

**CAUSES OF CREDIT NON-PAYMENT IN
COMMERCIAL BANKS: SMES' PERSPECTIVE**

By

KNUST

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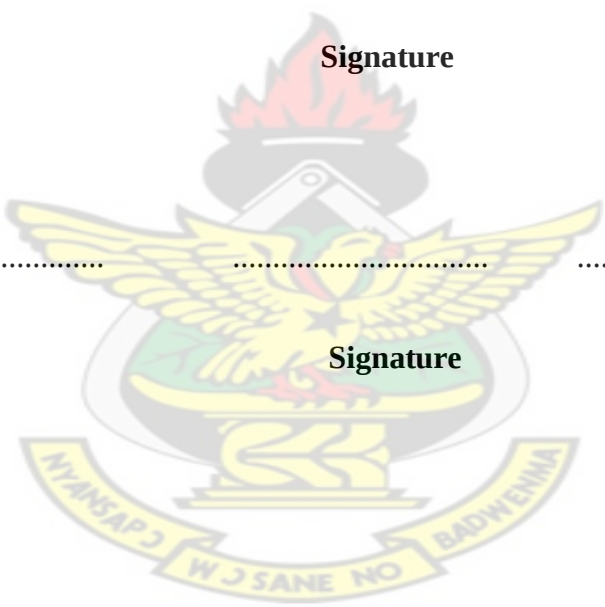
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CERTIFICATION

I hereby declare that this submission is my own work towards the award of the Commonwealth Executive Masters in Business Administration (CEMBA) and that to the best of my knowledge, it contains no material previously published by another person or any material which has been accepted for the forward of any other degree of the University, except where due acknowledgement has been made in the text.

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The logo of KNUST (Kwame Nnamdi Azikiwe University) is centered in the background. It features a yellow eagle with spread wings perched on a shield. Above the eagle is a red and orange flame. Below the shield is a yellow banner with the text 'NYANSAPɔ Wɔ SANE NO BADWENMA' in black. The shield itself has green and yellow sections.

ACKNOWLEDGEMENT

A simple 'THANK YOU' will not be enough to show how truly grateful I am to the many people that have supported me from the very inception of this study through to this thesis. It's been tough and exciting, but at each stage you stood by, guided and supported me and together we have come to what I believe is a successful end.

To begin, I am ever grateful to the almighty God, to whom I owe my very existence. He's been my shield, my fortress and my strength. Glory be Thy name.

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The last, but certainly not least of my words of gratitude goes to the people that gave me a peace of mind to study, kept my head clear of all 'foreign material' that could affect my studies and most of all, urged me on, encouraged me and prayed for me each and every step of the journey. You truly are my family, colleagues and friends and without you, I probably may not have come this far. God bless.

ABSTRACT

This study examined the causes of credit non-payment in commercial banks from SMEs perspective. A total of 200 SMEs were conveniently sampled from the study area but 171 responses were received. They were asked to cite the factors influencing credit non-payment in the study area. Descriptive statistics and measure of central tendency were also employed to describe the socio-economic characteristics of the respondents and also their acceptance to factors such as macroeconomic, bank related, bank staff related and customer related factors as influencing credit non-payment. The findings revealed that majority of the SME owners in the study area were degree holders. About half of the SMEs who applied for credit from commercial banks did so for commercial purposes while more than a third of the SMEs applied for credit for personal purposes. Majority of the respondents agreed that macroeconomic and bank related factors such as high inflation, exchange and interest rate, time of disbursement, time of repayments being too short and the credit being inadequate also contributes to the inability of SMEs credit non-payments. It was recommended that, the commercial banks should attempt to reduce their lending rates and other credit related charges and provide technical assistance to businesses. Furthermore a concerted effort should be made to keep the rate of inflation at a low level to aid business growth so as to place SMEs in a better position to repay their credit.

TABLE OF CONTENTS

	Page
Certification	ii
Acknowledgement	iii
Abstract	iv
Table of Contents	v
List of Tables	viii
List of Figures	x
 CHAPTER ONE	 1
INTRODUCTION.....	1
1.0 Background to the Study	1
1.1 Statement of the Problem	3
1.2 Objectives of the Study	4
1.3 Research Questions	4
1.4 Significance of the Study	5
1.5 Research Methodology	5
1.6 Scope and Limitation of the Study.....	5
1.7 Organization of the Study	6
 CHAPTER TWO	 7
REVIEW OF RELEVANT LITERATURE	7
2.0 Introduction	7
2.1 The History and Development of SMEs in Ghana	7
2.2 Definition of SMEs	8
2.3 Ghanaian definition of SMEs	10
2.4 Theories that banks use to assess credit repayment by client	12
2.5 Macroeconomic factors and non-payment	20
2.6 Bank specific indicators and non-payment	24

CHAPTER THREE	26
METHODOLOGY.....	26
3.0 Introduction	26
3.1 Research Method.....	26
3.2 Population	27
3.3 Sampling and Sampling Technique.....	27
3.4 Research Procedure.....	28
3.5 Instruments / Measures	29
3.6 Data Analysis	29
3.7 Pilot Study	29
 CHAPTER FOUR	 32
PRESENTATION AND DISCUSSION OF RESULTS	32
4.0 Introduction	32
4.1 Socioeconomic characteristics of respondents	31
4.2 Causes of credit non-payment	38
4.2.1 Macroeconomic factors and credit non-payment	38
4.2.2 Bank related factors and credit non-payment	41
4.2.3 Customer related factors and credit non-payment	46
4.2.4 Recommended policies to credit non-payment	51
4.3 Customer satisfaction	52
4.4 Discussion	57
4.4.1 Macroeconomic factors	58
4.4.2 Bank related factors	58
4.4.3 Bank staff related factors	59
4.4.4 Customer related factors	59
4.4.5 Customer satisfaction	60
 CHAPTER FIVE	 61
SUMMARY, CONCLUSION AND RECOMMENDATION	61
5.0 Introduction	61
5.1 Summary of the Study	61
5.2 Conclusion	62
5.3 Recommendations	63

5.4 Study Limitation and Direction of Future Research	64
6 REFERENCES	65
7 APPENDIXES	71

KNUST



LIST OF TABLES	Page
Table 4.1 Gender of respondents	32
Table 4.2 Age range of respondents	33
Table 4.3 Educational qualification	34
Table 4.4 Banking relationship	35
Table 4.5 Purpose of credit	36
Table 4.6 Interest rate charged	37
Table 4.7 Amount of credit disbursed	38
Table 4.8 High inflation rate	39
Table 4.9 High import duties/tariffs	40
Table 4.10 Time of disbursement of credit	42
Table 4.11 Inadequate credit	43
Table 4.12 Credit payment schedule	43
Table 4.13 High credit service charges	44
Table 4.14 Staff extortion	45
Table 4.15 Bank's knowledge of credit purpose	45
Table 4.16 Bank's visits/calls	46
Table 4.17 Business closed down	48
Table 4.18 Poor timing of credit	48
Table 4.19 Tenancy agreement	49
Table 4.20 Domestic problems	50
Table 4.21 Reasons for credit non-payment	51
Table 4.22 Suggestions to curtail credit non-payment	52
Table 4.23 Personal contact	53
Table 4.24 Quality of service	53

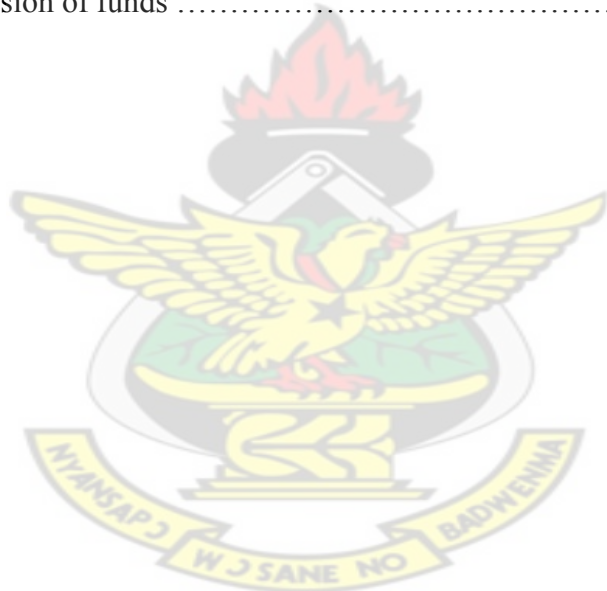
Table 4.25 Overall satisfaction	54
Table 4.26 Mean, standard deviation and t value for sex on quality of service, personal contact, and overall satisfaction.....	55
Table 4.27: Mean and Standard Deviation for Macroeconomic factors	56
Table 4.28: Mean and Standard Deviation for Bank Related factors	57

KNUST



LIST OF FIGURES

Fig. 4.1 Bank account status.....	34
Fig. 4.2 Credit approval and disbursement.....	36
Fig. 4.3 Change in government	39
Fig. 4.4 High exchange rate and credit non-payment	40
Fig. 4.5 High interest rate and credit non-payment	41
Fig. 4.6 Short repayment time and credit non-payment	42
Fig. 4.7 Theft/robbery and credit non-payment	46
Fig. 4.8 Poor business performance	47
Fig. 4.9 Diversion of funds	49



CHAPTER ONE

INTRODUCTION

1.0 Background to the Study

There is a general consensus that the growth and survival of Small and Medium Size Enterprises (SMEs) is crucial for employment generation and poverty alleviation. For instance, Parker, Riopelle and Steel, (1995) found that SMEs on average employ about 15.5% of the labour force in Ghana. As such governments and policy makers around the globe have formulated and implemented a number of policies aimed at providing the enabling environment for the SME sector to flourish. Despite these efforts, many challenges still remain; among them is the issue of finance.

Both at the macro and micro levels, the general perceptions have been that inadequate finance is the over-riding constraint on enterprise growth in Ghana (Akoena and Gockel, 2002). This perception is confirmed by the business barometer report for the last quarter of 2010 released by the Association of Ghana Industries (AGI).

According to the report, majority of SME owners surveyed ranked access to finance as the single most important factor hampering the growth of businesses in Ghana (AGI's Business Barometer Report, December 2010)¹. It is therefore argued that government and policy makers should pursue policies that will encourage financial institutions to extend more credit to the SME sector.

¹ The Association of Ghana industries (AGI) Business Barometer report is a periodic opinion survey about what chief executives make of the business environment.

Despite the numerous policy interventions and appeals however, commercial banks feel reluctant in extending credit to small and medium scale enterprises. Their main concern has been the issue of high default risk associated with SME financing.

Most SMEs do not keep proper financial records; they have limited credit history and usually do not possess any collateral which makes lending to them very costly and risky. Thus, the issue of credit non-payment is one of the major problems confronting commercial banks and policy makers with regards to SME financing. Baku and Smith (1998), assert that loan default is detrimental to both the lender and the borrower due to the fact that the costs of loan delinquencies would be felt by both parties. The lender has costs in delinquency situations, including loss of interest, opportunity cost of principal, legal fees and related costs. For the borrower, the decision to default is a trade-off between the penalties in lost reputation from non-payment versus the opportunity cost of forgoing investments due to working out the current credit.

Unlike most Non-governmental organizations (NGOs), lending programmes which are based on group lending models where peer monitoring and peer enforcement minimize the default risk, commercial banks usually lend to individual SMEs based on their peculiar characteristics. In the absence of peer monitoring and enforcement, there may be high incidents of credit non-payment among individual SMEs. The purpose of this study therefore, is to investigate the causes of credit non-payment in commercial banks from the perspective of SMEs in the Accra Metropolis.

1.1 Statement of the Problem

The issue of credit non-payment has been one of the topical issues in SME financing. The interest in the concept has arisen mainly due to the alarming rate of non-performing credits in the books of commercial banks which threaten financial sector stability. According to the Business News of the Daily Graphic (2011), Commercial banks are reviewing their internal controls, credit appraisal and risk management policies to reduce the soaring rate of credit non-payment. The Non-Performing Loans (NPL) ratio, which measures the ratio of loan losses to gross advances, deteriorated from 16.2 per cent in December 2009 to 17.6 per cent as at December 2010. This had reduced the share of the top five banks in the industry from 49.5 per cent in 2009 to 45 per cent in 2010.

