KWAME NKRUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY

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THE IMPACT OF VENTURE CAPITAL FINANCING ON SMALL AND MEDIUM ENTERPRISES IN THE TEMA METROPOLIS: THE CASE OF ELSA FOODS LIMITED

By

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COMMONWEALTH EXECUTIVE MASTERS IN BUSINESS ADMINISTRATION

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DECLARATION

I hereby declare that this submission is my own work towards CEMBA and that, to the best of my knowledge, it contains no material previously published by another person nor material which has been accepted for award of any other degree of the University, except where due acknowledgement has been made in the text.

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ABSTRACT

The study looked at the Impact of Venture Capital Financing on SMEs in the Tema Metropolis. Efforts by successive Government to improve on the performance and growth of SMEs had led to the enactment of different policies and act including the Venture Capital Fund to assist SMEs. SMEs still in Ghana have been faced with liquidity and financing challenges leading to business failures under production Industrial disputes and sometimes closures by regulatory authorities.

In order to achieve the objectives for the study, 50 questionnaires were administered to Manager/SME owners operating within the Tema Metropolis with focus on Elsa Foods Ltd using convenience sampling techniques. It was generally observed that SME's prefer self-financing and occasionally received support from financial institutions. The findings further shows that SMEs continue to rely on many financing options both at their conceptual and expansion stage. Majority of the SMEs were however not aware or had little knowledge about Venture Capital Financing as an alternative to financing. Firms that had benefited from Venture Capital Financing stated that they did not only receive capital inflow but was accompanied with monitoring, technical skills and expertise, access to management, marketing and distribution and reputation for attracting further finance. The study recommends that SMEs need to recognize the potential advantages of seeking equity finance from venture capital. Venture capital fund managers can do much to encourage venture capital investment from corporate investors. Government and policy makers should play a dual role as both facilitators and educators in encouraging the venture capital process.Following from the conclusions and recommendation a more detailed research involving SMEs from different industries and regions is highly recommended

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DEDICATION

This work is dedicated to my beloved Mum and Siblings for their love and affection as well their ceaseless prayers for me.

CHAPTER ONE

INTRODUCTION

1.1 Background

Data from the International Finance Corporation (2004) suggest that ‘in much of the developing world the private economy is almost entirely comprised of SMEs' and that ‘they are the only realistic employment opportunity for millions of poor people throughout the world'

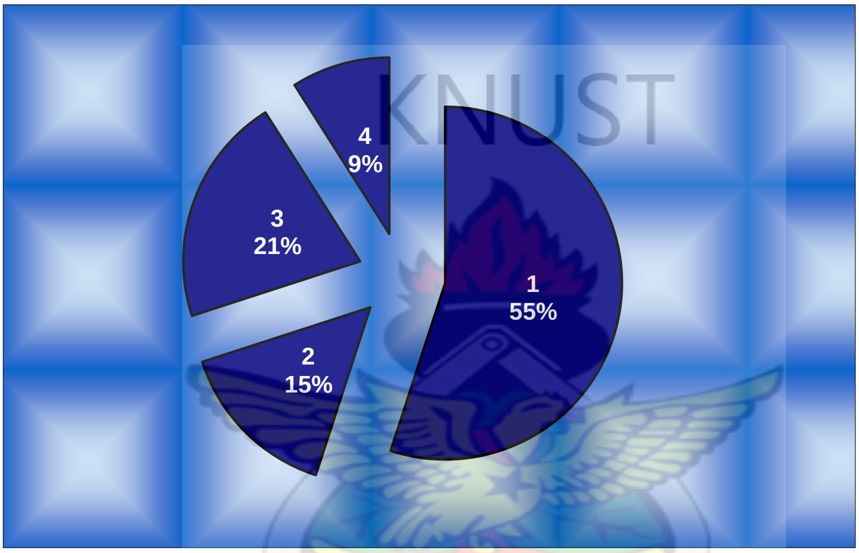


Figure 1: Fiscal Year 2004 Approvals in USD

Source: *2004 Annual Review Small Business Activities*

1. International Finance Corporation (IFC) $ 820 million
2. Multilateral Investment Guarantee Agency (MIGA) $ 219 million
3. International Bank for Reconstruction and Development (IBRD) $ 317 million
4. International Development Association (IDA) $ 141 million

Small and medium-sized enterprises (SMEs) are the backbone of all economies and are a key source of economic growth, dynamism and flexibility in emerging and developing economies. In Ghana, the total economic output of SMEs is about 50 per cent of gross domestic product (GDP), and this sector employs in excess of 60 per cent of the total labour force (ISSER, 1999). Thus, SMEs form a large proportion of the firm tissue in Ghana. One of the most important problems confronting SMEs concerns the issue of financing.

Financing is necessary to help SMEs set up and expand their operations, develop new products, and invest in new staff or production facilities. Many small businesses start out as an idea from one or two people, who invest their own money and probably turn to family and friends for financial help in return for a share in the business. But if they are successful, there comes a time when they need further funds to expand or innovate further. Some SMEs often run into problems, because they find it much harder to obtain financing from banks, capital markets or other suppliers of credit.

Almost every company we know of began as an SME. Vodafone as we know it today was once a little spin-off from Racal; Hewlett-Packard started in a little wood shack; Google was begun by a couple of young kids who thought they had a good idea; even Volkswagen at one point was just a little car maker in Germany (as opposed to being a giant small car maker globally) (Lukacs, 2005)

Microsoft may be a software giant today, but it started off in typical SME fashion, as a dream developed by a young student with the help of family and friends. Only when Bill Gates and his colleagues had a saleable product were they able to take it to the marketplace and look for investment from more traditional sources (Amissah, 2009).

The growth of SMEs has been hampered by the lack of adequate knowledge and a well structured financial market for the mobilization of capital. The role of finance has been viewed as a critical element for the development of SMEs (Cook and Nixson, 2000).

Recently, various funds have been setup to benefit SMEs but statistics provided by fund managers show that a disproportionate number of applicants have not been successful at accessing funding (Boateng, 2010).The need to explore alternative means of raising capital for business growth cannot be over emphasized. One of the innovative ways to raise funds for the growth of SMEs is venture capital.

Venture capital is an investment in a start-up or growing SME that is perceived to have excellent growth prospects. Venture capitalists raise and manage funds which are a pool of money raised from both public and private investors. Venture capitalists identify entrepreneurs with promising new ideas and assist with funding and professional management.

Venture capital investments provide the needed cash in form of equity for companies to develop technologies and products which, in turn, generate jobs and taxes that keep Ghana competitive. The objective is to generate sufficient long-term capital gains from the investors and the venture capitalists. Venture capital assists investors to access equity capital to finance expansion of business while maintaining control. The expertise and extensive relationships of the venture capitalist through its network add value to the company and increase credibility with customers, and finally, the company gain access to the venture capitalist knowledge in accounting, budgeting, computer systems, and back-office operations. (Amissah, 2009)

In venture capital financing agreement the venture capital firm will provide financing to enable a business to undertake a project and in return the venture capital company gets an ownership stake in the business (Boateng, 2010)

Limited data exist on venture capital as an alternative source for funds for SMEs. Therefore a research was made to gather information from SME's Owner manager in the SME sector to know about the impact of venture capital in the growth of its business.

1.2 Statement of the Problem

The SME sector constitutes in excess of 90% of the economy of the country. The need to provide affordable credit over a reasonable period for this sector cannot be over emphasized. SMEs, if properly structured and capitalized have the potential to grow and spearhead accelerated growth of this economy into a middle income status (Venture Capital Ghana, 2008)

SMEs still in Ghana have been faced with liquidity and financing challenges leading to business failures under production Industrial disputes and sometimes closures by regulatory authorities.

Just as it has been a great concern to all and sundry to promote the welfare of SMEs, it has also been a great cause of concern to all, the fact that the vital sub-sector has fallen short of expectation. The situation is more disturbing and worrying when compared with what other developing and developed countries have been able to achieve with their SMEs.

Their success is determined by their financing needs and the action of investors. SME financing needs reflect their operational requirements, while the action of investors depends on their risk perception and the attractiveness of alternative investment (which affects their willingness to invest). Government borrowing, the general economic climate, availability of collateral, quality of SME record keeping, and SME investor relations skills affect the way in which this challenge is managed

Additionally many non-financial constraints inhibit the success of such enterprises. SME owners are reluctant to be transparent or open up involvement of their businesses to outsiders. They seem to be unaware of or oblivious to the obligations and responsibilities they have toward capital providers, and the need to acquire or seek support for technical services like accounting, management, marketing, strategy development and establishment of business linkages. Management and support services are perceived to be cost prohibitive and non-value adding

Unfortunately since there is a dearth of long term investment funds for SMEs (as a consequence of the banks and securities markets shying away from the high risk investments in these sectors, it has became imperative for the Government to set up a scheme that will provide long term funding for the high risk investment needs of the SME sector. This has led to the establishment of Venture capital fund under the Venture Capital Trust Fund Act, 2004 (Act 680), to provide capital to Small and Medium Enterprises (SMEs) and to promote Venture Capital industry in Ghana.(Venture Capital Ghana,2008)

Does Elsa Foods know of venture capital funds? Has it ever applied for funding from Venture Capital organisations? What motivated the organisation to go for venture capital funds? What benefits have choked from sourcing funds from venture capital managers? This study seeks to provide answers to these questions.

1.3 Aim/Objectives

The main objective of this research is to examine the impact of Venture Capital Financing on SME's. The study will be focused on achieving the following objectives:

1. To determine SMEs alternative sources of funding.
2. To determine the SMEs Owner Manager's perception of venture capital funding.
3. To determine the impact of Venture Capital Financing in small business activities

1.4 Research Questions

The study addresses the following research questions:

1. What are the alternative sources of funding to SMEs?
2. What is the SMEs Owner Manager's perception of venture capital funding?
3. What is the impact of Venture Capital Financing on small business activities?

1.5 Significance of the Study

The study is justified for a number of reasons. Little studies have empirically examined venture capital as a source of finance within the Ghanaian context. The study is relevant will also identify venture capital as an emerging funding source for SMEs development in Ghana. This study has been motivated by the premise that in order to formulate a coherent strategy *vis a vis* the SME sector, it is necessary to (a) comprehend financing problems and different ways of sourcing funds, and (b) be able to identify venture capital as a financing option to SMEs. The findings of this research could offer an opportunity for SMEs to appreciate venture capital funding. The study would further seek to encourage government to expand the operations of the venture capital funding to drive SMEs contribute to economic growth, employment and the nation's development.

