

**ASSESSING THE CONTRIBUTION OF RURAL AND COMMUNITY
BANKS TOWARDS SMALL AND MEDIUM ENTERPRISE
DEVELOPMENT: A CASE STUDY OF TWO SELECTED RURAL
BANKS IN NKORANZA NORTH AND SOUTH DISTRICTS**

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DECLARATION

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

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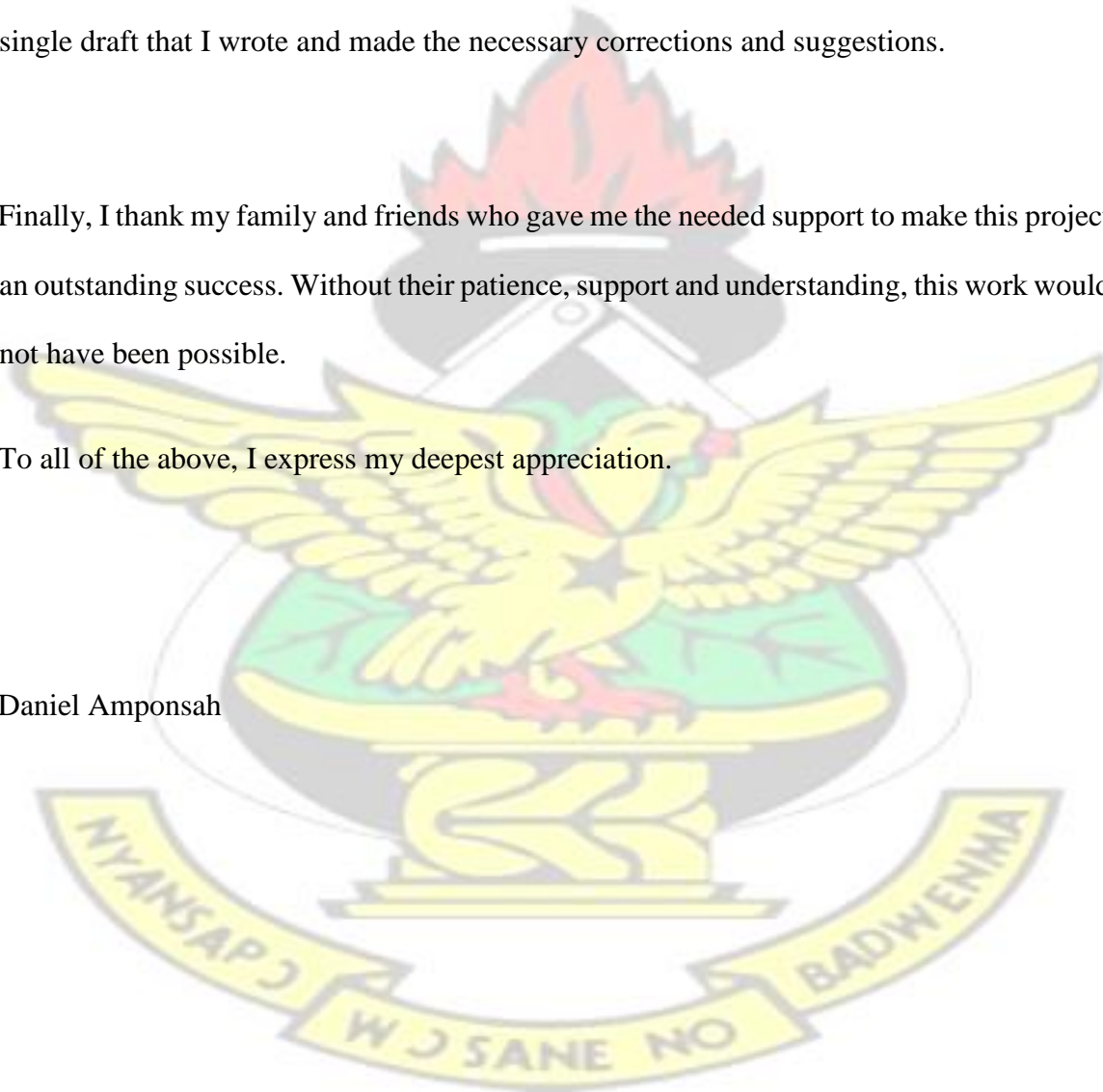
I am grateful to the Management and staff of the two rural banks which helped in the acquisition of the required information.

I cannot underestimate the value of my supervisor, Dr. W. A. Owusu Ansah in complimenting my effort. He listened to my problems and painstakingly read through every single draft that I wrote and made the necessary corrections and suggestions.

Finally, I thank my family and friends who gave me the needed support to make this project an outstanding success. Without their patience, support and understanding, this work would not have been possible.

To all of the above, I express my deepest appreciation.

Daniel Amponsah



DEDICATION

To my wonderful sons Emmanuel, Daniel and Michael

KNUST



ABSTRACT

This study seeks to evaluate the contributions, both financial and non-financial, made by Rural and Community Banks (RCBs) in Ghana towards Small and Medium Scale Enterprises (SMEs) development. The establishment of Rural and Community Banks was accentuated by the fact that the universal banks could not accommodate the financial intermediation problems of the rural poor and the Small and Medium Scale Enterprises

(SMEs) as they did not show any interest in dealing with these small scale operators. Data were collected from one hundred SME customers and some key staff of two selected rural banks, Nkoranza-Kwabre and Fiagya Rural Banks which are used as case study in the research. It was noted in the research that RCBs have helped in creating a dependable channel for savings mobilisation and access to credit among rural and urban dwellers particularly those in small businesses. The study also noted that the SMEs face challenges in some instances in applying for credits from the rural banks which include high collateral requirement, high interest rates, lack of proper financial records, and lack of information on the credit facilities available, delays in loans processing and unfavourable loan repayment plan or schedules. Appropriate recommendations have been provided which when adhered to could be mutually beneficial to SMEs and the RCBs.

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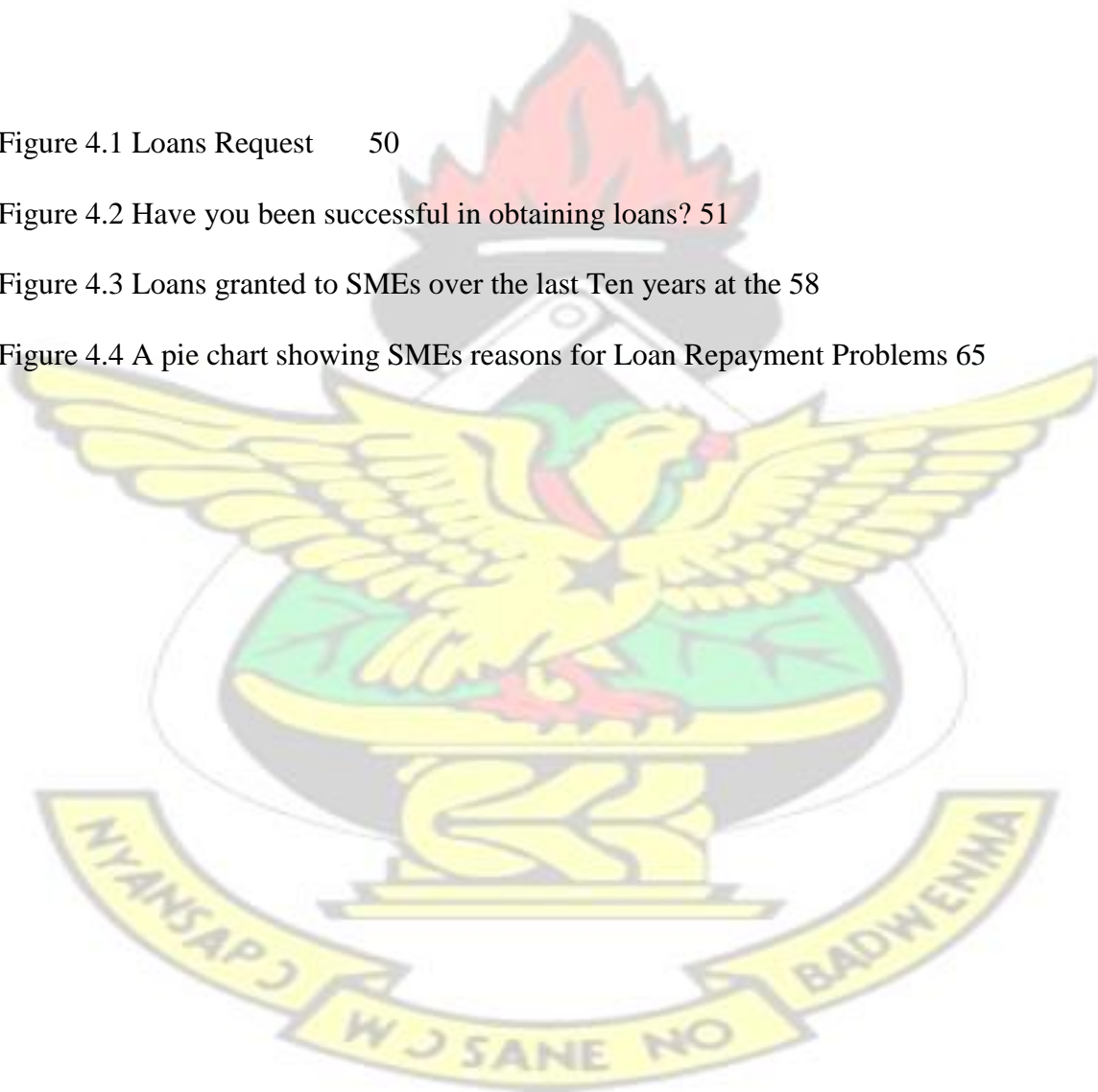
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CHAPTER ONE

1.1 BACKGROUND OF THE STUDY

The search for a system to tackle the financial problems of the rural dwellers in Ghana started as far back as 1960s under the Nkrumah regime. During that period, the need for a veritable rural financing system in Ghana to see to the needs of small scale farmers, fishermen, craftsmen, market women, traders and all micro-enterprises was felt. The need for such a system was accentuated by the fact that the bigger commercial banks could not accommodate the financial intermediation problems of the rural poor and the Small and Medium Scale Enterprises (SMEs) as they did not show any interest in dealing with these small scale operators (Bank of Ghana Research Department, 1976).

There was a yawning gap in the provision of financial advice and access to finance for the small scale operators and peasant farmers. These small scale operators and peasant farmers were generally neglected and were left to the mercy of informal sector intermediaries like money lenders 'Susu' operators, cocoa marketing cooperatives etc who charged usurious interest rates which consequently deterred borrowers and tended to discourage the indigenous entrepreneurs (Emmanuel Assiedu-Mante, 2011). Although the Government of Ghana took some policy measures to improve access to finance in to these areas, some of which were requirement that commercial banks lent at least 20 percent of their portfolio to agricultural sector, and also the establishment of the Agricultural Development Bank (ADB) in 1965 with an exclusive mandate of lending for agriculture and allied industries in rural Ghana (The Agricultural Credit and Co-operative Act, 1965, Act 286); nonetheless, lending to the rural sector and small scale entrepreneurs remained low; the commercial banks primarily concentrated their banking activities in urban areas and well established business. Mensah (1993) and Ranade (1994) found that the ADB's credit provision and

coverage were limited; only 27 percent of its branches were in rural areas, and lending to smallholder farmers and businesses made up only about 15 percent of its total portfolio.

In 1976, the Government of Ghana, through the Bank of Ghana, established the first Rural Bank in Ghana, Nyarkrom Rural Bank Limited, in the Central Region of Ghana. The aim was to channel credit to productive rural ventures and promote rural development and to reduce rural poverty through the provision of banking services to the previously “unbankable” market on a sustained and in a profitable manner. Rural Banks were to be focal points, vehicles and catalyst for rural and community development, key among which are the peasant farmers and people in the small and medium scale enterprises.

The Ghana experience to establish a rural bank was adopted from the Philippines. The Philippines experience now shows that the presences of rural banks with their expertise in financing micro-entrepreneurs and poor households have stimulated economic activity. The results suggest a comparative advantage of rural banking in building a closer relationship in the lending segment of the market favoring therefore the financing of projects that commercial banks would not have done (The Republic of Philippines: The Rural Micro-enterprise Finance Project Report (RMFP), 2004).

However, there is some anecdotal evidence that many beneficiaries of rural bank credits in Ghana are salaried workers, whose likelihood of loan repayment is believed to be better than that of these peasant farmers and small-scale enterprises.

The significance of small entrepreneurial businesses to national economies and society cannot be downplayed. They are important to national economic development and the seed bed to most large business. SMEs provide employment to a lot of young entrepreneurial talents. Most stakeholders have called for various interventions to help develop the SMEs, yet recent studies have proved that few of the SMEs in Ghana are competitive in today's globalised business environment (Joshua Abor and Peter Quartey, 2010).

With growing number of rural banks in Ghana, now at 132, with over 500 branches and mobilisation centres (ARB Apex Bank Efficiency and Monitoring Unit Report, 2011); one can conclude that rural banking system have come to stay and need to be strategically run to meet the purpose of their establishment. According to Roderick Okoampah, Microfinance Technical Officer, ARB Apex Bank, Apex News March 2012, Rural Banks and Small and Medium Scale Enterprises relationship can be mutually beneficial if the understanding is reached between owners of SMEs and the Rural Banks.

1.2 STATEMENT OF THE PROBLEM

Despite the growing recognition of the important roles Small and Medium Enterprises (SMEs) play in economic development, access to banking services still remains a worry for most of them. Whereas a small number of banks finance SMEs activities, most banks still deny these enterprises access to credit because of their credit risk management process. The World Bank report (1999), ranked Ghana 95th out of 175 countries on the ease of doing business. One major reason why Ghana felt short of the required standards was due to the difficulty of businesses, especially SMEs, in accessing credit from banks to expand their activities.

According to Dr. Kwasi Amissah-Arthur, Governor of Bank of Ghana, “recent development indicates that not enough credit is flowing to the real economy to spur productive activities and a credit survey carried indicated credit conditions for Banks showed some level of credit-tightening to enterprise and household”. Bigsten (1999), about 90% of small firms are refused loans when applied for from the banks due to inability to fulfill conditions such as collateral security. According to Mrs. Felicity

Acquah, Managing Director of Exim Guaranty, “the high risk associated with lending to SMEs, which mostly have inadequate collateral or security among others have often caused financial institutions to limit lending to them” (Business and Financial Times, 2011:2). Professor George Gyan-Baffour (Chronicle, 2008:1), indicated that, “high interest rates charged by universal banks as well as savings and loans companies are killing businesses in the country, especially Small and Medium Enterprises (SMEs); the trend between lending and borrowing is still high and is negatively affecting the growth of businesses in the country thereby forcing more businesses to close down”.