The high incidence of credit non-payment is not only a worry to commercial banks but regulators and government since high credit non-payment benefits neither the borrower nor the lender.

Baku and Smith (1998) asserted that credit non-payment is detrimental to both the lender and the borrower due to the fact that the costs of loan delinquencies would be felt by both parties. The lender has costs in delinquency situations, including loss of interest, opportunity cost of principal, legal fees and related costs.

For the borrower, inability to pay back loans may lead to loss of reputation or reduced credit worthiness which will intend affect any future borrowing decisions.

Credit non-payment is having a negative effect on the operations of commercial banks as the growing portfolio of outstanding credits is restricting the lending

abilities of commercial banks and as such, affecting their profitability and capital base since huge provisions for bad and doubtful debts have to be made each year.

It is therefore necessary to examine the causes of credit non-payment among commercial banks in Ghana from the perspective of SMEs.

1.2 Objectives of the Study

The general objective of the study is to examine the causes of credit non-payment from the perspective of the SMEs.

Specifically the objectives of the study are as follows,

1. To identify the major causes of credit non-payment from SMEs' perspective.
2. To assess whether SMEs are satisfied with banking services provided by commercial banks.

1.3 Research Questions

An efficient and effective credit risk management has a positive influence on the liquidity, profitability and capital base of banks. The study seeks to answer the following research questions;

1. What factors account for the alarming rate of credit non-payment?
2. Are SMEs satisfied with the banking services offered them by commercial banks?

1.4 Significance of the Study

This study will provide policy makers and management of banks a right focus and new strategies to improve the efficacy of the banking industry.

The study will also help in gauging the views of SMEs on the causes of credit non-payment and how best stakeholders in the banking industry in Ghana tackle the problem. Besides, the findings from the study may be useful in addressing deficiencies in existing lending policies and inform new policy options. The findings of this research could also serve as a good reference point for further research and a guide to potential investors.

1.5 Research Methodology

The study used descriptive analysis to analyze the causes of credit non-payment in commercial banks. Statistical techniques such as frequency, percentages, standard deviation, mean and statistical tools such as tables and bar graph are used to analyze the responses to the questionnaire. Detailed methodology is provided in chapter three.

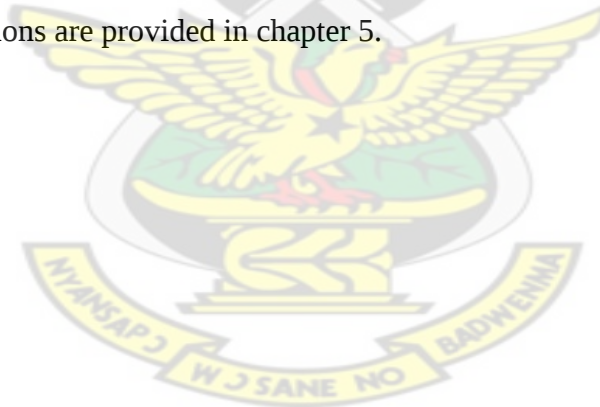
1.6 Scope and Limitation of the Study

Because of convenience, time and financial constraints, the study was restricted to some SME customers of some commercial banks in the Accra Metropolis. Due to the limited time available to the researcher, only 200 questionnaires were administered to commercial bank SME customers. The researcher was also limited

financially because of the cost involved in transportation and questionnaire administration.

1.7 Organization of the Study

The study is divided into five main chapters. Chapter 1 provides the background of the study, identifies the problem, states the objective of study, describes the study, the scope etc. In chapter 2, a brief review of relevant literature on the causes of credit non-payment is carried out. Chapter 3 discusses the methodology of the study. In this chapter, the analytical framework is examined; source of data and the sampling technique among other things are also discussed. In Chapter 4, there is a presentation and discussion of the findings of the study. Summary, conclusion and recommendations are provided in chapter 5.



CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

2.1 The History and Development of SMEs in Ghana

The history of the development of SMEs in Ghana dates back to the 1970's when it became necessary for Ghanaians to assume full control of the management of the national economy. The Ghanaian economy was before then virtually in the hands of aliens like the Lebanese (Ghanaian Enterprises Development Commission Annual Report, 1976). This was followed by the passage of the Ghanaian Business Promotion Act 334 (1970) which sought to promote private entrepreneurship. The Investment Policy Decree 329 (1975) reserved certain areas like leather products, garment manufacturing and few others under the economy solely for the operation of the Ghanaian businessman. The Ghanaian Enterprises Development Degree formulated by the National Redemption Council Decree (NRCD) 330 (1975) established the Ghanaian Enterprise Commission. The Commission was charged with the responsibility of developing the small scale enterprises by providing financial assistance, technical and advisory services to the sector.

As Government's attention began to focus on industrialization and the importance of the role the small scale enterprises play in the economy of the country, it became very relevant to have an integrated organization capable of responding to the needs of the small scale enterprises sector.

The National Board for Small Scale Industries (NBSSI) was therefore established in 1985 by the Act of Parliament Act 434(1981) to effectively promote the overall development of the micro and small enterprises (SMEs) to ensure efficiency and competitiveness in the production and distribution of goods and thereby contribute significantly to the development of the economy.

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

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

2.2 Definition of SMEs

There is no single, uniformly accepted definition of a small firm (Storey, 1994). Firms differ in their levels of capitalization, sales and employment. Hence, definitions which employ measures of size (number of employees, turnover, profitability, net worth etc.) applied to one sector could lead to all firms being classified as small, while the same size definition when applied to a different sector could lead to different result.

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

It has a relatively small share of the market place;

- It is managed by owners or part owners as a personalized business, and not through the medium of a formalized management structure;
- It is independent, in the sense of not forming part of a large enterprise.

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

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

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

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

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

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

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

2.3 Ghanaian Definition of SMEs

In Ghana, the most important criterion used in defining the size of enterprises is employment (Boon, 1989).

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

The NBSSI defines small-scale industries as production units that are engaged primarily in manufacturing outside the residence, with an investment and tools not less than GHS1, 000 and which engage less than nine people. (NBSSI, Annual Report, 1997). It is to be noted that some of these definitions vary according to the number of employees, level of investment, total assets and turnover.

The commercial banks mostly define SMEs based on their annual turnover. Barclays Bank classifies its business customers based on the following turnover: Small businesses = £100,000 - £1,000,000; Medium businesses = £1,000,000 - £6,000,000; Large businesses = £6,000,000 and above. For SG-SSB, SMEs must have total turnover of between GHS100, 000 to GHS1, 000,000 and any turnover above GHS1, 000,000 qualifies a business as corporate customer. SMEs of Ghana Commercial Bank must have not more than GHS100,000 of turnover and for Standard Chartered Bank, not more than USD\$25,000.

From the foregoing, it can be discerned that there is no consensus on the issue of the definition of SMEs. This study adopts the banks' definition of SMEs based on the classification of businesses by their turnover.

2.4 Theories that banks use to assess credit repayment by client

Traditional models of credit risk measurement focus on estimating Probability of Default, PD and typically define "default" as the event of bankruptcy, liquidation or insolvency. The most commonly used traditional credit risk measurement methodology is discriminant analysis, which has been applied successfully to forecast firms' default. Multiple discriminant credit scoring analysis was pioneered by Altman (1968) with z-score model: discriminant analysis identifies financial variables that have statistical explanatory power in differentiating defaulting firms from non-defaulting firms. Once the models' parameters are obtained, loan applicants are assigned a z-score assessing their classification as good or bad (The z-score itself can be converted into a PD). In the original version, Altman used the linear discriminant analysis (LDA) to predict up to 3 years in advance bankruptcy in a sample of 33 sound and 33 unsound manufacturing firms, using five economic financial variables. Altman, Hadelman and Narayan (1977) extend the z-score approach, including seven explanatory variables and found supporting evidence of predictive ability of LDA on an out-of sample set.

Several studies have been conducted to improve Altman's results, using different parametric, semi parametric and non-parametric approaches. Among parametric approaches, there are four methodological forms of multivariate credit scoring models: 1, the linear probability model; 2, the logit model; 3, the probit model; and 4, the multiple discriminant analysis model.

Logit models are commonly used for scoring purposes both in economic literature and in studies conducted by Central Banks in Italy, Germany, Austria, France, and United Kingdom. Altman and Narayanan (1997) surveyed the use of credit scoring

models throughout the world, pointing out that all studies limited attention to quantitative data only and found that financial ratios measuring profitability, leverage, and liquidity had the highest statistical explanatory power in differentiating defaulted from non-defaulted firms (see Allen, De Long & Saunders, 2004).

A number of studies have been conducted on European data sets (see Von Stein & Ziegler, 1984). Platt and Platt (1990) applied a logit analysis to predict bankruptcy with interesting results in terms of classification performance.

Laitinen (1999) predicted default using a data set on 3,200 Finland firms and selecting 15 variables out of 35; in the out of sample set sensitivity is 93.75% with specificity equal to 96.35%. Dietsch and Petey (2004) develop a one-factor credit risk model to assess estimates of stationary default probabilities and asset correlation for class of small medium firm, in order to assess the effects of new regulation of Basel II. Authors use data on internal ratings assessment from two large European financial information providers for an average 5-year period. Results showed that, on average, SMEs are riskier than large businesses; asset correlations in the SME population are very weak (1-3%) and decrease with size. Moreover, they do not find evidence supporting a negative relationship between asset correlations and PD across rating grades as assumed by Basel II; in particular over French data, the correlation increases with PDs, while the relationship is unclear over German data.

The authors explained the results in terms of segmentation on the basis of credit quality: while the segment of firms with good credit quality defaults are driven by positions in the business cycle, the one with average credit quality is populated by firms where defaults depend on specific factors of management and access to

productive and financial resource; for sub-prime segment firms with low credit quality tend to be sensitive to macroeconomic conditions. This then explains the non-monotonic relationship between average PD and asset correlations.

We focus our attention on studies on Italian firms (see Altman, Marco & Varetto, 1994). Cannata, Fabi and Laviola (2002) provide an empirical estimation of PD using a logistic model. The data set consists of quantitative, but not qualitative information on a sample of 180,000 Italian firms, collected by Company Accounts Register (CERVED) and Credit Register (of the Bank of Italy). Default is defined as the event of non-performing loan for the first time in a certain year by lending a bank; this is a narrower definition with respect to the one used in Basel II, since it does not include substandard loans and loans past due 90 days. A stepwise procedure is used to select significant explanatory variables and the procedure is run conditionally on the economic sectors (manufacturing, trade, construction) across which SMEs are distributed. They showed that SMEs are characterized by higher PDs, with an average PD of 1.6 for SMEs with sales less than 5 million euro. Using the estimated logistic model, Fabi, Laviola and Marullo Reedtz (2003, 2005) showed that Basel II Accord will lead to a substantial decrease in capital requirements for banks using Internal Rating Based (IRB) foundation approach; the capital requirement reduction is estimated to be 21% for portfolios constituted by corporate firms, 25% for SMEs, and 29% for SMEs with sales less than 5 million euro. Other studies apply logit model to examine the effect of Basel II Accord on capital requirements for Italian banks. Bocchi and Lusignani (2004) perform an analysis on 75,000 SMEs (according to Basel Committee, April 2003), obtained by pooling data of 15 medium sized banks. 24% of firms in the sample are classified as corporate SMEs and the remaining 76% retail SMEs. This study estimates the PD using a logit

model at a point-in-time basis, assuming Exposition At Default (EAD) equal to zero and a Loss Given Default (LGD) of 43%. Default is defined as the occurrence of non-performing loans, substandard loans, but past due for more than 90 days are not included. In the period under scrutiny, two third of exposures are associated with firms with PD less than 2%. Because at a PD of 2% capital requirement is evaluated at 8%, as in Basel II Accord, the new Capital Accord will reduce capital requirements for higher proportion of SME firms. The authors provide evidence of the negative relationship between firm size and PD, assumed by Basel II Accord, since the PD distribution by rating classes of retail SMEs lies to the right of the one derived for corporate SMEs.