Finally for Government and other stakeholders to always provide another source of funding to replenish the coffers of the scheme.

1.6 Scope of the Study

This highlights funding from financial institutions, other sources of funding, and the SME managers' views on the venture capital as an alternative source of funding and the impact of venture capital financing on their business operations

1.7 Limitations of the Study

The study will be limited to SMEs due to the increase in the size of the Industry. The study area will also be limited to an SME in Accra because of information sourcing challenges as some SMEs Owner managers are unwilling to give out financial information. The problem of inadequate and proper keeping of information by some SMEs will also place limitations on the research area.

Although the framework is grounded in the data, it does not necessarily hold true for all SMEs. The sample is small and not representative of various sectors that SMEs belong. However, its findings can be used as hypotheses for future studies using large and more representative samples of SMEs form various sectors in the Ghanaian economy.

1.8 Organization of the study

The study is organised into five chapters.

Chapter 1 provides a brief background to study, discusses the research problem, reason for the research and significance of the study.

Chapter 2 reviews previous research on Venture Capital Financing and Small and Medium Enterprises, the frame of reference discusses the research area and investigates what has not been attended to or given little attention.

Chapter 3 is the methodology and explains the process of the project work. This chapter aims to describe the type of research which was conducted, description and measurement of variables in the study, study sample and the instrument for data collection. The detailed sampling method and sample size was discussed

Chapter 4 aims to present the findings of the current study. The data was analysed in this stage using statistical techniques.

The final Chapter 5 summarises the findings of the study. The implications of the findings are also discussed here. The study draws conclusion and provides recommendation to the problems raised.

CHAPTER TWO

LITERATURE REVIEW

2.1 Venture Capital Financing

Venture capital financing has been practised for more than half a century. It is well developed in Western economies where it has helped many businesses to bring innovative ideas and products to the market. It is relatively new concept in Ghana although history has it that some venture capital financing took place in 1980s and 1990s (Boateng, 2010).Venture capital (VC) is a type of private equity capital typically provided for early-stage, high-potential, and growth companies in the interest of generating a return through an eventual realization event of the company. Venture capital investments are generally made as cash in exchange for shares in the invested company. A venture capital company will in all likelihood require a stake in your business (existing net assets) and the venture capital company will bring their finance (to increase or grow the assets), (Boateng,2010).

Venture capital typically comes from institutional investors and high net worth individuals and is pooled together by dedicated investment firms. By definition, VCs also take a role in managing entrepreneurial companies at an early stage, thus adding skills as well as capital (thereby differentiating VC from buy out private equity which typically invest in companies with proven revenue), and thereby potentially realizing much higher rates of returns (Boateng,2010)

A venture capitalist is a person or investment firm that makes venture investments, and these venture capitalists are expected to bring managerial and technical expertise as well as capital to their investments. A venture capital fund refers to a pooled of investment vehicle (often an LP or LLC) that primarily invests the financial capital of third-party investors in enterprises that are too risky for the standard capital markets or bank loans. Funding can be provided for any or all stages in a product life cycle i.e. product development, marketing, distribution, etc (Boateng, 2010)

Venture capital is also associated with job creation, the knowledge economy and used as a proxy measure of innovation within an economic sector or geography. Venture capital is most attractive for new companies with limited operating history that are too small to raise capital in the public markets and are too immature to secure a bank loan or complete a debt offering. In exchange for the high risk that venture capitalists assume by investing in smaller and less mature companies, venture capitalists usually get significant control over company decisions, in addition to a significant portion of the company's ownership and consequently value.

Young companies wishing to raise venture capital require a combination of extremely rare yet sought after qualities, such as innovative technology, potential for rapid growth, a well-developed business model, and an impressive management team (Boateng, 2010).

2.2 Venture Capital Trust Fund in Ghana

2.2.1 Overview of Venture Capital in Ghana

The venture capital industry in Ghana is relatively young compared to other African countries. Most venture capital companies were established between 1990 and 2000, and the industry developed rapidly shortly after this industrial take-off. Since then, several attempts have been made by government over the years to make available long term capital to Small and Medium Enterprises (SMEs). Notable among them was the Governments' Business Assistance Fund (BAF), a venture which failed to survive. The idea was that many of these SMEs which form the bedrock of Ghana's economy lacked the financial muscle to survive. It is estimated that some would have required just one hundred and fifty Ghana cedis (almost a $100) to have been functional.

Mensah (2004) observes that Long term financing in terms of equity capital, needed by growth-oriented mainly small and medium firms, is practically non-existent for SMEs. Only two commercial venture capital funds have been established in Ghana over the past 10 years. United State Agency for International Development (USAID) and the Commonwealth Development Corporation (CDC) sponsored the formation of a venture capital fund in Ghana in 1991. They responded to a perceived need for financial products and services made to cater for the long-term financing needs of growing small businesses in Ghana within the framework of Ghana's financial sector reform programme (Mensah, 2004).

Even though there appears to be a good number of potentially viable investments in the upper, small and medium sized segment, the risks and costs involved in handling shareholding in SMEs have so far made those investments not attractive. More often than not lack of management skills and unsuitable management systems give rise to much higher business failure risks for SMEs than for large companies (Steel, 1994). To offset these risks through increased involvement into the day-to-day management of the firms leads to high costs for the venture fund that can hardly be regained through the return of the relatively small investments. In addition to venture funds and private equity investments, the Ghana Stock Exchange (GSE) is potentially a practical alternative for SME equity financing. Established in 1990 with 9 listings, the GSE had 26 listed equities (GSE Annual Report, 2000).

According to Mensah (2004), the Government of Ghana's support for equity financing for SMEs has been inadequate. Conversely, it has provided incentives for vigorous participation of both issuers and investors on the Ghana Stock Exchange in the following means:

i. Capital gains on shares listed on the GSE were exempted until 2005
ii. Dividends are subject to a withholding and final tax of 10%
iii. Companies listed on the Ghana Stock Exchange enjoy a lower corporate tax rate. Until 2003, this rate was 30% compared to the general corporate tax rate of 32.5%. Effective 2004, companies listing on the GSE for the first time will enjoy a lower tax rate of 25% (compared to a general 30% corporate tax rate) for the first three years of listing.

Mensah (2004) asserts that government has keenly participated in the provision of equity financing for SMEs. In 2003 the Government announced its objective of supporting equity financing for SMEs through the earmarking of 25% of the National Reconstruction Levy over a period of three-year for the establishment of a venture capital fund (Quartey, 2003). It was clear that the modalities for the operation of the venture capital fund would be made known in the course of 2004.

According to Mensah (2004), in the absence of a regulatory environment, the sponsors agreed to establish, a non-bank financial institution to hold the funds - Ghana Venture Capital Fund (GVCF), and a management company, Venture Fund

Management Company to make investment decisions. Mensah (2004) asserts that USAID made available $1,094,000 grant to underwrite the operational expenditures over a period of 3 years that ended in 1994, whereas CDC's $2 million obligation to GVCF was leveraged for an additional $3.8 million in invested capital from developmental finance and local institutions. Therefore, joint investment capital became $5.8 million. The GVCF became operational in November 1992, and was wholly invested with 13 investee companies. The average investment was $250,000 (Mensah, 2004). Together with managing the GVFC, VFMC in 1995 was awarded the management of a $4 million Enterprise Fund, promoted by the European Union which was also entirely invested with eighteen direct investee firms and twelve indirect (through leasing) investee companies (GTZ, 2001). The average size of investment by the Enterprise Fund was $100,000. Subsequent to the GVFC, was a $5 million Fidelity Equity Fund established by a joint venture between Fidelity Discount House and FMO (The Netherlands Development Finance Company) (GTZ, 2001). This fund is also entirely invested with 10 investee companies, and managed by the Fidelity Investment Advisors. In the past years, there were also some form of foreign direct venture capital investment in Ghana from pan-African focused VCFs including Modern Africa Growth Fund, the Commonwealth Africa Investment Fund and the African Enterprise Fund (GTZ, 2001).

2.2.2 Venture Capital Trust Fund

The Venture Capital Trust Fund (VCTF, Trust Fund) was established by ACT 680, 2004 as a Government of Ghana initiative to provide finance to Small and Medium Scale Enterprises. Under the VCTF ACT, the Trust Fund is to:

- Providing financing to eligible venture Capita; Finance Companies (VCFCs) to support SMEs; and to
- The provision of monies to support other activities and programs for the promotion of venture capital financing"

The Mission of the Fund is:

- To provide low cost alternative source of funding to SMEs that will lead to efficient and profitable operations to create jobs and wealth

The Vision of the Fund is:

- To create a vibrant and well structured venture capital industry boasting of investments in various sectors, leading to poverty reduction through job and wealth creation with a collateral growth in government revenue (Venture Capital Trust Fund,2009)

Such support to the business sector is in consonance with the recognition that the private sector is the engine of growth of the economy and the policy to promote and support them, is to engage the private sector as an equal partner to help government achieve the country's developmental goals. The functions of the VCTF are basically

- The provision of credit and equity financing to eligible Venture Capital Financing Companies to support small and medium-scale enterprises which qualify for equity, quasi-equity and credit financing.
- The provision of monies to support other activities and programs for the development and promotion of venture capital financing in the country.

2.2.2.1 The Special Purpose Vehicle (SPV) Financing Scheme

Under the SPV Financing the trust fund has been providing financial resources directly to small holder farmers in the upper east, Upper West, Northern Region and Northern part of Brong Ahafo since 2006, to produce sorghum for the brewery industry in a sorghum value chain project. The trust fund provided a sum of GHC 1.04 million to the farmers for the project. Since inception of the scheme, a total of GHC 3.2 million has been disbursed (Business &Financial Times, 2010)

Figure 2: Sorghum Farm (Sorghum value chain project) under the Special Purpose Vehicle Financing. (***Source: www.venturecapitalghana.com.gh)***

2.2.2.2 Role of Fund Managers of VCFC

The Fund Manager is responsible for all investment – related analysis, evaluation and due diligence of applications for funding. It's critical that the fund Manager's team has the qualified expertise and skills set to review, analyse and evaluate the risk inherent in a potential investee company.