Many SMEs therefore resort to traditional sources of finance such as company-retained earnings, personal savings and borrowing from friends and relatives as source of credit for their businesses. The persistent complaint of SMEs about their problems regarding access to finance is a constraint that endangers the economic recovery of the country.

Rural Banks by the objective of their establishment were to mobilize deposits and channeled their lending to rural farming and small scale enterprises. Since the establishment of the first rural bank thirty-six (36) years ago the question one would ask is, what contributions have Rural Banks made to the SME development in terms of

finance and non-financial assistance?

Although, RCBs are to serve as catalyst for SMEs development in terms of financial and non-financial contribution not much research have sought to establish and provide empirical evidence as to whether this causal relationship have been attained and yielded any meaningful results. It is to harness this imbalance that this research seeks to attain and provide through its findings the needed information to help promote SMEs in Ghana through Rural Banking.

1.3 OBJECTIVE OF THE STUDY

The objectives have been categorised in into two. The main and the specific objectives

1.3.1 Main Objective

The purpose of this study is to ascertain the remarkable contributions (financial and nonfinancial) of Rural and Community Banks (RCBs) towards SME improvement, growth and expansion in Ghana using two selected rural banks in Brong Ahafo with their 100

SME clients as a case study.

1.3.2 Specific Objectives

1. To assess the credit policies used by the rural and community banks on SMEs
2. To assess the effects of the credit policies on the growth of the SMEs
3. To examine the product and services that SMEs are benefiting from in the rural banks.
4. To examine the role of the ARB Apex Bank Ltd as a “mini-central bank” for RCBs in the light of assisting rural banks to provide on-lending finance, education and training to enhance capacity building for RCBs towards the development of enterprises classified as small and medium.

1.4 RESEARCH QUESTIONS

In the forgoing, there are numerous concerns and questions that the researcher sought to answer:

1. What credit appraisal techniques are used by rural banks in granting credit to SMEs?
2. What are the effects of these credit appraisal assessments on SMEs propositions?
3. What are the major challenges that SMEs face in accessing credits from rural banks?
4. What is the future of the linkage roles and various interventions from the government and the ARB Apex Bank on SMEs development through the RCBs?

1.5 SIGNIFICANCE OF THE STUDY

Rural and Community Banks put together have the widest coverage and widest branch network in Ghana; with 133 Rural and Community Banks and over 500 branches

(Efficiency Monitoring Unit, ARB Apex Bank Report, September 2011). From Ghana Statistical Service, SMEs account for about 75% of all firms and have become an important contributor to the Ghanaian economy. From the forgoing, the two entities are of tremendous importance in the bit to promote national economic development. This research would help readers and accord them the following opportunities:

1. The study will assist the government and all stakeholders in SMEs to understand and appreciate the problems faced by SMEs in accessing loans and other services from RCBs and banks in general and its effects on their growth so as to come up with programmes, schemes and facilities to enable SMEs develop.

2. To furnish SMEs with information as to what they can do in order to meet the credit requirements of the rural banks and for that matter other universal banks at large.
3. This study identifies the procedures that rural banks adopt in granting credit to SMEs and critically assesses the terms and conditions for credit assessment by rural banks.
4. Additionally, the study suggests possible ways by which credit assessment can be made more flexible to SMEs and to enable the rural banks to realize the gap between their stringent credit policies and the actual problems that the SMEs face.
5. Also the information from this research is to help the rural banks put in place better credit assessment policies to suit SMEs.

1.6 SCOPE OF THE STUDY

In an attempt to investigate the development of SMEs through the services and support of rural and community banks, the research will focus on two selected rural banks within the Brong Ahafo Region. The chosen rural banks are Nkoranza-Kwabre Rural Bank Ltd and Fiagya Rural Bank Ltd. Manuals, qualitative and quantitative, from these banks will be used. The selection was based on the fact that geographically these banks share things in common which could help establish justifiable reason for our findings. Strategically, a number of SMEs can be located within the catchment areas of these banks. NkoranzaKwabre Rural Bank has its head office in Akuma in the Nkoranza North District and with

Branches in Techiman, Tuobodom, Nkkwabeng, Donkro-Nkwanta and Nkoranza. Fiagya Rural Bank also is in Nkoranza South Districts, with the head office at Busua; branches include Techiman, Nkoranza, Akomadan, and Sunyani.

Also, related literature work from local as well as foreign sources will be reviewed on the research topic. The research will also rely on related journals, newspapers, articles, internet, seminar and workshop papers and presentations.

1.7 LIMITATIONS OF THE STUDY

As much as it is desired to come out with conclusions which add to knowledge on possible enhancement of RCBs to transform and improve SMEs development in Ghana, the research was faced by a number of limitations, and some of these limitations were as follows:

- The unwillingness of banks to give out honest and reliable information due to privacy policies of the banks which partially affected the validity of the results of the study.
- The customers' unwillingness due to their level of intuition and understanding of the purpose of the research which also partially affected the validity of the results.
- This work is limited to the extent that the researcher was unable to cover all the RCBs in the country as a result of time and cost.
- The researcher is also a staff of Nkoranza-Kwabre Rural Bank Limited and as such responses might subjectively be to satisfy the researcher. However, a highly structured and open ended questionnaire was used to increase reliability.

- Constraints due to cost of transportation, printing and editing also hindered the scope and volume of work that could have been covered.

1.8 ORGANISATION OF THE STUDY

This study is organized in such a way as to give a systematic dissection of the research problem. The document is in five parts.

Chapter one consists of the introduction. It covers the background of the study, statement of the research problem, research objectives, research questions and significance of the study, scope of the study, limitations and organization of the study. Chapter two is the literature review. This chapter considers the theoretical framework of the research. It also explores work that has been done in this area both outside and inside the country. It also covers some secondary information on SME development in the country and topics discussed include credit policies that rural banks use in granting loans to SMEs, the constraint SMEs face in accessing credit from rural banks and the impact of credit on the growth of SMEs. It also looks at the various government interventions for SMEs channeled through RCBs. Chapter three is the research methodology. It discusses the techniques of data collection and analysis methods. Chapter four is the data analysis and discussion of findings. It discusses both the primary and secondary data collected from the selected rural banks and their respective SMEs customers. Chapter five consists of conclusions and recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

This Chapter seeks to find out what authors have written about the subject matter. It primarily deals with and put more lights on the research work by other authors with regards to the subject matter. It also encompasses reports on information found in existing literature on Rural Banks and Small and Medium Scale Enterprises. The chapter looks at the definition of SMEs, their Characteristics and Roles, Constraints to SMEs development - Bank's perspective, SMEs Financing from Banks, Principles of good lending on SMEs, Concept of Rural Banking and SME development, Supports for Rural

Banks towards SMEs Development

2.1 DEFINITION OF SMALL AND MEDIUM SCALE ENTERPRISE

What constitutes an SME is a matter of concern in various studies and literature. There are various definitions used to typify SMEs. According to Bock (1989), Georgia Institute of Technology has more than fifty definitions for SMEs .The International Labour Organization (ILO) gives a broad meaning which includes modern individual firms employing up to fifty employees, family units employing three to four people, group companies and small self employed firms in the informal sector of the economy (ILO,2002). The Ministry of Local Government and Rural Development considers any establishment that employs one to nine employees as a small-scale enterprise, ten to twenty employees as a medium-scale enterprise and above twenty employees as a largescale enterprise. The National Board of Small Scale Industries (NBSSI) in Ghana applies both

the 'fixed asset and number of employees' criteria. It defines a Small Scale Enterprise as one with not more than 9 workers, has plant and machinery (excluding land, buildings and vehicles) not exceeding 10 million Cedis – GH¢1,000.00 (US\$ 9506, using 1994 exchange rate; US\$0.9506). The Ghana Statistical Service (GSS) considers firms with fewer than 10 employees as Small-Scale Enterprises and their counterparts with more than 10 employees as Medium and Large-sized enterprises. Ironically, the GSS in its national accounts considered companies with up to 9 employees as SMEs (Kayanula and Quartey, 2000). UNIDO defines SMEs in developing countries based on the number of employees in an enterprise. A small enterprise has between 5 and 19 workers and takes the example of the ubiquitous small shops in the cities such as hair dressing saloons and chop bars. A medium enterprise has 20 to 99 workers and these include manufacturing firm and exporting companies. It is to be noted that some of these definitions vary according to the number of employees, level of investments, total assets and turnover.

There is no single, universal, uniformly acceptable definition of small scale enterprises. Several measures have been used to define the small scale enterprise sector. The most commonly used is the number of employees of the enterprise. However, in applying this definition, confusion often arises in respect of the arbitrariness and cut off points used by various official sources.

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

SMEs based on the number of employees ranging between one and twenty.

2.2 CHARACTERISTICS OF SMES

According to Hodgetts and Kuranthko (1998), there are four qualitative factors that distinguish SMEs from large firms namely;

1. Management of SMEs is independent, since the manager usually owns the firm.
2. Capital is usually supplied by an individual or a few individuals who hold ownership.
3. The area of operations is primarily local, although the market is not necessarily local.
4. The firm is small in comparison with the largest competitors in the industry.

The Bolton Committee Report (1971) suggested and proposed that a small firm has three essential characteristics:

1. It has a relatively small share of the market in economic terms;
2. It is managed by owner(s) in a personalized way, and not through the medium of a formalized management structure;
3. It is independent, in the sense of not forming part of a large enterprise and its ownership is relatively free from outside control in its principal decisions.

Taken together, these characteristics provide a qualitative and quantitative description of SMEs. Another distinguishing feature of small and medium-scale enterprises from larger

firms is that the latter have direct access to international and local capital markets whereas the former are excluded because of the higher intermediation costs of smaller projects. As Aryeetey et al (1994) notes, SMEs face the same fixed cost as large scale enterprises in complying with regulations but have limited capacity to market products abroad.

SMEs in Ghana can be categorised into urban and rural enterprises. The former can be subdivided into “organised” and “unorganised” enterprises (Liedholm & Mead, 1987). The organised ones tend to have paid employees with a registered office whereas the unorganised category is mainly made up of artisans who work in open spaces, temporary wooden structures, or at home and employ little or in some cases no salaried workers. They rely mostly on family members or apprentices.

Rural enterprises are largely made up of family groups, individual artisans, women engaged in food production from local crops. The major activities within this sector include:- soap and detergents, fabrics, clothing and tailoring, textile and leather, village blacksmiths, tin-smithing, ceramics, timber and mining, bricks and cement, beverages, food processing, bakeries, wood furniture, electronic assembly, agro processing, chemical based products and mechanics (Liedholm & Mead, 1987; Osei et al, 1993).

It is interesting to note that SMEs make better use of scarce resources than large scale enterprises. Research in Ghana has shown that capital productivity is often higher in SMEs than is the case with large scale enterprises (Steel, 1977). The reason for this is not difficult to see as SMEs are labour intensive with very small amount of capital invested. Thus, they tend to witness high capital productivity which is an economically sound investment. It has therefore been argued that promoting the SMEs sector in developing countries will create

more employment opportunities, lead to a more equitable distribution of income and will ensure increased productivity with better technology

(Steel & Webster, 1991).

2.3 ROLES AND IMPORTANCE OF SMEs

The importance of the small scale enterprise sector in the economic development and growth of low income countries has been widely recognised and need not be

overemphasized. This sector has the potential for the future growth of both employment and incomes as well as in alleviating urban and rural poverty. In order for the sector to flourish, the playing field has to be levelled in terms of policies and strategies that are required to assist the sector attain its full potential. Notwithstanding the various definitional issues and data problems, in a publication by the Business and Financial Times (BFT), Issue 1314, on 28th October 2011, headed “Pushing SMEs up”, the BFT reported that, statistics show that, in the manufacturing industry, 95 percent of the companies in the sector belongs to the SME and micro business; and of the 725000 workers in the service, manufacturing and other industry-sector, 460000 are engaged in the SME sector, and with a growth rate of 10%, the SME sector is estimated to generate 45000 new jobs annually. In spite of this, access to finance remains a dominant constraint for most Small and Medium Scale Enterprises. The sector contributes to the national objectives of creating employment opportunities, and training entrepreneurs.

SMEs have been one of the major areas of concern to many policy makers in an attempt to accelerate the rate of growth in low income countries like Ghana. These enterprises have been recognised as the engines through which the growth objectives of developing countries can be achieved. They are potential sources of employment and income. It is estimated that SMEs employ 22% of the adult population in developing countries

(Robson & Gallagher, 1995).

The Bolton Committee Report (1971) indicated that principal functions or roles of SMEs include:

i. Provision of employment for great number of people ii.

Essential sources of supply to individual companies iii.

Provide a variety of choice for consumers iv. Contribute

towards a balance and stable industrial structure

v. They are the seed-bed to large firms in the future vi. As

a source of business for new entrepreneurial talents

Small and medium-scale enterprises have certain advantages over their large-scale competitors. Firstly, they are able to adapt more easily to market conditions than large scale enterprises. Also, due to their flexible nature, SMEs are able to withstand adverse economic conditions. They are more labour intensive than larger firms and therefore, have lower capital costs associated with job creation (Anheier & Seibel, 1987; Liedholm & Mead, 1987; Schmitz, 1995). SMEs perform useful roles in ensuring income stability, growth and employment. Since SMEs are labour intensive, they are more likely to succeed in smaller urban centres and rural areas, where they can contribute to the more even distribution of economic activity in a region and can help to slow the flow of migration to large cities. Because of their regional dispersion and their labour intensity, the argument goes; small scale production units can promote a more equitable distribution of income than large firms. They also improve the efficiency of domestic markets and make productive use of scarce resources, thus, facilitating long term economic growth (Steel 1977).

2.4 CONSTRAINTS TO SMEs DEVELOPMENT

SMEs face a variety of constraints owing to the difficulty of absorbing large fixed costs, the absence of economies of scale and scope in key factors of production, and the high unit costs of providing services to small firms (Schmitz, 1995; Liedholm & Mead, 1987;

Steel & Webster, 1991). Below are set of constraints identified with SMEs.

2.4.1 Input Constraints

SMEs face a variety of constraints in factor markets (Levy, 1993). However, factor availability and cost are the most common constraints. The specific problems differs by country, but many of them are related, varying according to whether the business perceive that their access, availability or cost is the most important problem and whether they are based primarily on imported or domestic inputs. SMEs in Ghana emphasized the high cost of obtaining local raw materials; this may stem from their poor cash flows.

1) **Finance:** Access to finance remained a dominant constraint to SMEs in Ghana. Credit constraints pertaining to working capital and raw materials is one of the key issues facing SMEs (Aryeetey et al, 1994). This stems from the fact that SMEs have limited access to capital markets, locally and internationally, in part because of the perception of higher risk, informational barriers, and the higher costs of intermediation for smaller firms. As a result, SMEs often cannot obtain long-term finance in the form of debt and equity.