A number of papers tried to assess the effect of Basel II on credit pricing. Using data from Bank of Italy, Maino and Masera (2004) showed using simulation techniques that the cost of credit should stay the same for averaged rated SMEs (i.e. for those SMEs rated BB), which is in line with market evaluation of risk. On the contrary, SMEs rated below BB will experience a sharp increase in the cost of credit.

The main effect on the cost of credit due to Basel II will be to stop cross-subsidization among SMEs, since banks will be able to discriminate across firms on the basis of PDs: less efficient and productive SMEs, with higher PD, will pay a higher cost of credit, reflecting the higher risk banks incurred in financing them.

Moody's bank loans study (Carty and Lieberman, 1996) comprised a sample of 58 bank loans. Based on secondary market prices for defaulted bank loans they reported an average defaulted bank loan price of 71%. They did not observe a bi-modal distribution, but reported skewness toward the high end of the price scale.

In the same study, the authors measured the recovery rate for a sample of 229 small and medium-sized loans in the US. They reported an average recovery rate of 79% based on the present value of cash flows. Again, the distribution was highly skewed towards the high end of the scale.

Hurt and Felsovalyi (1998) studied the characteristics of C&I bank loan defaults in Latin America and concentrated on bank loss measurement in case of default. For 1149 defaulted bank loans in the 1970 – 1996 period they measured 31.8% average loss in the event of default, which corresponded to 68.2% average recovery rate.

They employed discounted cash flow approach. The LGD distribution proved to be highly skewed and reflected a large number of loans with small losses and a small number of loans with losses approaching 100%. Loan size turned out to be important explanatory factor for measured loan losses in the event of default.

One of the largest and more recent studies that focus on loans to small and medium-sized enterprises was made by Standard & Poor's Risk Solution Department (Franks, Servigny, Davydenko, 2004). It considers collateral as the key driver of recovery rates, which vary across banks within the same country and jurisdiction. Recovery rates also differ across countries where banks respond to different bankruptcy regimes and codes by adjusting different lending practices. In France, for instance, banks demand higher levels of collateral and target specific forms of collateral. The recovery rate in France differs significantly (it is lower) from recoveries in the UK and Germany.

The most recent study on bank loan LGD rates was published by Dermine and Carvalho (2006) who investigated LGD characteristics for 374 corporate bank loans to small and medium size firms in Banco Commercial Portuguese over the period

1995 – 2000. The authors applied mortality analysis to defaulted bank loan recovery rates and tested empirically the determinants of recovery rates. Additionally they provided information on the direct costs incurred by a bank in recoveries on bad and doubtful loans. The average recovery rate measured in their study was 71%, which was in line with some earlier studies in the field. More importantly, they showed that the frequency distribution of bank loans' LGD rates proved to be bimodal and in their multivariate analysis of the determinants of loan losses they identified statistically significant explanatory variables such as size of the loan, collateral, industry sector, year dummies and age of the obligor (firm). The work of Dermine and Carvalho (2006) to a large extent also inspired our analysis of bank loan recovery rates.

There is strong evidence that recoveries in recessions are lower than during expansions, for instance according to Carey (1998) and Frye (2000). Employing Moody's data they showed that during recessions recoveries are lower by one third.

Other studies by Grossman et al. (2001) and Acharya et al. (2003) argued that industry is another important determinant of LGD. Results of Altman and Kishore (1996) provide evidence that some industries such as utilities (70% average recovery) do better than others (e.g. manufacturing 42%).

The most ambiguous key characteristic is the size of a loan. Asarnov and Edwards (1995) and Carty and Lieberman (1996) found no relationship between LGD and size of loan on the U.S. market. Thornburn (2000) obtained similar negative result for Swedish business bankruptcies. However, Hurt and Felsovalyi (1998) showed that large loan default exhibit lower recovery rates. They attribute it to the fact that

large loans are often unsecured, and they are provided to economic groups that are family owned.

The determinants of corporate defaults in developed financial markets are discussed intensively in the literature. Loan default is closely related to corporate bankruptcy (Lízal, 2002). The causes of bankruptcy are problems in the fields of indebtedness, profitability, liquidity and solvency (Altman, 1968). Firms are more likely to default if they are highly indebted, less profitable, less liquid, and if the legal system does not create efficient incentives to repay the loans. Selected financial ratios related to these factors are commonly used to predict the probability of corporate bankruptcy in developed financial markets (Altman, 1968; Beaver, 1966), but less evidence is available for the new member states.

According to the Russian-European Center for Economic Policy (RECEP) report in 2005, all banks involved with SME financing in Russia have experienced rather low proportions of bad loans and defaults making this business a particularly low-risk and highly profitable one, provided that lending institutions have developed adequate specific credit policies for SMEs. At KMB total problem loans to SMEs is below 1%. This compares very favorably to the 10% level of problem loans in general, which tends to be standard among Russian banks and to 10-15% of all consumer loans currently going into default. Problem loans generally defined, that is including loans with deferred repayments and payments in arrears are 2-2.5% of the total SME credit portfolio at Vneshtorgbank and 2% at Sberbank. The Association of Regional Banks of Russia, ARBR, which includes approximately 200 banks of which 130 have their headquarters in the Moscow Region, has a more conservative assessment of problem loans to SMEs which amount to 5% of all loans to SMEs for its member-banks, still much less than problem loans in general. This may be

explained by the fact that most of the banks members of the ARBR do not have a special credit policy for SMEs.

Small Russian enterprises can therefore be considered to be reliable in repaying borrowed assets. In terms of repayment of short-term loans, small enterprises even tend to be more reliable than large and medium-sized enterprises (The Russian SME Observatory Report).

In a study by Ongena (1999) found that banks offer a lending relationship as the solution to the firm's ongoing credit needs. Bank default disrupts this relationship. Hence risk in the banking sector influences the value of the relationship, the cost of corporate finance, and the level and growth of real activity.

As bank default is often the result of fraud and internal irregularities, it is hard to predict. Bank default affects the economy through a number of different channels. The loss of the relationship, benefit for the firm is an important route through which the health of the banking sector influences real activity.

According to Amissah-Arthur (2010), one critical issue that has proved rather challenging for the banking industry and the broader economy this year has been high bank lending rates and its effect on access to credit. Traditionally, a low inflation and low interest rate environment is expected to ease credit conditions and stimulate economic growth. Contrary to this expectation, the response of lending rates within the banking sector to the monetary easing by the Bank of Ghana has been sluggish.

The Annual Percentage Rates (APRs) which reveal actual lending rates in the financial sector indicates that the average base rate charged on borrowing by

enterprises ranged between 27.5 percent and 38 percent at the end of August. By all standards, these rates are high and have instigated tight credit conditions in the economy for most part of this year. Some of the underpinning factors that the banks claim to have contributed to this situation include the high non-performing loan ratios and high loan loss driven mainly by Government's lack of fiscal capacity to honour its obligations to contractors and service providers. This is an aspect of what I have characterized earlier as the unsustainability of the Government's spending plans.

Indeed, the quality of the banks' aggregated loan book remains a source of financial sector vulnerability. High levels of non-performing assets in the balance sheets of banks have the potential to lower profitability and erode the capital base.

Indicators of asset quality, measured by the Non-performing loan (NPL) ratios hit a peak of 20 percent in February 2010, declining to 16.5 percent in September and 16.9 percent by end October.

2.5 Macroeconomic factors and non-payment

Econometric studies of business defaults started in the 1960s with work by Altman and co-authors (1968; 1971; 1973; 1984). These influential papers focus on explaining bankruptcies of publicly quoted businesses in a cross-sectional context using a small set of firm-specific variables.

Later work by Shumway (2001) attempts to account for the dynamic nature of defaults for publicly listed firms. Bharath and Shumway (2008) evaluated the out-of-

sample accuracy of the Merton (1974) model and found that the distance-to-default measure is not a sufficient statistic for the probability of default.

Over time the average default frequency and individual default probabilities displayed co-movement with macroeconomic and financial variables in a way that suggests that aggregate shocks might be an important driver of default. The seminal work of Bernanke, Gertler and Gilchrist (1999) provides a theoretical framework whereby both firm-specific factors and macro shocks affect the default outcome of individual firms. In the BGG framework, a firm default is affected by firm-specific productivity shocks and aggregate shocks (e.g., an aggregate productivity shock). Hence, it follows that an empirical model of default should feature variables that proxy for the underlying firm-specific productivity, as well as variables that proxy for unobserved aggregate shocks.

Hackbarth, Miao and Morellec (2006) provide an additional mechanism through which macroeconomic conditions affect default risk. They argue that, when cash flows depend on economic conditions, firms' optimal default thresholds will be affected by aggregate shocks. Hence aggregate shocks can trigger simultaneous defaults.

These theoretical insights have recently been explored in the empirical literature on default modeling, and there are small but growing number of papers investigating the importance of macroeconomic fluctuations on business defaults. Duffie, Saita and Wang (2007); Pesaran, Schuerman, Treutler, and Weiner (2006); Bonfim (2009); Lando and Nielsen (2010); and Tang and Yan (2010) provide empirical evidence that firm-specific factors alone appear unable to fully explain the variation in corporate default rates and credit spreads. Using data on listed U.S. industrial

firms, Duffie et al. (2007) found that macro-financial covariates, such as the three-month T-bill rate and the one-year S&P 500 return, have significant explanatory power for bankruptcy and default rates. Lando and Nielsen (2010) also found that the S&P500 index and the three-month T-bill rate to be significant, but in addition they document significant effect of the yearly change in US industrial production and a Treasury interest rate spread.

Pesaran et al. (2006) constructs a Merton-type model that links credit losses to macroeconomic variables via a large scale Vector Auto Regression (VAR) model, and found that alternative macroeconomic scenarios have important implications for default probabilities in a hypothetical loan portfolio. Bonfim (2009) controls for distended Gross Domestic Product, GDP growth, Consumer Price Index, CPI inflation, a coincident economic activity indicator, the yield curve, credit growth and the price variation in the stock market index in regressions on credit overdue.

She finds that all of these macroeconomic variables, when added separately, are significant in regressions on credit overdue, and that loan growth, the stock index and GDP growth are significant even in each other's presence.

Bloem and Gorter (2001) suggested that a more or less predictable level of non-performing loans, though it may vary slightly from year to year, is caused by an inevitable number of 'wrong economic decisions' by individuals and plain bad luck (increment weather, unexpected price changes for certain products, etc.). Under such circumstances, the holders of loans can make an allowance for a normal share of non-performance in the form of bad loan provisions, or they may spread the risk by taking out insurance. Enterprises may well be able to pass a large portion of these costs to customers in the form of higher prices. For instance, the interest margin

applied by financial institutions will include a premium for the risk of nonperformance on granted loans.

Bercoff, Giovanniz and Grimardx (2002) The macroeconomic variables such as money multiplier, and reserve adequacy, institutional characteristics and tequila effect had positive influence on NPLs. Fuentes and Maquieira (1998) undertook an in-depth analysis of loan losses due to the composition of lending by type of contract, volume of lending, cost of credit and default rates in the Chilean credit market. Their empirical analysis examined different variables which may affect loan repayment: (a) limitations on the access to credit; (b) macroeconomic stability; (c) collection technology; (d) bankruptcy code; (e) information sharing; (f) the judicial system; (g) pre-screening techniques; and (h) major changes in financial market regulation.

They concluded that a satisfactory performance of the Chilean credit market, in terms of loan repayments hinges on a good information sharing system, an advanced collection technology, macroeconomic performance and major changes in the financial market regulation.

