

# The assessment of small and medium scale enterprise loan delivery in ghana essay ...



## 1. 0 INTRODUCTION

Small and medium scale-enterprises (SMEs) are also vital to economic development. No society can be more developed without small and medium scale enterprises or businesses. Though these enterprises face some challenges in assessing loan, yet they also contribute significantly to nation's development. It is therefore prudent for these enterprises to assess loan easily so as to enable them expand their network or operations.

## 1. 1 BACKGROTUND OF THE STUDY

In today's Global Economy, small and medium-scale enterprises (SMEs) are the engine of growth and play vital role in economic development process. The significance of SMEs is acknowledged worldwide. SMEs occupy a place of pride in virtually every country or state. Because of their (SMEs) significant roles in the development and growth of various economies, they (SMEs) have aptly been referred to as " the engine of growth" and " catalysts for socio-economic transformation of any country." SMEs represent a veritable vehicle for the achievement of national economic objectives of employment generation and poverty reduction at low investment cost as well as the development of entrepreneurial capabilities including indigenous technology.

And as such SMEs form the vanguard of the modern enterprise sector and present the propelling force of economic modernization and growth in developing economies. The dynamic roles of SMEs in developing countries have been highly emphasized. These enterprises have been identified as the means through which the rapid industrialisation and other developmental goals of these countries can be realized.

In recognition of the enormous potential roles of SMEs, SMEs are regarded as the lifeblood of Ghana's economy by the government as they constitute a significant percentage of the economy. The SMEs sector constitutes in excess of 92% of the economy of the country and its output as a percentage of GDP accounted for 70% of GDP in 2011. Apart from increasing per capita income and output, SMEs create employment opportunities, enhance regional economic balance through industrial dispersal and generally promote effective resource utilization considered critical to engineering economic development and growth.

SMEs, if properly structured and capitalized have the potential to grow and spearhead accelerated growth of this economy into a middle income status. A vibrant SME sector can help reduce poverty through employment generation. Other intrinsic benefits of vibrant SMEs include stemming of rural urban migration, enhancement of standard of living of the employees of the SMEs and their dependents as well as those who are directly or indirectly associated with them.

However, the need to provide secured source of financing for this sector cannot be over emphasized. Government has identified the need for the development of Small and Medium Scale Enterprises (SME). One of such sectoral strategies is the introduction and pursuit of policies such as Venture Capital to encourage and strengthen the growth of SMEs in Ghana.

The important roles SMEs played, notwithstanding the benefits enjoyed from ARB Apex Bank, the enterprises face serious difficulties when trying to obtain

loans, especially from the formal financial institutions. Thus, the obvious question; how do financial institutions assess SMEs loan portfolio?

## 1. 2 PROBLEM STATEMENT / RESEARCH PROBLEM

Whilst SMEs are an important part of the business landscape in any country, they are faced with significant challenges that compromise their ability to function and to contribute optimally to the economy, especially lack of short, medium and long-term capital — inadequate access to financial resources and credit facilities. Financing has remained one of the key managerial problems decision that keep confronting business enterprises in Ghana today. For the SMEs, the accessibility to funds and the cost of raising them have remained issues limiting the capitalization requirements leading to premature collapse of the enterprises.

In spite of the relevance of the small-scale industry to Ghana's economic and industrial development, the sector faces a lot of problems. These problems include those of management, appropriate technological skill acquisition, a harsh policy environment, gender bias and financial requisitions. The study seeks ways to increase SME financing by identifying the financing opportunities currently available and also finding out the barriers to access these opportunities.

## 1. 3 OBJECTIVES OF THE STUDY

The primary objective of this study is to determine the lending practices of financial institutions towards the SMEs. Specific objectives:

In order to achieve the primary objective, the following specific objectives would be pursued: \* To identify the type of loan facilities available to SMEs in

Ghana; \* To identify the various sources of loan facilities for SMEs; \* To ascertain the challenges in accessing loan facilities by SMEs; \* To ascertain the assessment criteria used to evaluate loan appraisal for SMEs.

#### 1. 4 PURPOSE OR RATIONAL OF THE STUDY

The critical importance of adequate credit delivery to SMEs stem from the realization that their development is what is required to enable the country's industrial sector meet the contemporary changes of globalization; economic restructuring and poverty alleviation. The SMEs constitute the foundation for the sustained growth and development of the economy. In Ghana, perhaps the most important challenge facing policy makers in industrial development is the financing and technological upgrading of the myriad of SMEs that formed the back bone of industry and provide the bulk of employment and income generation.

Small-scale rural and urban enterprises have been one of the major areas of concern to many policy makers in an attempt to accelerate the rate of growth in low income countries. These enterprises have been recognized as the engines through which the growth objectives of developing countries can be achieved. They are seen as major potential source of employment and income in many developing countries. In addition, the study will contribute to literature on loan delivery as well as serve as a guideline for those who desire to understand further research into loan delivery. Besides, the study will also be useful to policy makers in making policies on loan thereby ensuring proper execution of policies covering loan delivery and provides information on the present outlook of loan assessment practice in existing financial institutions. THE LIMITATION OF THE STUDY

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This study would look at some of the reasons why Small and Medium Enterprises faces some challenges in assessing loan. During the study, it was found at that: a. Because of the nature of their operations or activities, must financial institutions do not want to grant them loan. b. Also, it was realized that mast of these enterprise were not legally recognized c. In addition, must small and medium enterprises do not have the start-up capital so financial institutions feel very reluctant to grant them loan.