2) **Labour market:** This is a less important constraint to SMEs considering the widespread unemployment or underemployment in Ghana (Osei et al, 1993). SMEs generally use simple technology which does not require highly skilled workers. However where skilled workers are required, an insufficient supply of skilled workers limits the specialization opportunities, raise costs, and reduce flexibility in managing operations

(Aryeetey et al, 1994).

3) **Equipment and technology:** SMEs have difficulties in gaining access to appropriate technologies and information on available techniques. This limits innovation and SMEs competitiveness. Schmitz (1989) notes that; the uncertainty surrounding new technologies restrict incentives to innovation.

4) **Domestic demand:** The business environment varies markedly among SMEs in Ghana, reflecting different demand constraints. There are also varying levels of uncertainty caused by macroeconomic instability and different levels of government commitment to private sector development. Limited access to public contracts and subcontracts, arising from cumbersome bidding procedures and/or lack of information, inhibit SME participation in the business environment. Also, inefficient distribution channels often dominated by larger firms pose limitations to market access for SMEs. For example in Ghana, demand constraints limit the growth of SMEs.

5) **International markets:** Previously insulated from international competition, many SMEs are now faced with greater external competition and the need to expand market share. SMEs experience some recession with the coming into effect of trade liberalization. Limited international marketing experience, poor quality control and product standardization and little access to international partners, impede expansion into international markets.

2.4.2 Legal Constraints

High start-up costs for firms, including licensing and registration requirements, impose excessive and unnecessary burdens on SMEs. The high cost of settling legal claims and excessive delays in court proceedings adversely affect SMEs operations. In Ghana, the

cumbersome procedure for registering and commencing business is a binding constraint affecting the productivity of SMEs (Aryeetey et al, 1994).

2.4.3 Managerial Constraints

- 1) **Lack of entrepreneurial and business management skills:** Berger & Udell (1995) contends that lack of managerial know-how places significant constraints on SMEs development. Even though SMEs tend to attract motivated managers, they can hardly compete with larger firms. The scarcity of talents has a magnified impact on SMEs. In the absence of effective management, SMEs' efforts to improve performance prove futile.
- 2) **Institutional constraints:** The lack of cohesiveness and the wide range of SMEs interests limit their capacity to defend their collective interests and their effective participation in civil society (Osei et al, 1993).
- 3) **Associations and collective action:** Associations providing a voice for the interests of SMEs in the policy-making process have had a limited role compared to those of larger firms. Dawson (1990) notes that the dependence of, the SMEs in Ghana on large-scale enterprises as purchasers of output, either for sale, as final goods or to be used as intermediate inputs, is very limited.

2.5 SMES FINANCING FROM BANKS

Traditionally, financial institutions have been cautious with lending to SMEs because of high default rates and risks associated with the sector (Dawson 1990). Few banks have therefore developed an explicit policy for SME target groups taking the particular requirements and needs into consideration, e.g. developing earmarked financial products

and appropriate credit management systems. As Opoku-Afriyie (1997) notes, only few banks have SME specific loan products, and many of these are donor funded. Few banking institutions have SME desks or departments. For the others, lending to micro and small businesses is simply transacted by credit officers from corporate finance departments of the bank who generally apply the same appraisal and lending principles to SMEs. There is always problem in assessing SMEs for lending proposition due to the failure of some of them to keep proper books of accounts and scarcity of the necessary information. Taking decisions as to whether to lend to small business against the background of inadequate information is a task which even the most experienced lenders find it difficult. Consultations should be made from colleagues whose judgment and objectivity is respected and can aid perfect evaluation and assessment.

2.6 CREDIT RISK ASSESSMENT AND ANALYSIS

According to Coyle (2000), credit risk is the potential loss from the refusal or inability of credit customers to pay what is owed in full and on time. It represents an amount of money that will be paid at some future date, in return for benefits received earlier, such as loans obtained. To him, credit risk exists because expected payment might not occur. Sinkey (1992) also defines credit risk as the primary danger in granting credit and the uncertainty that the borrower will not repay the loan. From Skora's (1992) point of view, credit risk is the risk of loss on a financial or non financial contract due to the counterparty's failure to perform on that contract. He describes the two components of credit risk as default risk and recovery risk. Default risk is the possibility that counterparty will fail to meet his obligations, whereas recovery risk is the possibility that the recovery value of the defaulted contract may be less than its promised value. Credit risk is a form of counterparty risk,

which is, the risk that the other party to a contract or agreement will fail to perform his side of the deal. This could however mean a refusal to provide promised loan facilities or a failure to pay amounts owed in full and on time. It is more natural to think of credit risk from the point of view of the provider, which may be the lending bank, but it needs to be reiterated here that the definition of credit risk can be extended to include the receiver of credit. In other words, it is a two-way risk affecting both counterparties to an agreement. For example, a lending bank accepts the risk of the customer's inability to repay the loan while the borrower bears the risk of the bank withdrawing its lending facilities. As Sinkey (1992) notes, credit risk management is concerned primarily with managing debtors and financing debts. Credit risk management calls for controls over the giving of credit. The objectives of credit risk management can be stated as safeguarding the company's investment in debtors, and optimizing operational cash flows.

2.6.1 PRINCIPLES OF GOOD LENDING FOR INDIVIDUAL BORROWERS

Generally speaking, lenders look up to business with emphasis on ability to pay in granting credits to businesses. As Herring (1989) notes the initial lending or borrowing proposition comes from the customer. The customer seeks to borrow a certain amount of money for a certain period of time and for a particular purpose, making it clear how the bank can expect to be repaid. It then becomes the task of the banker to decide whether the proposition is acceptable in its current form, whether it would be acceptable if it were amended, or whether it is not acceptable in any form.

2.6.1(i) Analyzing Lending Propositions

Many lending decisions are based on experience and on the banker's instinct that the customer will repay the loan promptly and in full. However, a structured objective approach must be used. (Ruth, 1987) sees one such approach to be considering each important factor in turn and assess whether the lending proposition satisfies certain criteria. The bank's principles of good lending to customers can be reduced to a simplified framework, **C A M P A R I** and **I C E**. This mnemonic stands for issues relevant to the lending proposition; **C** – **Character**, **A** – **Ability**, **M** – **Means**, **P** –

Purpose, **A** – **Amount**, **R** – **Repayment**, **I** – **Insurance**, and **I** – **Interest**, **C** – **Commissions**, **E** – **Extras**.

Character

The character of the borrower always is a prime factor in any lending decision. Banks are often willing to lend on the assurance of a particular person, management team or company name, although if taken to an extreme, a name-lending policy can be dangerous and may result in bad debts. A lender is wary of a borrower who could commit fraud. Integrity and honesty are not the only aspects of a character to consider since honest customers are not necessarily creditworthy (Sinkey 1992). It is usually more important to assess character in terms of whether the owners or directors have a financial interest in the business the departmental management is of good caliber the business premises give the impression of a well-run unit the company has well regarded financial advisers and if so, how established the relationship is between the company and those financial advisers.

Coyle (2000) asserts that the character of the borrower can be judged by either or both of these two methods;

Past Record: A banker can look at the history of the customer's account with the bank to establish whether he or she has kept good control over his or her money in the past. If the borrower does not have an account with the bank, the banker should pay particular attention to why the company has decided against asking its own bank for the advance.

Personal Interview: The customer's character can be accessed from a personal meeting, preferably reinforced by a visit to the customer's premises. However, it is not good to conclude, on the basis of an interview and personal impression that the borrower is of good character or strong ability. There ought to be factual information on which to assess the customer's qualities in these respects.

Ability

Ability here is meant not in the context of whether the customer has the ability to repay, but relates to whether the borrower has the ability to enter into a contract with the bank to borrow (Herring 1989). For example, when a company wishing to borrow is part of a larger group, it is essential to identify its status within the group, in order to assess the potential credit risk for the lender. A group of companies is not necessarily a legal entity. When one company in a group borrows money, the bank's transaction is not with the group as a whole. In the event of default and non-payment of loan interest or principal, the lender cannot take action against the entire group, nor the parent company, only the company that has borrowed.

Sinkey (1992) stresses that a lender must be satisfied with the creditworthiness of the borrowing company and can rely on the collective financial strength of the group only in cases where; the borrowing company is the parent company of the group, or the parent

company and/or other companies in the group provides a guarantee of payment to the lender, in the event that the borrowing company fails to honour its payment obligations.

A parent company could, for example, create a subsidiary company specifically for the purpose of borrowing or carrying out other specific financial transactions on behalf of the rest of the group. In such cases a lender will have a credit exposure to this company only, and would not have a claim on any of the group's assets in the event of default by the borrowing subsidiary. Even when the subsidiary is part of a major group whose debt capital has a triple-A credit rating, a lender will have a high credit exposure if it lends to a subsidiary that is financially weak. A lender should refuse a loan to a subsidiary company unless the subsidiary is financially strong, or unless other companies in the group are willing to provide guarantees. As a general rule, when a bank lends to one subsidiary in a group, the parent company will not allow the subsidiary to default on its payment obligation (Ruth 1987).

However, cases have arisen where a group has used one subsidiary for all its borrowings, and then allowed it to go into liquidation with unpaid debts, leaving all the other companies in the group intact and debt free. When lending to a company, the bank should also ascertain whether the directors are acting within the authority extended to them in the company's articles of incorporation. A comparison also can be drawn with personal lending, where the bank must ensure that the customer has the ability to borrow.

Means

Coyle (2000) describes means or capacity as the borrower having technical, managerial and financial abilities in order to operate profitably and succeed in business. A corporate

borrower should give the appearance of coping with changes in its business and technology, and should have premises, equipment, transport and staff adequate for the planned use of the loan funds. Its management should be suitably trained and have sufficient experience. Directors and managers should provide a well-balanced team with a suitable spread of skills and expertise, preferably including financial expertise. A oneman business or a business dominated by a single individual, for example an individual who is both chief executive and chairman, should be considered a high credit risk.

Financially, a bank should be satisfied that the customer's business has good financial systems and controls. If there is a history of financial difficulties, the management's record in sorting them out could be significant. Past achievements can give an insight into what could happen in the future.

Purpose

The purpose of granting credit must be acceptable to the lender. A bank must not lend money unless it knows what it is going to be used for, nor for a purpose that it regards as too risky or that it is outside its normal course of business (Ruth 1987). Financing new ventures are risky, and although many succeed, a considerable number fail. Loans for this purpose are always high-risk, and are generally referred to a specialist lender, such as a venture capitalist.

Amount

The amount of a loan should be consistent with the purpose for which the money is required. It should not exceed the capacity of the customer to repay in full and on time. The amount borrowed should not be excessive, given the size of the customer's business and the customer's equity stake (Ruth, 1987). The lending proposition should state exactly how much the customer wants to borrow. It is not for a bank to suggest how much it would be willing to lend the customer. However, the bank will check that the customer is not asking for more than is needed. This is especially important when overdraft is requested. Sinkey (1992) adds that the bank must check that the customer has not asked for too little; otherwise the bank will be in the position later of having to lend more simply to safeguard the original advance. When considering the amount of the advance, the bank accesses the equity contribution that the customer might have to put towards the transaction itself.

Repayment

The source of repayment must be known before any loan is granted. To Herring (1989), the ability to repay is vital and evidence of this ability ideally should be demonstrated by the borrower's cash flow in the past or by cash flow projections for the future. In the case of corporate lending, the primary source repayment for a loan is normally the activities that the loan will finance, typically the cash flow from normal trading operations or from a specific project.

Insurance

In this context, insurance for the borrowing refers to security. As Herring (1989) asserts, security is an important consideration in a lending decision. For high-risk loans or highvalue loans, a bank often will want the reassurance of an alternative source of repayment in case the customer's plans go wrong and the loan cannot be paid from the intended source. In other words, a bank must ask what its position would be if the customer fail to make the repayment as planned. Security thus provides a safety net for the lender in case things go wrong (Coyle 2000).

Interest, Commission and Extras (ICE)

A bank lends money to make money Stephens (1980). It must therefore consider the rate of interest at which it will be prepared to lend, and the commission and fees it charges. A loan for a high rate venture, such as a new business, would carry a higher rate of interest to compensate the bank for the risk. A secured loan to a credit customer of good standing, in contrast, would be offered at a lower rate. This is necessary to some extent, not just because of the lower credit risk, but because such a customer probably can obtain a loan elsewhere and therefore has the power to influence the price (interest rate) that the bank will offer. For a lending bank risks of non-payment, even with secured loans have to be compared with the potential profit from extra lending or higher interest rates (Ruth 1987).

2.6.1(ii) CANONS OF LENDING FOR APPRAISING NON-INDIVIDUAL BORROWERS - SMEs

In so far as the accounts opened at a bank is not in a personal name but for an entity such as enterprises, different mode of assessment and appraisal technique would be adopted by the Bank. According to C.N Rouse (1998) the following key assessment areas are of importance to lenders in evaluating SME lending, more especially when the accounts operations is in the name of the entity and no the proprietor:

- The technical ability and integrity of the proprietor
- The availability of physical and production resources (Business Resources)
- The present and potential profitability (Financial Performance)
- The impact of the proposition on future cash flows ➤ The adequacy of present and planned capital resources

a. The technical ability and integrity of the proprietor

Rouse (1998) notes that bankers examine the knowledge level of the borrower and how reliable, creditworthy he or she is. They also find out if the borrower has the needed capability or capacity and experience in running the business which is the subject matter for the advance. Evidence should be shown of the borrower's track record and how long he or she is known. The personal commitment in the business is also examined.

b. The availability of physical and production Resources (Business Resources)

A visit to the borrower's premises if possible to get the first hand information and evidence. A study of the resources composition is very important. It is good to know that the premises of the SME is of the premises the right size and in the best location. The key machines and plant; are parts available for the ageing machines and the cost of replacement should also be verified.

c. The Present and Potential Profitability (Financial Performance)

Rouse (1998) notes that there is always inadequate information with regards to the financial performance of, most SMEs and for that matter a bank lender would have to help construct a simple accounts and financial analysis like the break-even, cost/income ratios, to help the fortitude the financial stand of the SME. Rouse, noted that every proprietor would be able to provide some basic information like prices, cost of producing a unit, target market etc although not formally recorded. He further suggested that, if the borrower is not able to provide some of the rudimentary financial information and justify them, then the lender must be very cautious.

d. The impact of the proposition on future cash flow

The need to know the cash flow of the borrower and the examination of the borrower's bank accounts or bank statement is important to know whether the borrower would be able to pay back a loan or facility when granted. Rouse (1998) suggests the examination of credit given and credit taken days will aid the lender to know the cash conversion

cycle.

e. The adequacy of present and planned capital resources

Rouse suggests to bankers to find out if there is a reasonable level of capital in the business both as evidence of the borrower's commitment and as a buffer against loss; a lender needs to be wary of borrowers with inadequate capital (equity).

