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THE CONSTRAINTS OF FINANCE TO SMALL AND MEDIUM SIZED ENTERPRISES A CASE STUDY OF SG-SSB LIMITED

BY


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DECLARATION

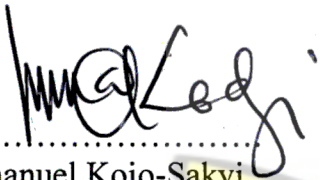
I hereby declare that except for the references to the other people's work, which have been duly acknowledged, the Work presented was done by me as a student of the Institute of Distance Learning of the Kwame Nkrumah University of Science and Technology under the supervision of Dr. Emmanuel Kojo-Sakyi



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DEDICATION

This Project work is solely dedicated to my parents, Mr. and Mrs. Berimah, my siblings, Sammy, Rebecca and Moses and my friend Ninette who contributed immensely to the success of this work.

KNUST



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May God bless them all.



ABSTRACT

Lack of access to finance is quoted as the a major constraint for all Small and Medium Sized Enterprises which can seriously affect their ability to survive, upgrade the technology in their businesses, increase their capacity, expand their market, improve management system, increase productivity as well as profitability.

Against this background of the problem identified above, the study set out to explore the constraints of finance to SMEs in Ghana. To achieve this objective, 18 SMEs customers of SG-SSB were randomly sampled and questioned. The responses derived from the questionnaire were analyzed with the SPSS software and presented in the form of frequency tables. Chi square tests were also conducted to determine the possible associations between the key variables under study. The responses were also qualitatively discussed.

The findings of the study revealed that most of the SME clients are unable to meet collateral requirements in accessing credit facilities from the SG-SSB and therefore resort to micro credit institutions and retained earnings as first choice to finance the growth and expansion of their businesses.

A conclusion was therefore drawn that indeed SMEs in Ghana face a lot of varying constraints or challenges ranging from lack of access to finance/capital, no marketing avenues for products and services, inefficient technology, competition etc

Deriving from the findings and conclusions made, the study recommends the rolling out of specialized credit facilities for SMEs to enhance quick and easy repayments, minimizing the strict use of landed property collateral requirement.

TABLE OF CONTENT

	Page
DECLARATION.....	ii
DEDICATION.....	iii
ACKNOWLEDGEMENT.....	iv
ABSTRACT.....	v
TABLE OF CONTENT.....	vi
LIST OF TABLES	ix
 CHAPTER ONE.....	 1
INTRODUCTION AND BACKGROUND TO THE STUDY.....	1
1.1 Introduction	1
1.2 Statement of the problem.....	3
1.3 Objectives	4
1.4 Research questions	4
1.5 Research Methodology	5
1.5.1 Selection of Research Site	5
1.5.2 Research design	5
1.5.3 Outline of the research process.....	5
1.5.4 Study population, sample and respondents selection.....	6
1.5.5 Data sources.....	6
1.5.6 Fieldwork and administration of the questionnaires.....	6
1.5.7 Data Entry and Analysis	7
1.6 Study area	7
1.6.2 Corporate Mission of the Bank.....	8
1.6.3 SG-SSB Policies towards SMEs.....	8
1.7 Significance of the study	9
1.8 Limitation of the Study.....	10
1.9 Chapter disposition	10
 CHAPTER TWO.....	 12
LITERATURE REVIEW ON THE CONCEPT, SCOPE, CHARACTERISTICS OF SMEs AND POLICIES FOR PROMOTING THEM IN GHANA	12

2.1	Introduction	12
2.2	The History and Development of SMEs in Ghana	12
2.3	Definition of SMEs.....	13
2.3.1	Department of Trade and Industry (DTI)	15
2.3.2	Ghanaian Definition of SMEs	16
2.4	The Scope and Role of SMEs in Ghana	17
2.5	Characteristics of SMEs In Ghana.....	19
2.6	Constraints Facing the SME Sector.....	21
2.6.1	Regulatory Requirements	21
2.6.2	Market.....	21
2.6.3	Lack of Modern Technologies.....	22
2.6.5	Logistics and Management Problems.....	22
2.6.6	Financial Constraints To SME Development	23
2.6.7	The key reasons for the financial constraints phenomenon	24
2.7	SMEs Constraints – The Role of Government	26
2.7.1	Investment Finance for SMEs	28
2.7.2	Business development service	28
2.7.3	Infrastructure support.....	29
2.7.4	Commercial & market linkages	29
2.7.5	Technology development services.....	30
2.8	Financing by Commercial Banks in the US and EU -Recent Developments	30
2.8.1	Reducing Information asymmetry of SMEs and improving risk management	30
2.8.2	Financial Information on SMEs.....	31
2.8.3	Credit Scoring Systems.....	32
2.9	Financing SMEs in the Recession	34
2.10	Summary and conclusion.....	36
CHAPTER THREE		38
THE IMPORTANCE OF SMEs TO THE ECONOMY AND THE SMEs AS BANKS CLIENTS ...		38
3.1	Introduction	38
3.2	Aims of this section	38
3.3	The Importance of SMEs to the Economy.....	39
3.4	SMEs as Bank Clients	43
3.5	Summary and Conclusion.....	49
CHAPTER FOUR		50

DATA ANALYSES, PRESENTATION AND DISCUSSION OF FINDINGS..... 50

4.1 Introduction 50

4.2 Data presentation 50

4.3 Discussion of findings 57

4.3.1 Background of participants..... 57

4.3.2 Credit Issues 58

4.3.3 Financial constraints facing SMEs in Ghana..... 60

4.4 Conclusion of analyses 70

CHAPTER FIVE 71

SUMMARY AND RECOMMENDATIONS 71

5.0 Introduction 71

5.1 Summary..... 71

5.2 Key findings 72

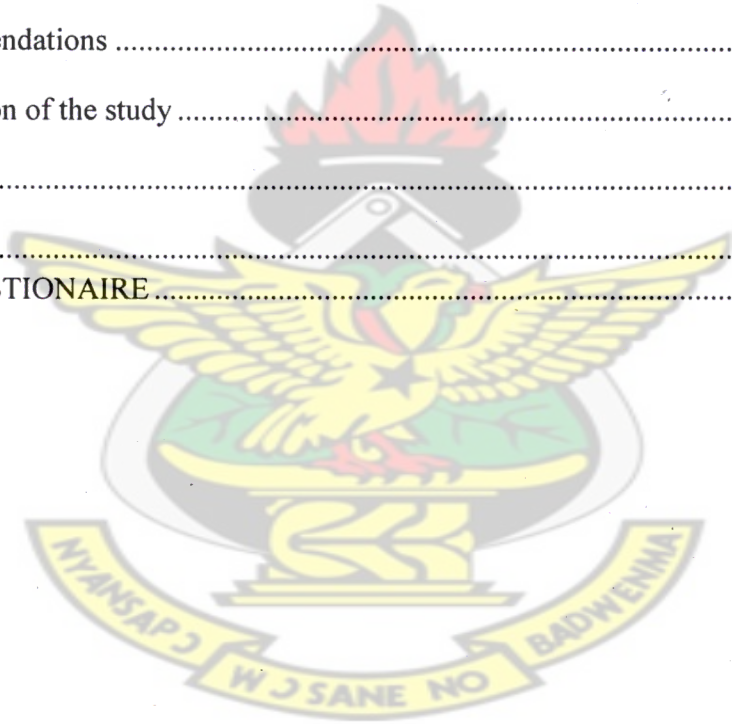
5.3 Recommendations 73

5.4 Conclusion of the study 74

REFERENCES 76

APPENDIX..... 79

RESEARCH QUESTIONNAIRE 79



LIST OF TABLES

Tables	Page
Table 1 Various Sectorial Definitions of SMEs.....	15
Table 2 Number of Years in Business.....	50
Table 3 Number of People currently Employed	51
Table 4 Means of Financing the Start Up Business.....	51
Table 5 Current Stage of your Business.....	51
Table 6 Means of Financing Expansion.....	52
Table 7 Does your Account bear your Business Name?.....	52
Table 8 Have you applied for a Credit for this Business?.....	52
Table 9 Requirement for Credit....	52
Table 10 Was the Credit Approved?.....	53
Table 11 Source of the Credit	53
Table 12 Why was the Request declined?.....	53
Table 13 Does the Loan processing period pose constraints to your Business?.....	54
Table 14 Did the Requirements pose constraints to your Business.....	54
Table 15 How long does it take to process your application?.....	54
Table 16 What percentage of interest rate are you paying?.....	54
Table 17 Does the Level of Interest pose a constraint to your Business?.....	55
Table 18 If Yes to Q17 how does it pose a Constraints?.....	55
Table 19 Did you provide Security for the Credit?.....	55
Table 20 Forms of Security provided.....	55
Table 21 Was it difficult in ascertaining the required Collateral?.....	56
Table 22 If Yes to Q21 what were the difficulties?.....	56
Table 23 Challenges affecting SMEs.....	56

Table 24 How much of your Business is financed by Suppliers Credit?.....	56
Table 25 Do you do Book Keeping on your Business and Account operation?.....	57
Table 26 General Challenges affecting SMEs.....	63
Table 27 Challenges posed by Requirements for the Loan.....	63
Table 28 Challenges posed by Interest on the Loan	65
Table 29 Challenges posed by Processing Period of the Loan	67
Table 30 Challenges faced by obtaining Collateral for the Loan.....	69



CHAPTER ONE

INTRODUCTION AND BACKGROUND TO THE STUDY

1.1 Introduction

It is now increasingly recognised that the Small and Medium Enterprises (SMEs) play an important role in income generation as well as employment creation around the globe. SMEs are considered to be one of the principal driving forces in economic development. They stimulate private ownership and entrepreneurial skills, they are flexible and can adapt quickly to changing market demand and supply situations. They generate employment, help in diversifying economic activities and make significant contribution to exports and trade. (Szabo, 1996)

In Africa the SME sector accounts for almost 90% of all the enterprises, in which they are located in both the rural and urban areas, whereby they provide more equitable distribution of income in all areas of the countries. This means that the SMEs are the main source of providing employment to the people and stimulate the development of the countries by promoting the entrepreneurship and the business skills amongst communities and strengthen the local production sector as well the industrial base. Therefore the SMEs in Africa have been considered to be very important engine for growth and for obtaining national development goals, such as poverty alleviation and economic growth (Mokaddem, 2006).

In Ghana, available data from the Registrar General indicates that over 90 percent of the Companies registered are micro, Small and Medium Enterprises. This group has been targeted as the catalyst for the economic growth and development and in so doing alleviate poverty as they constitute the major source of employment. It is interesting to note that while SMEs generate over half of the Private Sector Employment, the sector employs only about

15.5% of the labour force in Ghana (Parker et al, 1995). We emphasize the point, however, that despite this small number of direct employees, the number of people that depend on SMEs for their livelihoods is considered to be much higher than in any sector of employment. In acknowledging the growth problems that SMEs in Ghana face, one may point out SMEs will begin small and eventually die small without ever having any expansion in terms of employment.

There are myriad of constraints that inhibit the success of SMEs. It is generally believed that the most single important factor constraining the growth of the SMEs is the lack of finance.

Finance has been identified in many business surveys as the most important factor determining the survival and growth of SMEs in both developing and developed Countries. Access to finance allows SMEs to undertake productive investment to expand their businesses, to acquire the latest technologies and to build productive capacity thus ensuring their competitiveness, to create jobs and to contribute to poverty alleviation of the nation as a whole. Poorly functioning financial systems can seriously undermine the microeconomic fundamentals of a country, resulting in lower growth in income and employment.

Traditional commercial banks and investors have been reluctant to service SMEs for a number of well-known reasons. Some of the key reasons of the phenomenon are:

- SMEs are regarded as risky borrowers due to lack of tangible securities and poor systems of guarantees, lacking information about their ability to repay the loans.
- They also are regarded by creditors and investors as high-risk borrowers due to low capitalisation, vulnerability to market fluctuations and high mortality rates

- Information asymmetry arising from SMEs lack of accounting records, inadequate financial statements or business plans which makes it difficult for creditors to assess the creditworthiness of potential SMEs proposals.

Most commercial banks unfortunately do not put in place the institutional and legal structures to facilitate the management of SME lending risk hence they therefore shy away from granting facilities to SMEs. Ghana's SMEs therefore largely depend on their retained earnings and informal savings and loans associations (tontines) which are unpredictable, not very secure and have little scope of risk sharing because of their sectorial focus

The financial system is underdeveloped however and so it provides few financial instruments or low levels of intermediation. Capital markets are in their infancy, shareholding is rare and no long-term financing is available for SMEs. Non-banking financial intermediaries such as micro-credits institutions could be a big help in financing the activities of the SMEs but do not have the resources to follow up their customers as they expand.

In the bid to broaden the loan portfolios, SG-SSB has established an SME Department to strategically finance the SMEs both with and outside the Bank since they constitute the largest group of revenue generation for the Bank. Notwithstanding the creation of a specialized department for the sector the Bank has been very cautious with lending to the SMEs with no special tailored services.

1.2 Statement of the Problem

Apart from their normal engagement in their core commercial activities, Banks are regarded as the main bodies partnering development of the economy of a country.

Traditionally, however, SG-SSB and other commercial banks in Ghana have been cautious in lending to SME groups because of the perception of high default rates and risk associated

with the sector. Predominantly among the factors that project them as a risky group is the information asymmetry about their operations, lack of security and other forms of risks protections.