The speed and success of the funding processes primarily depend on the fund manager of the VCFCS are main drivers of the funding and disbursement processes.

Investment recommendations made by Fund Managers are either rejected or approved and ratified by Investment Committee of the Board of Directors of the respective VCFC (Venture Capital Trust fund, 2009).

Table 1: Venture Capital Finance Companies &Fund Managers

Fund Vitals	**Activity Venture Finance Company Ltd.**	**Bedrock VCF Company Ltd.**	**Fidelity Equity Fund II Ltd.**	**Gold Venture Capital Limited**	**Ebankese Fund Limited**
Fund size million(US$)	10	10	23.2	4.0	15
Date Established	2006	2007	2007	2007	2009
Fund Manager	Black Star Advisors	SIC-Financial Services	Fidelity Capital Partners	N/A	Oasis Capital
Strategic Focus	Generalist	Generalist	Generalist	Generalist	Real Estate
Geographic Focus	100% Ghana	100% Ghana	70% Ghana 30%Sierra Leone & Liberia	100% Ghana	100% Ghana
Investment Partners	GCB, ADB	SIC Insurance, NIB	European Partners, SSNIT	Gold Coast Securities Ltd	HFC Bank , GUA, WDBI Ltd, Oasis Capital
Sector Exposure	Education, Agric-Business, Pharmaceutical, ICT, Services, Financial Services, Manufacturing	Agri-Business, Manufacturing ,Retail, ICT, Medical Services	Education, Pharmaceutical ,Medical Services, Real Estates, Financial Services, Manufacturing	N/A	Predominantly real Estates
Life of Fund	10	10	10	10	15

Source: ***Business & Financial Times, Monday, June 14, 2010***

2.3 Types of Venture Capital Investment in Ghana

The life cycle of a business involves a number of stages of growth and development. Investors refer to the type of capital by the term that describes these stages of growth in a business e.g. ‘start-up’. Funding can also be referred to as stages, rounds or tranches, e.g. ‘first round’ or ‘early stage’.

Pre-seed/R&D: Refers to funds used to expand the concept and advance product development, usually during the research and development phase of the business.

Seed: Provided to companies which have not yet fully established commercial operations, and may also involve continued research and product development.

Start-up: The company is in the process of being set up or may have been in business for a short time. Such firms have not yet sold their product commercially and have no track record. Investee companies have completed the product development stage and require funds to initiate commercial manufacturing and sales.

Expansion: The Company is now established and requires capital for further growth and expansion. The company may or may not have made a profit at this stage. This is a period of rapid growth and the company will usually require several rounds of capital injection as it achieves the milestones set in the business plan.

Pre-Initial Public Offering: Funds used to cover the costs of the Initial Public Offering.

Initial Public Offering: The sale or distribution of company shares to the public for the first time i.e. listing on the stock exchange.

***Trade sale*:** The sale of a company’s shares to another company, often in the same industry sector.

Merger and acquisition: Purchase of shares in another company, usually in the same industry to create a joint venture or take-over.

Management Buy-out: These are funds provided to enable current operating management and investors to acquire an existing product or business from a public or private company.

***Management Buy-in*:** These are funds provided to enable a manager or group of managers from outside the company to buy in to the company. (Venture Capital Ghana, 2008)

2.4 SMEs in Ghana

2.4.1 Definitions and Contributions of SMEs

According to Storey (1994), there is no single, uniformly acceptable, definition of a small firm. To him, firms vary in their levels of capitalisation, sales and employment. Hence, definitions which employ measures of size (number of employees, turnover, profitability, net worth, etc.) when 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 a different result. The first attempt to overcome this definition problem was by the Bolton Committee (1971) when they formulated an “economic” and a “statistical” definition. Under the economic definition, a firm is regarded as small if it meets the following three criteria:

(a) it has a relatively small share of their market place;

(b) it is managed by owners or part owners in a personalised way, and not through the medium of a formalised management structure;

(c) it is independent, in the sense of not forming part of a large enterprise.

From the various definitions above, it can be said that there is no unique definition for a small and medium scale enterprise thus, an operational definition is required. This is one of the main issues this project intends to address.

An alternate criteria used in defining small and medium enterprises is the value of fixed assets in the organisation. However, the National Board of Small Scale Industries (NBSSI) in Ghana applies both the `fixed asset and number of employees' criteria. It defines a Small Scale Enterprise as one with not more than 9 workers, has plant and machinery (excluding land, buildings and vehicles) not exceeding 10 million Cedis (US$ 9506, using 1994 exchange rate).

2.4.2 Sources of Finance for SMEs

Husain (2005) identified two main sources of funds for small businesses. These are the internal and external sources of funds. Internal sources of funds have been the major source of funds for SMEs. This source of funds may be from personal contributions and retained profit. The external funds include bank loans or overdraft, venture capital funds, etc

Tonge (2001) has also identified the fact that funds from relatives or friends are second to personal savings as the relevant and the major source of start-up capital for small-scaled businesses. Love (2003) has also identified the fact that start-up capital for SMEs often come from equity source. A typical example according to Laeven and Love is the situation whereby some individuals do deposit their moneys with saving collectors and these moneys are returned to their owners after a specific time period.

According to Kauffmann (2005), Africa's SMEs usually depend on retained earnings, informal savings, among other things as their main source of funds and have little access to external funds, thereby hindering their emergence and eventual growth. Kaufman further points out that SMEs do not have adequate access to external funds as a result of the fact that these SMEs cannot meet the conditions set by financial institutions because they see SMEs as a risk-prone business due to poor guarantees and unavailability of information about their capacity to repay the loans. According to Ayeertey (1998), only few SMEs applications for loans in Ghana have the chance of being considered. He contends that lack of viable projects as well as collateral prevents majority of the SMEs from obtaining loans from financial institutions. Ayeertey believes that financial institutions find it difficult to obtain the necessary information needed to assess , the risks of new, untested ventures, as the success of such firms do usually depend on the abilities of the entrepreneur. On her part, Aidoo (2003), points out that only 10 percent of start-up firms in Ghana can obtain bank loans.

Some research seem to validate the view that SME owners/managers' financing decisions are consistent with the 'pecking order' theory (Sogorb and Lopez-Gracia, 2003; Watson and Wilson, 2002). For instance, Watson and Wilson (2002) suggest that under these circumstances an owners/manager will choose first – a personal source of finance; second – short-term borrowing; third – longer-term debt; and – finally, the least preferred, equity finance which might affect his/her control upon the business. Sogorb and Lopez-Gracia (2003) also suggest that owners/managers tend not to sufficiently organise their finances in order to obtain an optimal capital structure (i.e. debt versus equity ratio) but prefer financing options that both ensure and maintain their control upon a business.

2.4.3 SME Financing in Ghana

According to Mensah (2004), lack of finance is considered as the single most critical factor thwarting the developmental growth of the SME sector. Mensah (2004) claims that there are a number of conditions accounting for this lack of finance in Ghana. These include the following:

i. A relatively undeveloped financial sector with little levels of intermediation;

ii. The absence of legal and other institutional structures that ease the management of the SMEs;

iii. The huge risk of lending to SMEs; and

iv. High interest rates and rigid borrowing procedures.

According to Mensah (2004), because of the persistent financing gap, many measures have been launched by governments and other development partners to encourage the flow of financing to SMEs over and above what is available from existing private sector financial institutions. Mensah asserts that existing SME financing interventions can be grouped under the following:

i. Specialized Schemes

ii. Financing through financial corporations

According to Mensah (2004), the schemes have included the following:

1. *Business Assistance Fund:* The Business Assistance Fund was operated in the 1990s to grant direct government lending to the SMEs.
2. *Ghana Investment Fund:* The Ghana investment Fund Act (Act 616) was passed in 2002 to set up a fund towards the provision of credit facilities by designated financial institutions to companies. Conversely, the scheme was never implemented.
3. *Export Development and Investment Fund (EDIF):* In relation to this scheme, companies with export programmes could borrow up to $500,000 over a period of five years period at a subsidized interest rate of 15%. Despite the fact that the scheme is administered through financial institutions, the EDIF

board maintains rigid control, approving all the credit recommendations of the participating financial institutions.

2.4.3.1 Guarantee Facilities

Section 13 of the Loans Act of 1970 (Act 335) gives the Government of Ghana (GoG) the authority to make available government guarantee to any external financier who wish to make funds available to any Ghanaian organization and the terms of such facility require the provision of guarantee from the Government. Guarantee facilities are contingent liabilities of the Government (Mensah, 2004). The onus for repaying the facility lies with the borrower and not the Government. The facility crystallizes and becomes liability due from Government of Ghana (GoG) if the borrower is incapable to honour his/her loan obligation and the Government is called upon to settle the facility as a guarantor (Mensah, 2004). In that case the borrower is required to subsequently pay back the Government for the amount involved.

According to MoTI (2005), a Loan Guarantee Scheme was announced by the Ministry of Trade and Industries. Right now, the only government-assisted loan guarantee scheme in use is handled by Eximguarantee Company, which is majority-owned by the Bank of Ghana. Nonetheless, the company’s activities are limited by the amount of its guarantee fund. Even though GH¢1 million was made available in the 2004 budget to bump up the guarantee fund, this amount is still small, relative to the needs of the SME sector (MoTI, 2005).

Conceivably, as a result of the obnoxious experience of direct lending by government in the recent past, more current donor interventions in SME finance have used existing financial institutions to channel funds to SMEs (Mensah, 2004). He adds that a substantial number of lending programmes undertaken as partnerships between government and donors include the following:

1. Trade and Investment Programme (TIP), controlled by USAID and the Ministry of Finance; and
2. Private Enterprise and Export Development Fund (PEED) operated by Bank of Ghana but administered through banks

Mensah (2004) observes that some donors have implemented lending programmes directly with financial institutions which include the following:

i. Small Business Loan Portfolio Guarantee (USAID);
ii. European Investment Bank Facility;
iii. Care-Technoserve Fund for Small Scale Enterprises;
iv. DANIDA SME Fund;
v. GTZ Fund for the Promotion of Micro and Small Enterprises;
vi. SECO SME Financing Scheme; and
vii. FMO SME Financing Scheme

Furthermore, Oikocredit, an international NGO operates SME lending programmes through a local office and lends directly to the target group.