2.7 THE CONCEPT OF RURAL BANKING

RCBS are unit banks owned by members of the rural community through purchase of shares and are licensed to provide financial intermediation. Initiated in 1976, RCBs were to mobilize savings and extend credit services to rural areas not served by commercial and development banks. Financial Intermediation in the rural Ghana was at a very low level compared to the situation in the urban areas; the Banks which operated branches in the rural areas mostly served the interest of the large and resource-based companies (Asiedu-Mante, 2011). To overcome many of these difficulties, the Ghanaian government, through the Bank of Ghana, introduced the idea of rural banking into the country in 1976. The number of Rural Banks has grown from 1 in 1976 to 133 as at March 2012; as

detailed below:

Table 2.1 Regional Distribution of Rural Banks

REGION	NO.OF RCBs	NO.OF BRANCHES
Ashanti	24	133
Brong Ahafo	20	85
Central	21	93
Western	13	73
Eastern	22	101
Volta	12	38
Greater Accra	6	22
Northern	6	13
Upper East	5	11
Upper West	4	11
TOTAL	133	580

(Source: Efficiency and Monitoring Unit, ARB Apex Bank Limited)

2.8 RURAL AND COMMUNITY BANKS' OPERATIONS

The Bank of Ghana has streamlined Rural Bank lending operations to ensure that Bank credit actually benefits the small scale rural producer and the rural community. Until recently, rural banks were restricted to operating within the rural settings so as to ensure that the SMEs which are particularly in the small towns and communities benefit greatly from their services.

There is substantial anecdotal evidence of misdirection and misapplication of rural credit by the Rural Banks and the rural people. Many rural banks appear to give credit to people who do not fall into the Bank of Ghana target groups, the Government of Ghana, in collaboration with the Bank of Ghana, initiated the Rural Bank system with the hope that

small-scale rural producers and small towns would benefit from the new credit resources. It is uncertain whether or not the Rural Banks are fulfilling the basic functions for which they were created.

A rural bank is owned by the people in the rural community within which it operates. It is permitted to operate within forty kilometres radius from its head office. (This has now been relaxed for banks which have met the minimum capitalization and have the

necessary internal control mechanisms for effective supervision). It operates according to the dictates of the banking law and has primary and secondary reserve requirements. Its shareholders are mainly from its catchment area. It has a board constituted among the shareholders and operates on the principles of the Companies Code, 1963 Act 179 and the Banking Law 2004, Act 673. The ARB Apex bank regulations passed by the parliament of Ghana also regulates the rural banks. Each rural bank is also registered as a limited liability company and requires a banking licence and a certificate to commence business before it is permitted to operate. It has a minimum paid-up capital set by the Central Bank which currently stands at GH¢150,000.00 There are existing guidelines for establishing a rural banking relating to the following: □ Eligibility / Qualification criteria

- Ownership and capitalisation, including limitation to share ownership
- Regulations of the proposed company
- Feasibility report – business plan and financial projections for the first 5 years
- Permissible activities
- Operational requirements
- Viability (based on 5 year projection of income statement and balance sheet)
- Staffing requirements

- License
- Processing fee and licensing fee
- Initial training
- Equipment requirements and specifications

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REGULATORY BODIES OF RURAL BANKS

As per law established the Bank of Ghana per New Banking Act, 2004 (Act 673) and the Banking Amendment Act, 2007 (Act 738) regulates and supervise all banks in Ghana. The Bank of Ghana carries out both On-Site and Off-Site inspection of rural and community banks. The exercise of the On-Site responsibility is carried out at least once each year on a rural bank. In the case of the Off-Site supervision, the Bank of Ghana requires all rural and community banks to submit to it weekly, monthly, quarterly, half annually and annual returns.

In July 2002 the ARB Apex Bank Limited was established to provide vital banking as well as non-banking services to RCBs with the aim of improving their operational efficiencies. Again the ARB Apex Bank Limited is to function as a mini central bank to supervise RCBs in Ghana. Today the direct supervision of RCBs comes under the ARB Apex Bank Limited as per law established; ARB Apex Bank Limited Regulations, 2006

(L.I. 1875). ARB Apex Bank Limited through its Audit Department and Efficiency and Monitoring Unit carry out both On-Site and Off-Site inspection of RCBs. Again the ARB Apex Bank Limited draws up and undertakes on the job training programmes for the staff of rural and community banks

2.9 WHAT HAS BEEN THE IMPACT OF THE RURAL BANKS IN GHANA

The rural banking network controls about 9% of total domestic deposits of the banking sector in Ghana. They mobilise savings from their catchment areas and lend them out to deserving customers in the same area. They help existing enterprises in the rural communities to improve upon their performance and promote new economic activities thus assisting to enhance standards of living. They contribute to the socio-economic development of their catchment areas by using part of their profits to support brilliant but needy students, offer significant support for street lighting, construction of bore holes for potable water, construction of school buildings and health care facilities among many others. Indeed the contribution of RCBs towards corporate social responsibility in total far exceeds the contributions of all the other banks put together year-on-year. It is in this light that the clamour for the establishment of more rural banks keeps raging from one community to the other. It is therefore not surprising that the rural banking system constitutes the largest banking network in Ghana with over five hundred and ninety-five (595) offices dotted across the face of Ghana, (ARB Apex Bank, EMU Report, 2012)

2.10 ENHANCING SME DEVELOPMENT

There are several institutions, programmes and government agencies that aim at promoting SME development. These were created to help SMEs in various ways such as: access to finance, training programmes and technological development. These are discussed briefly under the following outline:

1. Government Institution

Government has implemented several programmes to benefit the SME sector in Ghana. This started in 1969 with the establishment of the Credit Guarantee Scheme, which was administered by the Bank of Ghana (BOG) to assist entrepreneurs to obtain bank credit.

Shortly after this, in 1970, the Ghana Business Promotion Programme was established to provide financial assistance to newly establish SMEs. Unfortunately these schemes did not have the intended impact because of low loans repayment rates and the fact that those beneficiaries were politically connected to former managers of foreign-owned enterprises (BOG Policy Brief, 2006)

Under an Act of Parliament in 1981, Act 434; The National Board for Small Scale Industries (NBSSI) was established to promote and develop the small-scale industrial sector because of their importance and contribution to the economic development of Ghana. The NBSSI also has a revolving loan scheme that is intended for working capital and fixed assets acquisition by enterprises in selected sectors. It collaborates with and receives support from several NGOs and international organizations such as the Friedrich Ebert Foundation, World Bank, and UNDP. Unfortunately, according to Adu-Amankwah (1999), this institution is poorly funded thus limiting the assistance that they can offer to help SMEs develop and grow in the economy.

In 1987, the industrial sector also witnessed the coming into operation of the Ghana Appropriate Technology Industrial Service (GRATIS). It was established by the Government of Ghana to promote small and medium scale industrialization, provide employment opportunities, improve incomes and enhances the development of Ghana. This is accomplished through the dissemination of appropriate technologies by developing and demonstrating marketable products and processes for small and medium enterprises. This is a move by the government of the day to reduce the dominance of foreign nationals in the

country supervise the operations of Intermediate Technology Transfer Units (ITTUs) in the country. GRATIS aims at upgrading small scale industrial concerns by transferring appropriate technology to small scale and informal industries at the grass root level. ITTUs in the regions are intended to develop the engineering abilities of small scale manufacturing and service industries engaged in vehicle repairs and other related trades. They are also to address the needs of non-engineering industries. So far, ITTUs have been set up in Cape Coast, Ho, Kumasi, Sunyani, Tamale and Tema. The Ministry of Private Sector Development (MPSD) was also established to coordinate and harmonize inter-sectoral efforts to propel the development of private sector as an engine of growth and poverty reduction. With a majority of the working population in this sector, government is aiming at a successful reform that will have a major effect on the development of society and economy.

Within the MPSD is the Business Development Unit, which aims to facilitate business support services targeted especially at the informal sector and access to credit for micro and SMEs. Some of these services are the African Development Fund (ADF) and Ghana

Government providing between 5 to 8 SMEs with up to US\$500,000 each for the next 5 years; the Italian Credit Facility of 10 million Euros; the Danish Government's contribution of US\$30 million for the Business Sector Programs Support; and the Swiss

Government support of US\$5 million which is being administered by The Trust Bank Limited. Also in addition to a US\$40m HSBC credit, MPSD has arranged for the SOFITEL Bank of USA to approve a release a US\$17m facility to the Ghana

Commercial Bank (GCB) to enable the bank to provide long-term project credit to SMEs.

Government has also issued several policy papers to support SMEs. These include the

Investment Code 1985 (PNDC Law 116), Draft Policy Paper on Micro and Small Enterprise Development (May 2002), MPSDs Policies, Strategies and Action Plan: 2002-

2004, Ghana Poverty Reduction Strategy Paper (2002-2004), and the National MediumTerm Private Sector Development Strategy (2004-20008), which articulates government's commitment to facilitate private sector-led growth. There have also been various programs and initiatives over the past 10 years to support the sector such as Vision 2020 and the Fund for Small and Medium Enterprise Development (FUSMED) (Kayanula and Quatey, 2000).

2. Non-Governmental Organization (NGOs)

As a result of the unsuccessful nature of direct lending by government in recent past, more donor interventions in SME finance have recently used existing financial institutions to channel funds to SMEs. Examples of some of the available credit facilities are Trade and Investment program created by USAID to provide assistance to SMEs in the non-traditional export sector, African Management Services Company funded by UNDP to assist SMEs (training and secondment) (Mensah, 2004).

EMPRETEC Ghana and TECHNOSERVE are other NGOs in Ghana established to offer assistance to SMEs. The former raises funds for SMEs through venture forums where entrepreneurs are linked with potential investors. The latter on the other hand, helps entrepreneurs to build businesses that create income, employment opportunities and economic growth for the nation. They train and mentor the entrepreneurs to identify customers' needs, employ capable managers and act strategically. (www.technoserve.org)

2.11 SUPPORTS FOR RURAL BANKS TOWARDS SMES DEVELOPMENT.

Rural banks have been provided capacity building and with funds available for SME sectors. Various interventions such DANIDA Support to Private Sector Development phase II (SPSD II), Rural Enterprise Project (REP), Support Programme and Enterprise Development (SPEED) Fund, Funds for Small and Medium Enterprises (FUSMED), Community Based Rural Development Project (CBRDP), Root and Tuber Improvement and Marketing Programme (RTIMP), Private Enterprise and Export Development (PEED), Social Investment Fund (SIF) and more are known to have been channeled through rural and community banks as interventions to alleviate poverty through rural agricultural and SME development (Asiedu-Mante E, 2011). Details of some of the interventions are noted below as explained by Asiedu-Mante E.2011.

1. DANIDA Support to Private Sector Development phase II (SPSD II)

This has the overall objective of facilitating the creation of sustainable and decent jobs in Ghana by providing funding support to private sector development efforts. The focus of the Rural Finance sub-component of the SPSPD II is to enable ARB Apex Bank Ltd and the RCBs to become viable financial Institutions to serve the financial needs of the rural people through four main interventions, namely; Capacity Development for the RCBs,

Rural Finance Wholesale Fund, Merger Fund for RCBs and Human Resource Development of Apex Bank. Particularly, the Rural Finance Wholesale Fund seeks to provide funds for Small and Medium Scale Enterprises

2. Support Programme and Enterprise Development (SPEED) Fund:

The Scheme came into being as a result of the collaborative effort between the Government of Ghana and the Government of Germany and Denmark to rehabilitate and resettle Ghanaian returnees/deportees from Germany. The idea was to grant returnees credit to

enable them start business and enterprises of the choice. The scheme as originally envisaged could not be sustained because most of the returnees could not stay and left the country again to seek greener pastures abroad. SPEED has recognized and given a new focus where rural banks are used as conduits to channel donor funds to micro enterprises operators in rural Ghana.

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3. Rural Enterprise Project (REP)

This was a scheme that targeted artisans with the intention of supplying their working capital and capital expenditure requirements. Some of the artisans in question under this scheme were carpenters, masons, steel benders plumbers, electricians etc

4. Funds for Small and Medium Enterprises (FUSMED)

The Fund for small and Medium Enterprise (FUSMED) was established to administer a credit facility of \$30.00 million from the International Development Association (IDA) and International Fund for Agricultural Development (IFAD) to the Government of Ghana for the development of small and medium size enterprises (SMEs). The objective of the SME project was to finance the development of the privately owned small and medium enterprises in the productive sectors of the economy with a view to increasing employment, output and incomes.

5. Community Based Rural Development Project (CBRDP)

This seeks to provide support to the rural community development. Funds are made available for the promotion of rural enterprises and the target mostly those in the cottage industries.

6. Root and Tuber Improvement and Marketing Programme (RTIMP)

RTIMP seeks to provide support value chain support for producers and marketers within the root and tuber products. Funds in both long and short term has been channeled through the rural banks and community banks for their customers engaged in such activities

7. Private Enterprise and Export Development (PEED)

The objective was to promote non-traditional exports by making export credit available through the banking system to exporters of non-traditional export commodities.

8. Social Investment Fund (SIF)

This was an initiative by the Government of Ghana, the UNDP, the African Development Bank and the African Development Fund. It was a 25.0 billion (GH¢2.5 million) revolving fund targeted at people engaged in income generating activities such as smallscale agriculture, food and fruit processing, soap making etc. As to whether these interventions have achieved the purpose of their establishment is something this study will help identify.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 INTRODUCTION

The first part of this chapter is concerned with the methodology that was employed in the study. This methodology has been drawn up to deal with issues in the research objectives and to answer the research questions. The main aim of this research is to identify and evaluate the contribution the rural banks in Ghana have made in enhancing the operations of SMEs; particularly in terms of financial and non-financial matters and also to identify the challenges SMEs face in assessing credit from rural banks. This chapter discusses how the fieldwork was organized and the techniques adopted to collect relevant data for the study as well as the data analysis technique used.

The methodology of every research is very important if the reliability and validity of the results of the study are to be attained. The process ensures the gathering of relevant and reliable data and the application of appropriate techniques in the analysis of the data in order to control potential errors.

3.1. THE RESEARCH DESIGN

A research design provides a framework for the collection and analysis of data (Bryman and Bell, 2007). It serves as a master plan for the methods and procedure that should be used to collect and analyze the data needed by the decision maker (Hair, Bush and Ortinaiu, 2003). Research design involves the strategy, structure or plan for conducting research project as stated by Sunders et al, (2007). Several methods of research designs are available

but the researcher sort to use a case study which involves detailed and intensive analysis of all documentary evidence to know the contribution of rural banks to SME development.