As a result, only few Banks have developed special explicit policy for SME target groups in taking their particular requirements and needs into consideration in developing earmarked financial products and appropriate credit management systems.

Though SG-SSB and other few Banks have SMEs desk specifically instituted to meet the needs of Small and Medium Scale Businesses in Ghana, many banking institutions are still reluctant to lend to SMEs. This therefore gives rise to the problem of finance for SMEs in Ghana.

1.3 Objectives

The study focused on achieving the following objectives:

1. To examine the process as well as the rate of success in obtaining credit facilities from SG-SSB by SMEs
2. To examine the challenges faced by SMEs in accessing funding for their businesses.
3. To suggest ways of reducing credit constraints.
4. Assess efforts being made by SG-SSB to address credit constraints faced by SMEs.

1.4 Research Questions

The study therefore attempted to investigate the following research questions with reference to the performance of SG-SSB SME desk established about 5 years ago:

- What are the constraints faced by SMEs in Ghana?

- How do these constraints affect the survival, growth and profitability of SMEs in Ghana?
- How can the constraints to credit faced by SMEs be addressed?

1.5 Research Methodology

This section deals with the details of the research methods employed during this study. Emphasis was placed on the approaches used in the research and the instruments used for the data collection during the research. Other areas covered here include the administration of the research instrument, the data collection procedure and the elements of the data analysis.

1.5.1 Selection of Research Site

Time constraints as well as the proximity of the Accra Metropolitan Area were primary determinants for its selection as the research area. Additionally, the SG-SSB bank was selected because it is one of the key financial institutions that have a clearly defined credit policy for SMEs in Ghana.

1.5.2 Research Design

The research design of this study was based around the case study. The choice of case study research design was based on the fact that it is a useful research strategy for policy and public administration research (Yin, 1994). Yin also provides that it is useful in investigating a phenomenon in-depth, especially when 'how' and 'why' research questions are being asked.

1.5.3 Outline of the Research Process

Before undertaking fieldwork, the relevant literature on SMEs and credit facilities in Ghana were reviewed. This review helped to isolate the research problem and questions and further provided the basis for developing a conceptual guide for the study. Both the theoretical and conceptual literature helped to clarify the research question and associated research

propositions. The literature search also helped with the interpretation, discussion and analysis of the data.

1.5.4 Study population, sample and respondents selection

Though SG-SSB operates throughout the country, the availability of SG-SSB staff in the Accra Metropolitan area to assist with the field work informed the researcher's choice of Accra for the study.

Eighteen (18) SMEs actively operating within the Accra metropolis and saving with SG-SSB were randomly selected for the study. To ensure that the sample was representative of the SMEs who saved with the bank, and to give every SME customer of the bank a fair chance of being part of the study, the simple random selection procedure was adopted.

1.5.5 Data Sources

Data for the study were gathered from primary and secondary sources.

Questionnaires containing both open and closed ended questions formed the main primary source of data. The closed part were used in order to present the respondent with a fixed set of choices while the open ones were to encourage respondents to share as much as possible in an unrestricted manner. The ease of administration and the fact that it takes relatively less of the respondent's time were considered in choosing questionnaires as the main primary data collection instrument.

The secondary data aspect of data was derived from the selected from Quarterly Bulletin and other relevant materials.

1.5.6 Fieldwork and administration of the Questionnaires

A questionnaire comprising 25 questions in English was administered to the sampled SMEs. Although a total of 18 responses were expected based on the sample size, 25 questionnaires

were sent into the field in case replacements were needed. At the end of the survey period, all 18 questionnaires were successfully administered and collected.

1.5.7 Data Entry and Analysis

The primary data was screened to ensure accuracy, consistency and reliability. The responses from open-ended questions were extracted and assigned codes before data entry. The Statistical Package for Social Sciences (SPSS) software was used for data entry, processing and analysis.

The frequencies which were generated formed the basis of calculating descriptive statistical values like means, percentages, ratios, rates, standard deviations and variances. Cross tabulations of variables was done to show relationships. Attempt was made to determine the relationship between some variables.

1.6 Study Area

SG-SSB Limited is a part of the Société Générale, Group worldwide operating in about fifty countries. The bank therefore derives its strategies from the overall group strategy. The group strategy is to strengthen its franchise in Africa and Asia using its presence in Europe and the Americas to support this strategy. The Bank's strategy in Ghana is to grow and develop its strong franchise in the country using its operations in Europe, the Americas and the Asia, to provide customers with a bridge to Ghana from these markets.

SG-SSB Limited is basically a commercial bank that mobilizes short-term and medium term funds from surplus sources and channels them to deficit areas. It is ranked among the six largest commercial banks namely, Ghana Commercial Bank, Standard Chartered, Barclays Bank, Ecobank and Agricultural Development Bank. The bank regards these banks already mentioned as well as emerging banks as its key competitors.

Besides its traditional role of operating current and savings accounts and time deposits, SG-SSB Limited now offers a wide range of services including trade finance, foreign exchange transactions, management and syndication of loans, project financing and foreign currency services. In recent times, the bank had been providing medium term finance for the construction of new factories and acquisition of plant and machinery as well as the rehabilitation of existing industries.

1.6.2 Corporate Mission of the Bank

The mission of SG-SSB is to create the preferred banking institution, which employs professionalism, teamwork and innovation to provide quality products and services that best satisfy the needs of its customers. To achieve this, values that relate to the mission have been made clear. These are:

- Aiming for enhanced shareholder value
- Focusing on quality
- Rewarding success
- Identifying with the group network
- Commitment to local communities and
- Achieving excellence

1.6.3 SG-SSB Policies towards SMEs

Almost all Banks in the country have established SME banking departments. Most notable ones are Barclays Bank, Merchant Bank, Standard Chartered Bank, SG-SSB etc The Small and Medium Scale Enterprises (SME) Departments are specially structured to meet the banking needs of Small and Medium Scale businesses. However, because of poor accounting practices and record keeping, lack of collaterals etc, many SMEs are unable to attract finance from the mainstream Banks.

The Bank in line with its mission to make SG-SSB the preferred Banking institutions has drawn the following policies to help grow and develop its SME portfolio.

- Establishment of SME Department and desk at all the branches in Ghana. Teams of SG-SSB professionals, spread countrywide, are available to provide flexible solutions and appropriate credit products to meet the unique needs of SME borrowers, applying experience and pooling resources from Societe Generale network.
- Addressing the inherent structural weaknesses such as mismatch of bank credit. The bank is to make available some kinds of flexible credit facilities to SME clients which hitherto a preserve for corporate customers, both long tenure and short tenure facilities for all clients
- To package and roll out a collateral free credit facility for SMEs to address the lack of collateral or inadequate collateral constraints to reliable and identifiable customers who have operated a relatively good credit turn over for six months or more.
- To help build the capacity of SME customers by organizing training or refresher programs for the SME managers to improve their skills in several areas including financial planning, recording keeping, reporting, and general management who in turn train the SME customers.

1.7 Significance of the Study

Finance has been identified as the most important factor determining the survival and growth of SMEs in both developing and developed Countries. Access to finance allows SMEs to undertake productive investment to expand their businesses, to build productive capacity thus ensuring their competitiveness, to create jobs and to contribute to poverty alleviation of the nation as a whole.

The relevancies of the study therefore are:

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- To give relevant information which would help in appreciating and understanding the constraints which stall development of SMEs in Ghana
- The study would also enable SG-SSB in appreciating how to design well tailored explicit policies, earmarked financial products and appropriate credit management systems to meet the particular requirements and needs of SMEs to facilitate the growth of their businesses.
- The study would also indicate the need for SG-SSB to re-orient the lending policies and educate SMEs about Collateral methodologies and other possible flexible lending policies which would help clear the myths and beliefs that lending is all about Collaterals.

1.8 Limitations of the Study

The study is limited in both its scientific and geographical scopes. Only 18 of the numerous SMEs were covered by the study. Indeed, time and financial constraints were the limitations that restricted the scope of the study. Language was another problem especially as some SME operators were not so fluent in the English language. The final challenge encountered bothered on the reluctance of some SME operators to provide financial data much needed for the study.

1.9 Chapter Disposition

This study will be divided into five chapters.

Chapter 1 has the Introduction which introduces the study and this covers the conception of SMEs and the general role which they play to the development of a country. It also identifies the constraints of finance to SMEs and how that inhibits their success. It also presents the Statement of the problem, the objective and relevance of the study.

Chapter 2 deals with the Literature Review on the Concept of SMEs which generally covers conception, structure and the development of SMEs around the globe. It also reviews the Scope and the Role of SMEs played by SMEs in the economy of Ghana and the world as a whole. The Characteristics of SMEs is also reviewed and this gives the distinguishing feature of SMEs from larger firms. Various elements of constraints facing SMEs in general which stall their growth and expansion and the various roles played by Government and Institutions towards alleviating these constraints is also reviewed. The review finally covers effect of Economic Recession on state of borrowing relationship between Financial Institutions and SMEs.

In Chapter 3, the study presents the Importance of SMEs and their contribution to creation and of wealth and employment. It also examines how strategically banking institutions are establishing new relationships with SMEs as it is presented “SMEs as the Banks Clients”.

Chapter 4 gives a brief overview of the selected case, SG-SSB, its background, policy, mission and objectives.

Chapter 5, the study presents discussions of the findings or data collected from the questionnaires administered to 20 clients of the Bank

Chapter 6 gives the Summary, Conclusion and Recommendations. The summary and conclusion give reasons why traditional banks are reluctant in servicing SMEs and constraints which handicap the growth of SMEs with Finance ranked as the constraints with high severity. The recommendations are brief initiatives proposed for SG-SSB to better serve its SMEs clients to meet peculiar needs to enable their growth as well as the economy.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter gives the literature on the conception and development of SMEs in Ghana and the justification of Government's attention on them. It also reviews the scope and the role SMEs in the development of the economy of any country. Further, the characteristics feature of SMEs which distinguishes them from other corporate bodies in terms of funds mobilisation, their intensiveness among others have been reviewed.

The section also gives a review of major constraints that confront SMEs, their characteristics, the impact and the effectual results it has on the growth and their productivity.

The policies of Government and Institutions towards the promotion of SMEs and as well as modes of supports to them have been reviewed and lastly the impact of inflation and money supply policy, interest rates policy and requirements on collateral, banking and intermediation laws and the current mode of financing the face of the world economic recession.

2.2 The History and Development of SMEs in Ghana

The history of the development of SMEs in Ghana dates back to the 1970's when it became necessary for Ghanaians to assume full control of the management of the national economy. The Ghanaian economy was before then virtually in the hands of aliens like the Nigerians and Lebanese (Ghanaian Enterprises Development Commission Annual Report, 1976). This was followed by the passage of the Ghanaian Business Promotion Act 334 (1970) which sought to promote private entrepreneurship. The Investment Policy Decree 329 (1975) reserved certain areas like leather products, garment manufacturing and few others under the economy solely for the operation of the Ghanaian businessman. The Ghanaian Enterprises Development

Degree NRCD 330 (1975) established the Ghanaian Enterprise Commission. The Commission was charged with the responsibility of developing the small scale enterprises by providing financial assistance, technical and advisory services to the sector.

As Government's attention began to focus on industrialization and the importance of the role the small scale enterprises play in the economy of the country, it became very relevant to have an integrated organization capable of responding to the needs of the small scale enterprises sector. The National Board for Small Scale Industries (NBSSI) was therefore established in 1985 by the Act of Parliament Act 434(1981) to effectively promote the overall development of the micro and small enterprises (SME) to ensure efficiency and competitiveness in the production and distribution of goods and thereby contribute significantly to the development of the economy.

To ensure the full impact of the activities of the NBSSI in the task of development of the small scale enterprises the Ghanaian Enterprises Development Commission and Department of Cottage Industries were merged with NBSSI in 1991 and 1994 respectively.

The main objectives among others for the establishment and strengthening of the NBSSI were to ensure the provisions of adequate finance and credit to SMEs, provide adequate and relevant capacity building programmes for the sector, provide improved technology base of the small and micro enterprises operation to increase productivity and achieve higher growth in the sector.

2.3 Definition of SMEs

There is no single, uniformly accepted definition of a small firm (Storey, 1994). Firms differ in their levels of capitalisation, sales and employment. Hence, definitions which employ measures of size (number of employees, turnover, profitability, net worth etc) applied to one

sector could lead to all firms being classified as small, while the same size definition when applied to a different sector could lead to different result.

The first attempt to overcome this definition problem was by Bolton Committee (1971) when they formulated an economic and statistical definition. Under the economic definition, a firm is regarded small if it meets the following three criteria:

- It has a relatively small share of the market place;
- It is managed by owners or part owners as a personalised business, and not through the medium of a formalised management structure;
- It is independent, in the sense of not forming part of a large enterprise.

The Committee also devised a statistical definition to be used in three main areas:

- Quantifying the size of the small firm sector and its contribution to GDP, employment, exports etc
- Comparing the extent to which the small firm sector's economic contribution has changed over time;
- Applying the statistical definition in a cross country comparison of the small firms' economic contribution.

Thus the Bolton Committee employed different definitions of the small firm to different sectors.

