SPSS" database application for analysis. Descriptive statistics were used in the presentation and analysis of empirical results.

4. Discussion of Results

4.1. Characteristics of Sampled Firms

Table 1 presents the characteristics of the firms based on industry classification, size, age and trade status. All in all, five industries were represented including: agriculture representing 3.2% of valid respondents, manufacturing (64%), mining and construction (8.0%), trading (5.6%) and general services (19.2%). Three size categories were defined on the basis of number of employees. Firms with less than 5 employees were classified as micro firms. Those with between 5 and 29 employees were classified as small firms and medium sized firms had between 30 and 99 employees. About 4 (3.2%) of the firms surveyed were in the microenterprise group, 75 (60.0%) were small firms and 46 (36.8%) were medium-sized companies. The firms were also categorized on the basis of date of establishment. Firms which have been in business for less than 1 year were labeled as "infant", those between 1 and 5 years were classified as "young", those with between 6 and 10 years were classified as "adult" and those with over 10 years were also labeled as "mature". There were 3 infant businesses representing 2.4% of the sample. Twenty three firms were young firms representing 18.4% of the sample, adult firms were 35 representing 28.0% while mature companies were 64 representing 51.2%. Majority of the firms were male (64%) and Ghanaian (91.2%) owned. Only 52 representing 41.6% of the sampled SMEs were found to be exporters.

Table 1

Characteristics of Sampled Firms

Industry	Freq.	%
Agriculture	4	3.2
Manufacturing	80	64.0
Mining & Construction	10	8.0
Trading	7	5.6
General Services	24	19.2
Total	125	100.0
Size		
Micro	4	3.2
Small	75	60.0
Medium	46	36.8
Age		
Infant	3	2.4
Young	23	18.4
Adult	35	28.0
Mature	64	51.2
Gender		
Male-owned	80	64.0
Female-owned	31	24.8
Both	14	11.2
Ownership		
Ghanaian-owned	114	91.2
Foreign-owned	11	8.8
Trade Status		
Exporters	52	41.6
Non-exporters	73	58.4

Source: Survey data.

4.2. Key Findings

Table 2 illustrates the awareness among the firms of the various financing schemes. Most of the firms are unaware of these financing schemes. Apart from EGF and DANIDA, less than 50% of the respondents are aware of the other financing schemes. This is particularly surprising given the problems SMEs face in accessing loans from commercial banks. Since most (79.2%) of these firms have been in business for over fives years, one would have expected that, they would be reasonably aware of other financing schemes available to the SME sector aside from bank financing. The low level of awareness may be due to inadequate and ineffective marketing communication implemented by these finance providers. Most of these schemes, apart from initially touring the country to launch their programmes in the regional capitals, they do not intensify their marketing communication efforts to get SMEs aware of these financing schemes. The small budget mostly assigned to administering these schemes by the donors could account for this problem.

Table 2

Awareness of the Various Financing Schemes

Financing Scheme	Freq.	%
EMPRETEC Ghana Foundation (EGF)	66	52.8
Danish International Devt. Assistance (DANIDA)	63	50.4
Export Development and Investment Fund (EDIF)	56	44.8
Japan International Cooperation Agency (JICA)	47	37.6
Ghana Private Sector Devt. Fund (GPSDF)	46	36.8
Deutsche Gesellschaft Fuer Technische Zusammenarbeit (GTZ)	43	34.4
Business Assistance Fund (BAF)	37	29.6
Department for International Development (DFID)	36	28.8
Ghana Investment Fund (GIF)	36	28.8
Trade and Investment Programme (TIP)	35	28.0
Private Enterprises and Export Devt. Fund (PEED)	33	26.4
Funds for Small and Medium Scale Enterprise Devt. (FUSMED)	32	25.6
Africa Project Development Facility (APDF)	24	19.2
Support for Private Enterprise Expansion and Devt. (SPEED)	16	12.8
Promotion of Small and Micro Enterprise Fund (PSME)	14	11.2
Business Sector Programme Support (BSPS)	6	4.8
Revolving Loan Fund (RLF)	4	3.2

Source: Survey data.

Table 3 indicates the use of the various financing schemes among the sampled firms. The results generally show a very low dependence on these sources of financing. Among the sampled firms, less than 10% have been successful in obtaining finance from each of these schemes. This simply reflects the fact that the sample contains a high proportion of firms (mostly over 50%) that are unaware of these financing schemes. Another reason may be the stringent eligibility criteria that make it difficult for SMEs to access these funds. The low use of the various financing schemes is not particularly encouraging since SMEs in Ghana do not have easy access to other sources such as bank loans.

Table 3

Use of Various Financing Schemes

Financing Scheme	Freq.	%
Deutsche Gesellschaft Fuer Technische Zusammenarbeit (GTZ)	9	7.20
Export Development and Investment Fund (EDIF)	8	6.40
Japan International Cooperation Agency (JICA)	8	6.40
Business Assistance Fund (BAF)	6	4.80
Trade and Investment Programme (TIP)	6	4.80
EMPRETEC Ghana Foundation (EGF)	5	4.00
Private Enterprises and Export Devt. Fund (PEED)	5	4.00
Funds for Small and Medium Scale Enterprise Devt. (FUSMED)	5	4.00
Danish International Devt. Assistance (DANIDA)	5	4.00
Ghana Private Sector Devt. Fund (GPSDF)	4	3.20
Africa Project Development Facility (APDF)	4	3.20
Department for International Development (DFID)	2	1.60
Promotion of Small and Micro Enterprise Fund (PSME)	2	1.60
Support for Private Enterprise Expansion and Devt. (SPEED)	2	1.60
Revolving Loan Fund (RLF)	1	0.80
Ghana Investment Fund (GIF)	1	0.80
Business Sector Programme Support (BSPS)	0	0.00

Source: Survey data.