In another study of Chile, Fuentes and Maquieira (2003) analyzed the effect of legal reforms and institutional changes on credit market development and the low level of unpaid debt in the Chilean banking sector. Using time series data on yearly basis (1960-1997), they concluded that both information sharing and deep financial market liberalization were positively related to the credit market development. They also reported less dependence of unpaid loans with respect to the business cycle compared to interest rate of the Chilean economy. Altman, Resti and Sironi (2001) analysed corporate bond recovery rate adducing to bond default rate,

macroeconomic variables such as GDP and growth rate, amount of bonds outstanding, amount of default, return on default bonds, and stock return.

It was suggested that default rate, amount of bonds, default bonds, and economic recession had negative effect, while the GDP growth rate, and stock return had positive effect on corporate recovery rate.

2.6 Bank specific indicators and non-payment

In a study of institutional finance structure and implications for industrial growth, Mohan (2004) emphasized on key lending terms of credit, such as maturity and interest-terms of loans to corporate sector.

The Indian viewpoint alluding to the concepts of ‘credit culture’ owing to Reddy (2004) and ‘lazy banking’ owing to Mohan (2003a) has an international perspective since several studies in the banking literature agree that banks’ lending policy is a major driver of non-performing loans (McGoven, 1993, Christine 1995, Sergio,1996, Bloem and Gorters, 2001).

The study also highlighted the issues in security-based or collateralized lending, which need careful examination in the context of growing services sector. Although public sector banks have recorded improvements in profitability, efficiency (in terms of intermediation costs) and asset quality in the 1990s, they continue to have higher interest rate spreads but at the same time earned lower rates of return, reflecting higher operating costs (Mohan, 2004). Consequently, asset quality is weaker so that loan loss provisions continue to be higher.

Jimenez and Saurina (2003) used logit model for analyzing the determinants of the probability of default (PD) of bank loans in terms of variables such as collateral,

type of lender and bank borrower relationship while controlling for the other explanatory variables such as size of loan, size of borrower, maturity structure of loans and currency composition of loans. Their empirical results suggested that collateralized loans had a higher PD, loans granted by savings banks were riskier and a close bank-borrower relationship had a positive effect on the willingness to take more risk. At the same time, size of bank loan had a negative effect on default while maturity term of loans, i.e., short-term loans of less than 1-year maturity had a significant positive effect on default.

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CHAPTER THREE

METHODOLOGY

3.0 Introduction

In this chapter, an attempt is made to provide the analytical framework of the study by which the research questions are answered. The chapter focuses on the research method used, methods of data collection, sampling method and technique, the data collection process and how data will be analyzed. The source from which the data is gathered is also provided.

3.1 Research method

The survey method is employed as the main research method of this study. In the use of the survey approach, questions are directed at relatively large groups of people in order to explore issues largely in the present (Jankowicz, 2000). The choice of the survey method is motivated by the fact that the method best describes the opinions, personal characteristics, perceptions, preferences and attitudes of respondents. Besides, since the study aims at finding the causes of credit non-payment among SMEs within commercial banks, the survey method is deemed appropriate as it enables one to contact relatively large number of people to obtain data on the same issue by posing the same question to all, and can be done using the structured techniques.

3.2 Population

Population has been defined as the total collection of elements about which we wish to make some inferences (Cooper and Schindler, 2001). The population for this study is all SMEs who are clients or customers to commercial banks in the Accra metropolis. These commercial banks include Ghana Commercial Bank, Barclay's Bank Ghana, Standard Chartered Bank Ghana, Agricultural Development Bank (ADB) and SG-SSB.

3.3 Sampling and Sampling Technique

Sampling, according to Cooper and Schindler (2001), involves selecting some of the elements in a population and draw conclusions about the entire population. The compelling reasons behind the decision to sample includes the lower cost, greater accuracy of results and greater ease of data collection associated with sampling.

The study employed non-probability sampling technique/methods. The non – probability sampling method adopted was the convenience method.

The choice of convenience sampling method is motivated by the fact that it is relatively easier in reaching respondents in Accra since the researcher resides and schools there. Based on convenient sampling technique, a sample of two hundred (200) SME customers from the Ghana Commercial Bank, Barclay's Bank Ghana, Standard Chartered Bank Ghana, Agricultural Development Bank (ADB) and SG-SSB within the Accra Metropolis were selected given the time constraints and limited resources available for carrying out the study. These banks were chosen because they are the oldest and largest banks in Ghana and also have a dedicated

desk for their SMEs. They have the largest customer base (about 65% of the total customer base). They also contribute about 60% of the total deposit with Bank of Ghana. It was therefore assumed that customers of such banks (SMEs who do business with them) will have either applied for credit and could provide practical reasons for their inability to repay the loan at the schedule time or not pay at all. Also majority of the SMEs in Ghana are assumed to own at least one bank account in the country and since the study is to determine the causes of credit non-payment in commercial banks from the SMEs perspectives, SME customers of the banks in the Accra metropolis were targeted.

3.4 Research Procedure

Research techniques are particularly, step-by-step procedures which you can follow in order to gather data, and analyze them for the information they contain (Jankowicz, 2000). A list of SMEs was obtained in the selected commercial banks database. These SMEs were contacted through the phone to explain the purpose of the study and seek their permission to take part in the study. The researcher scheduled a date to meet the owners of the organisations who agreed to take part in the study for them to complete a questionnaire. Although the purpose of the study had been explained to them on phone there was a sheet attached to the questionnaire that explained the research and a consent form they needed to sign. It was further explained to them that they had the right to withdraw at any point during the research without any consequences and whatever information they provided or did not provide would not affect their dealings with the bank in any way.

3.5 Instruments/Measures

The study employed questionnaire as the main instrument for collecting the necessary data needed to answer the research questions posed. The items on the questionnaire were either closed-ended or open-ended based on what the researcher expected from the question. The questionnaire had subscales such as Macroeconomic Factors; Bank Related Factors; Bank Staff; Customer Related Factors; and Satisfaction level. Majority of the items on the questionnaire were closed-ended questions. This is because they are easier for respondents to answer and also facilitates interpretation of data by standardizing alternative responses. A Likert scale-typed questionnaire was used with responses ranging from 1 to 5. A lower score on the scale indicates a high level agreement with an opinion while a higher score indicates disagreement. Open - ended questions were also asked in order to provide the opportunity for respondents to express their own opinions or suggestions about the causes of credit non-payment.

3.6 Data Analysis

Data collected for the study was analyzed using descriptive statistics and measure of central tendency. The results are presented using tables and bar charts. The Statistical Package for Social Sciences (SPSS) was used to process the data set.

3.7 Pilot Study

The questionnaire used for the study was piloted on a sample of 15 people who transacted business with a commercial bank within the Greater Accra Region. This

comprised of 40% males and 60% females. The respondents were within the ages of 30 to 60 years, with varying educational background mostly degree holders.

The data obtained was analyzed to ascertain the reliability of the questionnaire. The scale was grouped under four main sub-headings, i.e. macro-economic factors, bank related factors, customer related factors, and bank staff related factors and customer satisfaction. The result showed that when all the four items that were initially designed to measure whether macro-economic factors was used to compute the reliability of the scale, the reliability was 0.245 (details are shown in appendix B), when the item change of government was taken out of the list of items the reliability changed to 0.512 although this was below the minimum threshold (0.7) recommended by Nunnally and Bernstein (1994). Details are shown in appendix C.

The part of the questionnaire which measured bank related factors as the determinants of credit non-payment contained six items. When all the six items were to compute the reliability of the scale, the Cronbach alpha was 0.466 (see appendix B for details), but when the item 'no credit payment schedule' was taken out from the scale there was a change reliability value(0.609), the details are shown in appendix C. This was below the threshold recommended by Nunnally and Bernstein (1994).

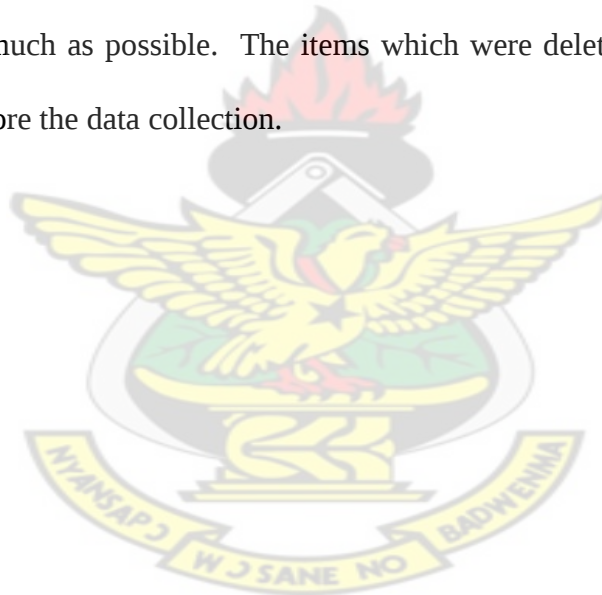
A three item sub-scale was used to measure if bank staff in a way contribute to credit non-payment. When all the three items were used to compute the reliability of the sub-scale, the Cronbach's alpha value was 0.720 (details are shown in appendix B) which was equivalent to the threshold recommended by Nunnally and Bernstein (1994).

There were seven items on the scale that was used to measure customer related factors which contributed to credit non-payment.

When all the items were used to compute the reliability of the sub-scale, the Cronbach's alpha value was 0.668 (details are shown in appendix B), which was approximately equal to the threshold recommended by Nunnally and Bernstein (1994).

The portion of the scale which measured the customers' satisfaction with their bank was made up of three items. When all the items were used to compute the reliability of the scale, the Cronbach's alpha was 0.819 (details are shown in appendix B), which was above the threshold recommended by Nunnally and Bernstein (1994).

The scale for the collection of the main data was modified to suit the reliabilities observed as much as possible. The items which were deleted in the analysis were reworded before the data collection.



CHAPTER FOUR

PRESENTATION AND DISCUSSION OF RESULTS

4.0 Introduction

This chapter presents the findings of the study based on the methodology espoused in chapter three. This is followed by the discussion of the results. The study adopted descriptive techniques and measure of central tendency to analyze the responses. Besides, some results are presented using tables and bar charts. In all about 200 questionnaires were sent out to collect the necessary data for the study. About 190 of the questionnaires were returned, which gives a return rate of 95%. Out of 190 questionnaires, there were 19 which were not properly completed and therefore could not be used as part of the analysis. The number of questionnaire used for the analysis for the study was 171.

4.1 Socio-economic Characteristics of Respondents

Out of 171 respondents survey, 85 (49.7%) were males, while 86 (50.3%) were females (see table 4.1 below).

Table 4.1: Gender of Respondents

Gender	Frequency	Percentage
Male	85	49.7
Female	86	50.3
Total	171	100

Source: Field Research (May 2011)

Of the 171 respondents, 32 (18.7%) were 20-29 years, 63 (36.8%) were 30-39 years, while 47 (27.5%) were 40-49 years. Also, there were 29 (17%) who were between the ages of 50-59 years (see table 4.2 below).

Table 4.2 Age range of respondents

Age (yrs)	Frequency	Percentage
20-29	32	18.7
30-39	63	36.8
40-49	47	27.5
50-59	29	17.0
Total	171	100

Source: Field Research (May 2011)

Most of the respondents (107) making up 62.6 % were degree holders, 48 (28.1%) had professional qualifications, while 8 had vocational qualifications. The remaining 8 had other educational qualifications, which included diploma. All the people who took part in the study had some form of education, which is good for the growth of the industry. This is because with their educational background they will better manage the affairs of the business and will have better understanding of business trends (see table 4.3 below).