Table 1: Various Sectorial Definitions of SMEs

Sector	Definition
Manufacturing	200 employees or less
Construction	25 employees or less
Mining & Quarrying	25 employees or less
Retailing	Turnover of 50,000 pounds or less
Services	Turnover of 50,000 pounds or less
Motor Trades	Turnover of 100,000 pounds or less
Wholesale Trades	Turnover of 200,000 pounds or less
Road Transport	Five Vehicles or less

Source: The Bolton Committee (1971)

2.3.1 Department of Trade and Industry (DTI)

The Department of Trade and Industry (DTI) in UK defined the small business by using the number of employees as one of the determinant of the size of the firm and the turnover. This means that a clear description of the major characteristics of the SME comes from the Report of the Bolton Committee on Small Firms of 1971. Therefore according to the DTI statistical definition, they still maintain the statistical definition of the Bolton Committee on Small businesses. (Tonge, 2001)

Many criticisms have been levelled against the Bolton Committee definition and it is against this backdrop that the European Commission (EC) coined the term Small and Medium Enterprises (SMEs) in 1996. They adopted a single definition for SME that to be applied across all the Community proposals and programs from December 1997 onwards. This definition is the same as that of the DTI (Tonge, 2001).

However, for statistical purpose, the definition which was used by the DTI is as follows:

- Micro Enterprises - firms with 0-9 employees
- Small Enterprises - firms with 10-99 employees
- Medium Enterprises - firms with 100-499 employees

Thus the SME sector is comprised of enterprises which employ less than 500 workers. In effect, the EC definitions are solely based on employment rather than the multiplicity of criteria. Secondly, the use of 500 employees as the small firm's upper limit is more appropriate given the increase in productivity over the last two decades (Storey, 1994). However, the EC definition is too all embracing for a number of countries. Researchers would as a matter of fact, have to use definitions for small firms which are more appropriate to their particular situation (an operational definition).

It is increasingly recognised that the Small and Medium Enterprises (SMEs) play a crucial role in the employment creation and income generation in Ghana. SMEs all over the world and in Ghana in particular can be easily be established since their requirements in terms of capital, technology, management and even utilities are not as demanding as in the case for large enterprises.

2.3.2 Ghanaian Definition of SMEs

In Ghana, the most important criterion used in defining the size of enterprises is employment (Boon, 1989). The Ministry of Local Government and Rural Development (Ghana) considers any establishment that employs 1 to 9 employees as a small – scale enterprise, 10 to 20 employees as a medium scale enterprises, and above 20 employees as a large –scale enterprise.

The NBSSI defines small –scale industries as productions units that are engaged primarily in manufacturing outside the residence, with an investment and tools not less than GH¢1,000 and which engage less than nine people. (NBSSI, Annual Report, 1997). It is to be noted that

some of these definitions vary according to the number of employees, level of investment, total assets and turnover.

From the foregoing, it can be discerned that there is no consensus on the issue of the definition of SMEs. Given the changes in the value of domestic currency, heterogeneity of assets and variations in turnovers, using these factors to differentiate scale of operations of enterprises does not seem very appropriate. For these reasons this study adopts the definition of SMEs based on the number of employees ranging one and twenty.

2.4 The Scope and Role of SMEs in Ghana

The importance of SMEs within the industrialisation period is understood again since 1970's (Financing of SMEs in Turkey, 2008). Perhaps now, SMEs are the seed which economy in many developing countries is grown. This means that the role of the SMEs in developing the economy of a country varies from economy to economy, depending upon the political system of the country, industrial climate within the country and the material resources available.

The implication of this is that in a particular economy, we would expect more entrepreneurial activities and faster business growth during a regime with more opportunities and freedom for private business than in a restrictionist regime. This is an interesting context for transition economies in Africa (Kuzilwa, 2005). This means that the Ghanaian government had to move to a more market oriented economy from the centrally planned economy so as to allow private sector development as well as the economy in general.

In Ghana about 70% of enterprises are micro to small sized and it is estimated that nearly 40% of the Ghana's GNI is attributable to informal sector activity (Ghana Government, 2002). It is believed that these small firms can easily propel growth in the economy than the large ones due to their numbers and niches they occupy in the national economy.

Since SMEs create employment to majority, they are therefore considered to be labour intensive; this is because they are operated at a relatively low level of investment. At present, the significant problem facing Ghana is unemployment in which the government has to deal with. Most of the people who remain unemployed end up in the SME sector, in which they establish their own employment mostly in the form of informal sector. This is due to fact that SMEs require a low rate of capital formation.

Small-scale rural and urban enterprises have been one of the major areas of concern to many policy makers in an attempt to accelerate the rate of growth in low income countries. These enterprises have been recognised as the engines through which the growth objectives of developing countries can be achieved. They are potential sources of employment and income in many developing countries.

However, some authors have contended that the job creating impact of small scale enterprises is a statistical flaw; it does not take into account offsetting factors that makes the net impact more modest (Biggs, Grindle & Snodgrass, 1988). It is argued that increases in employment Small and Medium Enterprises is not always associated with increases in productivity. Nevertheless, the important role performed by these enterprises cannot be overlooked. Small firms have advantages over their large-scale competitors. They are able to adapt more easily to market conditions given their broadly skilled technologies. However, narrowing the analysis down to developing countries raises the following puzzle: Do small scale enterprises have a dynamic economic role?

Due to their flexible nature, SMEs are able to withstand adverse economic conditions. They are more labour intensive than larger firms and therefore, have lower capital costs associated with job creation (Anheier & Seibel, 1987; Liedholm & Mead, 1987; Schmitz, 1995). SMEs perform useful roles in ensuring income stability, growth and employment. With regards to

their labour intensiveness, they are more likely to succeed in smaller urban centres and rural areas, where they can contribute to the more even distribution of economic activity in a region and can help to slow the flow of migration to large cities. Because of their regional dispersion and their labour intensity, the argument goes, small scale production units can promote a more equitable distribution of income than large firms. They also improve the efficiency of domestic markets and make productive use of scarce resources, thus, facilitating long term economic growth.

In short, SMEs contribute to employment growth at a higher rate than larger firms. They also form the backbone of a market economy and for the transition economies which in the long-term might provide most of the employment (Szabo, 1996).

2.5 Characteristics of SMEs In Ghana

A distinguishing feature of SMEs from larger firms is that the latter have direct access to international and local capital markets whereas the former are excluded because of the higher intermediation costs of smaller projects. In addition, SMEs face the same fixed cost as Large Scale Enterprises (LSEs) in complying with regulations but have limited capacity to market products abroad.

SMEs in Ghana can be categorised into urban and rural enterprises. They can be sub-divided into 'organised' and 'unorganised' enterprises. The organised ones tend to have paid employees with a registered office whereas the unorganised category is mainly made up of artisans who work in open spaces, temporary wooden structures, or at home and employ little or in some cases no salaried workers. They rely mostly on family members or apprentices. Rural enterprises are largely made up of family groups, individual artisans, women engaged in food production from local crops. The major activities within this sector include:- soap and detergents, fabrics, clothing and tailoring, textile and leather, village blacksmiths, tin-

smithing, ceramics, timber and mining, bricks and cement, beverages, food processing, bakeries, wood furniture, electronic assembly, agro processing, chemical based products and mechanics (Liedholm & Mead, 1987; Osei et al, 1993, World Bank, 1992; Gray, Cooley & Lutabingwa, 1997).

It is interesting to note that small scale enterprises make better use of scarce resources than large scale enterprises. Research in Ghana and many other countries have shown that capital productivity¹ is often higher in SMEs than is the case with LSEs (Steel, 1977; Child 1971). The reason for this is not difficult to see, SMEs are labour intensive with very small amount of capital invested. Thus, they tend to witness high capital productivity which is an economically sound investment. Thus, it has been argued that promoting the SME sector in developing countries will create more employment opportunities, lead to a more equitable distribution of income and will ensure increased productivity with better technology (Steel & Webster, 1991).

Small and Medium Scale Enterprises can be said to have the following characteristics. They:

- Mobilise funds which otherwise would have been idle;
- Have been recognised as a seed-bed for indigenous entrepreneurship;
- Are labour intensive, employing more labour per unit of capital than large enterprises;
- Promote indigenous technological know-how;
- Are able to compete (but behind protective barriers);
- Use mainly local resources, thus have less foreign exchange requirements;
- Cater for the needs of the poor and;
- Adapt easily to customer requirements (flexible specialisation)

¹ value added per unit of capital invested.

2.6 Constraints Facing the SME Sector

The absence of supportive laws regulations, enabling economic environment and infrastructure severely limits the availability of financing to SMEs as well as hindering SMEs' the growth and productive capacity of SMEs. This study highlights on most of the critical constraints which impede their growth and development of SMEs, and they are as follow:

2.6.1 Regulatory Requirements

One of the problems facing the SME sector is the complex regulatory environment that serves as impediment in the development. Due to these regulatory requirements, according to Steel (1977), majority (about 60%) of the SMEs have not registered with Registrar General's Department. Steel has also confirmed that small firms bear a relatively high burden through indirect taxes and fixed levies unrelated to profits and the inability to obtain exemptions or rebates available to larger firms.

2.6.2 Market

According to Buame (2000) another problem area against the development of SMEs relates to the structure and the size of consumer market as well as the accessibility to export market. Other external constraints include the inaccessibility to market information and inadequate export infrastructure and the limited penetration of the regional and sub-regional market in Africa. Over liberalization of trade enables importer to bring in goods that undercut the market for goods produced locally by SMEs, that is competition from imported goods. This development stifles the growth of SMEs in Ghana.

Buame further confirms that competition from foreign companies places strong pressure on SMEs in terms of efficiency, price, quality, cost, control, marketing expertise, customer

satisfaction and innovativeness. SMEs thus face competition from three main sources: imports, large scale enterprises etc.

2.6.3 Lack of Modern Technologies

One of the major constraints to SMEs is the lack of modern technologies. According to Buame (2000) the impact of technological change in SMEs has revolved around increased capabilities that technological change brings to SMEs, the cost of new capabilities, the effect on productivity, the impact of the new technologies have on economies of scale, the cost of access of the new technologies and the impact of technologies on the way the business operate. However, most SMEs do not have access to modern technologies. Their technical skills also are not up to date. Most of them lack the necessary theoretical background to buttress their skills since owners of SMEs normally have low level of education.

2.6.4 Inadequate Physical Infrastructure

Another constraint to the development of SMEs is inadequate or poor physical infrastructure in the form of energy, transport and communication facilities especially in the rural areas and these effectively restricts SMEs to the old technologies, primitive methods of operation, unprofessional conduct hence low profits.

2.6.5 Logistics and Management Problems

According to Checchi et al (1977) inadequate raw materials and spare parts are major logistics problems that hamper development in SMEs in Ghana and this mainly due to the difficulty of obtaining import license and shortage of foreign exchange. This is a serious constraint especially when finances are inadequate. It leads to stifling of SMEs and their total extinction. According to Siropolis (1994) failure of the most small enterprises is due to lack of entrepreneurial skills. Most of them have not had any formal entrepreneurial training, which does not augur well for development.

Entrepreneurship is more than inspirational zeal and hard work. The entrepreneur must know how to write a business plan, research a market, keep accounting records, pay taxes and be socially responsible, this is lacking in most Ghanaian small business operators. The inseparability of the owners' personality from his/her business reflects itself in many ways and not all of them are in the interest of the firm. SMEs have limited opportunities to specialise in management with the owner-manager usually bearing all the managerial responsibilities, which leads to inefficiency. Siropolis (1994), concede to the fact that the inefficiency in management is due to the fact that most managers of small enterprises have unbalanced experience to handle increased demands on their skills and knowledge.

2.6.6 Financial Constraints To SME Development

Finance has been identified in many business surveys as the most important factor determining the survival and growth of SMEs both in the developing and developed countries. Access to finance allows SMEs to undertake productive investments to expand their businesses and to acquire the latest technologies, thus ensuring their competitiveness and that of the national as whole. Poorly functioning financial systems can seriously undermine the microeconomic fundamentals of a country, resulting in lower growth in income and employment.

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Despite their dominant numbers and importance in job creation, SMEs traditionally have faced difficulty in obtaining formal credit or equity. For example, maturities of commercial bank loans extended to SMEs are often limited to a period far too short to pay off any sizeable investments. Meanwhile, access to competitive interest rates is reserved for only a few selected blue-chip companies while loan interest rates offered to SMEs remain high. Moreover banks in many developing countries lent overwhelmingly to the government which

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offered less risk and higher returns. Such practices have crowded out the most private sector borrowers and increased the cost of capital for them. Governments cannot expect to have dynamic private sector as long as they absorb the bulk of private savings. In the case venture capital funds, they have been concentrated in high technology sectors. Likewise, the international institutions have ignored the plight of SMEs. For a lot of capital funding commissions like the Bassle capital accords have not been analysed and framed with any consideration for their impact on the ability of commercial banks to service the SME sector. These preferences and tendencies have exacerbated the lack of financing for SMEs. (Cook & Nixon 2000)

2.6.7 The key reasons for the financial constraints phenomenon

Traditional commercial banks and investors have been reluctant to service SMEs for number of well-known reasons, which have been explored in numerous UNCTAD expert meetings. They include the following:

- SMEs are regarded by creditors and investors as high-risk borrowers due to insufficient assets and low capitalization, vulnerability to the market fluctuations and high mortality rates.
- Information asymmetry arising from SMEs' lack of accounting records, inadequate financial statements or business plans makes it difficult for creditors and investors to assess the creditworthiness of potential SMEs proposals.
- Lending SMEs is likely to be backed by collateral than lending to larger firms so as to reduce the moral hazard and adverse selection. This may lead to situations in which the decision to extend loans is based not on the expected returns but rather on access to the necessary collateral. Many SMEs lacking access to good collateral suffer from credit rationing or are denied access financial supports.