3.2 STUDY POPULATION

Population is the complete set of individual (subjects), study group, objects or events having observable characteristics in which the researcher is interested in studying. It is the totality of all subjects that conform to a set of specifications, comprising the entire group of persons that is of interest to the researcher and to whom the research results can be generalized.

It is imperative to have a precise description of the population of elements (persons, organization, objects, etc) that is to form the focus of the study, as viewed by Ross, (1991). According to Ross (1991), the specifications provide clear guidance as to which elements are to be included in the population and which are to be excluded.

There are 133 rural banks in Ghana (Apex EMU report 2012). However the research selected two main rural banks with 6,464 customers from all their branches for the study. The banks are Nkoranza-Kwabre Rural Bank Limited and Fiagya Rural Bank Limited located in the Nkoranza North and South Districts respectively.

3.3 SAMPLING SIZE AND SAMPLING TECHNIQUES

One hundred SMEs who are customers of the two rural banks were selected for this research and all the SMEs were also located within the Nkoranza District and Techiman Municipality, which were very convenient for the research. The nature of business of the

various SMEs sampled included clothing, handicrafts, interior decoration, groceries, printing and publishing and general merchants. The researcher decided to use two rural banks and one hundred SMEs as the sample size because; it would have been difficult to collect data on the entire population due to budget (cost) and lack of time.

The researcher used convenience sampling and purposive sampling techniques for the study. The selection of the SMEs for the research was done by convenience sampling, where respondents were chosen on the basis of accessibility. De Vos, (1998) states that convenience sampling is the rational choice in cases where it is impossible to identify all the members of a population.

Purposive or judgmental sampling technique was also used to select respondents of ten top management members of staff and ten other members of staff from the two selected rural banks who were also contacted for information. Purposive or judgmental sampling technique is a non-probability sampling technique in which an experienced individual selects the sampling based on his or her judgment about some appropriate characteristics required of the sample member. Using purposive sampling, researchers select samples that satisfy their specific purpose, even if they are not fully representative as noted by Zikmund, Babin, 2010. According to Saunder et al, (2007), purposive sampling enables the researcher to use his or her judgment to select cases that will best enable him or her answer his or her research question(s) and to achieve his or her objective. Neuman, (2000) also states that, purposive sampling helps the researcher to select cases that are particularly informative.

The Supervising Managers, Operations Managers, Internal Auditors, Accountants, Branch Managers and Projects Officers were the top officials selected and contacted as respondents for the rural banks.

3.4 DATA COLLECTION INSTRUMENTS AND DESIGN

Data collection refers to process of picking out facts and figures that are relevant to the researcher in relation to the research objective and to answers the research questions. The study used both primary and secondary data.

Primary Data

Primary data provided the relevant data needed to evaluate Rural Banks and the impact they have made on SMEs accessibility to funds from them. Primary data collected from the SMEs dealt with issues such as effects of the rural banks policies on the growth of the SMEs in terms of profit, assets and capital;

Secondary Data

Secondary data was used to establish the rural banks' contribution to SME development in terms of financial and non-financial assistance. Secondary data collected comprised data from journals, books and publications on rural banking, the internet, written policies of the selected banks, and available circulars and articles on rural banks from ARB Apex

Bank Ltd

The secondary information collected were on issues including:

- Loan policies used by the rural banks and their methods of appraising the SME clients' proposition.

- The ARB Apex Banks contribution in enhancing the abilities of the rural bank in their operational activities.
- Loan portfolio of the selected banks and the SME customers' component in it.
 - Products and services available to the SMEs customers at the rural banks.

3.5 RESEARCH INSTRUMENTS

Instruments used for the collection of primary data consisted of questionnaires and interviews with managers of SMEs and some top management of the selected rural banks respectively. The questionnaire consists of both open and closed ended questions. The few open ended questions allowed the respondents to give answers in their own words whilst the closed ended questions provided a number of alternative answers for which the respondents were instructed to choose what options best suited them. Certain factors were taken into consideration in structuring the questionnaire. The most important factor was the nature of the respondents. SME managers are always pressed for time since most often they were in the middle of business transactions or business meetings and did not have enough time to fill the questionnaires. There was also the danger of respondents getting bored and giving less accurate answers when given a lengthy questionnaire. For these reasons, simple and straightforward questions were asked. The interviews with managers of SMEs helped the researcher to gain first-hand knowledge and understanding of the challenges that the SMEs face in accessing loans from rural banks. It also assisted the researcher to note the services and products available to the SMEs and some of the successful and remarkable role played by the rural banks in the SME development in the nation. The interview was perfectly structured to avoid asking leading and provocative questions.

3.6 METHOD OF DATA ANALYSIS

Data collected from the questionnaire and other information gathered during the interview was transformed and used for the analysis. Responses were coded and

Microsoft Excel (MS-Excel) was used to analyze the data. Descriptive statistics such as percentages and frequencies have been used to report the results. Tables, graphs and pie charts have been used for the presentation and interpretation of results.

3.7 BRIEF HISTORY OF NKORANZA KWABRE AND FIAGYA RURAL BANK

Nkoranza-Kwabre Rural Bank Ltd

It was founded in March, 1982 at Akuma but started full operations in 1983. Currently the Bank operates five branches apart from the Head Office in Akuma. Two of the branches are located in Techiman and Tuobodom in the Techiman Municipality whilst the rest are located in Nkwabeng, Donkro-Nkwanta and Nkoranza in the Nkoranza South District.

The Mission Statement of the bank is to become one of the best performing rural banks in Ghana by providing extensive range of innovative and high quality services and products to satisfy the diverse needs of individuals as well as small and medium scale entrepreneurs.

Fiagya Rural Bank Ltd

Fiagya Rural Bank was also founded in 1983 with its head office at Busunya. The Bank has four Branches at Nkoranza, Techiman, Afrancho, and Sunyani. The corporate mission of the Bank is to offer quality dependant and gender sensitive financial intermediation services to promote accelerated economic growth and development in support of improved quality of life in its catchment area through prudent management and use of Bank's resources.

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION OF FINDINGS

4.0 INTRODUCTION

The data collection for the study was done basically through the usage of questionnaire for the SMEs, interviews with top management of the two selected banks and primary and secondary data from the selected rural banks. A population of 100 SMEs was targeted and questionnaires were distributed to them. A 100% response rate was received, which was very impressive considering the short time given to these respondents. Some of them were initially reluctant to respond due to unwillingness to disclose their private information and their relationship with the banks which might undermine confidentiality.

Others also complained about the time given them to provide answers to the questions. According to them, it was too short, however, they took time out of their busy schedule to complete the questionnaire.

4.1 FIELDWORK RESPONSES TO THE QUESTIONNAIRE FOR THE SMES

4.1.1 Location and Type of the of SMEs Business

All the respondents were SMEs located in the Nkoranza District and Techiman Municipality in the Brong Ahafo Region of Ghana and were the customers of the selected rural banks.

Out of the 100 respondents, 14 have registered their businesses as enterprises; none of the respondents was registered as private, public or unlimited liability company and 86 were

as sole proprietorships but with no formal registration. This is indicated in the Table 4.1

Table 1 Table 4.I Frequency Distribution of Type of Participant business

FORM	Frequency	Percentages (%)	Cumulative (%)
Enterprises	14	14%	13%
Company	0	0%	13%
Sole Proprietorship	86	86%	100%
Total	100	100%	100%

(Source: Research questionnaire)

4.1.2 Nature of SME business

SMEs cut across the various sector of the economy, hence the 100% responses received were fairly spread across a wide range of the sector including trading, manufacturing, service, cottage industry, farming, exporting and importing and transport. Details could be seen from Table 4.2.

Trading covers retail businesses, general merchants or dealers in general goods and household items;

Manufacturing covers those in ‘gari’ processing, soap making, and batik tie and dye making;

Services include the barbers and beauty salon owners, Susu collectors, masons, fitting shops or car mechanics, motor bicycle and tricycle mechanics, tailoring and dressmaking, computer training and business services;

Cottage industries include producers of handicrafts, pot makers, burnt bricks producers, carpenters, graphic designing, photographers and printing press;

Farming includes the peasant farmers in crops production, poultry, cattle rearing and retailers of foodstuff;

Transport include vehicle owners and drivers

Exporting and Importing involve trading across the frontiers of Ghana

Others includes businesses not mentioned in the categories outlined

Table 4.2 Frequency Distribution of Nature of SME business that the participants were engaged in

Nature	Frequency	Percentages (%)	Cumulative (%)
Trading	32	32%	32%
Manufacturing	11	11%	43%
Service	21	21%	64%
Cottage Industry	9	9%	73%
Farming	15	15%	88%
Transport	7	7%	95%
Exporting and Importing	0	0%	95%
Others	5	5%	100%

Source: Research questionnaire

4.1.3 Level of Education

From the Table 4.3 it is obvious that more than 69% of the respondents have completed junior high level education. 7% have not attained any formal education and in fact they expressed their desire to pursue academic education when given the chance and the opportunity. 10% have attained primary education but stopped on the way and could not complete Junior High. 11% of the respondents have completed their senior high education. 3% of the respondents have completed tertiary education.

Table 4.3 Level of Education

Education	Frequency	Percentage	Cumulative (%)
None	7	7%	7%
Primary	10	10%	17
Junior High	69	69%	86%
Senior High	11	11%	97%
Tertiary	3	3%	100%

Source: Research questionnaire

4.1.4 Working Experience on the Job and Numbers of Staff

All the respondents have worked not less than a year on their job and have enough experience on their jobs. The number of key staff in business ranged between 1 and 18. This satisfies the researchers desire to define SMEs as businesses with maximum of 20 staff or workers.

4.2 RESPONDENTS DEALINGS WITH THE RURAL BANKS

4.2.1 Type of Accounts with the bank

It was seen from the responses that 54% operates only ordinary savings accounts, 9% operates only ordinary current account and 29% operates both savings and current and 8% have other accounts such as fixed deposit accounts in addition to the ordinary savings and current accounts. Details could be seen from Appendix X

4.2.2 No. of years with a rural bank

Rural banks have been in existence in Ghana for over thirty six (36) years. The two selected rural banks have been in existence for about 30 years (since 1982). Out of the 100 clients interviewed 63% percent have been with their banks for at most 5 years. 24% have been with their banks between 6 and 10 years and 13% have been with their banks for over 10 years as could be seen from the distribution in the table 4.4 below

Table 4.4 No of years with the bank

Years	Frequency	Percentage	Cumulative %
Up to 5 years	63	63%	63%
6 to 10 years	24	24%	87%
Over ten years	13	13%	100%

Source: Research questionnaire

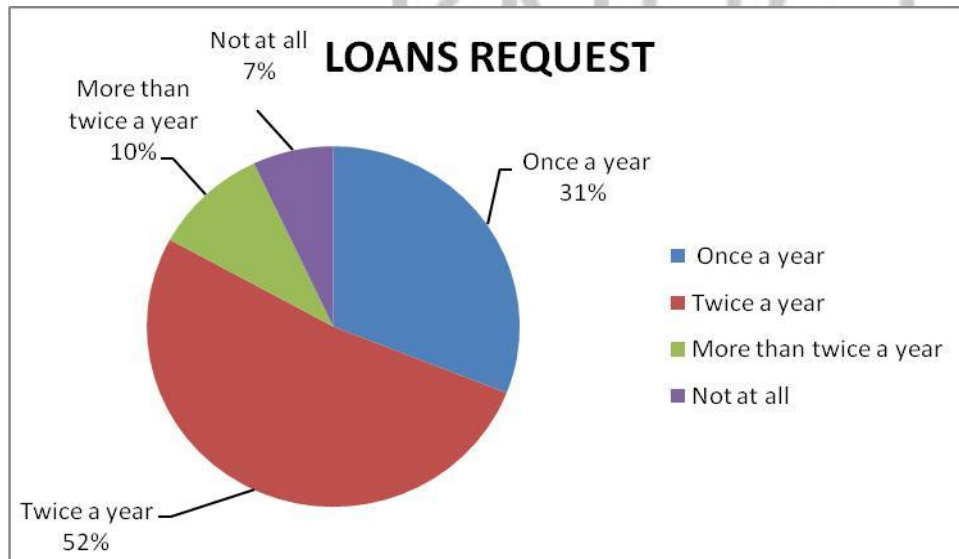
4.2.3 Loans Request

Majority of the SMEs interviewed had applied for loan from their banks for reason of inadequate capital. The details can be seen from the pie chart shown in figure 4.1 below. Out of the 100 respondents, 7% have not applied for a loan before from their rural bank, 93% have applied for a loan out of which 31% were those who applied at most once a year, 52% applied at least twice a year and 10% more than twice a year. The maximum loan

duration for the SMEs was 12 months. Most of the loans duration was between 6 months and 8 months. This pushes the SMEs to reapply for new loans as soon as they

finish repaying to bring their working capital to the desired level.

Figure 4.1 Loans Request



Source: Research questionnaire

When asked have you been successful in obtaining loans? The following responses were received.

Table 4.5 Have you been successful in obtaining loans

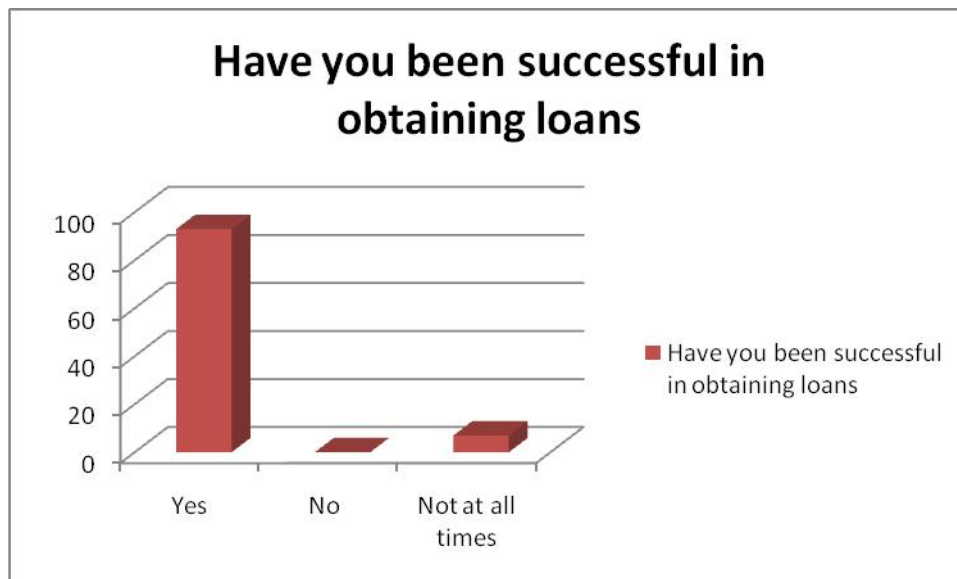
Have you been successful in obtaining loans	Frequency	Percentage	Cumulative %
Yes	86	86%	86%
No	0	0%	86%
Not at all times	7	7%	93%

Source: Research questionnaire

It is noted that most of the applicants interviewed had their loans request granted.