In a report by the United Nation Conference on Trade and Development (UNCTAD) meeting in 2002, the problems of banks failing to lend to SMEs were given as follows:

1. SMEs are regarded by creditors and investors as high-risk borrowers due to insufficient assets and low capitalization, vulnerability to market fluctuations and high mortality rates;
2. 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 SME proposals;
3. High administrative/transaction costs of lending or investing small amounts do not make SME financing a profitable business.

However, Tagoe, Nyarko and Anuwa-Armah (2005) have indicated that there has been a number of trends in the financial services industry that are forcing banks to have a closer look at the SME markets. Also to develop mechanisms to improve the profitability of lending to SMEs.

2.4.3.2 Reasons why banks do not lend to SMEs

According to Abor (2000), while the banks are definitely more qualified to talk about lending to SMEs, it is a widely held view that banks, particularly commercial banks, have difficulties in financing start-ups and SMEs in spite of the significant number of SMEs. In addition, SMEs dominate economic activities and make a very significant contribution to GDP.

Aryeetey *et al*. (1994) outline some of the reasons why banks are reluctant to lend to SMEs:

- Limited branch network
- Limited range of financial instruments and lending conditions

- Banks' risk-averse behaviour; preference for investing in Treasury bills
- Non-performing assets, which make the banks too cautious to undertake further lending
- Lack of established information network such as a credit reference bureau for tracking defaulters
- Weak inter-bank collaboration
- Banks' inadequate capacity to appraise the creditworthiness of SMEs

2.4.3.3 Factors that banks consider when financing SMEs

According to Abor (2000), banks require cash flow forecast and budget before considering any financing proposal. If customers are unable to produce these themselves, banks usually look out to accountants to assist them. Once those documents are produced, the bank then question assumptions behind them.

Abor (2000) argue that lack of historical sales data then makes it difficult to verify whether the sales targets are realistic and therefore bankers face the difficulty to distinguish between impressive-looking documents produced and designed to maximize the chances of obtaining a loan and the underlying soundness of the lending proposition.

Black and Strahan (2002), also argue that, it is ironic that cash flow forecasts are always positive and therefore it would be prudent for bankers to be skeptical of these forecasts unless they are supported by recent actual performance.

Love and Mylenko (2003) outline the following evidence that is generally required by banks in their lending decisions.

(a) *The ability and integrity of the proprietors of the business:*

- How long have they had a relationship with us?
- Do they have a track record with any other bank or with us? Why are they coming to us?
- Has the account been satisfactorily conducted?
- What is their reputation in town?
- What experience do they have in running a business?
- What is their personal commitment to the business? How much is their stake?

(b) *The availability of physical and production resources:*

- Are the premises of the right size and in a good location?
- Is the machinery in good condition? How old is it? Maintenance record?

According to Husain (2005), many small scale firms are owner- or family-operated, and as a result, they do not keep business and personal finance separate. Thus, when a family problem appears, such as school fees for a relative's child, inevitably the cash for the business is used.

This means that while one immediate problem is solved, a potential future cash flow problem for the business ensues. He adds that there is a need for trust between a banker and his customer. He suggested that, one approach to mitigate the high degree of uncertainty that surrounds small business lending is to insist on 'good' security in all cases.

Tagoe, Nyarko and Anuwa-Armah (2005) asserts that, banks see SME lending as a high-risk activity, given the larger proportion of business failures in this sector. As a result, they will inevitably charge a higher risk premium. They suggested that, the price to some extent could be mitigated depending on:

- The level of capital that the owner has in the business
- The degree of profitability
- The extent to which profits remain in the business
- The value/desirability of security offered

2.5 Success of Existing Schemes

According to Mensah (2004), SME financing in Ghana has not been effective. He cited the following reasons as factors accounting for their ineptness:

1. Sufficiency of the institutional framework
2. Regulatory Framework
3. SME Managerial Capacity and Lack of Training

As Kayanula and Quartey (2000) put it, 'we cannot say the same thing about the financial resources used to run a business'. According to them, the acquisition of financial resources leads to contractual obligations. They assert that the idea that financing agreements create a contractual, responsibility means that the supply of financing to businesses depends on whether contracts can be designed to create the appropriate incentives for both the supplier and user of the funds. This is called the principal agent problem.

In business financing, the principal is the supplier of funds and the agent is the user of funds (Dawson, 1993). He added that, the perfect contract is one that stimulates the agent to act in the best interests of the supplier of funds. If such contracts can be made, the supply and demand for funds will be brought into equilibrium since there is a mutually beneficial agreement between the supplier and user of funds.

Mensah (2004) also identified that there is also a problem of adverse selection. He explains that this relates to the information requirements of a lending contract. Thus, for a lender to make a well informed lending decision, he needs information about the borrower's financial situation, their assets and liabilities and character indicators that would give the lender the assurance that the loan would be paid back.

Nevertheless, Abor (2000) believes that the borrower has the reason to conceal all negative information from the lender. For instance, the borrower may not have the assets that she claims to have; or the success of the business that she runs may be less rosy than the picture she paints to the lender. When the potential borrower knows more about her exact finances than the lender, negative information which is significant to the lending decision is not revealed and the lender is exposed to the risk of selecting borrowers with a high credit risk (Mensah, 2004). He goes further to explain that in the absence of opportunities for scrutinizing borrower actions and for confirming the information provided by borrowers, there might be situations where borrowers either pull out from the market or lenders impose borrowing conditions which are difficult for most borrowers to comply.

The contracting problem described by Mensah (2004), is not limited to loan financing. To him, investors who make funds accessible to businesses by acquiring shares are also in a contractual bond which entitles them to partake in the profits of the business. Undoubtedly, their wishes are best served when the managers of the firm take actions that maximize the returns to shareholders.

Mensah (2004) further suggests that since the shareholder is not capable of keeping an eye on all management dealings, the manager may take unnecessary risks or pay himself a fat salary when the shareholder is not looking. The trust with which investors would have held shares are therefore affected by the confidence that they have in the available monitoring systems. He argues that the means of monitoring include audit systems and timely and truthful financial statements and the problems of moral hazard and adverse selection are predominantly found in Ghana.

Guiso, Sapienza and Zingales, (2004) also argue that an important condition for a well-organized financial system is that there should be readily reachable information about participants in the system. The unavailability of such information creates moral hazard and adverse selection costs that can give rise to credit markets failure. Market failure is seen in the reluctance of lenders to extend credit at any price. Creditworthy borrowers are kept out of the market.

According to Mensah (2004), in economies with advanced credit markets a host of resources have been put into the establishment of infrastructure for collecting, storing and retrieving information about participants in the financial system. He argues that the lack of such identification system in Ghana has been a major issue in the low level of credit market development. He also asserts that cultural beliefs that are in conflict with the information and monitoring requirements of formal financial contracts also affect this system.

2.6 The Impact of Venture Capital Financing on SMEs

According to Manigart et al. (2002), venture capital is thought to be an important alternative for companies that have difficulties accessing more traditional financing sources and it (venture capital) is a strong financial injection for early-stage companies that do not have evidence for persistent profitability yet.

Reynolds (2000) asserts that venture capitalist needed to trigger, maintain and to speed up the small enterprise's growth and its performance, and therefore to result in improved profitability. Thus, its primary role: it is the main contributor in getting rid of the most financial impediments that occur in the establishing phase of a new business. Nevertheless, it is 'seed money' for the small business; it helps smart ideas to rise up.

Mason and Harrison (2004) claim that venture capital financing is associated with high levels of risk, which refers to the uncertainty of the positive returns that may occur even after a number of years or never. Not only this, but venture capitalist may also embark on a new business strategy which defers from entrepreneur's one; the former can even throw the entrepreneur out of the firm.

Mason and Harrison (2004) argue that venture capitalists invest only in promising projects. At the very beginning, investors are deeply skeptical, bad mood reasoning with more answers 'no', rather than 'yes'. Baeyens and Manigart (2003) assert that venture capitalists screen potential investments in regards to the collecting information about business, its market approach, management team or entrepreneur, all in order to reduce the initial information asymmetry and potential problems with entrepreneurs. In other words, before final contracting, venture capitalist spends much of his time and efforts in assessing and observing the opportunity, in terms of its market size, strategies, customer adoption etc. (Kaplan and Strömberg, 2001). This, in turn, should eliminate the possibility to access a non-quality project (adverse selection problem) and should ensure that the funds will not be diverted to fund an alternative project (moral hazard problem) (Berger and Udell, 2002). In this phase of initial scanning, investor should be convinced that his money will not simply 'evaporate'. Instead of that, it should make future value for him.

According to Hellmann and Puri (2002), it can be inferred that, once the investor introduces its money in a business, he must devote much of his time in helping the business to succeed, structuring internal organization and appropriate human resources management. In other words, venture capitalist's help and adding-value are decanted in professionalization of the firm. By and large, it seems that firm's professionalization is the major benefit from the venture capital financing.

Hellmann and Puri (2000) offer good explanation of the process of professionalization. Besides above mentioned features, they point out the speed of developing and bringing ambitious product to the market by venture backed companies. This is crucial to achieve market leadership, especially among innovative firms. Venture backed companies are, in fact, found to pursue more radical and ambitious product or process innovations than other companies.

Gans and Stern (2003) found that venture capital financing strongly impinge on firm's innovation, patenting processes and the influx of technological opportunities. This is the unique way to extract the social significance of an innovation. Hence, triggering innovations, along with the firm's professionalization, is another valuable feature of the venture capital funding.

Besides many features provided by the venture capitalist discussed above, venture capital has one more important attribute: providing credibility, it attracts new funding. Baeyens and Manigart (2003) explain this by the fact that, through screening, observing and value-adding, venture capitalists reduce the information asymmetries and financial risks, and therefore adjoin legitimacy to the venture backed company and consequently influence on further financing. The last is an admirable fundament for further expansion of the firm. This, in turn, spurs the growth and development of entrepreneurship in the national economy in general.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The study is aimed at accessing the impact of venture Capital financing on Small and Medium Scale Enterprises in Ghana with the focus on ELSA Foods Limited. To achieve this, the study adopted qualitative and quantitative approach in soliciting both Primary and Secondary data sources for the successful completion of the thesis.