- Financial institutions charge higher interest rates to SMEs than to larger companies in order to compensate for the higher cost of information collection, the smaller volumes of external financing and the greater risk of failure.
- The significant administrative and transactions costs associated with lending or investing small amounts do not make financing a profitable business for commercial banks (Wang, 2003).

As a result, commercial banks are generally biased toward large corporate borrowers, who provide better business plans, have credit ratings, more reliable financial information, better chances of success and higher profitability for the Banks. When the banks do lend to SMEs, they tend to charge them a commission for assuming risk and apply tougher screening measures, which drives up the costs on all sides. Commercial banks in developing countries and countries with economies in transition often prefer to lend to government and thus the public sector crowds out the private sector. Such preferences were aptly put by the western banker in Nigeria: "We are not a charity". Why should I take risks with SMEs when I can make good money elsewhere". Lastly, there is also the problem of insider lending and/or cronyism which diverts finance away from SMEs.

Many governments and international financial institutions have tried to address the problems of high cost and risks by creating subsidized credit programmes and/or providing loan guarantees. Such projects have often fostered a culture of non-repayment or failed to reach the target group or achieve financial self-sustainability.

Examples of such failed interventions are targeted credit schemes set in Sub-Saharan Africa in the early 1980s by the development finance institution (DFIs). Their aim was to provide either long-term credit or specialised services to priority sectors in the rural areas. The financial policies pursued were interventionism with governmental influencing the credit flows through a system of subsidies, interest ceilings, policy-based credit allocations etc.

banks lacked the incentive to increase their efficiency or to develop their capacity for risk assessment and monitoring of loans, which contributed to a general deterioration in the quality of banks' portfolios. In some countries the share of non-performing loan values rose to 90% of the banks portfolios (Nissanke, 2001).

Macroeconomic stability and confidence in the financial system, in general, require strong institutions which can exert prudential supervisory authority. These conditions are of course requisite for a well functioning banking system which, if disposed, will give SMEs access to long-term finance. Financial reform is urgently needed in many countries. However, such reform is not on its own sufficient to secure SMEs access to long term finance. Lack of structural reforms should not be used as an excuse to put off the much needed work at the micro level which could increase the ability and the profitability of lending to the SME sector. Rather reforms at the macro level and innovation at the micro level need to be undertaken simultaneously.

2.7 SMEs Constraints – The Role of Government

Least controversial is the role of government in providing the contractual and informational framework and enduring a stable macroeconomic environment. Government is the natural provider of key institutions such the legislation and the court systems. Similarly, given the governments monopoly over the issue of monetary instruments, ensuring macroeconomic stability is a natural government task. As discussed above it is through these policies that the government can push outwards the Access Possibilities Frontier and ensure a long-term sustainable increase in SMEs access to finance. While these environment reforms do not focus specifically on SMEs, they help close the gap between firms of different sizes and level the playing field. Through these policies the government helps develop markets that can then be used by financial institutions to reach out to SMEs.

The Government of Ghana, in an attempt to strengthen the response of the private sector to economic reforms undertook a number of measures in 1992. Prominent among them is the setting up of the Private Sector Advisory Group and the abolition of the Manufacturing Industries Act, 1971 (Act 356) which repealed a number of price control laws, and The Investment Code of 1985 (PNDC Law 116) which seeks to promote joint ventures between foreign and local investors. In addition to the above, a Legislative Instrument on Immigrant Quota which grants automatic immigrant quota for investors has been enacted. Besides, certain Technology Transfer Regulations have been introduced.

Government also provided equipment leasing, an alternative and flexible source of long term financing of plant and equipment for enterprises that cannot afford their own. A Mutual Credit Guarantee Scheme was also set up for entrepreneurs who have inadequate or no collateral and has limited access to bank credit. To complement these efforts, a Rural Finance Project aimed at providing long term credit to small scale farmers and artisans was set up.

In 2007, Ghana government has put in place programs and interventions as means to dealing with the constraints of SMEs to foster their development and growth. These interventions are spelt out in our policy implementation Blue Print, the Trade Sector Support Program.(Kyerematen, A, 2006).

The essential elements of Government's strategy for the development of the SME sector are as follows:

- The establishment of an SME Directorate at the Ministry of Trade and Industry to provide strategic policy direction and guidance for the development of the SME sector. The Directorate also coordinates interventions by all other MDAs in SME development.

- Strengthening SME support institutions such as NBSSI, GEPC, EMPRETEC, and NGOs working in the area of entrepreneurship and enterprise development;
- Facilitating SME financing, through improvement of SMEs' access to appropriate forms of capital;
- Expanding market access for SMEs, which involves the facilitation of innovative marketing schemes to enhance SMEs access to domestic and external markets;
- Technology Improvement for SMEs through the enhancement of SMEs' access to Research and Development (R&D) infrastructure, as well as other Technology related facilities;
- Entrepreneurial Skills Development through harmonization and coordination of entrepreneurial programmes and activities of various training agencies so as to enhance the managerial, technical and other competencies of SME operators;
- Provision of vital information to SME to facilitate effective linkages and networking among SMEs & between SMEs and Large Scale Enterprises.

The implementation of these strategies is being undertaken through a number of programmes which may be grouped under the following broad categories:

2.7.1 Investment finance for SMEs

- **Micro Finance and Small Loans Centre (MASLOC):** This is under the office of the President and provides finance through the Rural Banks for non-lending to SMEs.
- **Community-Based Rural Development Programme (CBRDP) (World Bank):** Provides loans to Farmer Based Organisations.
- **Export Development and Investment Fund (EDIF):** Provides funding to enterprises in the export sector.

2.7.2 Business development service

Entrepreneurship and Management Training Through Business Advisory Centres (BACs): MOTIPS/PSI through the National Board of Small Scale Industries (NBSSI) provides entrepreneurship training through a network of Business Advisory Centres (BACs).

2.7.3 Infrastructure support

Technology Improvement and Capital Goods Centre: Revamping of the Kumasi Suame Industrial Estate and the Creation of Technology Improvement and Capital Goods Centre.

Garment Village: Factory shells have been provided in the Tema Free Zone Enclave and the former GNTC Adherent warehouses for mass production of garments for exports.

Ghana Industrial & Commercial Estates Limited (GICEL): This is sponsored by SSNIT to provide production space for SMEs. The facility is located at Weija. GICEL is basically an industrial estate where various small enterprises and artisans practice their trade.

2.7.4 Commercial & market linkages

Sub-Contracting and Partnership Exchange Programme (SPX) : This programme is facilitating local and international subcontracting and outsourcing of non-core activities to SMEs by large local and international companies. This is meant to support SMEs to expand their operations. Under this programme, a database on 400 SMEs has been established to facilitate effective linkage with large scale companies.

Export Trade Houses: The Trade Houses specialize in export marketing so that producers of exportable products can concentrate on production activities to enhance the supply base and improve supply response. Currently, 3 Export Trade Houses have been established, namely: Ghana Trade Centre; Ghana ECOWAS Export Trade House (GEXTRACO); and GNPA

Export Trade House. These would act as export brokers between SMEs and selected external markets.

National Product Gallery: A web-based product gallery has been developed to support SMEs to show case their products.

Consumer Credit Scheme to Promote SMEs: This is being put in place to enable Ghanaians to purchase Made-in-Ghana Goods on Credit.

Trade Fairs and Exhibitions: The Ghana Trade Fair Company provides a platform for SMEs to showcase their products and services through various trade fairs and exhibitions.

2.7.5 Technology development services

Technical Improvement Programme: This is aimed at conducting technology audits and retooling industries to improve their productivity and enhance their competitiveness.

Ghana Standards Board (GSB): Provides quality assurance services to SMEs to enable them meet both local and international standards and other technical requirements.

CSIR and other Research Institutions: Provide R&D support services to SMEs. (Ministry of President's Special Initiative)

2.8 Financing by Commercial Banks in the US and EU -Recent Developments

To compete effectively in the SME financing sector, banks need to provide financial services that meet the specialized needs of SMEs while coping with the high risks and costs associated with servicing them. To achieve this, an increasing number of banks have adopted separate strategies to service SME customers. The current trend is to shift from a product –based focus to a more customer oriented focus of providing packages of financial services tailored to their

needs. This has the potential of considerably improving the banks' relation with the SME sector, as well as increasing the profitability of providing financial services to it.

In this section we review a number of initiatives undertaken by banks to better serve the SME sector. These include:

2.8.1 Reducing Information asymmetry of SMEs and improving risk management

The key for banks to improve the risk management of their SME portfolio is to have better information, i.e. to reduce the information asymmetry that they face when dealing with SME customers. To achieve this, two sets of infrastructure need to be in place. Individual financial institutions need to have efficient mechanism in place in order to process and analyse vast amounts of data to support their decision making. Further there is a need to have the appropriate infrastructure in place for the financial markets that enables the production of reliable and timely financial information on SMEs. Before proceeding to explore the innovative approaches that banks have undertaken to reduce the information asymmetry, we highlight some of the issues regarding reliable financial information on SMEs.

2.8.2 Financial Information on SMEs

Part of the reluctance of banks to lend to SMEs is the banks' ability to evaluate risk because of the lack of reliable information. In well developed and stable financial markets creditors and investors usually demand and receive transparent, reliable and comparable financial information. The better the information the higher the investor confidence and the lower the cost of capital. Such financial information is provided in the financial statements which follow national or even international accounting standards. Banks and regulatory authorities can even demand more information than what is publicly available or required. In addition financial analysts, rating agencies or business intelligence providers, generate information which is available to creditors and investors.

However, even in highly developed economies, such as those in the European Union, SMEs are not required to report on their financial performance in a standardized manner if they do not reach a significant threshold in total assets, turnover and/or number of employees. This means that many SMEs in developed and developing countries do not produce reliable financial information, which could be used by creditors or investors. Instead, these users are left to specify for themselves what financial information they require thus placing a costly burden on SMEs to comply with different reporting formats. Even more important, the majority of SMEs do not generate the basic financial information that entrepreneurs need for efficient management.

After reviewing many hurdles SMEs face in generating reliable financial information, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) identified several desired characteristics that should be in an accounting system for SMEs. These include user-friendliness, flexibility to accommodate growth, standardized formats and adherence to generally accepted accounting practices. Such a system could reduce information asymmetry faced by creditors and investors as well as providing useful information to entrepreneurs. The innovative mechanisms used by financial institutions for credit appraisal and rating sometimes presuppose the existence of such reliable financial information. The basic pre-condition for using such mechanisms to reduce both transactions costs and risks is reliable accounting information. Such reliable financial information could be obtained from SMEs if the accounting and reporting requirements took into consideration both the types of transactions SMEs usually have as well as their ability to actually account for them given their level of business skills.

2.8.3 Credit Scoring Systems

The challenge that banks face in managing SME risks is to make an accurate risk assessment of a large number of SME loan applications without generating high costs per application. Therefore, banks that work with large numbers of SMEs need to use automated processes in making their lending decisions in order to drive down the costs of each lending decision. This requires rather costly investment into IT systems and training of staff involved in small business lending. These investments will, however, typically pay off through efficiency gains and improved risk assessment provided that the bank holds a sufficiently large SME portfolio.

Credit Scoring is an automated statistical method used to assess the risk of default or credit applicant. It involves analyzing large amount of historical data on borrowers to identifying certain characteristics that predict the like hood of the borrower defaulting on his/her loan some time in the future. These data could include, for example the economic sector, years in business and size of assets. Using the results from the analysis, the bank can design a scoreboard for evaluating the risk associated with each credit application. Using a weighted average, or some other methodology, the bank can then derive from the scoreboard a single quantitative measure or credit score to evaluate the credit application. These steps can also easily be automated.

Credit Scoring System is therefore a method that analyses a large sample of past borrowers to calculate the probability that a loan applicant with certain specific characteristics will default. The system derives a single quantitative measure- the score- from a large statistical sampling of past borrowers in order to predict the future payment performance of an individual loan applicant .

The rest of the initiatives include:

- Reducing costs of lending by applying the latest information technologies, streamlining the organisation and simplifying the lending process.
- Developing products better adapted to SMEs process.
- Improving financial services for SMEs through training of bank staff and the segmentation of SME customers.
- Cooperating with SME organizations and other business development providers in order to reduce risks and costs and combine financial with non-financial services.

2.9 Financing SMEs in the Recession

Financial Institutions claim to have continued to lend to small firms in the slowing economy, despite the impact of credit crunch on them. Information on trends in SME lending appears contradictory. Banks have indicated that they have increased lending to SMEs in the year to September 2008, SMEs cite anecdotal and survey evidence of credit becoming tighter and expensive. The main high street Banks established new banking relationship with over 500,000 small businesses in the 12 months to June 2008. Term lending grew 11% to £44 billion and borrowing on overdrafts was up to 3%. Additionally, lending figures for the last quarter of the year of 2008 show that growth in the supply of credit has slowed further to quarterly rate of 0.3%. Overdrafts appeared to stabilise in the last quarter, while deposits fell much more sharply than in the previous months.

The latest figures reflect the economic climate for the sector with borrowing continuing to expand, but deposit growth slowing. Faced with more difficult trading conditions, many businesses are using the cash they generate rather borrowing. Those seeking finance are generally taking fixed rate structured loans or using previously agreed facilities. (British Bankers Association Report -2008)

The data suggest that securing the sector's working capital needs to be the priority for policymakers. For the time being, overdraft lending appears to be the only truly problematic area in the SME finance supply chain, and this is likeliest to affect SMEs working capital, exposing even fundamentally sound businesses to prospect of liquidation. For lenders, on the other hand, extending overdrafts carries additional risk because these are tied to a specific programme of use whose returns can be forecast with confidence. Lenders' safest option is to ask for detailed rolling cash flow forecasts and statements, and there of banks doing precisely that.