Table 4.3: Educational Qualification

Educational Qualification	Frequency	Percentage
Degree	107	62.6
Professional	48	28.1
Vocational	8	4.7
Other	8	4.7
Total	171	100

Source: Field Research (May 2011)

Majority of the clients (167), making up 97.7% had bank accounts, while only 2.3% of the clients did not have a bank account. This is good for businesses, since majority of the interviewees had developed a saving culture for their businesses. It would also make it easier for the banks to access them through their records when they apply for credit. (See fig. 4.1 below)

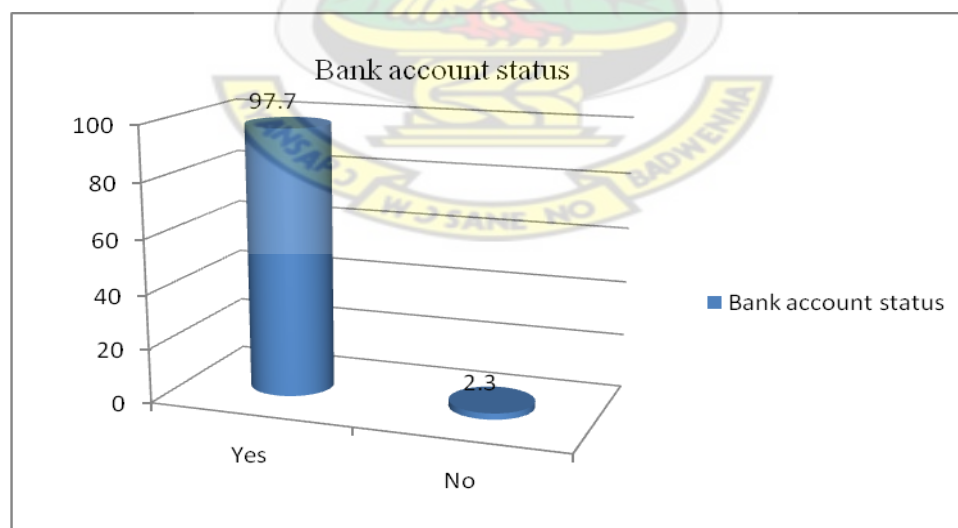


Fig. 4.1: Bank account status

About the same number of respondents (61 and 60) had below 5 years and 5-10 years of banking relationships respectively. Twenty four respondents had 11-15

years of banking relationships while 26 had more than 16 years of banking relationships. Most of the people interviewed had a long relationship with their banks which is good for the banks and the businesses themselves. This will help the bank to check on how their clients run their accounts and the past records of them as well as their credit worthiness which will be a good basis for commercial banks in deciding whether or not to grant credit. (See table 4.4 below).

Table 4.4: Banking relationship

Duration	Frequency	Percentage
Below 5	61	35.7
6-10	60	35.1
11-15	24	14.0
16 and above	26	15.2
Total	171	100

Source: Field Research (May 2011)

Majority of the clients making up 147 have applied for credit from a commercial bank, while 24 clients have never applied for a credit from a commercial bank.

Out of the 156 clients, majority (132) making up 77.2% had their loan applications approved and disbursed, while 24 of the clients making up 14% did not have their loan applications approved and disbursed.(see fig. 4.2 below)

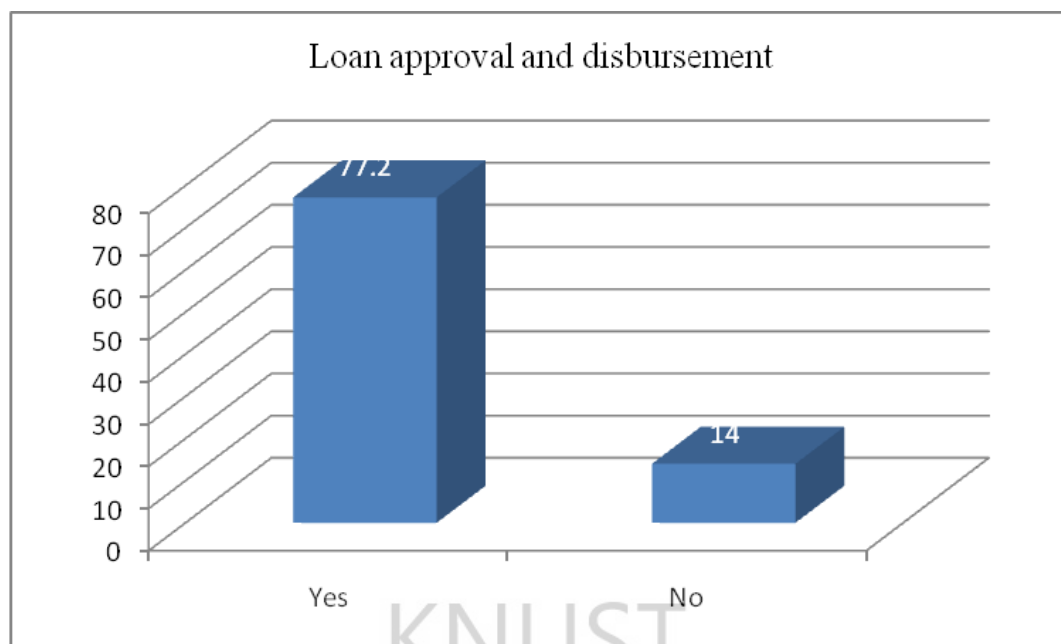


Fig. 4.2: Credit approval and disbursement

Among those respondents who said they had applied for credit before, about 53% (n=90) of the respondents said that they sought the credit for commercial purposes e.g. capital acquisition, purchase of raw materials, clearing of goods from the port, business expansion etc., while 33% (n=57) of them said the credit was for personal purposes e.g. acquisition of personal vehicle and houses, payment of children tuition etc., and the rest did not cite any purposes for the credit. (See table 4.5 below)

Table 4.5: Purpose of credit

Purpose	Frequency	Percentage
Personal	57	32.7
Commercial	90	52.5
Total	147	85.2

Source: Field Research (May 2011)

About 55% (n=94) of the respondents indicated that at the time they applied for the credit the interest rate charged was between 21 and 30%, 12% (n=20) of the respondents said that at the time they applied for the credit the interest rate was around 11 to 20%, while 13% (n=22) said the interest rate was above 31%, and 6% (n=10) said the interest rate was less than 10%. The general average price of credits in Ghana is between 21% to 30% so it is assumed that respondents who indicated that the interest rate charged was 10% and below, were charged per month.(see table 4.6 below)

Table 4.6: Interest rate charged

Interest rate	Frequency	Percent
0-10%	10	5.8
11-20%	20	11.7
21-30%	94	55
31% and above	22	12.9
Total	146	85.4

Source: Field Research (May 2011)

About 64% (n=110) of the respondents said the amount they applied for was over five thousand Ghana cedis (GHS 5000), while about 13% (n=22) said the credit they applied for was within one thousand and one cedis and five thousand cedis (GHS 1001-5000), and about 8% (n=14) said they applied for credit within five hundred and one thousand Ghana cedis (GHS 500-1000). (See table 4.7 below)

Table 4.7: Amount of credit disbursed

Amount	Frequency	Percent
GHC 501-1000	14	8.2
GHC 1001-5000	22	12.9
Over GHC 5000	110	64.3
Total	146	85.4

Source: Field Research (May 2011)

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4.2 Causes of Credit non-payment

4.2.1 Macroeconomic factors and credit non-payment

In finding out which macro-economic factors would cause SMEs to default the credit they have taken from the banks, about 63% (n=108) of the respondents agreed that change of government was one of the reasons why SMEs default or are unable to pay their credit at the scheduled time. This may be particularly true if the new government pursue tight fiscal policies in order to reduce budget deficit created by the previous administration. When such measures are taken, it reduces the level of economic activity and brings about low consumer confidence in the economy. (See fig. 4.3 below)

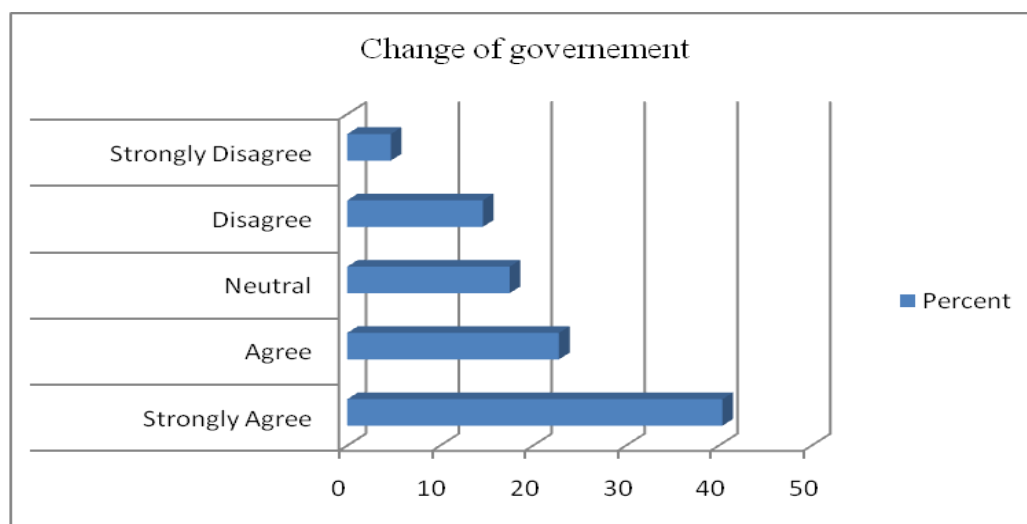


Fig. 4.3: Change in government and credit non-payment

It should also be noted that about 93% (n=159) of the respondents agreed that high inflation rate could also account for SMEs not paying their credit. High inflation rate leads to uncertainty in planning thus imparting negatively on business performance. High inflation rate also reflects in rising interest rates which makes credit payment even more difficult. (See table 4.8 below)

Table 4.8: High inflation rate

	Frequency	Percent
Strongly Agree	102	59.6
Agree	57	33.3
Neutral	12	7
Total	171	100

Source: Field Research (May 2011)

About 60% (n=153) of the respondents also affirm that high exchange rate could account for SMEs defaulting their credits. High exchange rates may affect the cost of production by raising the price of imported raw materials and machinery needed

for production. This may erode the provided margin of SMEs and weaken their ability to repay their credits. (See fig. 4.4 below)

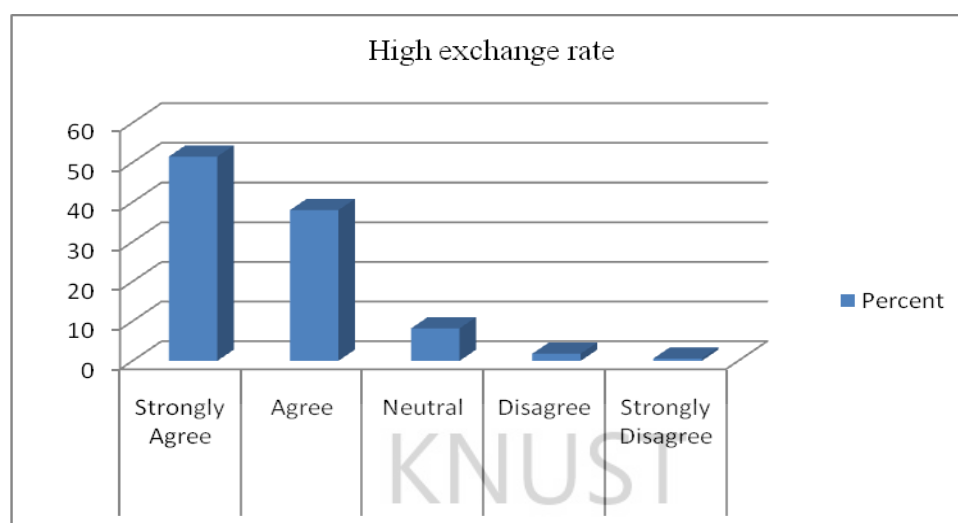


Fig. 4.4: High exchange rate and credit non-payment

Besides, 87.2% of the respondents asserted that high import tariffs may be blamed for credit non-payment. Only 2.9% of the respondents surveyed disagreed. (See table 4.9 below)

Table 4.9: High import duties/tariffs

	Frequency	Percent
Strongly Agree	88	51.5
Agree	61	35.7
Neutral	17	9.9
Disagree	5	2.9
Total	171	100

Source: Field Research (May 2011)

4.2.2 Bank related factors and Credit non-payment

In determining which bank related factors would cause SMEs to default a disbursed credit, about 94% (n=160) of the respondents agreed that high annual interest rates charged on the credits could account for SMEs defaulting. (See fig. 4.5 below)