3.2 Scope of Study

3.2.1 A brief History of Elsa Foods Limited

Elsa Foods Limited is located at Kpone off Tema-Akosombo highway. It was borne out of an Enterprise registered in 1978 to produce Pasta products at a time when Ghana was witnessing shortages of almost all essential commodities. The Enterprise was temporary closed when main input for the pasta production wheat flour was unavailable. However in 1988 the business was reactivated to keep the name on the local market. In 1994 the Enterprise was incorporated into a Limited Liability Company to produce the current flour products. The flour products include Fula, Plantain Fufu, Yam Fufu, Cocoyam Fufu, Hausa Porridge, Fortified Tom Brown, Cowpea Flour. Elsa also engages in the processing of other food products including Red Palm Oil, Agbelima (Cassava Dough), Banku Mix, Snow White Kokonte and Tuo Zaafi. Elsa ensures these products are manufactured under strict hygienic condition. The diversification came as a result of lack of preservation of most agricultural farm produce and its resultant post harvest losses.

3.2.2 Management Structure of Elsa Foods

Elsa Foods Limited is ably managed by Mrs. Elizabeth Maldini as the Managing Director and she is supported by Mr. Maldini as a Director. They have been in the business for over 20 years and hence acquired rich experience in their line of business.

3.3 Research Methodology

3.3.1 Research Design

The study focused on SME based in Accra. The study was limited to ELSA Foods due to the increase in the size of the organisation. The study area was also limited to an SMEs in Tema because of information sourcing challenges as some SME managers were unwilling to give out financial information. The problem of inadequate and proper keeping of information by some SMEs also placed limitations on the research area. The research area seemed feasible because of time and cost constraints. To capture the type of SME's a survey approach was adopted. This involved a cross sectional study of SMEs in Tema

3.3.2 Sampling

The study sample is defined as located in Tema. Two groups of SMEs were used in the study. Data was collected from 50 SMEs. The method of sampling was based on convenience sampling. This purpose was to select firms based on their availability for the study

3.3.3 Survey Instrument

- Primary Source of Data

Primary data were gathered through the administration of questionnaires to owners, director(s) and middle management employees of the organisation. The researcher conducted the survey with aid of questionnaires.

The main reason for using questionnaire lies in the quality of the data obtained. Unambiguity was reduced and a better rate of return of the interviews was achieved.

Structured and unstructured questionnaires were used to elicit responses from respondents. The structured part will be used in order to present the respondent with fixed set choices whiles the unstructured will sought to encourage respondents to share as much information as possible in an unrestricted manner.

Face to Face interviews and personal observations were also used to solicit information from the organisation.

- Secondary Source of Data

The secondary data helped the researcher to gain more insight into existing literature on venture capital financing. The secondary data included financial statements, financial plans, strategic plans, internet sources, newspapers, journals, financial institution reports, quarterly bulletin and other relevant collateral materials from venture capital trust fund.

3.3.4 Analysis of Data

Data for the analysis were extracted from the field survey carried out by the researcher. The analysis for the collected data was done using Microsoft Excel 2003 and results are presented below

CHAPTER FOUR

RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter presents the discussion of results of the data obtained during the survey of SME customers. This highlights funding from financial institutions, other sources of funding, and the SME managers' views on venture capital as an alternative source of funding. A total of 50 questionnaires were given out. Out of which 40 respondents administered and return their questionnaires. It gives vivid characteristics of SME respondent firms in Tema and no efforts were spared to boost the response rate of the survey and interview. The researcher adopted frequency counts and percentages as main statistical techniques for the interpretation of data.

4.2 Findings

4.2.1 The Case of Elsa Foods Limited

The revelations from the study date as far as the company's incorporation in 1994. Elsa Foods Limited has been able to raise funds from the two main categories of finance. The shareholders of the company consist of Family members and Venture Capital. It was revealed that Venture Capital had 45% stake in their business. The firm mainly acquire funds mainly through family/personal financing and occasionally accessed loans or overdraft facilities from banks.

The table below shows that the analysis was done in terms of total amount targeted and amount raised. In all instances to date, the firm could not raise 50% of its financing needs (see Table 2). In all the years considered for this analysis, the ratio was less than the amount required by the firm. This suggests that the majority of financing is through other means.

Table 2: Amount of Finance from Financial Institutions for the past 5 Years

Year	*Amount Expected (GH¢)*	*Amount Raised (GH¢)*
2003	150,000	50,000
2004	200,000	100,000
2005	350,000	150,000
2007	400,000	200,000
2008	500,000	250,000

Source: Firm's Annual Report; 2003-2008

It was further observed that over the years the company had made 15 enquiries about financial assistance from financial institutions. However on 8 occasions, the firm was either discouraged from accessing financial assistance or the success rate of applications appeared quite low.

They could associate the key constraints in accessing financial assistance to financial lenders because of conditions attached to lenders' methodologies used by the banks and other recognized financial institutions.

In the case of acceptance, they were asked whether they had received the loans amount they requested or wanted. These are the responses:

a. Fully constrained: either applied and were rejected or did not apply due to:

- Insufficient collateral or the ability to document sufficient asset holdings to secure the loan;
- High transaction costs, i.e., the costs of obtaining property titles, compiling enterprise projects or paying other loan fees made the effective cost of the loan prohibitive; and

- Fear of risk, specifically the loss of their wealth prevented them from pursuing a loan.

b. Partially constrained: Received a loan but for less than requested or wanted given the loan terms; and

c. Unconstrained: Either received full loan amount or had no interest in a loan.

The study also explored other financing options by the firm. The study asked about the firm's awareness of other sources of finance, and whether it has applied for them in relation to their business activities within the last three years. Surprisingly, there is a relatively high awareness of other sources of finance employed by the respondent firm. The findings contained in Table 3 shows the firm reliant on the other sources of funding. While the savings of the founders remains the dominant source of initial capital, the proportion of the business dependent on such funding fell from 50 per cent in the initial establishment to 30 per cent of the current financing level.

Table 3: Sources of Initial Financing of the Firm (Percentages)

Main source of initial funding	*Initial Establishment Financing*	*Current Level of Financing*
Founder's own savings	50	14
Founder's immediate family	30	10
Profit retained	17	30
Venture Capital	-	45
Other main sources	3	1

Source*: Elsa Foods Ltd*

The study evidence relating to the on-going financing preferences of the firm is also set out in Table 3. The financing preferences at the onset are constrained towards owners' equity (personal savings). As expected, retained earnings featured as a prominent source of internal funding in the current level of financing. The firm is currently retaining most part of its profits compared to initial establishment of the organisation. These intended retention rates have also to be considered in the light of the rather modest growth intentions of the firm. These show the preference to internalise the financing of the firm.

The firms level of awareness with respect to informal source of financing remains relatively low. However, when the need arose to raise cash quickly there is preference towards short-term debt.

Initially the firm simply preferred to have all of short term debt-laden business rather than merely relinquishing some control over its operations. Hence they receive these short -debt financing from Ecobank Ltd and occasionally relied on suppliers credit.

Other financing options exploited by the firm include funding from the Government of Ghana and the African Development Foundation. This still remained inadequate to support the company's growth.

Though initially the firm demonstrated an aversion to raising equity financing it was still the last resort to support the firm's growth and expansion stage.

The firm therefore considered Venture Capital and explored that option. The age of a business and its potential to succeed was an important factor that led to the successful application of Venture Capital. Although their pre-investment views may have been colored by perceptions in Equity Financing, Venture Capital Financing has impacted positively on their business operations

Benefits of Venture Capital Fund to Elsa Foods Ltd

Elsa foods Ltd confirmed that expansion and growth of the firm would not have been possible without venture capital financing. The Firm activities changed as a result of venture capital financing in terms of improved cost efficiency, thus good financial management, improved product quality and internationalisation and introducing new goods on the market.

Specifically Elsa Foods Limited can now boast of:

- The availability of adequate working capital for production and storage facilities needed for raw materials during harvest season
- Improved retooling efficiency and increased capacity
- Increased financial leverage of the company
- Recruitment of Qualified personal which has enhanced efficiency and rapid growth
- Various permits and license required by respective authorities to ensure that they are in compliance with statutory provision
- Additionally new and improved products specifics such as Fortified Swety Gari and Fufu range which are now being exported

The firm stated that the pre-investment requirements of Venture Capital Financing were strenuous mainly because of Processes and Procedures involved in terms of Analysis, Evaluation and due diligence which could discourage a potential SME.

4.3 Profile of other Respondent Firms

An Analysis of the sample and respective response rate of SME's is given below.

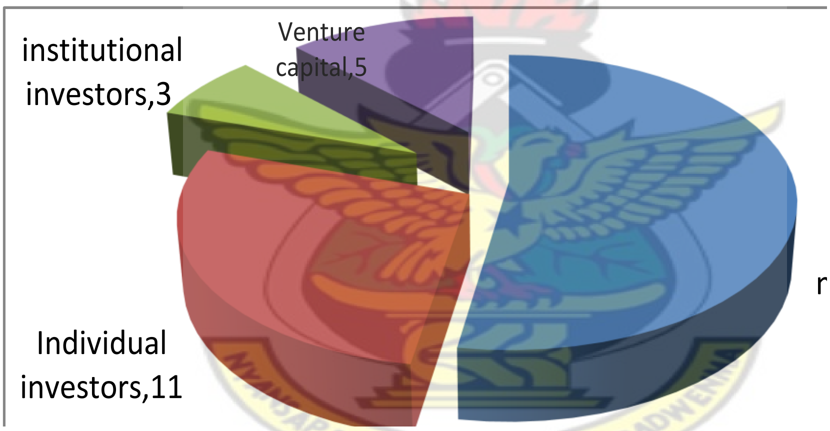
4.3.1 Ownership structure of Small and Medium Enterprises

Table 4: Shareholders/ Owners of SME's

SOURCE	NOS	PERCENTAGE
Family members	21	52.5
Individual Investors	11	27.5
Institutional Investors	3	7.5
Venture/ Private equity fund	5	12.5
TOTAL	**40**	**100**

Source: *Field Data, 2011*

Figure 5: Shareholders/ Owners of SMEs



Source: *Field Data, 2011*

The research investigated into the ownership/shareholder ship structure of the SMEs. It revealed that the firms were made up of 52.5% family members. 27.5% composed of individual members, 7.5 % institutional investors and 12.5 % had venture capital financing having a stake in their business. This depicts that most SME's use their own family resources to setup their businesses coupled with other forms of investments