Despite these developments, SMEs access to credit must be seen in the wider context for lending businesses. Credit is tightening much faster for SMEs and highly for larger firms whose finances are much healthier. The stark economic outlook is the main reason for the tightening credit. Banks naturally need to anticipate that there will be fewer credit businesses in a recession than during times of rapid growth, Bank of England advised.

The second leading reason is that lenders have become more risk-averse. In practice this means that some creditworthy SMEs cannot access finance because banks are unsure how much risk they are undertaking or what levels of lending they will be able to sustain in the event of a deeper financial crisis

Tightening conditions in the market for trade credit insurance are interfering with the ability of SMEs to finance working capital through factoring, while the use of both secured lending and asset-based finance has become difficult due to falling property and asset prices.

While tightening credit does not constitute poor commercial practice in principle, it can translate as such, especially in the absence of competition. Complaints from SMEs most often concern new charges, higher interest rates, reduced overdrafts facilities or withdrawal of previously agreed loans.

Some SME organisations have also drawn attention to the quality of advice provided by lenders, citing lack of experienced personnel authorised to provide personalised service. Anecdotal evidence suggests that some lenders may occasionally encourage late payments as a form of free credit.

Apart from its adverse effect of the recession on SMEs' cash flow, it appears that poor practice has strained the relationship between lenders and SMEs and reduced the credibility of Banks as a source of advice. This could affect the willingness of SMEs to take advice when they need it the most. (British Bankers' Association, 2008)

2.10 Summary and conclusion

Small and medium-sized enterprises (SMEs) are considered to be one of the principal driving forces of economic development. They stimulate private ownership and entrepreneurial skills; they are flexible and can adapt quickly to changing market demand and supply situations; they generate employment, help diversify economic activity and make a significant contribution to exports and trade. A lack of legislation, a limited understanding of entrepreneurship, and lack of infrastructure and financial means are major constraints facing the growth and development of SMEs.

This chapter reviewed the literature on structural definition and characteristics of SMEs and their contribution towards financial and economic development of an economy. In the review it was established that SMEs were established when it became necessary for Ghanaians to assume full control of the management of the national economy.

SMEs as defined by the Ministry of Local Government and Rural Development (Ghana) considers any establishment that employs 1 to 9 employees as a small – scale enterprise, 10 to 20 employees as a medium scale enterprises, and above 20 employees as a large.

Finance has been identified as a major constraint to SMEs. Access to finance allows SMEs to undertake productive investments to expand their businesses and to acquire the latest technologies, thus ensuring their competitiveness and that of the national as whole.

The review also established the Government of Ghana role which was to strengthen the response of the private sector to economic reforms and undertook a number of programs and interventions and instituted both national and international bodies to help streamline and finance the activities of SMEs. Prominent among them is the setting up of the National Board for Small Scale Industries (NBSSI), Micro Finance and Small Loans Centre (MASLOC) etc. Further, the review also indicated that the lack of legislation, a limited understanding of entrepreneurship, and lack of infrastructure and financial means are major issues constraining the growth and development of SMEs.

The review also gave recent development on the effect of Economic Recession, with banks tightening their credit policies to SMEs and deposits rate is highly on the decline. Lenders have become more risk-averse. In practice this means that some creditworthy SMEs cannot access finance because banks are unsure how much risk they are undertaking. The next chapter deals the importance of SMEs to the Economy and the SMEs and Banks Relationship in Ghana.

CHAPTER THREE

THE IMPORTANCE OF SMEs TO THE ECONOMY AND THE SMEs AS BANKS CLIENTS

3.1 Introduction

This section would examine to the importance of SMEs to the economy and the relationship that exists between the Banks and SMEs.

The contributions of SMEs to employment and wealth creation as well as poverty reduction are pronounced. This is buttressed by the fact that the industrial and business sector in Ghana is dominated by SMEs especially in the small enterprises. For example, about 70% of the Ghanaian enterprises are micro to small sized and it is estimated that nearly 40% of the Ghana's GNI is attributable to informal sector activity (Ghana Government, 2002). It is believed that these small firms can easily propel growth in the economy than the large ones due to their numbers and niches they occupy in the national economy.

SMEs have become a strategic sector for most banks as they continue to establish new banking relationships with SMEs. This is because SME constitute the one of the biggest sources of revenue generation for their operations. The improving liquidity of securities markets in many countries is increasingly providing large corporations direct access to the capital markets and allowing them to by-pass financial intermediaries. Therefore, banks are under increasing pressure to expand their business towards SME customers and to develop mechanisms to improve the profitability of lending to SMEs.

3.2 Aims of this section

- To examine SMEs contributions to an economy
- To examine the relationship that exists between the Banks and SMEs

3.3 The Importance of SMEs to the Economy

Economists are increasingly recognizing the importance of Small and Medium Enterprises (SMEs) for economic growth and development. Such businesses, often defined as having less than 250 employees, are widely believed to encourage entrepreneurship, generate employment and reduce poverty.

“Smaller businesses are the foundation of the emerging private sector in developing countries and governments should help them to survive and thrive,” said a World Bank report in 2000 that explored the importance of SMEs in developing countries.

Ghana is no exception. Sustainable and wide-spread private sector growth in Ghana must come from a flourishing pool of small and medium enterprises. This sector has been largely absent in Ghana’s economy, which is heavy on large-scale businesses and micro-enterprise, but light in that dynamic SME middle ground. Studies have shown that in high-income countries, such as the United States, SMEs contribute a higher share of GDP and employment than they do in lower-income countries, such as Ghana

According to the World Bank, in a typical high-income country about 57 percent of employment and 51 percent of GDP are generated from the SME sector. While in a typical low-income country, only about 18 percent and 16 percent, respectively, are generated by SMEs. The opposite trend is true in the case of the informal sector’s contribution to economic growth. In a typical low-income country, about 47 percent of GDP and 29 percent of employment are generated by the informal sector while in high-income countries these figures are only 13 percent and 15 percent, respectively.

These small and micro businesses that are not registered tend to be mired in a survival strategy rather than expanding. While they do provide jobs, informal businesses produce little growth, attempt limited innovation and generate low-income wages, say experts. In Ghana

the many road-side cooked food kiosks and shoe repair stops are constant reminders of an economy that needs a growth catalyst. SMEs and the entrepreneurs who will run them are the most effective mechanism in bringing workers into a more productive formal economy.

SMEs are important to almost all economies in the world, but especially in developing countries and, within that category, especially to these with the major employment and income distribution challenges. On what we may call the static front, SMEs contribute to output to the creation of “decent jobs” on the dynamic front. They are nursery for larger firms of the future and are the next important step up for expanding micro enterprises, they contribute directly and often significantly to aggregate savings and investment, and they involved in the development of appropriate technology. In asking ourselves how important the SME sector is we must of course go beyond simply looking at its share of output, employment or any other aggregate variable to the key question-“ How much difference does it make to overall economic performance whether the SME sector is large or small, or whether it grows rapidly or slowly?”

It is fact of life, at any level of a country’s development, that some needed activities involve few or no economies of scale while others involve considerable economies of that sort. The size distribution of firms within a country, and the associated combination of technologies – from the very labour intensive to the very capital intensive is of course influenced by these “givens”. That distribution can also be influenced by international trade. An important challenge in many countries is to assure that a significant share of output takes place outside the overly capital intensive large scale sector. Achievement of this goal is more difficult if SME activity in general is discouraged by the policy or setting. It can be facilitated when large firms (whose size may be necessary because some parts of that process to smaller more labour intensives firms. It can also be facilitated by the phenomenon referred to as “clusters” in which small firms collaborate together to handle those aspects of the business that are

indeed characterised by economies of scale. The ideal setting within which SMEs can play their positive contribution to the maximum thus includes these structures and their advantages.

In developing countries with large informal or micro enterprise sectors, SMEs constitute the middle of the size range, a fact that explains much of their strategic importance. In terms of organizational structure, SMEs are on average, considerably more complicated than micro-enterprise, which involve largely the self-employed, sometimes accompanied on the job by a few family workers and hence usually having under 5 workers. On the other hand SMEs are on average, a good deal less complicated structurally than are corporations and other large firms, with their layers of management, high division of labour, etc. In the past the weight of the non-agricultural SME sector in output and employment has traditionally reached its peak in the upper income tier of developing countries, where agriculture no longer constitutes a large part of the economy. At still higher levels of development its share tended to wane in favour of larger firms (and the public sector), but the last 2-3 decades appear to have seen an alteration in this pattern, at least as far as employment is concerned associated partly with an at times dramatic fall in the share of the total employment found in the manufacturing sector in both industrial and (nearly all) developing countries (Palma, 2005).

The intermediate technology characteristic of SMEs is what gives the SME sector a special role in the generation of adequate or decent employment. When most jobs are in the micro enterprise sector, too many of them are destined to be low productivity and hence low income in character. SME firms can be substantially more productive, so in terms of potential to generate "decent" jobs this sector competes with large private firms and the government, but it has the advantage of being able to generate many more jobs for a modest input of capital. The key mechanism in generating decent employment in most developing countries involves

the expansion of this sector fast enough to absorb people previously unemployed or engage in low productivity informal sector jobs.

Developing countries without substantial SME sectors (hence often described as having a missing middle in their firm size structure) tend only to have capital and the income from it concentrated in the larger firms but also have a “labour elite” in that sector, able to bargain for wages much higher than else in the economy. With the sector economy’s capital stock almost completely used up by the large firms (usually as a result of capital market imperfections), there is little remaining capital to be distributed among the many workers not hired by large firms, this produces a large micro enterprise sector with the SME sector squeezed out of capital. The equilibrium wage in the micro enterprise sector is very low and the capital incomes are low as well. In short, income is very unequally distributed. Hence the SME sector is large; these extremes in the distribution of both capital income and labour income are avoided.

Apart from being the sector to which one would like to see a high share of resources allocated at a given point in time, for the above reasons, the SME sector also plays a dynamic role in generating growth, especially pro-poor growth. Nearly all developing economies have large micro enterprise sectors that the SME sector itself, are highly heterogeneous in many respects- the goods or services produced, the entrepreneurial capacity of the owner, and the potential for growth etc. Many are survivalist in character but others have dynamic potential. In most countries for which data are available, it appears that most small firms (of say 6-25 workers) began their lives as micro-enterprises and then grew.

SMEs tend to dominate a country’s new and fast growing industries. Economies which discourage SMEs in any general sense are therefore likely to discourage some newer dynamic industries from putting down the roots they might otherwise do. In this respect, and in others,

SMEs are associated with dynamism. An economy composed essentially of older larger firms runs the risk of becoming atherosclerotic.

Broad empirical evidence highlighting the importance of SMEs includes the facts that:

- The most successful developing country over the last 50 years, Taiwan, is built on a dynamic SME sector. This has produced both (both its time) record braking growth and quite low level of inequality, by comparative standards. The experience of Korea, Taiwan's partner among the Asians Tigers and a more or less equally fast grower, has provided the laboratory to illustrate another point – inequality can fall significantly when the weight of the SME sector rises quickly, as it did for a period after mid-1970s in Korea (Palma, 2005).
- SMEs tend to use medium-sophistication technology, which is approximately consistent with the factor endowment ratios in most developing countries.
- Many firms “grow into” or “grow out of” the SME size range, with both of these transitions having something positive to be said for them.
- The SME size range is where many important entrepreneurs and firms of the future get their start.

3.4 SMEs as Bank Clients

SMEs have become a strategic target sector for most banks. Put differently, even if SMEs were ever a niche bank business, they no longer are. The improving liquidity of securities markets in many countries is increasingly providing large corporations direct access to the capital markets and allowing them to by-pass financial intermediaries. Therefore, banks are under increasing pressure to expand their business

towards SME customers and to develop mechanisms to improve the profitability of lending to SMEs.

In fact, foreign banks and large banks have become very aggressive in targeting SMEs. Moreover, the market structure is competitive; that is, virtually all banks are trying to attract SMEs and more competition is expected in the future as banks get more involved in their segment. But despite being competitive, banks see the sector as far from saturated and thus see profitable growth prospects. Several factors seem to be driving these patterns, suggesting that these new developments are not simply a cyclical phenomenon, associated with the recent period of credit buoyancy, but that they reflect structural changes and are, hence, part of a long-term trend. Factors that seemed important prior to the completion of the questionnaire-based surveys (like the institutional and macroeconomic policy environments) do not appear to be binding constraints for banks pursuing businesses with SMEs in the countries under study. Nonetheless, these factors seem to limit the range of products that banks offer and may become binding as banks try to deepen their relation with SMEs through more complex products, including long-term lending. In the rest of the section, we document these findings in more detail.

Despite the competitive market structure, banks see SMEs as profitable growth prospect. Banks expand their engagement with SMEs by both deepening relations with existing clients and targeting untapped pools of new clients. Furthermore, the most proactive banks do not appear to have a sector-specific or regional focus when targeting SMEs. They tend to cover as broad a basis as possible. They try to gain market share in every sector and region and they have aggressive growth targets, which is useful for developing products on a large scale and better diversifying and managing risks, as described in the next section. (However, competition has been putting downward pressure on lending interest rates leading to an apparent under-pricing of risks in the hottest markets). Again, all this is contrary to the idea

of niche banks being the only ones interested in serving SMEs, with segmented markets (where each bank specializes in a set of clients) and with interactions based mainly on relationship lending.