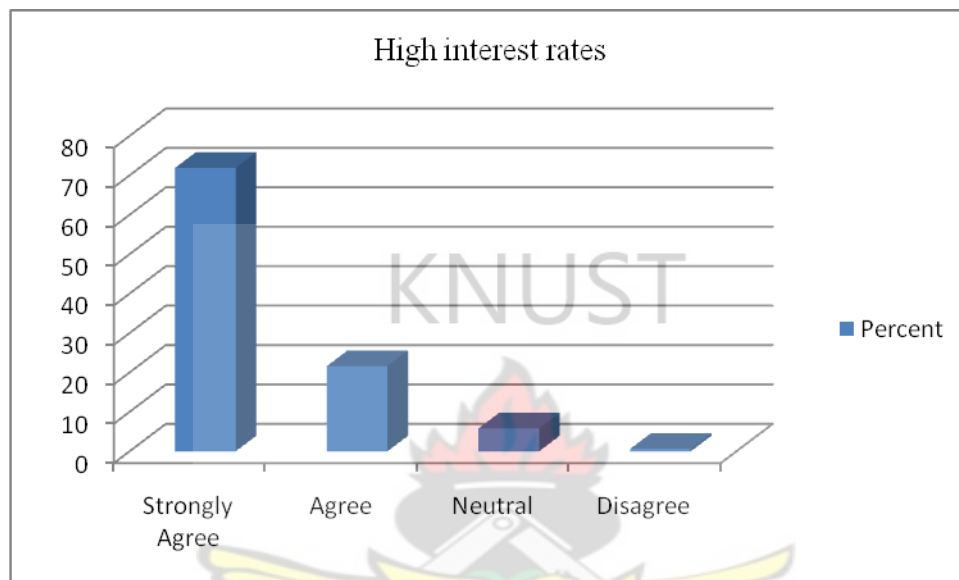


Fig. 4.5 High Interest rate and Credit non-payment

SMEs have limited time within which they have to repay the credit, and because this time frame is too short sometimes the investment has not started yielding results thereby making the SMEs to default. 84% (n=143) of the respondents agreed that the time of the disbursement or the delaying in the crediting of customers account could explain why SMEs default. (See table 4.10 below)

Table 4.10: Time of disbursement (delay in crediting of loan to account)

	Frequency	Percent
Strongly Agree	75	43.9
Agree	68	39.8
Neutral	15	8.8
Disagree	12	7
Strongly Disagree	1	0.6
Total	171	100

Source: Field Research (May 2011)

78% (n=134) of the respondents agreed that SMEs have limited time within which they have to repay the loan, and because this time frame is too short, sometimes the investment has not started yielding results thereby causing the SMEs to default. (See fig. 4.6 below)

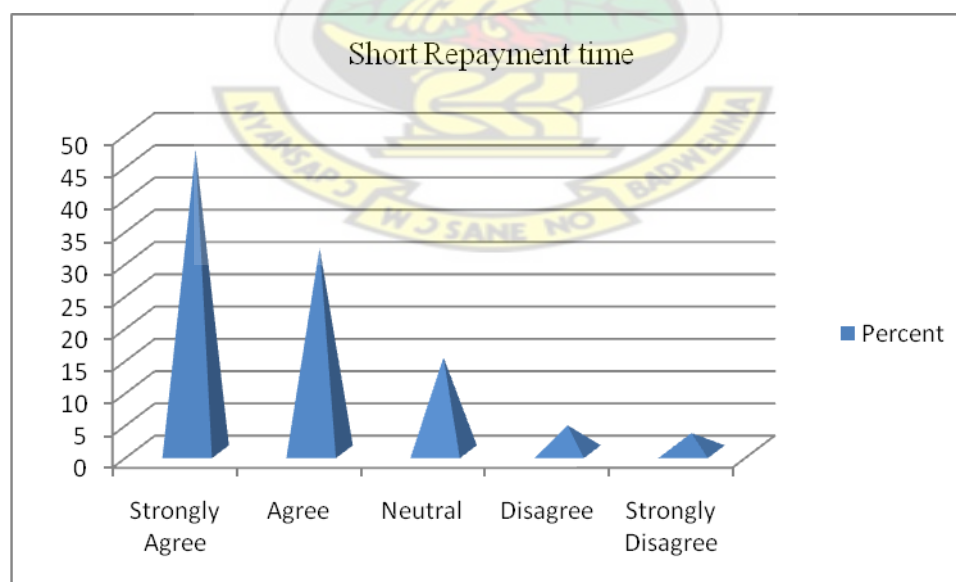


Fig. 4.6 Short repayment time and credit non-payment

About 83% (n=142) of the respondents agreed that sometimes the credit is not adequate for the intended purpose, therefore could not achieve their aim for them to be able to repay the loan. (See table 4.11 below)

Table 4.11: Inadequate credit

	Frequency	Percent
Strongly Agree	70	40.9
Agree	72	42.1
Neutral	23	13.5
Disagree	6	3.5
Total	171	100

Source: Field Research (May 2011)

About 44% (n=75) of the respondents agreed that there was no credit payment schedules for the SMEs to follow in repaying their credit and this could explain their non-payment. (See table 4.12 below)

Table 4.12: Credit payment schedule

	Frequency	Percent
Strongly Agree	34	19.9
Agree	41	24
Neutral	58	33.9
Disagree	29	17
Strongly Disagree	9	5.3
Total	171	100

Source: Field Research (May 2011)

About 91% (n=155) of the respondents agreed that high credit service charges, which includes processing, facility and legal fees, could be one of reasons why SMEs default their credits. (See table 4.13 below)

Table 4.13: High credit service charges (processing, facility, legal fees etc.)

	Frequency	Percent
Strongly Agree	106	62
Agree	49	28.7
Neutral	10	5.8
Disagree	6	3.5
Total	171	100

Source: Field Research (May 2011)

To find out how bank staff contributed to the problem of SMEs credit non-payment, about 60% (n=102) of the respondents agreed that bank staff extortion from SMEs in order to facilitate the credit could result in non-payment, while about 40% (n=69) of the respondents agreed that bank staff did not know what the credit would be used for, and about 43% (n=73) of the respondents agreed that calls and regular visit from staff of the banks could also account for the non-payment of SMEs.(see tables 4.14 to 4.16 below)

Table 4.14: Staff extortion (giving money to staff to enhance loan approval)

	Frequency	Percent
Strongly Agree	45	26.3
Agree	57	33.3
Neutral	41	24
Disagree	23	13.5
Strongly Disagree	5	2.9
Total	171	100

Source: Field Research (May 2011)

Table 4.15: Bank's knowledge of credit purpose

	Frequency	Percentage
Strongly Agree	31	18.1
Agree	38	22.2
Neutral	60	35.1
Disagree	38	22.2
Strongly Disagree	4	2.3
Total	171	100

Source: Field Research (May 2011)

Table 4.16: Bank's visits/calls

	Frequency	Percentage
Strongly Agree	31	18.1
Agree	42	24.6
Neutral	62	36.3
Disagree	29	17
Strongly Disagree	6	3.5
Total	170	99.4

Source: Field Research (May 2011)

4.2.3 Customer Related factors and Credit non-payment

To ascertain factors from the perceptive of SMEs as the contributing factors for their inability to repay their credits, about 77% (n=131) of the respondents agreed that theft or robbery was a contributing factor to their inability to pay their loans. (See figure 4.7)

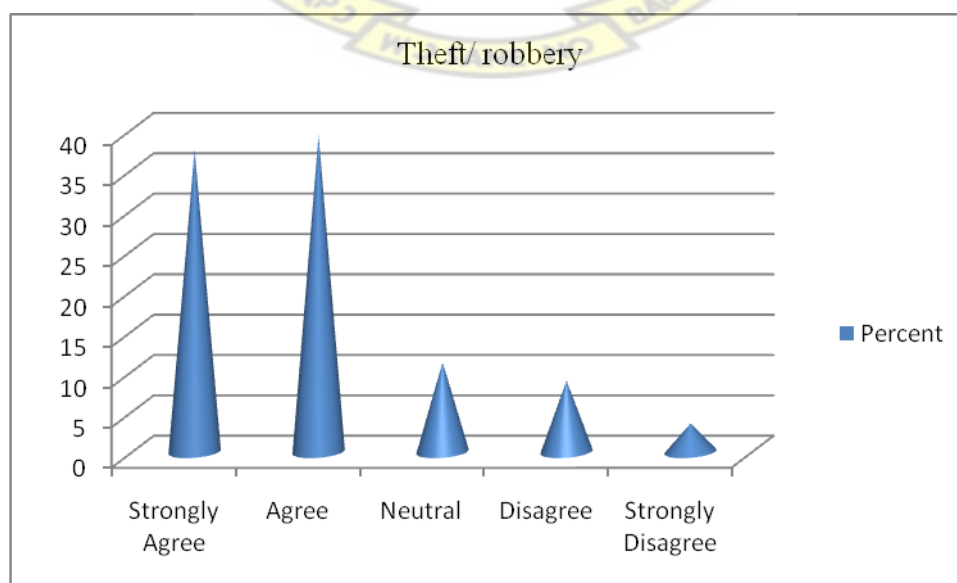


Fig. 4.7 Theft/ robbery and credit non-payment

Out of the total, 90% (n=153) of the respondents agreed that poor business performance was a contributing factor, 85% (n=146) of the respondents agreed that business failure or closed down was a contributing factor to credit non-payment among SMEs, 76% (n=130) of the respondents agreed that most credits are not properly timed and so contributing to their inability to repay, 67% (n=114) of the respondents agreed that rent or royalties linked to their place of operation contributes to their inability to repay their loans. (See fig. 4.8 and table 4.17 – 4.19 below)

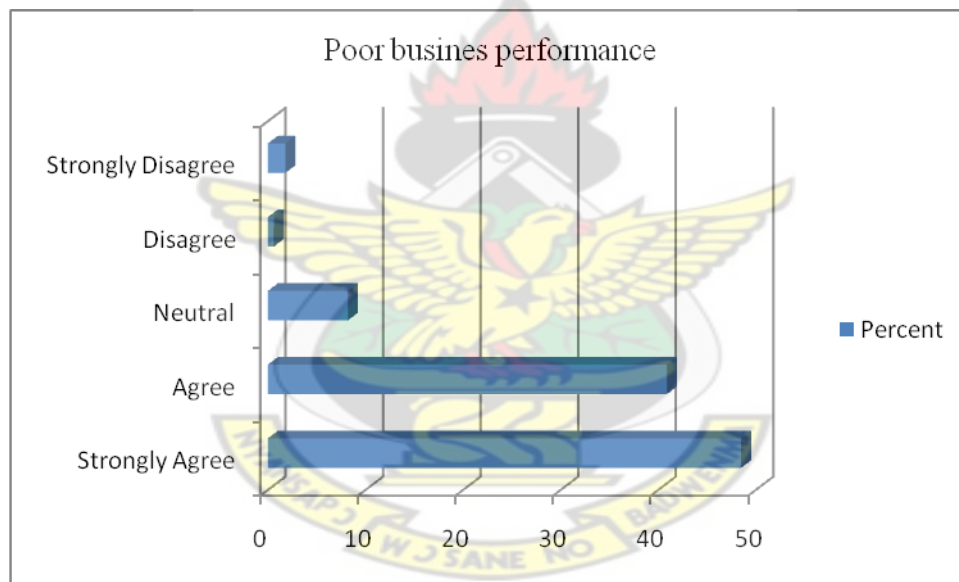


Fig. 4.8: Poor business performance and credit non-payment

Table 4.17: Business closed down

	Frequency	Percentage
Strongly Agree	87	50.9
Agree	59	34.5
Neutral	21	12.3
Disagree	4	2.3
Total	171	100

Source: Field Research (May 2011)

Table 4.18: Poor timing of credit

	Frequency	Percentage
Strongly Agree	67	39.2
Agree	63	36.8
Neutral	25	14.6
Disagree	12	7
Strongly Disagree	4	2.3
Total	171	100