Although 7% had their applications rejected due to some reasons.

Figure 4.2 Have you been successful in obtaining loans?



Some of the reasons that they cited include lack of adequate collateral (security or guarantor), lack of proper business records and improper accounts operations. Those who qualified were pleased and said they operate their accounts well and are faithful to the banks and have no questionable reputation at the banks. They said it is always difficult to borrower at the first time but if you win the confidence of the bankers it is easy thereof. A discussion with the bank official confirmed that some of the reasons by which loans request were refused and why some granted. A plausible issue noted was that the parties involved were able to tell and explain the conclusions arrived following their application request. Although some of the SMEs complained of their disappointments sometimes it was clearly seen that if you were able to meet the banks' policy you would qualify for the loan.

4.2.4 Respondents View on Interest Rate

77% of the clients interviewed said the interest charged by their banks were exorbitant.

33% said it was moderate and none saw it to be low as shown in table 4.6 below. Although majority noted it was high, they lamented that they have few possible alternatives. The most plausible options could have been to borrow from the commercial banks or the major banks but they said most do not open their doors to the SMEs but instead concentrate on the corporate clients only. Among the problems of the SMEs high interest rate was ranked second after collateral requirement. Refer to Table 4.7

From the rural banks perspective, average interest was 32% for Fiagya Rural Bank and 30% for Nkoranza Kwabre Rural Bank. The SMEs suggested interest range of 15% to 22% as something laudable for their operations if it could be possible. Asked why interest rate was high the banks mentioned issues like cost of on-lending funds from their collaborators, high default rate, operational cost on staff salaries, utilities and the like.

Table 4.6 below shows the responses on interest rate.

What is your view on their interest rate?	Frequency	Percentage	Cumulative %
HIGH	77	77%	77%
MODERATE	33	33%	100%
LOW	0	0	100%
Total	100	100%	

4.3 BUSINESS GROWTH OF THE RESPONDENTS

From the responses that were received, 81% of the SMEs were satisfied so far with their dealings with their banks and 19% were not perfectly satisfied with their bank. The level of satisfaction was further rated as high, moderate or low. 56% were highly satisfied with

the banks performance in terms of products and services, 25% were moderately satisfied and 19% had a low satisfaction with their operations with the banks. The details could be referred at the Appendix (I) and (II)

Although the respondents have challenges in their dealings with rural banks all the SME respondents stated that they have had business growth in profit, assets and capital. However they were not able to quantify the actual growth since they do not maintain any proper books of accounts.

The researcher further probed them to know if they could quantify their growth in terms of cash for a year following their dealings with the rural banks. The responses was that out of the 100 respondents 9 confirmed that they could estimate the growth of their business between GHø100 and GHø200, 6 estimates a cash growth of GHø201 to GHø500; 39 estimates a cash growth of GHø500 to GHø1000 and 46 estimates a cash growth of GHø1000.00. Details could be seen at Appendix XI

4.4 CONDITIONS PRECEDENT TO ACQUIRING A RURAL BANK CREDIT

Credit refers to either a loan or an overdraft granted to a borrower by a bank. From the secondary data gathered and the interview with the top officials of the selected rural banks on policies on facilities to SMEs, it was noted that all applicants for a credit facility must have active rural bank account which could be current account, a savings account or both. It was seen from the data gathered that rural banks classify their loans according to the sector as Agric or Farming, Trading, Transport, Cottage Industry and Others. They also classify their loans according to the type of account the applicants have and also according to private enterprises, public enterprise and individuals (Bank of Ghana Returns submission requirement). Their loans portfolio to the SMEs were those loans such as microfinance

loans, loans to the cottage industries, loans to non-commercial/large scale farmers, susu loans, trading loans and other individual loans to private enterprises. The general approach used to appraise applicant by the rural banks' policy is that customers must operate satisfactorily the accounts for a minimum of three month and with a turnover of about three times the amount been applied for which according to them indicates the clients activeness in the accounts operations.

Specifically, Susu loans and microfinance loans were also granted to SMEs and on the following grounds. With the Susu loans the applicant must have made a daily contribution of a predetermined amount continuously for a minimum of three months into an account without drawing from it before qualifying for a rural bank loan. In some extreme cases according to the Supervisors applicant could be considered even if a withdrawal has gone into the account. For the group loans or microfinance loans (credit with education) members of the solidarity group must have undergone six weeks continues credit education and some payments into their savings accounts during that period before qualifying for a loan.

According to the Management in situation where the banks receives on-lending or managed funds for the SMEs these funds come with their own procedures but the beneficiaries must have accounts with the rural bank.

Credit Application

All credit application must be addressed to and received by the Manager or head of the agency who will initial them with comments. The applications are referred to the project officers of the bank or the credit officers for the appraisal. It was noted that the method of

appraising both the loans to SMEs and that of the other loans were not greatly different. It was noted that they however relax some of their condition to favour the SMEs. Notably, the two banks use what is known as the 5Cs of credit in evaluating their customers

The "Five C's" of Credit Analysis

1. Capacity

Capacity repay is the most critical factor they look for. They will want to know exactly how you intend to repay the loan. They will consider the cash flow from the SME business, the timing of the repayment, and the probability of successful repayment of the loan. Payment history on existing credit relationships is considered as an indicator of future payment performance. They also check for other contingent sources of repayment.

2. Capital

It is the money you personally have invested in the business and is an indication of how much you have at risk should the business fail. Rural Banks expect a borrower to have contributed from their own assets and to have undertaken personal financial risk to establish the business before asking them to commit any funding through loan or overdraft. Asked if they would be ready to assist an SME borrower with no capital the response from the Management was that you a least need 'bait to catch a fish'.

3. Collateral

Giving a lender collateral means that you pledge an asset you own, such as your home car or vehicle, land, or any valuable asset to the lender with the agreement that it will be alternative repayment source in case default. A guarantee, on the other hand, means

someone else signs a guarantee document promising to repay the loan if the borrower defaults. The SMEs interviewed find it difficult to meet the security of the banks because of the standards set for perfect security. The banks mentioned that to them a good security must have the following features:

1. Easy to value
2. Easy to take legal title
3. Easy to market or realise
4. Should impose no liability on the bank
5. Must appreciate or increase in value

4. Conditions

It focuses on the intended purpose of the loan. The banks would want to be clear with beneficial business purpose. They will consider the local economic climate and conditions both within the industry and in other industries that could affect the business or the ability of the borrower to repay his obligation but relatively beyond his control.

5. Character

This is the general impression, feeling or intuition one will make on the potential borrower. In the interview with the officers of the bank, they made it clear that they try to ascertain whether or not a borrower is sufficiently trustworthy to repay the loan or generate enough

return on funds invested in the business. By so doing they check and review the educational background and experience in business as well as in the industry the borrower is operating. The quality of your references and the background and experience levels of your employees also will be taken into consideration. It was noted that business with questionable character will have their application denied. It was also noted that the banks tell them reasons for the application being denied or approved and the terms of the loans thereon.

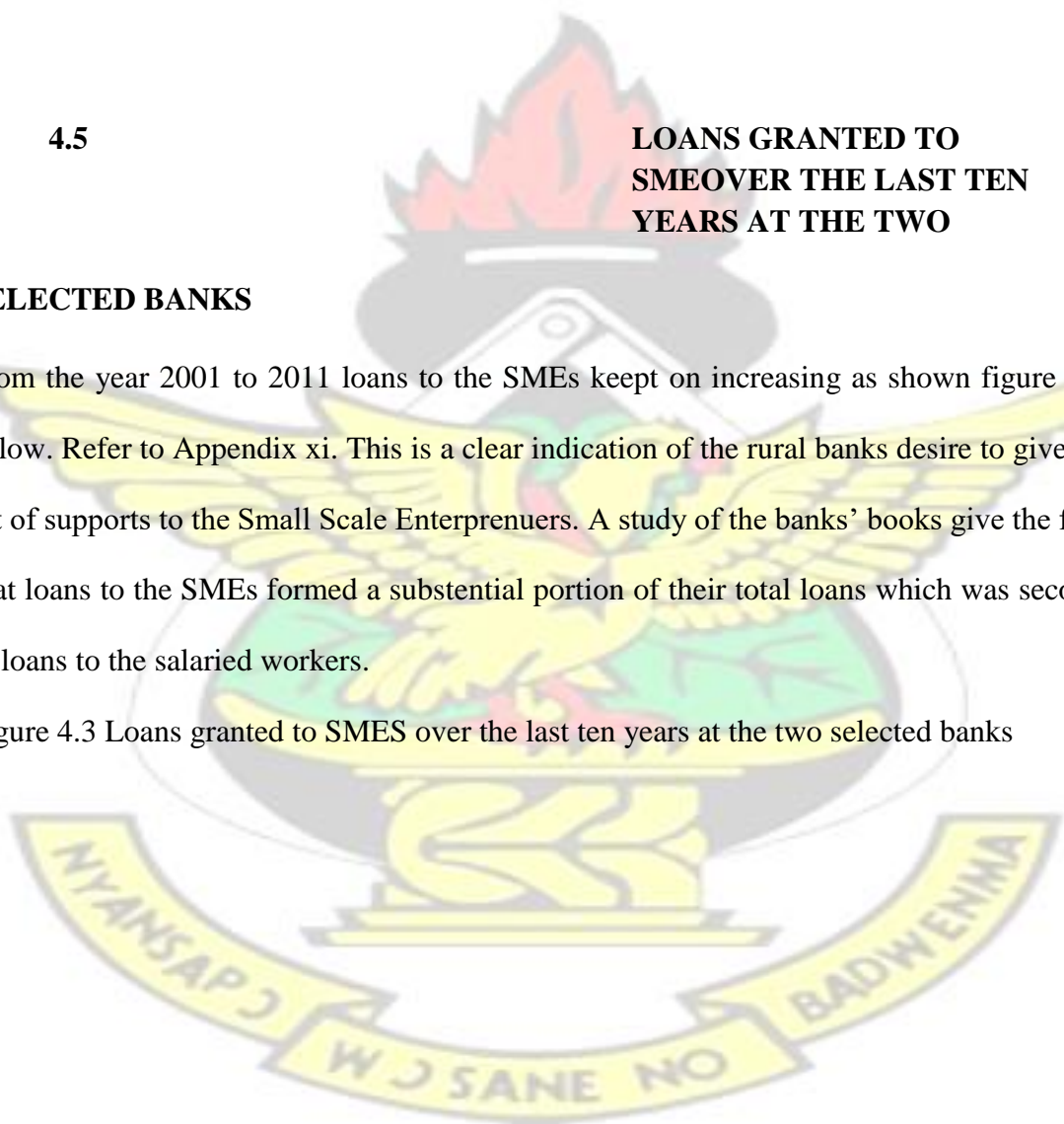
4.5

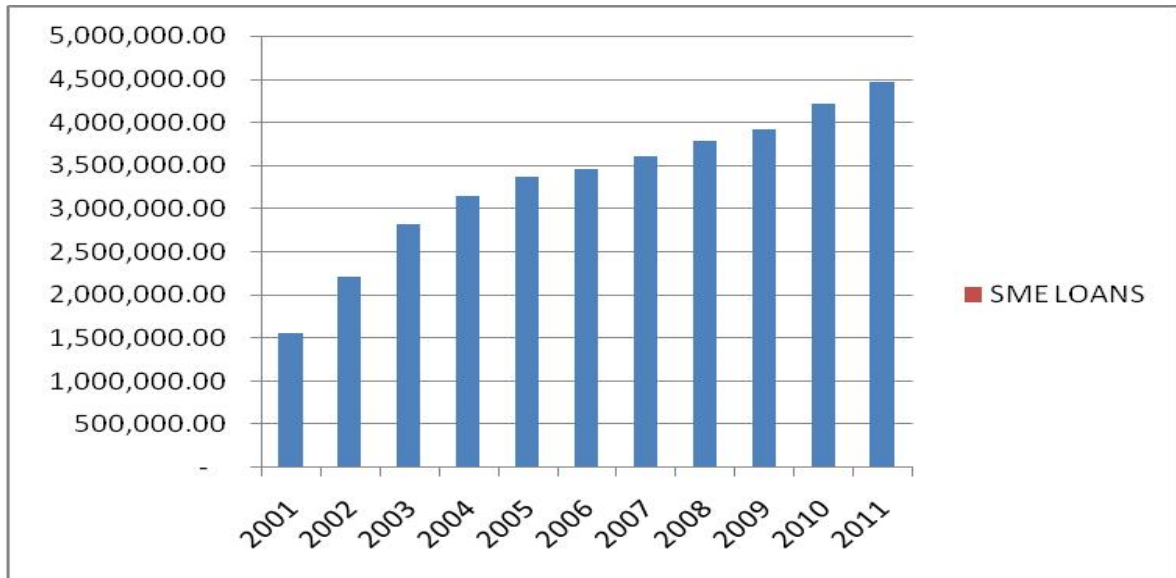
LOANS GRANTED TO SME OVER THE LAST TEN YEARS AT THE TWO SELECTED BANKS

SELECTED BANKS

From the year 2001 to 2011 loans to the SMEs kept on increasing as shown figure 4.3 below. Refer to Appendix xi. This is a clear indication of the rural banks desire to give a lot of supports to the Small Scale Entrepreneurs. A study of the banks' books give the feel that loans to the SMEs formed a substantial portion of their total loans which was second to loans to the salaried workers.

Figure 4.3 Loans granted to SMES over the last ten years at the two selected banks





4.6

CHALLENGES SMES FACE IN ACCESSING CREDITS FROM THE THE

RURAL BANKS

As shown in the Table 4.7 below, 32% of the SMEs sample cited high collateral requirements by the banks as a challenge, 22% were against high interest rates, and 10% cited delay in credit processing as their biggest challenge. Also 12% cited lack of proper financial records but only 6 of the respondents representing 6% cited lack of information on the credit facilities available in the various banks, the remaining 18% mentioned loan repayment as a challenge. From Table 4.7, it was realized that high collateral requirement is a major challenge for most of the SMEs when accessing credit from the bank since 32% of the SMEs were having this as a challenge. Few SMEs admitted that lack of information on the credit facilities as a challenge since only 6% of the SMEs realized this issue as one.