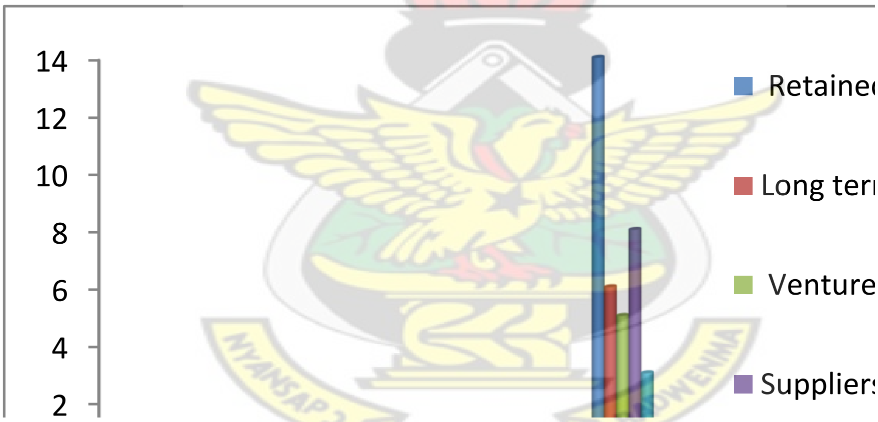
4.3.2 SMEs Sources of Financing

Table 5: SMEs main source of long term assets financing

SOURCE	NOS	PERCENTAGE
Retained earnings	14	39
Long term loan	6	17
Venture Capital	5	14
Suppliers Credit	8	22
Stock market / Capital market	3	8
TOTAL	**36**	**100**

Source: Field Data, 2011

Figure.6 SMEs main source of long term assets financing



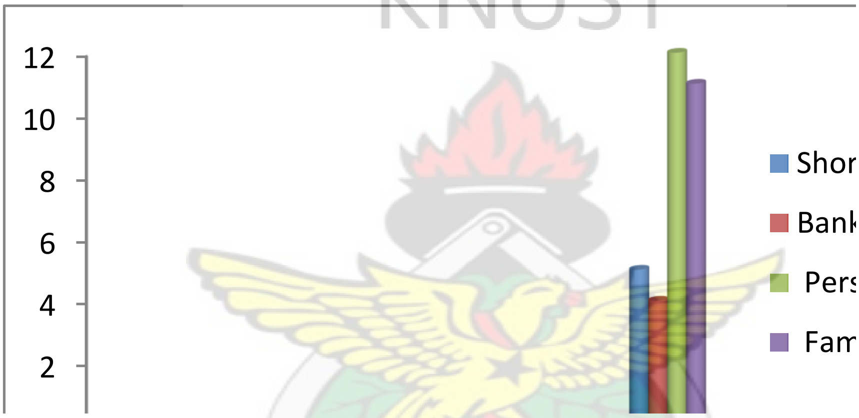
Source: *Field Data, 2011*

Table 6: SME's Short term Assets financing

SOURCE	NOS	PERCENTAGE
Short term loan	5	15.6
Bank Overdraft	4	12.5
Personal Funds	12	37.5
Family Funds	11	34.4
TOTAL	**32**	**100**

Source*: Field Data, 2011*

Figure 7: SME's Short term Assets financing



Source: *Field Data, 2011*

Start-up capital is one of the major problems facing SME's in Ghana. Since incomes levels are low and most people have not been build up savings on their own starting a new economic venture becomes an arduous task. This is where access to funding from financial institution becomes important. Some firms contacted provide information about the sources of funding (Tables 6&7).

The table 6 indicates that majority of firms (39%) obtained their long term assets financing investments through Retained earnings. 17% through long term loans, 14% through venture Capital Financing. About 22% of firms indicated financing through supplier's credit and only 8% through stock market/ Capital market. In terms of short term financing majority of the financing came from personal and family funds representing 37.5% and 34.4%. Only 15.6% of Short term loan and 12.5% of Bank Overdrafts were accessed from Financial Institutions by SMEs.

SMEs indicated other sources of financing from Foreign Partners, NGOs, Factoring and invoice discounting, Hire purchase and leasing and that financing does not come from only ones source, but from a combination of other sources. Some SMEs further stated that in relation to the banks, they were constrained in accessing financing because they could not fulfil the requirements had no interest in banks because business was bad and some said they were asked to join an association before getting the loan.

Some SMEs do not want others to know about their financial difficulties and would therefore not go for financial assistance. Others felt the interest charged was too high. Others felt if they go for loan, they may not be able to pay it.

Emphatically, some SMEs owners lamented that in the past they had depended on short term debt to operate their business which created a financial haemorrhage, depleting their assets and leading to the eventual collapse of their businesses.

Other Alternative Source of Financing:

The research also shows the awareness of a number of different types of potential alternative funding opportunities. It was revealed that some SMEs level of awareness with respect to other informal sources of financing remains relatively low. Awareness is particularly low for co-operative and associations that provide small loans for small businesses. Some of the firms were aware of microfinance organisations such as Boafo Microfinance and Sinapi Aba as providing small loans to small organizations; however they indicated that they did not explore those options. This could be attributed to SMEs attention to securing loans or financial assistance from formal banking sources.

In general information gathered from the research that financial institutions were not supportive in granting loans to SMEs because.

- SME's rarely have a long history or successful track record that potential investors can rely on in making an decisions;
- Larger companies (particularly those quoted on a capital market) are required to prepare and publish much more detailed financial information – which can actually assist
  SMEs in their finance-raising process;
- Banks are particularly nervous of smaller businesses due to a perception that they represent a greater credit risk. Because the information on SMEs is not readily available in other ways, SMEs only resort to providing financial information when they seek finance. They will need to give a business plan, list of the company assets, details of the experience of directors and managers and demonstrate how they can give providers of finance some security for amounts provided.
- Prospective lenders – usually banks – will then make a decision based on the information provided. The terms of the loan (interest rate, term, security, and repayment details) will depend on the risk involved and the lender will also want to monitor their investment.

- A common problem is often that the banks will be unwilling to increase loan funding without an increase in the security given (which the SME owners may be unable or unwilling to provide).
- A particular problem of uncertainty relates to businesses with a low asset base. These are companies without substantial tangible assets which can be used to provide security for lenders.
- When an SME is not growing significantly, financing may not be a major problem. However, the financing problem becomes very important when a company is growing rapidly, for example when contemplating investment in capital equipment or an acquisition.

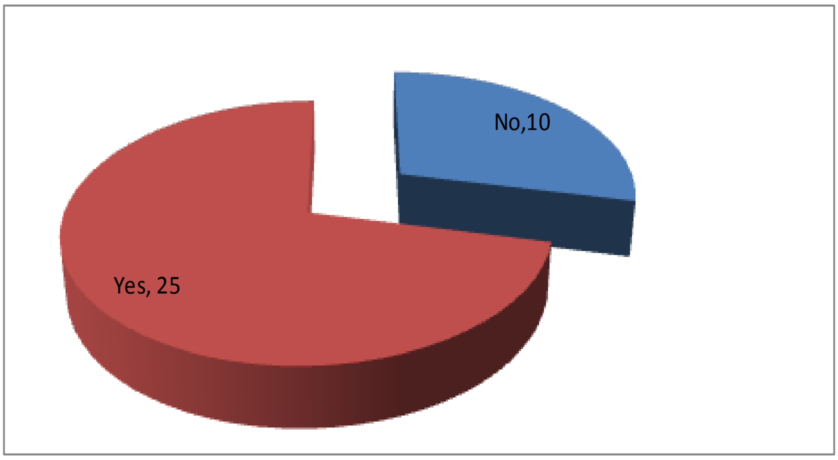
4.3.3 SMEs Awareness of the existence and requirements of Venture Capital Financing in Ghana

Table 8: Awareness of existence and requirement of Venture Capital Financing

RESPONSES	NOS	PERCENTAGE
Yes	10	29
No	25	71
Total	**35**	**100**

Source: *Field Data, 2011*

Figure 9: Awareness of the existence and requirement of Venture Capital Financing



Source: *Field Data, 2011*

SMEs were also asked if they were aware about the existence and requirements of Venture Capital Financing in Ghana. Responses from the firms suggested that 71 % have little or no idea about Venture Capital Financing for SMEs. Only 29% of the firms were aware of the existence and requirements of Venture Capital Financing. This point out a low level of awareness on Venture Capital Financing as a source of financing to SMEs.

This was attributed to the low level of publicity by the Venture Capital Finance Companies and the Government. This could be achieved through Television, Radio and Print media Programs, workshops and seminars to educate the business community on the attributes and advantages of venture capital financing. This would sensitize business operators and create awareness of the existence of alternative source of financing their business other than debt

The researcher gathered that SMEs that were aware of venture capital did so through other SMEs and few articles about venture capital financing they read in the newspapers. Some of the requirements they stated include Audited Financial Reports for past three years where applicable, Tax Clearance Certificate and Incorporation Papers

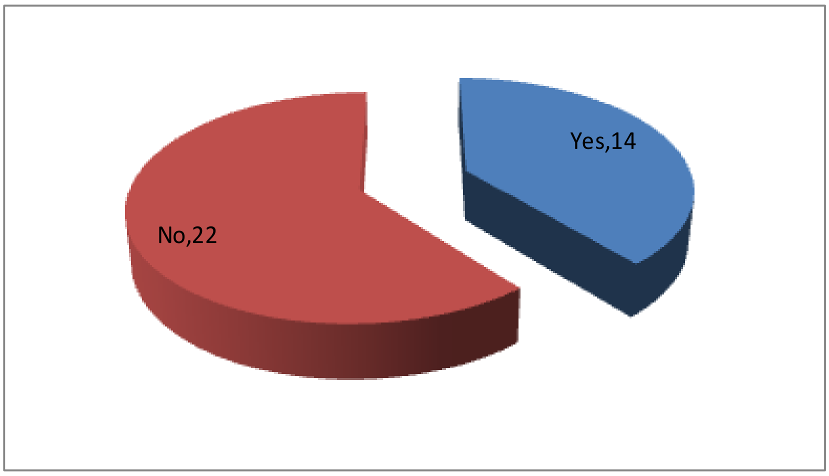
4.3.4 Application for Funding for Venture Capital Financing by SMEs

Table 10: Application for Funding for Venture Capital Financing by SMEs

RESPONSES	NOS	PERCENTAGE
Yes	22	61
No	14	39
Total	**36**	**100**

Source: Field Data, 2011

Figure 10: Application for Funding for Venture Capital Financing by SMEs



Respondents who were aware of Venture Capital Financing were asked whether they had applied for venture Capital Financing. 61% pointed out that they had applied for this means of financing and 39% however had not applied.