Source: Field Research (May 2011)

Table 4.19: Tenancy agreement (rent or royalties linked to place of operation)

	Frequency	Percent
Strongly Agree	59	34.5
Agree	55	32.2
Neutral	45	26.3
Disagree	12	7
Total	171	100

Source: Field Research (May 2011)

Moreover, 86% (n=147) of the respondents agreed that diversion of credits or using credits for different purposes other than what was intended for contributes to SMEs inability to repay, and 73% (n=124) of the respondents agreed that domestic problems which might include many dependents may account for credit non-payment among SMEs. (See fig. 4.9 and table 4.20)

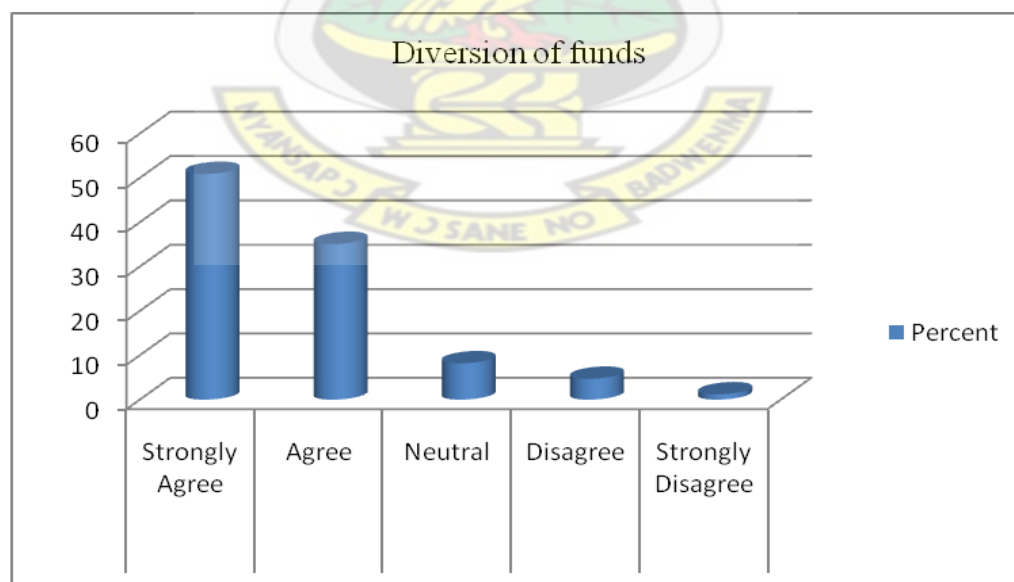


Fig. 4.9: Diversion of funds and credit non-payment

Table 4.20: Domestic problems (i.e. many dependents)

	Frequency	Percent
Strongly Agree	41	24
Agree	83	48.5
Neutral	39	22.8
Disagree	7	4.1
Strongly Disagree	1	0.6
Total	171	100

Source: Field Research (May 2011)

The respondents assigned various reasons which in their opinion affect their credit non-payments. Some of these reasons included credits not being used for right purpose, interest rate are very high, period for the repayments of credits are very short, personal reasons, poor business performance, high inflation rate, poor repayments plan, credits are too expensive, lack of cash flow, high bank charges, bad economic issues, lack of monitoring, inability to be creative, change in repayments after sometime, late disbursement of credit does not motivate repayments of loans, poor book keeping, entrepreneurs lack deep understanding of the venture in which they are into and therefore run at a loss so could not pay their credits, lack of planning, and closed down of business/bankruptcy. (See table 4.21 below).

Table 4.21: Reasons for credit non-payment

Reason for credit non-payment	Frequency	Percent
High interest rate	46	41
Period of repayments	15	13
Misuse of funds	20	18
Poor business performance	6	5
High inflation rate	2	2
Poor repayments plan	1	1
Loans too expensive	4	4
High bank charges	8	7
Lack of cash flow	2	2
Bad economic issues	3	3
Lack of monitoring	2	2
Others	3	3
Total	112	100

Source: Field Research (May 2011)

4.2.4 Recommended policies to credit non-payment (Views of Customers)

The respondents who took part in the study cited a number of ways through which credit non-payment could be addressed. Some of the recommendations given included, credit should be disbursed in trenches or cheques should be issued to suppliers on behalf of the company to avoid misuse of funds, reduction of bank charges, lower interest rates, time of repayments should be extended, the banks

should monitor the credit they grant, structuring of repayments plan, credit worthiness of customers should be assessed, reduction of policy rate, and reduction in bank's base rate (see table 4.22 below).

Table 4.22: Suggestions to curtail credit non-payment

	Frequency	Percent
Reduce bank charges	9	11
Lower interest rate	50	63
Extend repayment period	11	14
Monitoring of loans	7	9
Repayment plan	1	1
Credit worthiness	1	1
Total	79	100

Source: Field Research (May 2011)

4.3 Customer satisfaction

To find out how satisfied SMEs were as customers of the commercial banks, about 5% (n=9) of the respondents were extremely satisfied with the quality of service rendered to them by the banks, while 51% (n=87) were satisfied with the quality of service, and about 19% (n=33) of the respondents were dissatisfied with the service rendered to them by the commercial banks. About 10% (n=17) of the respondents were extremely satisfied with their personal contacts with the banks, while 51% (n=87) were satisfied with their personal contact, and 15% (n=15) were dissatisfied

with their personal contact. When the customers were asked about their overall satisfaction with the banks, 7% (n=12) of the respondents were extremely satisfied, while 46% (n=78) were satisfied, and 16% (n=27) were dissatisfied with the banks. (See table 4.23 – 4.25 below)

Table 4.23: Personal Contact

	Frequency	Percent
Extremely Satisfied	17	9.9
Satisfied	88	51.5
Neutral	41	24
Dissatisfied	24	14
Extremely dissatisfied	1	0.6
Total	171	100

Source: Field Research (May 2011)

Table 4.24: Quality of Service

	Frequency	Percent
Extremely Satisfied	9	5.3
Satisfied	87	50.9
Neutral	42	24.6
Dissatisfied	30	17.5
Extremely dissatisfied	3	1.8
Total	171	100

Source: Field Research (May 2011)

Table 4.25: Overall Satisfaction

	Frequency	Percent
Extremely Satisfied	12	7
Satisfied	78	45.6
Neutral	54	31.6
Dissatisfied	24	14
Extremely dissatisfied	3	1.8
Total	171	100

Source: Field Research (May 2011)

It was further computed to find out if there was any difference between males and females on their personal contact, quality of service and their overall satisfaction. The result computed shows that there was no significant difference between males ($M=2.59$, $SD=.917$) and females ($M=2.60$, $SD=.885$) on the quality of service ($t_{(169)} = -.119$, $p>0.05$), see table 4.26 for details.

That is the null hypothesis was supported and the alternative hypotheses rejected. It was further observed that was no significant difference between males ($M=2.42$, $SD=.905$) and females ($M=2.45$, $SD=.849$) on their personal contact with the banks ($t_{(169)} = -.224$, $p>0.05$), see table 4.26 for details. The null hypothesis was supported while the alternative hypothesis was rejected. Furthermore, the result shows that there was no significant difference between males ($M=1.59$, $SD=.890$) and females ($M=2.57$, $SD=.875$) on their overall satisfaction ($t_{(168)} = .137$, $p>0.05$), see table 4.26 for details. The null hypothesis was retained while the alternative hypothesis was rejected.

Table 4.26: Mean, standard deviation and t value for sex on quality of service, personal contact, and overall satisfaction.

	Gender of Respondent	N	Mean	SD	T	df	p
Quality of Service	Male	85	2.59	.917	-0.12	169	.905
	Female	86	2.6	.885			
Personal Contact	Male	85	2.42	.905	-0.22	169	.824
	Female	86	2.45	.849			
Overall Satisfaction	Male	85	2.59	.890	.137	169	.891
	Female	86	2.57	.875			

Source: Field Research (May 2011)

On the average (M=2.20, SD=1.24) the respondents agreed that change of government was a factor that could strongly affect credit payment, furthermore, most of the respondents on the average (M=1.47, SD=.62) strongly agreed that high inflation rate was a contributing factor in the ability of SMEs to repay their credit. Moreover, the average (M=1.6, SD=.76) by the respondents (i.e. they agreed) was that high exchange rate that affected the ability of SMEs to repay a loan. Also, on the average (M=1.64, SD=.78) the respondents agreed that high import duties/tariffs accounted for the inability of SMEs to repay the credit they have taken (see table 4.27 below)

Table 4.27: Mean and Standard Deviation for Macroeconomic factors

	N	Minimum	Maximum	Mean	Std. Deviation
Change of government	171	1	5	2.20	1.246
High inflation rate	171	1	3	1.47	.626
High exchange rate	171	1	5	1.62	.760
High import duties/tariffs	171	1	4	1.64	.779

Source: Field Research (May 2011)

The result of the study shows that on the average ($M=1.35$, $SD=.62$) most of the respondents strongly agreed that high annual interest rate charged on loan contributes to the inability of SMEs to repay the credit, on the average ($M=1.81$, $SD=.91$) most of the respondents agreed that time of the disbursement of the credit affects their ability to repay the credit, also, on the average ($M=1.85$, $SD=1.10$) most of the respondents agreed that the time for the repayment of the credit was too short thereby affecting the ability to repay. (See table 4.28 below)

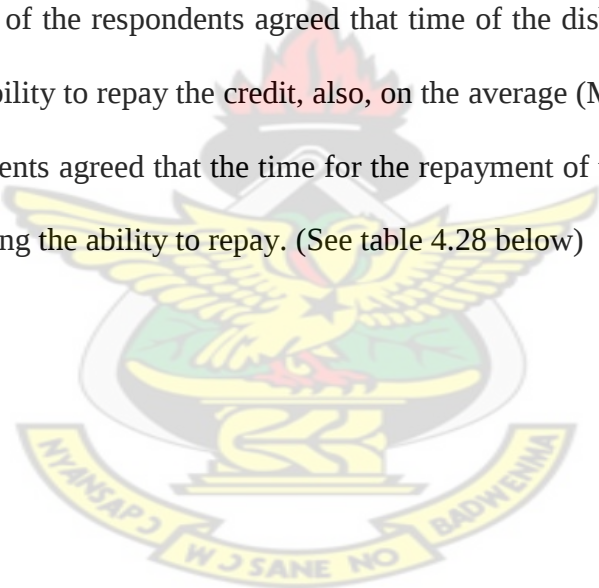


Table 4.28: Mean and Standard Deviation for Bank Related Factors

	N	Minimum	Maximum	Mean	Std. Deviation
High annual interest rate charged on loan	171	1	4	1.35	.618
Time of disbursement(delay in crediting of loan to account)	171	1	5	1.81	.910
Time for repayment too short	171	1	5	1.85	1.012
Loan amount not adequate for purpose	171	1	4	1.80	.804
No loan repayment schedule	171	1	5	2.64	1.136
High loan service charges (processing, facility, legal fees)	171	1	4	1.51	.762

Source: Field Research (May 2011)

4.4 Discussion

The purpose of this study was to investigate from the perception of SMEs factors that contribute to their default of loans granted them by the commercial banks. The results of the study indicated that there were a number of variables that accounted for the default SME's. The discussion of the findings in this study will be done for each factor. After this the following will be discussed: theoretical contributions of the study; practical implications of the study; directions for future research, study limitations and the conclusion.

4.4.1 Macroeconomic factors

Most of the respondents that took part in the study agreed that macroeconomic factors contributed largely to the inability of the SMEs to repay the loans granted them by the commercial banks. This was expected since factors such as high inflation rates, high exchange rates, and high import duties/tariffs are influenced by changes in government. This is because every government has its own plans, strategies, ideas and programs and the focus on how their governmental goals can be met could ultimately affect the fore mentioned variables. These variables affect the running of business entities and could affect gains to be made. This was consistent with findings by Frye (2000), Hu and Perraudin (2002), Düllmann and Trapp (2004), and Altman, Brady, Resti, and Sironi (2005). They found that recovery rates were positively related to macroeconomic conditions at the time of default. Specifically based on data for both U.S. public and private corporations from 1988 to 2007, they found that a one standard-deviation improvement in any of several standard macroeconomic performance variables at default, controlling for macroeconomic conditions at the inception of a loan, induces an increase in the expected firm recovery rate of about 7% of the total debt principal.