There is an array of factors driving banks' desire to become involved with SMEs. The most relevant aspect mentioned by banks is the perception of high risk-adjusted profitability of the sector. This means not only that profits in the SME sector are attractive, but importantly that they are attractive relative to the alternatives controlling for risk. For example, banks have experienced a thinning of margins in the corporate sector because of intensified competition from local and international capital markets, and in the consumer sectors because of strong competition from other financial and non-financial institutions (such as department stores). Similarly, with more stringent fiscal policies improving government access to capital markets and in the consumer sectors because of strong competition from other financial and non-financial institutions (such as department stores). Similarly, with more stringent fiscal policies improving government access to capital markets, the opportunities for lending to the government as a spread over the cost of funds have shrunk significantly.

Other factors that banks mention as important drivers of their involvement with SMEs are their relation with large corporate clients and the fact that SMEs are a strategic sector for growth in their economies. These factors are partially linked.

First, large banks use (to the extent possible) their relations with large firms to try to identify and sort out the SMEs that are worth approaching. Significant dealings with the corporate sector allows banks to go downstream, partly using "chain" relations, that is SMEs that act as suppliers or outsourcers to large corporations. The large corporations might gain in ensuring that the SMEs with which they work are offered appropriate financial products and services and thus, operate more efficiently. In turn, banks benefit from the knowledge embodied in

large corporations about the quality of SMEs, as this knowledge can help reduce substantially the problem of asymmetric information that banks face when approaching new SMEs.

Second, ongoing changes in the organization of production appear to be placing SMEs, in a new strategic place. It appears that the most dynamic SMEs are those connected to large firms via supply or outsourcing chains. The interviews with banks confirm the idea that large firms use SMEs increasingly to outsource certain activities. This gives them more flexibility, by allowing them to focus on their own business, limit litigation risks (like labour disputes), and reduce fixed operating costs. The evidence surveys that banks are increasingly engaged in the SME sector is consistent with the hypothesis that the mentioned changes in industrial organization, with less vertical integration and greater modularity and network economies via supply chains and outsourcing, generate new demands of financial products and services for SMEs that large banks are better able to provide.

In effect, banks seem particularly well-placed to take advantage of the new demand for products and services from SMEs. Unlike large corporations, SMEs do not have the size to efficiently undertake certain financial and administrative activities in house (such as payroll, payments to suppliers, collection of receivable, import-export paperwork, and even some accounting and bookkeeping activities). Therefore, as large firms outsource activities to SMEs and engage them as suppliers, causing SMEs to expand, SMEs in turn outsource some activities to banks, especially those activities that banks can supply more efficiently, given the economies of scale that banks can exploit through their large service platforms, back-office and IT infrastructures, and broad base of technical expertise. This, in turn, raises the scope for banks to carry out cross-sales and offer SMEs fee-based service, tapping into non-traditional banking businesses.

There are many ways in which banks can exploit scale effects, synergies, and linkages. For example, leveraging on its relation with a large corporation, a bank can incorporate the SMEs with which the large corporation works, then proceeds to cross-sell an integrated package of products to the SME, including fee-based services, and then move on to attract as clients the employees of the SME and the family of the owner of the SME. Moreover, banks can offer similar products across SMEs and sectors, with a small customization to meet the firm-specific or sector-specific needs. Banks can also offer software packages to manage the SME accounts online, as well as advisory services. As a consequence, banks not only broaden their sources of income, but also diversify risk, in terms of lending to a new type of firms and deriving income from non-lending activities. This also limits the burden that lending imposes on banks' limited capital. In this context, government programs become less essential for banks to reach out to SMEs, and are usually not deemed by interviewed banks as decisive factors.

Many of these changes in the relation between banks and SMEs are connected to technological advances that allow banks to offer products and services at a scale and cost that they were not able to offer before. In terms of lending, credit scoring allows banks to reduce the costs and time of making small loans, process a larger volume of such small loans more efficiently, and be better able to monitor the default risk of the portfolio. Studies done by Frame, Srinivasan, and Woosley (2001); and Berger, Frame and Miller (2005) show that at least in the U.S the use of scoring models is associated with an increase in lending to SMEs. However, credit scoring works best for micro and very small enterprises. As the size of loans get larger, banks find it harder to use automatic credit scoring methods (Marquez 2008).

However, banks that are actively engaged in the SME sector using more sophisticated business models and risk management systems (see below), have also developed standardized and streamlined ways of screening and rating the creditworthiness of the larger SMEs, for

which automatic scoring methods do not apply well. Another way in which technology has helped banks sell services to SMEs is through online banking. Firms can now use banks' websites to, for example, process payments, input accounting and administrative data, monitor receivables, manage their liquidity, make investments, make international money transfers buy insurance products, and more generally hedge risk.

Aside from helping identify factors that drive bank engagement with SMEs, the surveys also allow us to identify the obstacles that banks perceive as limiting their engagement with SMEs. As expected, the responses in this regard are heterogeneous across countries and the patterns are less clear, but several aspects are worth highlighting. SME-specific factors seem important and, among those, banks tend to highlight the informality of SMEs. Interestingly, while banks would welcome further improvements in macroeconomic stability as well as in the quality of the informational, regulatory, legal, and contractual environments, they do not see deficiencies in these areas as major impediments or bringing constraints at present in their involvement with SMEs. These responses, which are not consistent with out initial expectations, may have a number of explanations. First, these countries are middle- income countries that might have already undertaken the basic macro, institutional, and contractual reforms needed for SME financing to occur. Therefore, in other less developed countries, where minimal reforms have not taken place, macroeconomic and institutional factors might be important binding obstacles and government action in these areas might be needed to enable significant lending to SMEs. Second, banks have learned to cope with a less than perfect macroeconomic, informational, and contractual environment by using products that help to deal with these deficiencies and thus limit risk exposure. For example, banks use short-term loans (mostly for working capital), require collateral and broad guarantees from the SME owners, and focus on products that tend to reduce the risk of SME lending like check discounting, leasing and factoring. Third, it is also possible that macroeconomic

factors are not perceived to be constraining because of the relatively strong growth and benign liquidity and interest rate conditions prevalent in the countries in the sample at the time of the surveys. If the macroeconomic situation in the surveyed countries were to deteriorate significantly, banks might change their perceptions on the prospects for the SME segment. Finally, one would expect that deficiencies in the contractual environment would become more binding as banks try to engage in long-term lending.

Moreover, the lending technology (with the exception of Serbia) and other bank-specific factors do not appear to be significant obstacles for banks to expand their engagement with SMEs. This suggests that banks' capacity to serve SMEs is greater than commonly believed, which runs contrary to the conventional ideal that supply-side factors are the main explanation behind the frequently mentioned problems for SMEs to obtain financing at affordable terms.

3.5 Summary and Conclusion

This chapter dealt with the importance of SMEs to the economy. It is increasingly being noted that "smaller businesses are the foundation of the emerging private sector in developing countries and governments should help them to survive and thrive," said a World Bank report in 2000 that explored the importance of SMEs in developing countries.

This section also dealt with fact that SMEs have become a strategic sector for most banks. Put differently, SMEs have been the main niche for bank's business and inspite all the tailored services and products meant for SMEs, there is still some element of risk and doubt about the operations of SMEs hence the lending policies continue to become much tighter.

CHAPTER FOUR

DATA ANALYSES, PRESENTATION AND DISCUSSION OF FINDINGS

4.1 Introduction

The study set out to investigate the constraints of finance to small and medium scale enterprises. In pursuit of this goal, questionnaires were administered to 18 SME customers of SG-SSB. This chapter therefore presents the analyses of the primary data collected. It also includes a discussion of the data collected within the context of the objectives of the study.

The chapter was grouped into 3 sections with the first section presenting the analyses of data and the second section discussing the analysed data. The final section provides a conclusion for the analyses by drawing associations between key variables of the study.

4.2 Data presentation

Table 2: Number of Years in Business.

	Frequency	Percentage
1-3	3	16.7
4-6	3	16.7
7-9	1	5.6
10-12	6	33.3
13-15	5	27.8
Total	18	100

Table 3: Number of People currently Employed.

	Frequency	Percentage
1-3	4	22.2
4-6	8	44.4
7-9	2	11.1
10-12	3	16.7
13-16	1	5.6
Total	18	100

Table 4: Means of Financing the Start Up Business.

	Frequency	Percentage
Personal Savings	12	66.7
Bank credit	1	5.6
Supplier credit	3	16.7
Friends and relations	2	11.1
Total	18	100

Table 5: Current Stage of your Business.

	Frequency	Percentage
Starting	15	83.3
Expanding	1	5.6
Considering expansion	2	11.1
Total	18	100

Table 6: Expected means of financing Expansion.

	Frequency	Percentage
Bank credit	11	73.3
Re- Investment	4	10
Total	15	83.3

Table 7: Does your Account bear your Business Name?

	Frequency	Percentage
Yes	17	94.4
No	1	5.6
Total	18	100

Table 8: Have you ever applied for a Credit for this Business ?

	Frequency	Percentage
Yes	18	100
No	0	0
Total	18	100

Table 9: Requirements for the Credit.

	Frequency	Percentage
Collateral	2	11.1
Type of business	2	11.1
Acc. Inst & Collateral	14	77.8
Total	18	100

Table 10: Was the Credit approved?

	Frequency	Percentage
Yes	10	55.6
No	8	44.4
Total	18	100

Table 11: Source of the Credit.

	Frequency	Percentage
SG-SSB	3	30
Other commercial banks	1	10
Relatives and friends	1	10
Micro finance institution	4	40
Suppliers	1	10
Total	10	100

Table 12: Why was the Request declined?

	Frequency	Percentage
Insufficient document	2	25
Lack of collateral	5	62.5
Business not registered	1	12.5
Total	8	100

Table 13: Does the Loan processing period pose Constraints to your business?

	Frequency	Percentage
Yes	15	83.3
No	3	16.7
Total	18	100

Table 14: Did the requirements pose a Constraint to your business?

	Frequency	Percentage
Yes	16	88.9
No	2	11.1
Total	18	100

Table 15: How long does it take to process your Loan application?

	Frequency	Percentage
2-4 weeks	6	33.3
4-6 weeks	11	61.1
6-10weeks	1	5.6
Total	18	100

Table 16: What percentage of Interest rate are you paying?

	Frequency	Percentage
25%-30%	9	50
31%-40%	9	50
Total	18	100

Table 17: Does the level of Interest rate pose a Constraint to your Business?

	Frequency	Percentage
Yes	17	94.4
No	1	5.6
Total	18	100

Table 18: If Yes to Q 17 how does it pose a Constraint?

	Frequency	Percentage
All profit on payment	13	72.2
Working capital on repayment	5	27.8
Total	18	100

Table 19: Did you provide Security for the Facility?

	Frequency	Percentage
Yes	18	100
No	0	0
Total	18	100

Table 20: Forms of Security provided.

	Frequency	Percentage
Guarantor	9	50
Account	2	11.1
Landed property	7	38.9
Total	18	100

Table 21: Was it difficult in ascertaining the required Collateral?

Yes	15	83.3
No	3	3
Total	18	100

Table 22: If Yes to Q 21 what were the difficulties?

	Frequency	Percentage
Long documentation process	6	33.
Lack of collaterals	8	44.4
Documentation and collateral	1	5.6
Total	15	100

Table 23: Challenges affecting SMEs.

	Frequency	Percentage
Lack of access to finance or funds	10	55.6
No market for products or service	2	11.1
Competition	2	11.1
Problem with location	4	22.2
Total	18	100

Table 24: How much of your Business is financed by Suppliers Credit?

	Frequency	Percentage
1-20%	9	50
21-40%	9	50
Total	18	100

Table 25: Do you do Book Keeping on your Business and Account operation?

	Frequency	Percentage
Yes	10	55.5
No	8	44.4
Total	18	100

4.3 Discussion of findings

4.3.1 Background of participants

The sample included eighteen (18) SMEs in Ghana who save with the SG-SSB bank. As presented in table 1, 16.7% each of respondents had been in existence for 1 -3 years and 4 - 6 years respectively, 5.6% of respondents had been operating between 7 – 9 years while 33.3% had been operating between 10 -12 years. The remaining 27.8% had also been operating for 13 – 15 years.

Also 22.2%, 44.4%, 11.1%, 16.7 and 5.6% of respondents employed 1-3 persons, 4-6 persons, 7-9 persons, 10-12 persons and 13-16 persons respectively. This is shown in table 2.

Table 3 shows that out of the 18 respondents questioned, 66.7% financed the start of their business from their personal savings, 5.6% financed the start of their business from bank credit while 16.7% financed the start of their business from supplier credit. The remaining 11.1 financed the start of their business from friends and relations.

Further, 83.3% of respondents indicated that their businesses were at the starting stage while 5.6% indicated that their business was expanding. 11.1% of respondents also indicated that their businesses were considering expansion. Details of the current stages of the businesses of respondents are shown in table 4.

The 15 respondents whose businesses were at the starting stage were also asked to indicate how they intended to finance the expansion of their businesses. In their responses, 73.3% indicated that they intended to expand their businesses through the use of Bank credit. The remaining 26.7% however intended to finance their expansion. This is shown in table 5.