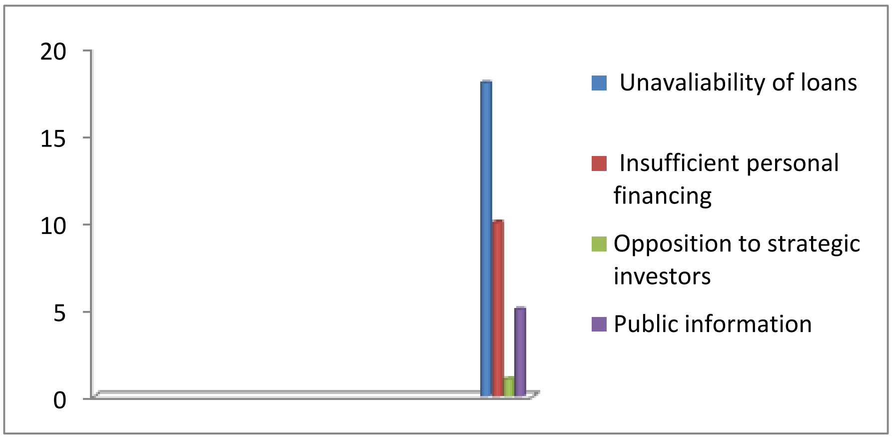
4.3.5 Motivation and Choice for Venture Capital Financing

Table 11: Motivation and Choice for Venture Capital Financing

RESPONSES	NOS	PERCENTAGE
Unavailability of loans	18	53
Insufficient Personal Financing	10	29
Opposition to Strategic Investors	1	3
Public Information	5	15
Total	**34**	**100**

Source: *Field Data, 2011*

Figure 11: Motivation and Choice for Venture Capital Financing



Source: *Field Data, 2011*

The study asked why the firm chose venture capital at some point compared to other forms of finance. 53% of the respondents indicated that it was due to unavailability of loans or lack of financial support from financial Institutions. 29% revealed that further financing through their owners had been either being impossible or insufficient. 3% of the respondents revealed that the firm was generally opposed to any types of strategic investors. Finally, public support programmes were considered attractive and accessible, but insufficient in meeting the firm's current capital needs.

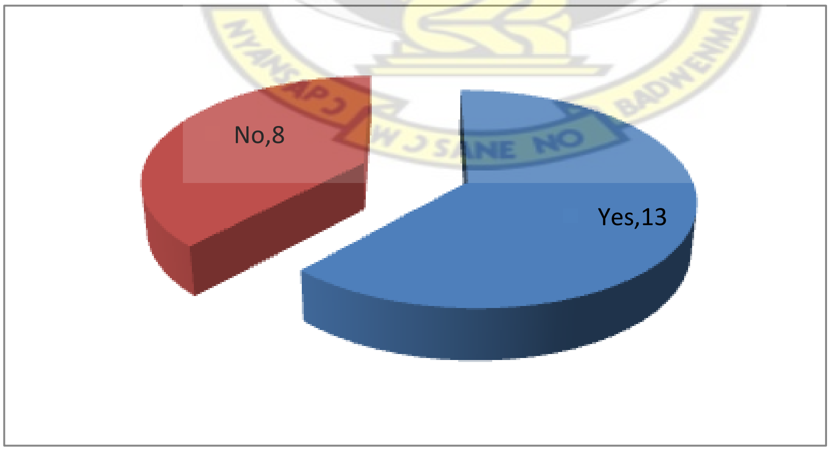
4.3.6 Rate of Success in raising funds from Venture Capital Fund

Table 12: Rate of Success in raising funds From Venture Capital Financing

RESPONSES	NOS	PERCENTAGE
Yes	13	62
No	8	38
Total	**21**	**100**

Source: *Field Data, 2011*

Figure 12: Rate of Success in raising From Venture Capital Financing



Source: Field Data, 2011

Respondents who had applied for Venture Capital Financing were asked if they were successful. 62% of them were successful and 38% were unsuccessfully. This indicates that almost half of SMEs were not successful due the strenuous measures associated with the process. Moreover they indicated that documentation, evaluation, due diligence process and the type of business could also have been a contributing factor. The unsuccessful SMEs also attributed their failure to lack of a strong business concept with strong market growth potential, and a strong management team and the inability to demonstrate past successes in similar businesses.

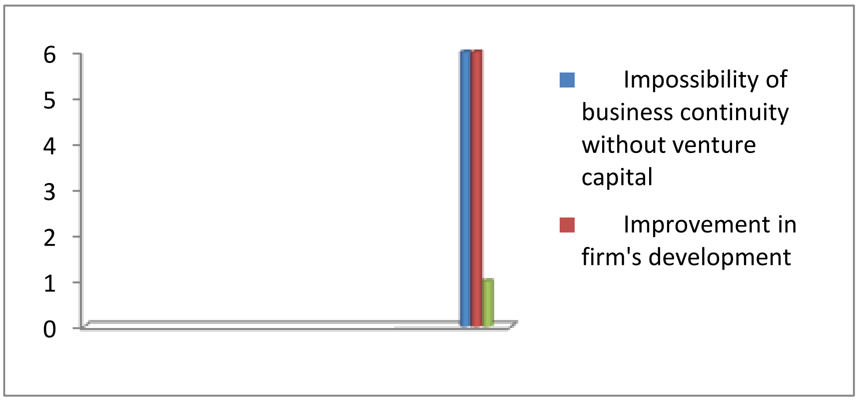
Fig 4.3.7 Impact of Venture Capital Financing on SMEs

Table 12: Impact of Venture Capital Financing on SMEs

RESPONSES	NOS	ERCENTAGE
Impossibility of business continuity without venture capital	6	46
Improvement in firm's development	6	46
No change in firm's development	1	8
Poor development in firm after Venture Capital	0	0
Total	**13**	**100**

Source: *Field Data, 2011*

Fig 12: Impact of Venture Capital Financing on SMEs



Source: *Field Data, 2011*

The study was conducted to find out whether Venture Capital had impact on their businesses.46% respondents firms stated that it was impossible for their businesses to continue without venture capital and also improved on their firm's development. 8% of respondents indicated that Venture Capital Financing had little or no improvement on their businesses.

It was also revealed that the firm's growth improved as a result of venture capital.

4.3.7.1 Benefits of Venture Capital Fund to Respondent firms

The study also asked managers specifically what kinds of firm activities changed as a result of venture capital financing (Table 13)

Table 13: Benefits as a result of Venture Capital

Category	Rank
Existence, seed/start-up and expansion	1
Employment	2
Growth strategies	3
Comparism with competitors	4
Financial management	5
Diversification of products	6
Sales territory	7
Production innovation	8
Organisation and human resources	9
Product quality	10
Customer service	11

Source: *Field Data, 2011*

The responses of the venture-backed companies prove that venture capital investment is crucial to the existence, feasibility and success of businesses in the seed/start-up and expansion stages.

The creation and growth of these young companies has also had a significant impact in terms of new employment opportunities.

Investee companies use venture capital investment funding to implement a range of growth strategies. The survey shows that increased expenditure on research and development, marketing and training has resulted in significant improvements in turnover and profitability.

Over half the respondents considered that their performance in the post-investment period had been significantly better than that achieved by their competitors. The perception some companies was that the growth in their Earnings before Interest and Tax (EBIT) had been either the same as or greater than that of their competitors

Financial management was named as the most important area of change, followed by the development of three typically growth-oriented strategies: expanding the variety ('diversification'), geographical sales area ('internationalisation') of existing products and introducing new goods and services ('product innovation'). Conversely, the managers thought venture capital financing had had comparatively little impact on cost efficiency, product quality and measures to protect the firm's intellectual property.

Respondents were again asked to name the advantages derived from endorsement of venture capital. The firm had initially contacted prospective corporate investors because they foresaw a number of potential advantages to be gained from venture capital finance when compared with other forms of external equity financing. These advantages are largely related to the perceived objectives of the organization. Although their pre-investment views may have been colored by subsequent experience, the firm had typically believed that investors with strategically-oriented motives would provide valuable nurturing for the firm. The firm already had an established business relationship with the investing company prior to venture capital negotiations.

As was anticipated by the firm prior to its receipt of venture capital finance, the benefits of venture capital to the firm was to be more than just financial (Table 13). The research indicated the advantages of this form of funding over more conventional sources of external equity finance.

Table 14: Additional Benefits for Investee Firms that have arisen as a result of Venture Capital Finance

Category	*Rank*
Strengthening of vertical relationships	1
Access to corporate operational expertise	2
Opportunity to establish further business relationships	3
Extra production/research & development support	4
Access to corporate marketing/distribution networks	5
Lower performance targets	6
Access to corporate technical expertise	7
Credibility	8
Access to corporate management expertise	9
Help with short-term problems	10

Source: *Field Data, 2011*

While the firms did outline advantages associated with pricing and more realistic performance targets, they placed particular emphasis on the credibility which they had gained from their links with major multinational corporations, the help that they have obtained with short-term problems, their access to management and technical expertise, and also to the markets and distribution channels of investing companies. These benefits illustrate the importance of corporate investors in providing the firm with operational, technical and marketing expertise and financial resources. As venture capital providers typically offer different types of value-added contribution, usually involving managerial and financial advice rather than technical assistance, these findings indicate the potential complementarity of venture capital and other external equity sources for SMEs.

While we have observed that VC-financed firms have lower average probabilities of failure, it is possible that venture capitalists are able to sell their poor performers to other companies due to their connections or natural synergies with potential acquirers, whereas non-VC-financed firms simply must shut down

Venture Capitalists invest in firms with ideas and with no immediate revenues that require large initial investments. We find that firms born with no commercial revenues are disproportionately financed by venture capital.

4.3.7.2 Limitations of Venture Capital Financing to Respondent firms

Some of the limitations SMEs in Venture Capital financing outlined were

- To be successful acquiring this form of equity financing, you usually need to have a strong business concept with strong market growth potential, and an exceptionally strong management team that can demonstrate past successes in similar businesses.
- Conflicts of interest arising in terms of decision making in the business
- Strenuous measures associated with the process in terms of documentation, evaluation, due diligence

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Summary of Findings

In summary the study conducted determined various source of financing available to SMESs their perception and Impact of Venture Capital Funding as alternative source of funding. A number of issues were identified through the survey with the aid of a questionnaire. Face to face interviews and personal observations were also made on with SME owner/managers in relation to their sources of finance, preference for financing, awareness of venture capital funds, requirements needed to source Venture Capital Funds and intention to source funds from venture capitalists.