Table 4.7
**Frequency and Percentage Distribution of
 Accessing Credit from the the rural banks**

The Challenges smes face in

CHALLENGES	FREQUENCY	PERCENT (%)
High Collateral Requirements	32	32
High Interest Rates	22	22
Delays in Credit Processing	10	10
Lack of Proper Financial Records	12	12
Lack of Information on Available Credit Facilities	6	6
Loan Repayment	18	18
TOTAL	100	100

High collateral requirements

When the SMEs were asked whether the degree of collateral requirements impeded SMEs access to loans, 92% of the SMEs sampled had a problem with collateral requirements. The remaining 8% did not have a problem with the collateral requirements as shown below.

4.8 SMEs with Collateral and without Collateral

COLLATERAL TO SECURE LOAN	FREQUENCY	PERCENT (%)
CUSTOMERS WITH COLLATERAL (YES)	8	8

Table Frequency and Percentage Distribution of

CUSTOMERS WITHOUT CALLATERAL (NO)	92	92
TOTAL	100	100

From Table 4.8, it was realized that most of the SMEs do not have collateral since 92% of the SMEs sampled admitted this problem. This was due to the documentary process the SMEs have to go through before they can get a lease for land purchased. It was also recognized that few SMEs have collateral for credit process since only 8% of the SMEs wanted to be assessed on the basis of collateral.

To minimize default in the repayment of loans, banks request for collateral. This demand for collateral from the banks' point of view seems reasonable, but from the SMEs' point of view, this seems difficult to satisfy since 92% of the sample claimed that high collateral requirements impede their access to credit from the banks as shown in Table

4.8.

In addition, the SMEs also specified the type of collateral they will readily meet when demanded by the banks and this is captured in Table 4.9.

4.9 type of Collateral for SMEs

TYPE OF COLLATERAL	FREQUENCY	PERCENTAGE (%)	CUMMULATIVE PERCENTAGE
Land	8	8	8%

Table Frequency and Percentage Distribution of

Houses	10	10	18%
Vehicles	14	14	32%
Firm Buildings or shops	16	16	48%
Savings or Lien	12	12	60%
Third Party Guarantee (Guarantor)	40	40	100%
Total	100	100	100%

Of the 100 sample, 8% of the SMEs indicated that they would be able to provide land as collateral, 10% could provide a house, 14% could readily make available vehicles as collateral and 16% found it easy to provide business buildings or shops. Savings or Lien was also indicated as being convenient to provide, this accounted for 12% and 40% said they could get an guarantor.

It was realized that all the SMEs have collateral that they can use to secure their loan application, but the issue of concern here is whether the banks will accept this collateral or not. Thus the degree of collateral, but not just the collateral itself, was found to impede the SMEs' access to credit. The study further considered the various types of collateral

that SMEs would readily meet when demanded by banks. This showed that 40 out of the 100 SMEs sampled could readily make available people to guarantee them as shown in Table 4.9. This however seem to suggest that most SMEs do not have immovable assets that they can provide as collateral, but since rural banks have traditionally requested immovable assets, this group of SMEs is constrained. From Table 4.9, it was also realized that few SMEs have land to be used as a collateral since just 8% of the SMEs admitted they have land to used as a collateral. The bankers stated that a guarantor needs to be a salaried earner on Controller and Accountant General's Department payroll (government worker) who takes his or her salary through their banks which is more often than not difficult to see by the SMEs.

Delays in credit processing

As evident in Table 4.7, 10% of the SMEs sampled cited delays in credit processing as a major challenge facing SMEs. The procedures and processes for loan approval tend to be cumbersome, bureaucratic and time consuming. The result is that SMEs receive their loans late and are therefore not able to use them at the right time and this represents 10% of the SMEs sampled as shown in Table 4.7. It sometimes take more than a month for applicants in some occasions to receive approval for their loans. This is because the branch's credit officer has to forward the loan request to the Head Office where the credit committee and board of directors who meet fortnightly and monthly respectively to approve them. These SMEs were not satisfied with the lead time for the loan approval since business activities are time bound.

Lack of proper financial records

It is well known that SMEs do not appreciate record-keeping as a resource. Recordkeeping and other simple management tools affect the profitability of SMEs. For this reason, the study sought to find out the information base of the SMEs. Rural banks rely on the business records of SMEs to establish their inventory turnover, cash flows, profitability and the riskiness of granting the credit. In the research it was evident that this was a challenge that is faced by the SMEs since 12% of the total SMEs sampled admitted to this problem as shown in Table 4.7.

Inadequate financial record keeping and the consequent failure to make good use of available financial information is characteristic of SMEs. These SMEs are mostly sole proprietorships that tend to have a less distinct separation between the finances of the owner and those of his own personal household transactions. This lack of proper financial records, as the researcher observed, was due to various reasons ranging from the reluctance to reveal critical information to competitors, to non-transparent practices to minimize their tax burden. Nevertheless, it precludes the establishment of long-term bank-client relationships that are part and parcel of the SMEs creditworthiness.

Lack of information on the credit facilities available.

Most SMEs do not go in for loans from banks because they lack information on the credit facilities available to them. From Table 4.7, it was realized that 6% of the sample contended that the lack of information on the credit facilities available was a challenge to them. This problem can be attributed to two main reasons which are illiteracy and prejudice against loan application. The need for a sound, accessible and usable credit information referral system is pressingly apparent, especially for SMEs. Illiteracy and prejudice against the

banks' credit policies were the main reasons advanced for this lack of information on credit facilities.

The researcher however realized that those who stated illiteracy as a reason have little or no formal education, and thus lacked the ability to ascertain the various credit products that are made available by their banks. It was further realized that other SME operators though literates, have certain prejudices against the rural banks credit requirements, and this had clouded their access to any available information on credit facilities.

Loan Repayment

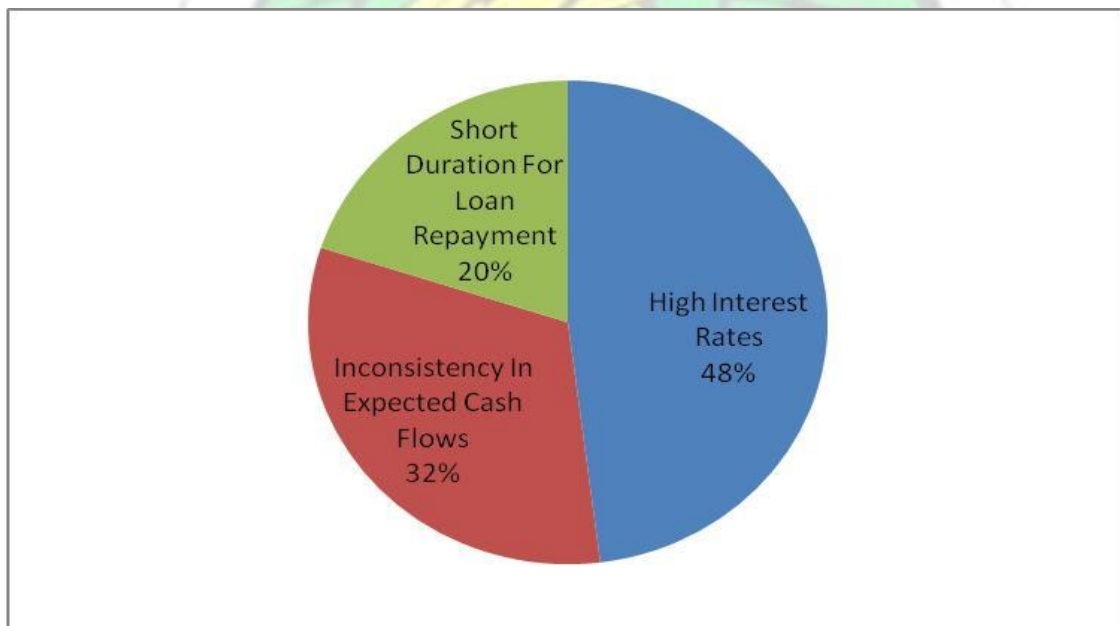
Loan repayment has been one of the major problems facing SMEs over the years. This problem arises out of the inability of SMEs to repay loans given out to them in full and at the scheduled date of repayment. The SMEs interviewed asserted that this was a problem to them and gave reasons such as high interest rates, inconsistencies in expected cash flows and short duration for loan repayment. Due to the high interest rates that rural banks charge on loans as was agreed by 77% of the respondents (Table 4.6), SMEs find it difficult to repay loans on time. Inconsistencies in expected cash flows also affect loan repayment adversely. Most of the SMEs were of the opinion that due to late disbursement of loans from the banks, they could not undertake their businesses at the right time and since they subject these SMEs to pay their loans in installments their expected cash flows are distorted hence their inability to repay the loans.

It was also realized that the rural banks laid emphasis on how to recover their loans rather than giving adequate grace period or moratorium to cushion the cost of the loan. The SMEs complained that rural banks give short duration for loan repayment without even considering the gestation period of the business activities that these SMEs are involved in. However, some who were satisfied with loan repayment attributed their satisfaction to the timely disbursement of loans by their banks and the flexibility the banks give them to plan their own repayment schedules.

Many SMEs have complained that high interest rates adversely affect their inability to pay back loans. Inconsistency in expected cash flows and short duration for loan repayment were also cited by some SMEs as reasons for their inability to repay loans.

This is clearly seen in Figure 4.4.

Figure 4.4 A pie chart showing SMEs reasons for Loan Repayment Problems



4.7 OTHER SERVICES PROVIDED TO SMES

a. Advisory Services

When asked what other services SMEs have apart from credit from their banks, advisory services was mentioned by the Management of the banks. By this the SMEs are given practical advise on financial matters. They are sometime picked for training which are usually sponsored by either Apex with subsidy from the government and other non governmental organisation.

b. Mobile Banking Services

The Management of the banks said Mobile Banking is fast becoming the modus operandi of some of the rural banks especially those with extensive agency networks. The Banks move to the door steps of the SMEs customer and their other customers to collect deposits. This saves the SMEs from thier busy schedule in situation where they do not have time to go to their banks. However, withdrawals are made at the bank.

c. Money Transfers

The Management also maintained that Local and Foreign Money Transfers are also available at the rural banks for their customers. The product enables customers and noncustomers of the bank to pick remittance through the wide area network of the rural and community banks operating in the country. The transfer is done through electronic means. It is secured, fast and reliable means of transferring funds. Most of the SMEs especially those in retail trading have patronised it greatly to help thier businesses and this prtects from issues like high way robbery.

d. Value Chain Enhancement

The rural banks were also known to provide a platform for businesses to link up with each other. For instance the farmer could be linked with a transporter who will come with a connected trader or buyer to the farm to buy the farm produce and sell to a producer or to the end user. In situations where the bank has such customers they provide platform for them to be linked to each other for their economic improvement.

e. Custodians of Valuables

In situation where clients have valuables like will, gold, official documents etc for safe keeping it was noted that these things could be kept with the rural bank.

4.9 ARB APEX BANKS' CONTRIBUTION TO SME GROWTH

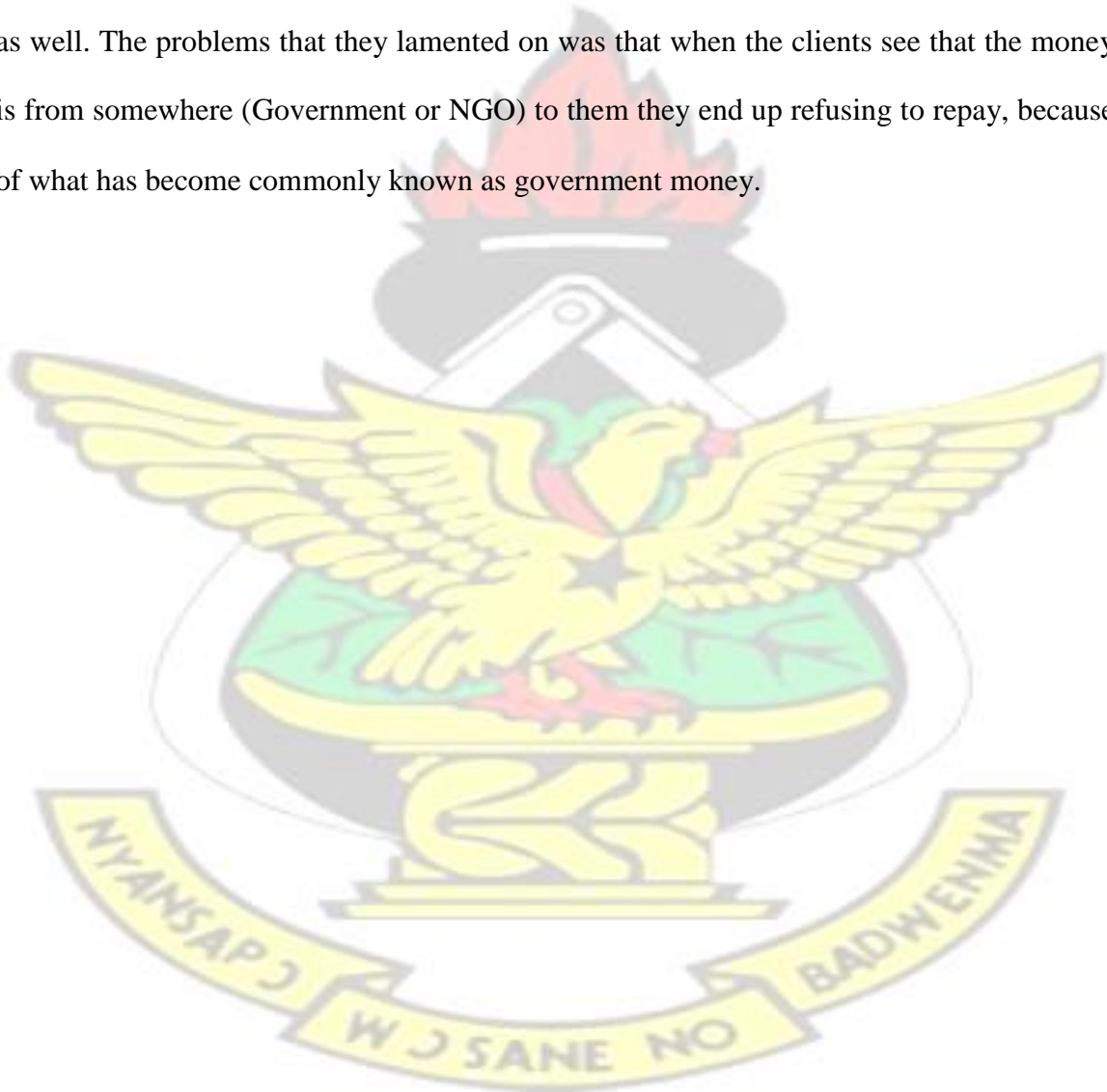
ARB Apex Bank's contribution to the development of rural and community banks cannot be low keyed. Since the establishment of ARB Apex Bank 10 years ago they have help build the capacity of the rural and community banks to give expedite services. The

Government of Ghana, the Bank of Ghana and other Non-Governmental Agencies (NGOs) have also helped in the fight for the rural banks to provide effective and efficient services to the SME customers. During the fieldwork, it came to light that about 16 of the cutomers interviewed were beneficiaries of the support facilities from government and non-governmental organisations channel through the rural banks. The Management of the two banks were unwilling to give the quantum of their exposures to the individual beneficiaries because of the oath of secrecy which prevents them from giving out some confidential information.