4.4.2 Bank Related Factors

The respondents agreed that bank related factors such as high annual interests charged on loans, the time of the disbursement of the loan as well as the time for the repayment of the loan provided to SMEs may not be adequate for the purposes for which they were intended. No specific structure or schedule for the repayment and high loan service charges were identified as the contributing factors to the inability

of the SMEs to repay their credit. Factors such as high credit charges and interest rate affect the value of the credit granted to SMEs. This is because if the interest rates go high it increases the interest to be paid on the loan which makes it more expensive than perceived. The present finding was consistent with the findings of McGroven, (1993); Christine, (1995); Sergio, (1996); and Bloem and Gorters (2001), where they found banks' lending policies were a major driver of non-performing loans.

4.4.3 Bank Staff Related Factors

Majority of the respondents agreed that the staff of commercial banks also contribute to the inability of the SMEs to repay the credit granted them. Some agreed that extortion by staff of the banks in order to facilitate the credit and staff not knowing what the credit is meant for, so loans are granted for thing that may not yield profit, are also major contributing factors.

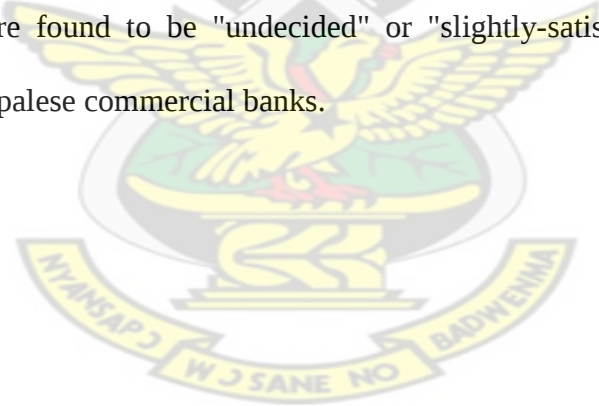
4.4.4 Customer Related Factors

The respondents agreed that there are factors which are associated with customers contributing to their inability to repay their credit. Some of the factors that they agreed to included theft or robbery at the business premises, poor business performance which may lead to the close down of the business. If the business shut down, payment of the credit becomes difficult since income generation also becomes difficult. They further agreed that the timing of the credit could also affect

the payment with time as the major component here. If the credit is not granted on time it could be used for other purpose rather than the one intended.

4.4.5 Customer Satisfaction

Most of the people interviewed were satisfied with the services rendered to them by their banks. More specifically they were satisfied with quality of the services rendered them and their personal contact/relationship with the bank. This was consistent with the work of Gautam and Dhital (2004), where they found that customer perception on banks' satisfaction program and the perceptual customer satisfaction is average in Nepalese commercial banks. They further found that, the mean satisfaction is slightly higher than the mean program perception. In general, customers were found to be "undecided" or "slightly-satisfied" with the present services of Nepalese commercial banks.



CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter provides a general summary and conclusion for the study, as well as recommendations for policy analysis and further studies. At the end of the chapter, limitations of the study are provided.

5.1 Summary of the Study

The study investigated the causes of credit non-payment in commercial banks from the perspective of SMEs. This is in line with current efforts aimed at unraveling the reasons behind the high incidence of credit delinquencies in the books of commercial banks in Ghana. The review of literature revealed the causes of credit non-payment as being multifaceted and can be attributed to a number of factors including macroeconomic variables, bank related variables and customer related variables among others. Baku and Smith (1998) asserted that, credit non-payment is detrimental to both the lender and the borrower due to the fact that the costs of credit delinquencies would be felt by both parties. The lender has costs in delinquency situations, including loss of interest, opportunity cost of principal, legal fees and related costs. For the borrower, the decision to default is a trade-off between the penalties in lost reputation from default versus the opportunity cost of forgoing investments due to working out the current credit.

In order to investigate the issue, the study adopted the survey method where questionnaires were issued to SMEs in the Accra Metropolis. Descriptive statistical and measure of tendency were used to analyze the data.

The findings from the study indicated that a number of macroeconomic factors, bank related factors, bank staff related factors and customer related factors account for the alarming rate of credit non-payment in commercial banks.

5.2 Conclusions

The following conclusions can be drawn from the study;

First, most respondents who took part in the study agreed that macroeconomic factors contribute largely to the inability of the SMEs to repay the credit granted to them by the commercial banks. This was expected, since factors such as high inflation rate, high exchange rate, and high import duties/tariffs are influenced by the change in government. This is because every government has its own programs, focusing how they try to achieve their aims could affect the fore mentioned variables. These variables affect the running of business entities and could affect gains to be made.

Secondly, the study lends credence to the fact that bank related factors such as high annual interests charged on credits, the time of the disbursement of the credits, time for the repayment of the credits, credit provided to SMEs may not be adequate for the purposes for which they were sorted for, no specific structure or schedule for the repayment and high credit service charge as the contributing factor to the inability of the SMEs to be unable to pay their credit.

Factors such as high credit charges and interest rate affect the value of the credit granted to SMEs. This is because if the general interest rate goes high it increases the interest to be paid on the credit which makes it more expensive than perceived.

Third, majority of the respondents believed that the staff of the banks also contribute to the inability of the SMEs being unable to pay the credit granted them. Some agreed that extortion by staff of the banks in order to facilitate the credit is also a contributing factor. Most SMEs are not truthful about exactly what the credit is meant for, so credit are granted for things that may not yield profit to assist in paying credit.

Fourth, the findings from the study attest to the fact that customer related factors such as theft or robbery at the business premises, poor business performance which may lead to the closure of business and time of taking the credit may account for credit non-payment.

Finally, it was revealed from the study that customers are generally satisfied with the services offered them by the commercial banks but indicated that there is more room for improvement.

5.3 Recommendations

Based on the conclusions from the study, the following policy recommendations are provided;

First, government should continue to pursue prudent fiscal and monetary policy that will ensure macroeconomic stability and provide the enabling environment for businesses to flourish.

A concerted effort should be made to keep the rate of inflation at a low level to aid business growth so as to place SMEs in a better position to repay their credit.

Second, the commercial banks should attempt to reduce their lending rates and other credit related charges and provide technical assistance to businesses. The banks must also ensure that there is timely release of funds.

Lastly, small scale businesses should desist from the practice of using borrowed funds for other purposes rather than the intended purpose for which the funds were acquired. If these measures are taken, it will help a long way in reducing the alarming rate of credit non-payment in Ghana.

5.4 Study Limitations and Direction of Future Research

Some of the limitations of this study are that, care should be taken when interpreting the results or generalizing of results. First of all, there is a potential common method variance problem as a result of using self-report measures which raise some doubt about the objectivity of the data collected. Additionally, consistency bias may have led to an exaggeration of the relationships found in the study since participants may have responded in like manner to questions.

The current study also provides implications for future research. Future research could examine from the banks perspective what they believe to be the reason why SMEs defaults credit granted to them. Credit non-payment will continue to engage economist, bankers and other interested bodies over the next two decades.

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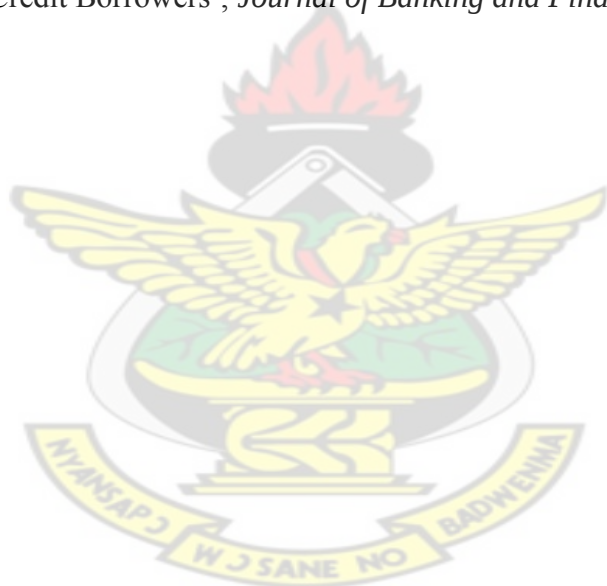
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APPENDIX A: RESEARCH QUESTIONNAIRE

CAUSES OF CREDIT NON-PAYMENT IN COMMERCIAL BANKS: SMES' PERSPECTIVE

SECTION A. DEMOGRAPHIC PROFILE

- SA1 Gender Female [] Male []
- SA2 Age 20-29 [] 30-39 [] 40-49 [] 50-59 []
60 and over []
- SA3 Educational Qualification Degree [] Professional [] Vocational []
others (Specify).....
- SA4 Do you have a bank account? Yes [] No []
- SA5 Name of bank.....
- SA6 Banking relationship (Duration) below 5yrs [] 6 – 10yrs []
11-15yrs [] 16yrs and above []
- SA7 Have you ever applied for credit in any Commercial bank? Yes [] No []
- SA8 Was the credit approved and disbursed? Yes [] No []
- SA9 What was the purpose of the credit? Personal [] Commercial []
- SA10 What was the interest rate charged? 0-10% [] 11-20% [] 21-30% []
31% and above []
- SA11 How much did you apply for? Below GHS 500 [] GHS 501–1000 []
GHS 1001 - 5000 [] Over GHS 5000 []

SECTION B. CAUSES OF CREDIT NON-PAYMENT; CUSTOMERS' VIEW

This section deals with causes of credit non-repayment. Please show the extent to which you agree or disagree as indicated by the scale below.

No.		Scale				
	These factors are likely to affect the repayment of credit.	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
		1	2	3	4	5
	Macroeconomic Factors					
SB1	Change of government					
SB2	High inflation rate					
SB3	High exchange rate					
SB4	High import duties/tariffs					
	Bank Related Factors					
SB5	High annual interest rate charged on the credit					
SB6	Time of disbursement(delay in crediting of facility to account)					
SB7	Time for repayment too short					
SB8	Credit amount not adequate for purpose					
SB9	No credit payment schedule					
SB10	High credit service charges (processing, facility, legal fees etc)					
	Bank Staff					
SB11	Staff extortion(giving money to staff to enhance credit approval)					
SB12	Staff knowledge on what credit will be used for					
SB13	Bank regular visits/calls to you					
	Customer Related factors					
SB14	Theft or robbery					
SB15	Poor business performance					
SB16	Business closed down					
SB17	Poor timing in taking credit					
SB18	Tenancy agreement(rent or royalties linked to place of operation)					
SB19	Diversion of funds(used credit for a different purpose)					

No.	These factors are likely to affect the payment of credit.	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
SB20	Domestic problems (i.e. many dependents)					

SECTION C. SATISFACTION LEVEL

This section deals with your SATISFACTION LEVEL as a customer. Please show the extent to which you were satisfied or dissatisfied as indicated by the scale below.

No.	SATISFACTION LEVEL	Scale				
		Extremely Satisfied	Satisfied	Neutral	Dissatisfied	Extremely dissatisfied
		1	2	3	4	5
SC1	Personal Contact					
SC2	Quality of Service					
SC3	Overall Satisfaction					

In your opinion, why do you think borrowers generally default with their credit repayment?

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What suggestions would you give to the bank to help curtail the alarming rate of credit non-payment among its borrowers?

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APPENDIX B: Reliabilities of the sub-scales when the original number of items is used.

sub-scales	cronbach's alpha
macro-economic factors	.245
bank related factors	.466
bank staff related factor	.720
customer related factors	.668
customer satisfaction	.819

Source: Field Research (May 2011)

APPENDIX C: Reliabilities of the sub-scales when some of the items are deleted.

sub-scales	cronbach's alpha
macro-economic factors	.517
bank related factors	.609

Source: Field Research (May 2011)