The study further chronicles other alternative means financing to SMEs. For instance, while some respondents indicated most of their funding was from personal sources, friends and relatives and retained earnings, others pointed out that occasionally they received support from financial institutions such as the bank. The respondents however added that they found it much difficult to obtain financing from these financial institutions due to the conditions and requirements needed to assess financing. The study consequently suggests that SMEs prefers self-financing, because it is less expensive relative to commercial loans. They remained much skeptical and considered them as high risk borrowers.

The findings also further assert that the SMEs continue to rely on many financing options, both at their conceptual and expansion stages. Moreover, there may also be intermediate solutions in which the firm opts for a mix of sources of finance: self-financing, short or long term debt and, in some cases, equity.

Some SMEs benefited from the patience and understanding of corporate investors and the relatively high valuation of their equity. Moreover, SMEs gained credibility in the marketplace, access to management and technical expertise, and marketing and distribution channels. These non-financial value-added aspects of direct venture capital suggest the complementarity of this form of investment and other, more conventional forms which offer the benefits of more financially-oriented advice and management expertise. On the few occasions when investees did experience value-added, it took the form of technically-oriented advice and credibility, as was the case with direct investment.

There is likely to be a strong link between perceptions and behaviour regarding use of venture capital funds as suggested by the theory of reasoned action. The results suggest that there are many areas concerning venture capital that SME principals are uncertain about. It is clear SME principals know the importance of 'investment determinants' such as the personality and drive of the business owner, and the need for the owner to provide quality information and to have a business plan.

Though few of SMEs respondents remained optimistic about venture capital financing most them were 'uncertain'.Though this level of uncertainty would suggest that it is unlikely local SMEs would utilise venture capital above other sources of finance. It would also seem that in order for SMEs to be comfortable with using venture capital they require much more information in a number of areas. SMEs and their advisors particularly need information about the level of risk associated with venture capital, that is, they must be convinced that venture capital involves no more risks than other forms of finance. Clearly much more education is needed before venture capital will be utilised by local SMEs.

5.2 CONCLUSIONS

Several conclusions could be extracted from the arguments that have been advanced.

Firstly, deep pre-screening process should be performed before investing in small, start-up business since a well performed initial scan ensures good investment.

Capital inflow is accompanied with the process of value-adding which provides the company with monitoring, skills, expertise, help and, basically, reputation for attracting further finance. Although findings in the last section show that venture capital funding is related to strengthened control, potential conflict of interests and founder replacement from the top manager's seat, Venture Capital remains crucial factor for spurring innovations, enhancing growth opportunities, especially for the small and medium-sized enterprises and therefore, creating new jobs. The latter are enough reasons for every national economy to take care for the venture capital financing as proven chance for the realization of smart ideas.

5.2.1 Practical Implications

The study has important implications for stakeholders in the SME sector. To be successful in acquiring this form of equity financing the following should be observed

- Good information management and the ability to use information to present a well-crafted business case for financing reduces risk perception
- The need to have strong business concept with strong market growth potential, and an exceptionally strong management team that can demonstrate past successes in similar businesses.
- SME umbrella associations and SME assistance organizations should help SMEs to source funds from venture capital. The EU-BAS assistance to procure consultancy services is a step in the right direction, as is the Africa Project Development Facility (APDF) of the World Bank.

5.3 Recommendations

In view of the findings, a number of recommendations are made for further action to be taken in support of SME Financing

5.3.1 Small and Medium Enterprises

- SMEs need to recognize the potential advantages of seeking external equity finance from corporate sources. Corporate investors can therefore become very important assets for SMEs both financially and strategically as they provide tangible and intangible value-added resources which can play a valuable role in SME growth.

- Businesses with the primary objective of raising external equity finance will typically require only limited contact with corporate investors and should therefore approach independent venture capital funds which have raised finance from corporate sources.
- If one of the major objectives of the SME is to benefit from the value-added offered by corporate investors then contact should be made directly with companies operating in appropriate industrial sectors with venture capital public funds.
- The most suitable partners may be companies with whom previous business relationships have been established. Venture capital links offer far greater opportunities ranging from the gain of hands-on advice and resources from investors to forming further collaborative relationships with them.
- SMEs should be trained and assisted to set up basic planning and record keeping systems, and to write financing proposals.

5.3.2 Venture Capital Managers

Venture capital fund managers can do more to encourage venture capital investment.

- Non-financial companies can be a very significant alternative source of funds for independent venture capital groups specializing in investing in SMEs at a time when they are experiencing difficulties in raising funds from financial institutions.
- Venture capital fund managers need to recognize the motivations of the corporate investor and to tailor their funds accordingly.

- Venture capitalists should consider allowing investing corporations to influence fund investment criteria and have closer contact with investee firms, particularly when corporate objectives are oriented strategically.
- Dedicated funds designed specifically for the requirements of an individual corporation provide greater opportunities for the company to benefit strategically and obtain windows on innovation, growth and expansion.
- Venture capitalists have a role to play in stimulating direct venture capital investment via co-investments with corporations.Linking up with direct corporate investors in this way can help them to learn and gain experience and also benefit the investee firm.
- Develop Intensive Education and Awareness Programmes to inform the general public and businesses on the attributes and merits of Venture Capital Financing.

5.3.3 Government and Policy makers

Since Private Sector is the engine of growth of the economy as such government and Policy makers should:

- Provide credit and equity financing to eligible Venture Capital Finance Companies (VCFCs) to support SMEs
- Provide monies to support other activities and programs for the promotion of Venture Capital Financing
- Serve as both facilitators and educators in encouraging the venture capital process.
- Provide tax incentives to companies prepared to make venture capital investments. Tax breaks are an important method for initially stimulating

interest in an activity that many corporate executives are possibly not currently considering. Policy makers should consider offering large companies similar incentives.

- Investigate the feasibility of establishing some form of guaranteed funding potential scheme operated by consultants, venture capitalists and other experts, which could provide would-be investors with advice and information concerning potential investees.
- Be a government-funded marriage bureau service to act as a match-maker for investor and investee companies.
- Organise seminars and reports to business leaders by underline the need for, advantages of, and guidelines for success in inter-firm strategic partnerships.
- Place particular emphasis on the importance of publicizing successful examples of alliances and specifically venture capital role models.
- Always provide another source of funding to replenish the coffers of the scheme

5.4 Suggestions for further Research

From the forgoing Conclusions and Recommendations the following research questions are worthy of exploration

- Why SME’s are not still willing to use Venture Capital Finance as Alternative source of funding?
- In spite of the ranging benefits that are accrued to SME’s in using Venture Capital Financing as a means of financing, SMEs still prefer Commercial Banking Activities to Venture Capital Funds?

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LIST OF ABBREVIATIONS

IPO = Initial Public Offering

LP = Limited Partnership

LLC = Limited Liability Company

SMEs = Small and Medium Enterprises

VC = Venture Capitalist

VC = Venture Capital

VCFC = Venture Capital Fund Companies

BOG = Bank of Ghana

APPENDIX

SURVEY QUESTIONNAIRE

The researcher would like to learn about the impact of Venture Capital Financing towards financing of SMEs and attitudes towards venture capital as an alternative source of fund. Any information provided would be used for the sole purpose of this academic exercise and would be kept in strict confidence.

1. Name of organisation ....
2. When was the firm established? ....
3. What is the nature of business of your company? ....
4. How many employees do you have?..
5. For how long has your business been in operation? ....
6. What is the ownership type of your business?...
7. What is the number of shareholders of your company?.....................................
8. Who are the shareholders/owners of your company (Please tick (√) as many as applicable)

Family members	
Individual investors	
Institutional investors	
Venture / private	
Others, please specify	

9. What is your company's main source of long-term assets financing? (Tick as many as applicable)

Retained earnings	
Long-term Loan	
Venture Capital	
Suppliers Credit	
Stock market/capital market	
Others, please specify	

10. If venture capital is the answer to Q9, what motivated your company's choice for venture capital financing? (Tick as many as applicable)

Unavailability of loans	
Insufficient personal financing	
Opposition to any types of strategic investors	
Public Information	

11. What is your company's main source of short-term assets financing? (Tick as many as applicable)

Bank Overdraft	
Personal funds	
Family Funds	
Others, please specify	

12. Are you aware of the existence of any venture capital fund in Ghana
Yes□/□No

13. Has your company ever applied for fund from any Venture Capital Fund in Ghana
Yes□/□No

14. If you have applied for any venture capital fund, were you successful in raising funds?
Yes□/□No

15. Why was your application rejected if you answer to question 14 is No?

Insufficient document	
Lack of Collateral	
Business not registered	
Bad credit history	
Others, please specify	

16. Do you know any company that has benefited from any venture capital fund
Yes□/□No

17. Are you aware of the requirements of the venture capital funds?
Yes□/□No

18. Please, list the important ones
……………………………………………………………………………………………………
……………………………………………………………………………………………………

19. Do you find the requirements of Venture Capitalist as strenuous?
Yes□/□No

20. Does your company intend to apply for funding from a venture capital fund?
Yes□/□No

21. At what stage of your operation did you receive a venture capital help?

22. Has your company attempted to raise finance from venture capital firm in the past two years? Yes □/□No

23. If no, why did you not opt for venture capital

Obtained enough financing through loans	
Sufficient self- financing resources	
Finance through stakeholders	
Outright rejection	
Not interested	

24. What benefits has your company derived from participating in venture capital financing?

....
....

25. How has venture capital impacted on your company?

Impossibility of business continuity with Venture Capital	
Improvement in Firm's development	
No Change in firm's development	
Poor development in firm after venture capital	

26. What changes have you observed as a result of venture capital finance in terms of?

1 = much more, 2 = slightly more , 3 = About the same, 4 = Slightly less, 5 = much less

Please tick (√) if applicable

	1	2	3	4	5
Product Quality					
Financial Management					
Diversification of products					
Sales territory					
Innovation					
Customer Service					
Organisation and human resources					

Thank you for taking time to complete this questionnaire!