The perception of ease of access of the financing schemes is illustrated in Table 4. SPEED and RLF are perceived to be the easiest to acquire followed by GPSDF, PSME and APDF. Some

(EGF, FUSMED, BAF, JICA, TIP and DFID) are also perceived to be relatively easier to access. EDIF, GTZ, DANIDA, GIF and PEED are however perceived as difficult to acquire with mean values of less than 2.50. Considering the information asymmetry that exists regarding the quality of small businesses' investment projects, finance providers may demand collateral security. This clearly makes it difficult for SMEs to qualify for financing.

Table 4

Perception of Ease of Access to Financing Schemes

Financing Scheme	Mean
Support for Private Enterprise Expansion and Devt. (SPEED)	5.00
Revolving Loan Fund (RLF)	5.00
Ghana Private Sector Devt. Fund (GPSDF)	3.67
Promotion of Small and Micro Enterprise Fund (PSME)	3.00
Africa Project Development Facility (APDF)	3.00
EMPRETEC Ghana Foundation (EGF)	2.86
Funds for Small and Medium Scale Enterprise Devt. (FUSMED)	2.83
Business Assistance Fund (BAF)	2.75
Japan International Cooperation Agency (JICA)	2.67
Trade and Investment Programme (TIP)	2.50
Department for International Development (DFID)	2.50
Export Development and Investment Fund (EDIF)	2.33
Deutsche Gesellschaft Fuer Technische Zusammenarbeit (GTZ)	2.33
Danish International Devt. Assistance (DANIDA)	2.00
Ghana Investment Fund (GIF)	2.00
Private Enterprises and Export Devt. Fund (PEED)	1.67

Source: Survey data.

Table 5 illustrates how respondents rank the difficulty they encounter when applying to the financing schemes. The most common difficulty (26.4% of respondents) was the lack of securable assets required by finance providers. Most of these schemes are routed through the banks who also review applications using their criteria such as collateral requirement. The essence of involving the banks is to avoid the credit risk involved in lending to SMEs. Some (22.4%) indicated that, the lack of knowledge by finance providers about the nature of the respondent's business was a problem while 16.8% mentioned that, they did not meet the eligibility criteria for accessing the finance. A number of firms (15.2%) however admitted their lack of knowledge about lending criteria used by providers which represent a difficulty in accessing finance and others (12%) also admitted that, they had difficulty finding out about available finance. Bureaucracy and delayed processing of applicants proposals were also identified as difficulties by some respondents (12%). Eleven (8.8%) mentioned the lack of financial performance track record as a problem. This should not be strange for start-up businesses. A few (3.2%) also indicated the problem of high interest rates.

Table 5

Problems faced in Accessing Financing Schemes

Problem	Freq	%
Lack of securable assets	33	26.4
Lack of knowledge by finance providers about my business	28	22.4
Do not meet eligibility criteria	21	16.8
Lack of knowledge by my business about lending criteria used by providers	19	15.2
Difficulty in finding out about available finance	15	12.0
Bureaucracy	15	12.0
Lack of financial performance track record	11	8.8
High Interest	4	3.2

Source: Survey data.

3. Conclusion and Policy Recommendations

SMEs play an important role in the development of the Ghanaian economy. However, their level of growth is often hampered by the limited access to finance. This paper sets out to investigate the awareness and use of the various financing schemes (quasi-commercial credit) available to the Ghanaian SME sector. The results of this study reveal low awareness and usage levels of the various financing initiatives among SMEs. Most of the schemes are perceived as difficult to access. The difficulties SMEs often face in accessing these funds include: lack of securable assets, lack of knowledge by finance providers about the nature of respondents business, stringent eligibility criteria, lack of knowledge about lending criteria, difficulty in finding out about available finance, and bureaucracy. These really limit SMEs' ability to access funds from these initiatives.

In the light of the key findings, policy actions should include better information provision regarding the various sources of finance. This could involve the financing initiatives pursuing a more aggressive and continuous marketing communication campaign to inform SMEs of the various financing schemes available to the sector. Eligibility criteria should be made a bit more flexible to enable more SMEs to qualify for access to these funds. Routing these facilities through the commercial banks should be reconsidered. Evaluation of applicants' proposals could be done by qualified consultants affiliated to these schemes and the banks should rather be appointed as managers of the loan facilities for a fee. In that case, government bears the credit risk. This could further expedite processing and give applicants a better chance of accessing these facilities.

Policy makers would have to place greater emphasis on facilitating equity capital. Equity capital provides a base for further borrowing, reduces businesses' sensitivity to economic cycles, and provides SMEs with access to syndicates of private and institutional venture capital suppliers. There could also be policies aimed at encouraging SMEs to access public equity capital through the reduction of listing requirements and subsidizing flotation cost. These policy prescriptions could go a long way to improve Ghanaian SMEs' access to long-term financing to spur up growth.

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