4.3.2 Credit Issues

Table 6 shows that 94.4% of respondents had accounts in SG-SSB which bore their business names rather than their personal names. Also all respondents, as shown in table 7, admitted that they had applied for a loan/ credit for their business at one point or the other. 77.8% of respondents cited that the requirements for the loans they applied for was the existence of an accounting institution and Collateral. On the other hand, 11.1% each provided that the requirement for the loans they had applied for were collateral and the type of business they were venturing into.

However, only 55.6% of respondents had their application approved with the remaining 44.4% having theirs refused. For those respondents whose applications were approved, 30% indicated that SG-SSB was the source of their credit, 10% each also indicated that the source of their credit were other commercial banks and relatives and friends respectively. 40% also identified microfinance institutions as their source of credit while the remaining 10% cited suppliers as their source of credit.

Of the 8 respondents whose request for credit for their business had been declined, 25% provided that their request was declined because of insufficient documentation, 62.5% claimed their request had been declined because of the lack of collateral and the remaining 12.5% said their request was declined because their businesses were not registered.

Interestingly, as much as 88.9% of the total number respondents admitted that the requirements for the loan posed a constraint to their businesses.

The study also sought to obtain information on the duration for processing loans for SMEs. 33.3% of respondents in answering this question provided that it took 2 – 4 weeks to process their loans. Also 61.1% of respondents provided that it took between 4 - 6 weeks to process their loans while the remaining 5.6% indicated that it took between 6 -10 weeks to process their loans. 83.3% of the total respondents further agreed that the loan processing period posed a constraint to their business.

Respondents were also asked to indicate the interest rates payable on the loan they applied for. In response 50% of respondents said the interest rate was 25%-30% while the other 50% indicated that the interest rate was 31%-40%. Unsurprisingly, 94.4% of respondents agreed that the interest rate on the loans they accessed was a major constraint to their business. A follow up question was asked in order to ascertain how the interest rate charged on the loans they accessed constrained their businesses. In their response, 72.2% of respondents claimed that they had to spend all the profit they made on repaying the interest while the remaining 27.8% also indicated that they had to spend their working capital on repaying the interest.

All respondents agreed without reservation that they provided security for the loan facility. Further 50% of the respondents indicated that they provided a Guarantor as security for the loan, 11.1% indicated that they provided an accounts receivable as security for the Loan while the remaining 38.9% provided landed property as security for the loan. Additionally, 83.3% of respondents indicated that they faced difficulties in ascertaining the required collateral as against 16.7% who did not. Specifically, 40% indicated of those who faced problems indicated that the major problem they faced was the long documentation process, 53.3% pointed to the lack of collaterals while 6.7% identified documentation and collaterals

Respondents were also asked to indicate the percentage of their businesses that was financed by suppliers' credit. In their response, 50% of respondents each indicated that 1-20% and 21-40% of their businesses were respectively financed by suppliers' credit.

Further, 55.6% of respondents kept books on their business and account operations while the remaining 44.4% did not. For those respondents who did not keep the books, 37.5% said they did not do so because they felt it was a waste of time while remaining 62.5% said they did not do so because they had no trained personnel.

Finally, respondents were asked to indicate the major problem they faced in operating SMEs. Their answers show that 56% lack access to finance, 11% have no market for products/services, 11% face stiff competition and the remaining 22% have a problem with the location of their business.

4.3.3 Financial Constraints facing SMEs in Ghana

In Africa the SME sector accounts for almost 90% of all the enterprises and are located in both the rural and urban areas (Mokaddem 2006). In Ghana, available data from the Registrar General also confirms that over 90 percent of the Companies registered are micro, Small and Medium Enterprises. This group is therefore a major contributor to economic growth, development, poverty alleviation and employment (Parker et al, 1995). Despite their relative importance to the Ghanaian economy, SMEs have over the years been plagued with a host of challenges that threaten to undermine the contribution they make to the nation.

This study therefore provided bases for the assessment of the challenges faced by SMEs in their day-to-day operations and within the context of their ability to acquire and utilise credit facilities in order to survive, grow and enhance their profit.

A myriad of constraints that inhibit the success of SMEs have been identified in literature. One such key constraint is the problem with location. SMEs especially in developing countries have faced difficulties because mainly because they are unstrategically situated. Blili (1993) provide that most small scale businesses are either sited far away from their sources of inputs or from the open market for their goods.

Another key issue identified by the European Commission (1996) is the unavailable market for products or services of SMEs such that much of what they produce are not patronised, go waste or are sold at giveaway prices. More often than not, most local consumers prefer foreign goods and services or products from large multinationals rather than from local SMEs. Buame (2000) in furtherance of the above identifies the structure and the size of consumer market as well as the accessibility to export market as a principal challenge of SMEs in Ghana. Other external constraints include the inaccessibility to market information and inadequate export infrastructure and the limited penetration of the regional and sub-regional market in Africa.

Buame further confirms that competition from foreign companies places strong pressure on SMEs in terms of efficiency, price, quality, cost, control, marketing expertise, customer satisfaction and innovativeness. SMEs thus face competition from three main sources: imports, large scale enterprises etc.

In spite of the above challenges, it is generally believed that the most single important factor constraining the growth of the SMEs is the lack of finance. Finance has been identified in many business surveys as the most important factor determining the survival and growth of SMEs in both developing and developed Countries. Access to finance allows SMEs to undertake productive investment to expand their businesses, to acquire the latest technologies and to build productive capacity thus ensuring their competitiveness, to create jobs and to

contribute to poverty alleviation of the nation as a whole. Poorly functioning financial systems can seriously undermine the microeconomic fundamentals of a country, resulting in lower growth in income and employment.

Respondents of the study confirmed Buame (2000), Blili (1993) and the European Commission's (1996) assertions that indeed SMEs in Ghana were constrained by the lack of market, competition and poor location. Further, the study also confirmed that the major challenge faced by SMEs was the lack of access to finance.

However, in contrast to Gupta and Cawthon's (1996) study that links particular challenges faced by SMEs to the number of years in business such that SMEs gradually traverse challenges faced at the start-up point and face new ones as they grow, the study found no association between the challenges affecting SMEs in Ghana and the number of years the SME has been operating in Ghana. This is shown by the Chi squared test of significance shown for table 28 which shows no association whatsoever between the number of years an SME has operated and the particular challenges they may face.

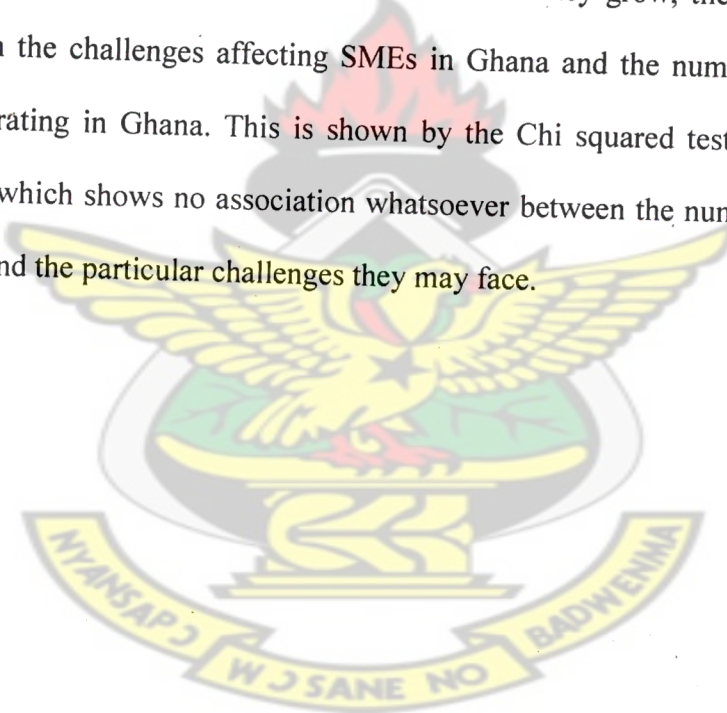


Table 26: General challenges affecting SMEs

		Challenges affecting SMEs				
		Lack of access to finance/funds	No market for products/services	Competition	Problem with location	Total
How long has the business been in existence	1 - 3	66.7%	0%	0%	33.3%	100%
	4 - 6	66.7%	33.3%	0%	0%	100%
	7 - 9	0%	0%	0%	100%	100%
	10 - 12	33.3%	16.7%	33.3%	16.7%	100%
	13 - 15	80.0%	0%	0%	20%	100%
Total		55.6%	11.1%	11.1%	22.2%	100%

Chi-Square Test

	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	11.910 ^a	12	.453
Likelihood Ratio	12.768	12	.386
N of Valid Cases	18		

Table: 27 Challenges posed by requirements for the loan

		Did the requirements for the loan pose a challenge to your business		
		Yes	No	Total
How long has the business been in existence	1 - 3	66.7%	33.3%	100%
	4 - 6	100%	0%	100%
	7 - 9	100%	0%	100%
	10 - 12	100%	0%	100%
	13 - 15	80%	20%	100%
Total		88.9%	11.1%	100%

Despite their dominant numbers and importance in job creation, SMEs traditionally have faced difficulty in obtaining formal credit or equity. Moreover banks in many developing

countries lent overwhelmingly to the government which offered less risk and higher returns. Such practices have crowded out the most private sector borrowers and increased the cost of capital for them.

SMEs have in recent times had to turn to bank credit facilities, supplier credit, and friends and relations in addition to the conventional personal savings for means of funding. This is the case presented by respondents of the study in table 6 where as much as 73.3% of respondents indicated that bank credit was the likely source of funds for their expansion. Despite the availability of credit facilities by SG-SSB, other commercial banks, relatives and friends, micro finance institutions and suppliers, the requirements for accessing these credit facilities has posed a major challenge to SME operators. As shown in table 9, most SMEs in Ghana are unable to meet the requirements of loan facilities like the provision of collateral and the type of business requirement. Further, the main requirement that was a hindrance to SMEs in the study was the requirement for the SME to possess an account in the credit-lending institution in addition to the provision of collateral. This was supported by almost 80% of respondents in table 9.

The chi-square test of significance for table 29 presents that though the requirements for SMEs to access credit facilities was a challenge to their existence, it was not in any way associated with the number of years they had operated in the industry. In other words, all SMEs, from start-up ones to expanding ones faced problems when it came to meeting the requirements for credit.

Chi-Square Test

	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	3.130 ^a	4	.533
Likelihood Ratio	3.735	4	.443
N of Valid Cases	18		

Table 28: Challenges posed by Interest on the loan

		Does the interest rate for the loan pose a challenge to your business		Total
		Yes	No	
How long has the business been in existence	1 - 3	66.7%	33.3%	100%
	4 - 6	100%	0%	100%
	7 - 9	100%	0%	100%
	10 - 12	83.3%	16.7%	100%
	13 - 15	80%	20%	100%
Total		83.3%	16.7%	100%

Forfas (1998) accounts that commercial banks are generally biased toward large corporate borrowers, who provide better business plans, have credit ratings, more reliable financial information, better chances of success and higher profitability for the banks, than SMEs. They therefore are very reluctant to lend funds to SMEs. Eventually, when the banks do lend to SMEs, they tend to charge them a commission for assuming risk and apply tougher screening measures, which drives up the costs on all sides. The resultant effect is the hike in interest rates charged SMEs.

The interest rate situation is further exacerbated by the fact that commercial banks in developing countries and countries with economies in transition often prefer to lend to government and thus the public sector crowds out the private sector. Such preferences were aptly put by the western banker in Nigeria: "We are not a charity". Why should I take risks with SMEs when I can make good money elsewhere". In effect, SME operators are forced to pay competitive interest rates with the public sector for loans and this drives up the interest rates payable on the loans.

Further credence is provided by Wang (2003) who asserts that financial institutions charge higher interest rates to SMEs than to larger companies in order to compensate for the higher cost of information collection, the smaller volumes of external financing and the greater risk of failure.

In confirmation of the above, 94.4% of respondents cited high interest rates as a major challenge faced in operating SMEs in Ghana. Respondents further indicated that the interest on the loans they obtained from banks ranged between 25% to 40%. Apart from the usual inconsistencies associated with high interest loans, respondents made particular mention of the fact that all the business profit they made was consumed on the repayment of the interest charged on the loan. Some also indicated that they had to use their business working capital to repay the interest on the loan in some instances.

Notwithstanding the above, the study showed that there was no association between the number of years in operation and whether interest rates posed a challenge to SMEs. This means that SMEs, regardless of how many years they have been in operation were challenged by the high interest they had to pay on loans.

Chi-Square Test

	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	1.440 ^a	4	.837
Likelihood Ratio	1.990	4	.738
No. of Valid Cases	18		

Table 29: Challenges posed by processing period of the loan

		Does the processing period for the loan pose a challenge to your business		Total
		Yes	No	
How long has the business been in existence	1 - 3	100%	0%	100%
	4 - 6	100%	0%	100%
	7 - 9	100%	0%	100%
	10 - 12	83.3%	16.7%	100%
	13 - 15	100%	0%	100%
Total		94.4%	5.6%	100%

Governments cannot expect to have dynamic private sector as long as they absorb the bulk of private savings. In the case venture capital funds, they have been concentrated in high technology sectors. Likewise, the international institutions have ignored the plight of SMEs in favour of large scale businesses and financial institutions. For a lot of capital funding commissions like the Base capital accords have not been analysed and framed with any consideration for their impact on the ability of commercial banks to service the SME sector. These preferences and tendencies have exacerbated the lack of financing for SMEs in many ways.