Various interventions such as DANIDA Support to Private Sector Development phase II

(SPSD II), Rural Enterprise Project (REP), Support Programme and Enterprise Development (SPEED) Fund, Funds for Small and Medium Enterprises (FUSMED), Community Based Rural Development Project (CBRDP), Root and Tuber Improvement and Marketing Programme (RTIMP), Private Enterprise and Export Development (PEED), Social Investment Fund (SIF) and more were noted to have been channeled through rural banks and towards SMEs' development.

The management of the banks was of the view that such on-lending funds help their clients and them as the disbursing banks since they come with training and development services as well. The problems that they lamented on was that when the clients see that the money is from somewhere (Government or NGO) to them they end up refusing to repay, because of what has become commonly known as government money.



CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.0 INTRODUCTION

The theme of this study is “Contributions of Rural and Community Banks towards the Development of Small Medium Scale Enterprises”. In achieving this, the study highlighted and sort answers to questions on the credit appraisal techniques used by rural banks in granting credit to SMEs, the effects of these credit appraisal assessments of SMEs businesses, the major challenges that SMEs face in accessing credits from rural banks and finally the future of the linkage roles and various interventions from the Government, NGOs and the ARB Apex Bank on SMEs development through the Rural and Community Banks.

5.1 SUMMARY OF FINDINGS

It was clearly noted that rural banks in Ghana have helped greatly in creating a dependable channel for savings mobilisation and access to credit among rural and urban dwellers particularly those in small businesses.

Like all other bank financial institutions, rural and community banks mobilize funds from their customers for safe keeping and also grant credits to their customers for various purposes. Access to credit through the rural banking sector in Ghana has really enhanced development through the generation of jobs and all kinds of economic activities including those relating to agriculture, fishing, transportation, cottage industries, trading and commerce, education and health care among many others.

The rural banks have acted as economic stimulants within their catchment areas and have hastened the pace of development of their SME clients businesses as was noted from the fieldwork conducted. As noted by the researcher, the loans portfolio of the selected rural banks to the SME applicants from year 2001 to 2011 kept on increasing. The rural banks also relax most of their appraisal methods and loans policies to meet the demands and the reach of their SME customers. They also provide other services such as safe custody, money transfer for both local and foreign, advisory services, value chain enhancement and mobile banking services.

In spite of the contribution by the rural banks to assist the development of the small entrepreneurs, the study also noted that the SMEs face challenges in some instances in applying for credits from the rural banks which include high collateral requirement, high interest rates, lack of proper financial records, and lack of information on the credit facilities available, delays in loans processing and unfavourable loan repayment plan or schedules.

The ARB Apex Bank Ltd with support from the Government and NGOs has also contributed to the training and development of personal of rural banks. Also noted in the study was that a lot of funds do flow to the Apex Bank to the rural banks for on-lending. The problem noted thereof was that some the SMEs were not in the known of such information and at the end do not benefit, and those who knew sometimes fell reluctant to repay due to the source of the money which they think is free.

5.2 RECOMMENDATIONS

All the attributes of the banking industry are now being enjoyed by SMEs operating with the rural and community banks of Ghana the noted problem is lack of the needed

information of the products and services available to the SMEs. To this extent it is important that advertisement are made to remove the cloud on the services of the rural banks available to their customers particularly the SMEs.

Also the banks should from time to time organize programs and workshops for SMEs on the aspects of their credit policies, assessments and evaluation. Such programmes and workshops must have a substantial component devoted to the training on financial record keeping and bank transactions or proper accounts operations. This will increase the confidence the rural banks have in the SMEs and especially give them more access to credit.

Furthermore, SMEs need to be properly organized in terms of financial record keeping and management setup in order to enable proper credit assessment to be done by the rural banks.

Also, there is a strong need of financial literacy education for the majority of the SMEs owners. This should be looked at again to ensure that the entrepreneurs of small businesses are effectively trained and better placed to be able to manage the loans or debt they contract to help the growth of their businesses and also to ensure prompt and consistent repayment of loans.

There should be a lot of advertisements on other alternative sources of finance such as venture capital schemes set up by the government for SMEs to help provide start-up capital for them.

Finally, The Bank of Ghana can lower the prime rate and check the other monetary policies so that the banks' rate can come down to help enhance the development of SME.

5.3 SUGGESTION FOR FURTHER RESEARCH

There are 133 rural banks in Ghana out of which two of them were selected. Further research could consider other rural banks that have not been used in this research to assess their contributions to SMEs development.

5.4 CONCLUSION

The purpose of this study was to ascertain the contributions (financial and non-financial) of Rural and Community Banks (RCBs) towards SMEs improvement, growth and expansion in Ghana. It was noted that the Rural Banks have in no small way helped the Small and Medium Scale Enterprises by the provision of access to credit (working capital), provision of advisory services, value chain enhancement, custodian of variables, money transfer services and mobile banking services. These notwithstanding the SMEs face challenges such as high collateral requirement, high interest rates, lack of proper financial records, lack of credit information, delays in loans processing and unfavourable loan repayment schedules.

The SME/Rural and Community Bank relationship are mutually beneficial when the understanding is reached between owners of SMEs and the rural banks.

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APPENDIX 1

QUESTIONNAIRE TO BE ADMINISTERED SME OF THE SELECTED

RURAL BANKS

FOR ACADEMIC PURPOSE ONLY - STRICTLY PRIVATE AND

CONFIDENTIAL

RESEARCH QUESTIONNAIRE

The data gathered is part of a research work being undertaken by Mr. Amponsah Daniel on his thesis dissertation at the Kwame Nkrumah University of Science and Technology on the topic: “Assessing the Contribution of Rural and Community Banks towards Small Scale Enterprise Development”. The researcher has chosen Nkoranza –Kwabre Rural and Fiagya Rural Bank and their SME customers for as case study.

You are entreated to answer the following questions as objectively as possible. Your response will be treated with the strictest of confidence.

PARTICULARS OF RESPONDENT

Name of Enterprise (if any).....

Number of Employees.....

Nature and Type of Work.....

Level of Education.....

Number of years in work / Working Experience

Date of Responding

1. How long have you saved with a Rural Bank
 - a. 0-5 years
 - b. 6-10 years
 - c. Over ten years
2. What accounts do you have with the Rural Bank?
 - a. Ordinary Savings Account only
 - b. Ordinary Current Account only
 - c. Savings and current Account
 - d. More than the ordinary savings and current accounts
3. How often do you apply for loans?
 - a. Once a year
 - b. Twice a yearly
 - c. More than twice a year
 - d. Not at all
4. Have you been successful in obtaining loans
 - a. Yes
 - b. No

c. Not at all times

5. If yes, what made it possible?

.....

6. If no, why were you refused?

.....

7. What interest rate was charged on your loan?

.....

.....

8. What is your view on their interest rate?

a. HIGH []

b. MODERATE []

c. LOW []

9. What level of interest seemed reasonable?

.....

.....

10. What challenge do you face in assessing credits from your rural bank?

a. High collateral requirement []

b. High interest rate []

c. Delay in credit processing []

d. Lack of proper financial records []

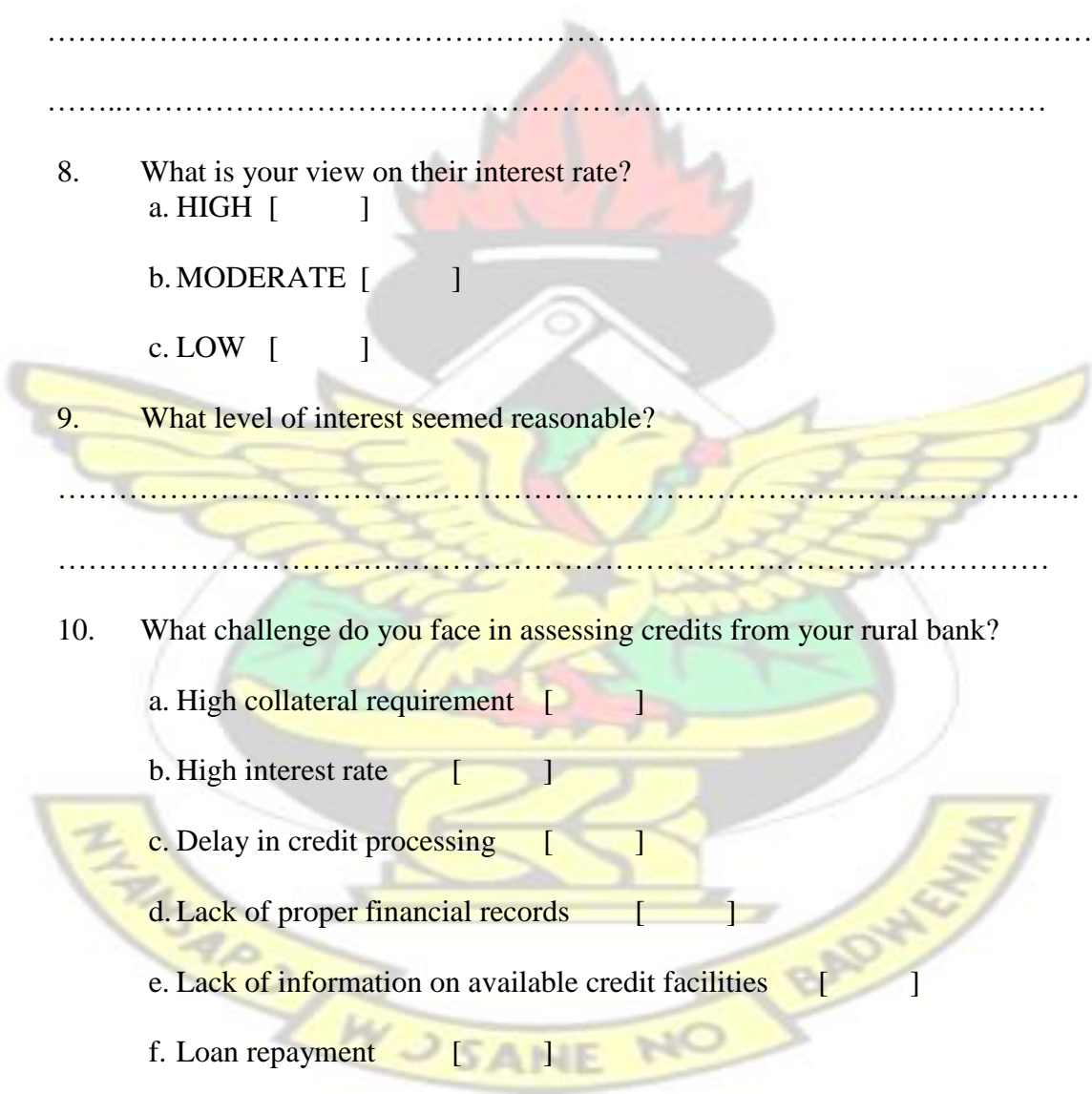
e. Lack of information on available credit facilities []

f. Loan repayment []

11. Do you have collateral to secure your loan?

a. Yes [] No. []

12. Which of the following security can you ready make available for loan?



- a. Land []
- b. House []
- c. Vehicle []
- d. Building []
- e. Personal guarantee []
- f. Business savings or Lien []

13. Are you able to pay you loans on time?

- a. Yes [] b. No []

14. What are your views on loan repayment plans by your bank?

.....

15. Do you like services of the Rural Bank?

- a. YES [] b. NO []

16. What is the level of satisfaction with the bank loans policy requirement?

- a. HIGH []
- b. MODERATE []
- c. LOW []

17. Has your capital increased?

- a. YES [] NO []

18. Has your profit increased?

- a. YES [] NO []

19. Is there fixed assets increased

- a. YES [] NO []

20. What amount of cash do you think you have added to your business as a result of your relationship with the bank?

- a. GHø100 to GHø200.00
- b. GHø201.00 to GHø500
- c. GHø501 to GHø1000.00
- d. GHø1000 and above

21. Have you benefited from any government intervention through your rural bank or any other rural bank or ARB Apex Bank?

- a. YES [] NO []



**APPENDIX
I**

Do you like services of the Rural Bank	SME	Percentage	Cumulative %
Yes	81	81%	81%
No	19	19%	100%

APPENDIX II

What is the level of satisfaction with the bank loans policy requirement	SME	Percentage	Cumulative %
High	56	56%	56%
Moderate	25	25%	81%
Low	19	19%	100%

APPENDIX III

What accounts do you have with the Rural Bank?	SME	Percentage	Cumulative %
Ordinary Savings Account only	0	0	0
Ordinary Current Account only	0	0	0
Savings and current Account	91	91%	91%
More than the ordinary savings and current accounts	9%	9%	100%

IV

APPENDIX

Has your capital increased	SME	Percentage	Cumulative %
YES	100	100	100%
NO	0	0	

APPENDIX V

Has your profit increased	SME	Percentage	Cumulative %
YES	100	100%	100%
NO	0	0	0

APPENDIX VI

Increased in fixed assets	SME	Percentage	Cumulative %
YES	100%	100%	100%
NO	0	0	0

APPENDIX VII

Have you benefited from any government intervention through your rural bank or any other rural bank?	SME	Percentage	Cumulative %
YES	63	63%	63%
NO	37	37%	100%

VIII

If yes for 14 above, what impact did it have	SME	Percentage	Cumulative %
HIGH			
MODERATE			

APPENDIX

LOW			
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APPENDIX IX

Cash growth	SME	Percentage	Cumulative %
GHø100 to GHø200	9	9%	9%
GHø201 to GHø500	6	6%	15%
GHø500 to GHø1000	39	39%	54%
Over GHø1000	46	46%	100%

APPENDIX X

Type of Accounts	SME	%	Cumulative (%)
Current Account only	9	9%	9%
Savings Accounts only	54	54%	63%
Savings and Current Accounts only	29	29%	92%
More than Savings and Current Accounts	8	8%	100%

XI**SME LOANS GRANTED BY THE SELECTED BANKS**

YEAR	SME LOANS GH¢
2001	1,564,000.00
2002	2,211,000.00
2003	2,812,000.00
2004	3,140,000.00

APPENDIX

2005	3,361,000.00
2006	3,455,000.00
2007	3,601,000.00
2008	3,782,000.00
2009	3,915,000.00
2010	4,216,000.00
2011	4,462,000.00