One such notable way is the delay or extended processing time for loans for SMEs. As provided by Wang (2003), the significant administrative and transactions costs associated with lending or investing small amounts do not make financing SMEs so much of a profitable business for a commercial banks. Considering further the risks associated with lending to small unestablished ventures, lenders will want to prove beyond all reasonable doubts that the applicant can provide reasonable and profit-worthy justification of the use of the loan funds, a

clear and workable repaying plan as well as a justifiable security to insure themselves against losses.

The time median time frame for such processes to be carried out is between 4 to 6 weeks by which time the conditions that necessitated the loan may have changed or price fluctuations and other economic factors may have altered significantly such that the loan obtained will no longer be adequate for the purpose which the SME intends to use it for.

Though the above scenario was supported by the study, no association was drawn between the processing period for loans and the number of years in business such that all SMEs irrespective of how long they had been operating faced problems with the lengthy processing time for the loans they sought.

Chi-Square Test

	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	2.118 ^a	4	.714
Likelihood Ratio	2.317	4	.678
No. of Valid Cases	18		

Table 30: Challenges faced in obtaining collateral for the loan

		Was it difficult in obtaining the required collateral		Total
		Yes	No	
How long has the business been in existence	1 - 3	100%	0%	100%
	4 - 6	66.7%	33.3%	100%
	7 - 9	100%	0%	100%
	10 - 12	83.3%	16.7%	100%
	13 - 15	80%	20%	100%
Total		83.3%	16.7%	100%

Chi-Square Test

	Value	Df	Asymp. Sig. (2-sided)
Pearson Chi-Square	1.440 ^a	4	.837
Likelihood Ratio	1.990	4	.738
No. of Valid Cases	18		

Maturities of commercial bank loans extended to SMEs are often limited to a period far too short to pay off any sizeable investments. Meanwhile, access to competitive interest rates is reserved for only a few selected blue-chip companies while loan interest rates offered to SMEs remain high (Curran et al, 1996). This is because SMEs often venture into risky enterprises and have yet to carve a niche for their products or services.

In aversion or management of such risks associated with lending to SMEs especially in the unpredictable unstable business environments in developing countries requires that lending institutions require collateral for the credit they provide businesses. All SMEs are thus required to provide security for the loans they access. However, many SMEs face great difficulties in satisfying the collateral requirements of lending institutions, from finding eligible guarantors to providing landed property. Though the study indicates that SMEs face a huge challenge in obtaining collateral for their loans, there was no association between obtaining collateral and the number of years an SME had been in operation. This is shown in table 32.

4.4 Conclusion of analyses

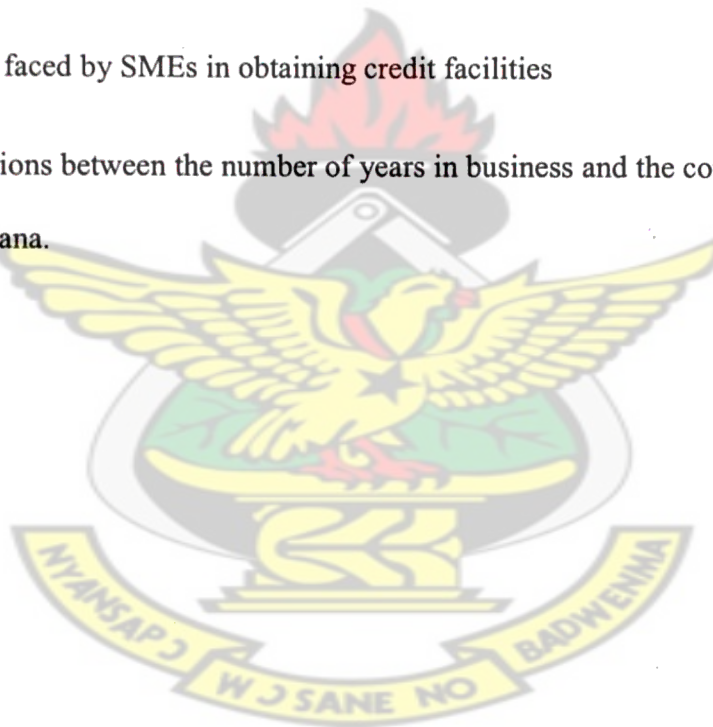
The study examined the constraints of finance to SMEs in Ghana using 18 SME customers of SG-SSB in Accra as examples. The findings suggest that indeed, SMEs face strong financial

constraints although greater gains could be made from that sector if attention is paid to the barriers identified.

Also this work was exploratory in nature and the results represent data from a relatively small sample size, particularly as it was collected from one bank. This did, however, have the strength of bringing broad representation from across the Accra Metropolitan Area, which is a large and diverse geographical area.

Considering the limitation of the study (the population sample was not on a national scale), the results of the study provide new insights into

- a. The importance of finance in the survival, growth and profitability of SMEs
- b. The barriers faced by SMEs in obtaining credit facilities
- c. The associations between the number of years in business and the constraints faced by SMEs in Ghana.



CHAPTER FIVE

SUMMARY AND RECOMMENDATIONS

5.0 Introduction

This chapter deals with the summary, conclusion and recommendation of the study. It is done through the reviews of the previous chapters while trying to recap the main topical issues in the discussions. It is hoped that the recommendations will impact general design of policies and products to better serve the SMEs clients to enhance the development of SMEs and therefore the economy of Ghana.

5.1 Summary

The study set out to assess the constraints of finance to SMEs in Accra using SME customers of SG-SSB as examples. In pursuit of this goal, the study reviewed relevant secondary data gathered from the internet, journals and publications on the subject of the research.

Primary data was also collected from eighteen (18) SME operators randomly selected from the SME customers of SG-SSB in Accra through the administration of a closed questionnaire on issues concerning the study. An unstructured interview was also conducted with authorities on object of the study. This formed the bases upon which the questionnaire was drawn.

The questionnaires were analyzed, interpreted and presented in the form of frequency tables and contrasted with the empirical evidence provided in the literature review.

Finally a conclusion was drawn to the fact that though there were financial barriers that constrained SMEs activities in Ghana, these constraints were not in any way associated with how long the SME has been operating in Ghana.

5.2 Key findings

The study was to examine the constraint of finance to SMEs, the case of SG-SSB and the impact of this constraint on the growth and development of SMEs

- The work revealed various constraints that bedevilled the growth and development of SMEs such as Competition, No market for product and services and lack of access to finance. Lack of access to finance ranks as the most significant constraint, scoring 56% from the respondents view. Finance has been identified in many business surveys as the most important factor which determines the survival and growth of SMEs to undertake productive investments to expand their businesses and to acquire the latest technologies, thus ensuring their competitiveness and that of the national as whole.
- The study also revealed that 66% of the respondent used their personal savings as the Start up Capital for their business. Bank Credit is however targeted as the highest alternative means by which their businesses would sustain and expand.
- Even though majority of these SMEs have applied for credit to enable the expansion of their businesses SG-SSB and traditional commercial banks have been reluctant to provide credit facilities as SMEs are regarded as high-risk borrowers due to insufficient assets and low capitalization and Information asymmetry due to lack of accounting records.
- The study further revealed that Collateral is ranked the highest most sought requirement from the Bank with 56% score from the respondents view as means of reducing the risk of lending to SMEs. It is ranked as the major constraint to accessing credit facilities. The key requirement of collateral security to credit is the most reported causes of delay and impediment in their business operations and sometimes loss of business opportunities. To meet the collateral requirement therefore increases in transactional costs of SME borrowings.

- The study also revealed that SG-SSB and other commercial banks charge higher interest rates to SMEs than to larger companies in order to compensate for the higher cost of information collection, the smaller volumes of external financing and the greater risk of failure.
- The study revealed that even though SG-SSB SSB has established an SME Department to strategically roll products to meet the financial needs of SMEs, the policies with regards to the SMEs products still remain the same with no effectual reduction in the financial constraint to lending to the SMEs. This is evidenced by the findings that only 30% of the total successful respondents of Ten (10) had loan from the Bank. The rest though are clients to the Bank had their loans from other sources because of unmet requirements.

5.3 Recommendations

In view of the findings, a number of recommendations are outlined by the study to redress the situation:

- There is a need for SG-SSB to be competitive through modification and development of new dynamic methodologies for providing financial services that meet the specialized needs of SMEs while coping with the high risks and costs associated with servicing them. This implies the rolling out of specialised credit facilities for specific purposes to enhance quick and easy repayments, minimising the strict use of landed property collateral requirement.
- Reducing information asymmetry of SMEs and high perceived risks by using credit scoring systems, using information providers, risk self-assessment for SME entrepreneurs, pricing to the level of risk, sharing risk with third parties, using covenants as an alternative to loan guarantees and setting up special support units for high risk customers such as start-ups.

- Reducing costs of lending by applying the latest information technologies in streamlining the organisation and simplifying the lending process, centralization of credit analysis and document preparation, developing virtual banking as a new distribution channels, creation of objective system for credit analysis such as credit scoring etc.
- Developing products better adapted to SMEs process.
- Improving financial services for SMEs through periodic training of its staff and the segmentation of SME customers to their meet specific needs. SMEs managers must be equipped with business and entrepreneurial skills, suitable hardware and credit risk assessment systems. The managers must also be trained to be flexible and sensitive to SMEs issues.
- Cooperating with SME organizations and other business development providers in order to reduce and share risks and costs and combine financial with non-financial services. Cooperation SG-SSB bank with third parties e.g. loan and mutual guarantee schemes could solve the collateral obstacle.

5.4 Conclusion of the study

In conclusion, it is evident that SMEs face a lot of varying constraints or challenges ranging from lack of access to finance/capital, no marketing avenues for products and services, inefficient technology, competition etc

Lack of access to finance is quoted as the a major constraint for all Small and Medium Sized Enterprises which can seriously affect their ability to survive, upgrade the technology in their businesses, increase their capacity, expand their market, improve management system, increase productivity as well as profitability. Provision of finance is therefore the answer to most all of the challenges to SMEs.

It is therefore important that SG-SSB and other commercial banks through modification and development of new dynamic methodologies provide financial services that meet the specialized needs of its SMEs clients while coping with the high risks and costs associated with servicing them. This entails rolling out of specialised credit facilities for specific purposes to enhance quick and easy repayments, minimising the strict use of landed property collateral requirement. This will ensure total development of the sector, for the sector to play its primary role as the engine of growth of the Ghanaian economy.

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APPENDIX

RESEARCH QUESTIONNAIRE

This questionnaire is meant to solicit data for a research on the constraints of credit to SMEs, the Case of SG-SSB. It is meant solely for an academic purpose. (All responses shall be treated with strict confidentiality. Your co-operation is very essential)

1. When was the business started?.....
2. How many people are currently employed in your company?.....
3. Rank the following problems by order in which they affect your business, 1 being the most significant.
 - (a) Lack of access to finance/funds
 - (b) No market for products/services
 - (c) Competition
 - (d) Problem with location
4. How did you finance the start up of the business?
 - (a) Personal Savings
 - (b) Bank Credit
 - (c) Supplier Credit
 - (d) Friends and Relations
 - (e) Others(specify)
5. In your opinion which of the following best describes the current stage of your business
 - (a) Starting
 - (b) Expanding
 - (c) Considering Expansion
6. If (a) is your answer how do you intend to finance the expansion?
 - (a) Bank Credit
 - (b) Re-Investment

(c) Friends and Relation

(d) Other(Specify)

6. Does your account bear your business name? (a) Yes (b) No

7. If No, what are the reasons?

8. Have you ever applied for a credit in for this business? (a) Yes (b) No

9. Was the Credit approved? (a) Yes (b) No

10. If Yes where was the source of the Credit

(a) SG-SSB

(b) Other Commercial Banks

(c) Relatives and Friends

(d) Micro Finance Institutions

(e) Suppliers

11. What were the requirements for the credit

(a) Accounts with the Financial Institution

(b) Collateral

(c) Turnover

(d) Type of Business

12. If No, what was the reason why the request was declined?

(a) Insufficient document

(b) Lack of collateral

(c) Business not registered

(d) Bad credit history

(e) Others, please specify

13. Did the requirements pose a constraint to your business? (a) Yes (b) No

14. How long does it take to process your loan application? (a) 2-4 weeks (b) 4-6 weeks

(c) 6-10 weeks

15. Does the loan processing period pose constraints to your business (a) Yes (b) No

(If the loan was not granted please go question 23)

16. What percentage of interest rate are you paying on the loan? (a) Less than 25%
(b) 25%-30% (c) 31%- 40% (d) above 40%
17. Does the level of the interest pose a constraint to your business? (a) Yes (b) No
18. If Yes to Q.17 how does it pose a constraint?
- (a) All the business profit is consumed on the repayment
- (b) The business working capital has been used on the repayment
19. Did you provide security for the facility? (a) Yes (b) No
20. If Yes to Q.19 what form of security did you provide?
- (a) Guarantor
- (b) Accounts Receivable
- (c) Landed Property
- (d) Others, please specify
21. Was it difficult in ascertaining the required collateral?
22. If yes to Q. 21 what were the difficulties
- (a) Long documentation process
- (b) Lack of collaterals
- (c) Others, please specify.....
23. How much of business is financed by suppliers' credit (a) 1-20% (b) 21-40% (c) 41-100%
24. Do you do book keeping on your business and account operations? (a) Yes (b) No
25. If No to Q. 24 give reasons
- (a) Waste of time
- (b) No trained personnel to do it
- (c) It is expensive

Thanks for your time.