### 1. 5 OUTLINE OF THE RESEARCH

The study would be structured into five chapters. Chapter one would be devoted for the introduction to the study. Chapter two would consist of the literature review where the theoretical framework and conceptual issues would be discussed. Chapter three would present the methodology which discusses the methodological foundation and data analysis technique. Chapter four would be presentation and analysis of data obtained from the field survey. Chapter five would discuss the results that would be obtained as well the summary of major findings, conclusion and policy recommendations.

### DEFINITIONS OF TERMS

SMEs: Small and Medium scale Enterprises.

Indigenous: Native.

Enterprise: A bold undertaking, boldness, a business activity. Capital: Money with which a business is started.

Venture: An undertaking that involve risk.

Economy: A country's system of using its resources to produce wealth.

## CHAPTER TWO

### LITERATURE REVIEW

#### 2. 0 INTRODUCTION

This chapter reveals previous research work done theoretical and empirical by other researchers and authors on similar topics. This chapter review covers the broad concepts of SMEs, the loan facility available and how the financial institutions access their credit worthiness. This chapter also discusses the challenges as well as the contribution of SMEs to the development of Ghana's economy.

#### 2. 1 CONCEPTUAL FRAMEWORK OF SMEs

The concept of small and medium-sized enterprises generally relates, to non-agricultural activities (such as handicrafts and textiles), agro-processing i. e., all types of small scale agro-processing (such as nuts, roots and tubers, fruits, etc), commodity production (such as glasscutters'/rabbits, snails, mushroom, honey/bee keeping) and Service enterprises that provide personal, community and domestic such as construction, hairdressing, tailoring and dress making, and repair services among to mention but a few.

16 According to the International

Finance Corporation. [<http://www.2.ifc.org/sme-definitions.html>, 2004] an SMEs is any enterprise which falls into these categories; \* Micro enterprise-up to ten [10] employees, total assets of up to \$100, 000 and total annual sales of up to \$100, 000 \* Small enterprise-up to fifty [50] employees, total assets of up to \$3 million and total annual sales of up to \$3 million \* Medium

enterprise-up to three hundred [300] employees, total assets of up to \$15 million and total annual sales of up to \$15 million.

These definitions are admittedly subjective and still under review. They are broadly consistent with those used by most other international financial institutions. Still, it should be noted that the number shown above depend heavily on choice of these definition [or any other] definition.

Venture Capital Trust Fund Act 2004 [Act 680] refers to small and medium enterprise as an industry, project and undertaking or economic activity whose total capital base excluding Land and Building does not exceed the equivalent of one [1] million US dollar. Small and medium scale enterprise are enterprises engaged in operation from the stage till when the food reaches the table of the consumer and this operation includes processing, wholesaling and retailing.

## 2. 2 GENERAL OVERVIEW OF SMEs

The heterogeneous nature of the SME sector complicates the problem defining it. The concept is defined in different ways, depending on the purpose of classifying firms as micro, small, medium-sized or large. As defined by Schumpeter (1911), entrepreneurship is characterized by five major activities which involve either (a) the creation of a new good or a new quality; (b) the creation of a new method of production; (c) the opening of a new market; (d) the capture of a new source of supply; and/or (e) the creation of a new organization or industry (Iversen, 2005: p. 5). From above, entrepreneurs then can be seen as individuals who lead in new innovations



and in this process take upon the risk by themselves with a view to profiting from their innovations.

In Ghana, all enterprises related to SMEs adopted the SME criteria of their own. The National Statistical Service (NSS) which published the industrial statistics, defined small scale industries as those employing 29 employees or fewer, the rest are all considered as medium and large-scale enterprises. According to the Venture Capital Fund Act 2004 [Act 680] in Ghana, an SMEs is an industry, project, undertaking or economic activity which employs not more than 100 people and whose total asset base, excluding land and building, does not exceed the cedi equivalent of \$1 million in value. Also, according to the records of the Registrar General's Department in Ghana, about ninety percent [90%] of registered companies are SMEs. Data from the Social Security National Insurance Trust [SSNIT] supported this assertion as it shows that 90 percent of companies employ less than 20 percent. The National Board for Small Scale Industries (NBSSI) describes Micro and Small Enterprises as those enterprises employing 29 or fewer workers. Micro enterprises are those that employ between 1-5 people with fixed assets not exceeding USD 10, 000 excluding land and building. Small enterprises employ between 6 and 29 or have fixed assets not exceeding USD 100, 000 excluding land and building. The National Board for Small Scale industries (NBSSI) further classified SMEs as follows: Micro enterprise: less than 5 employees;

Small enterprise: 6 - 29 employees;

Medium enterprise: 30 - 99 employees; and

Large enterprise: 100 and more employees.

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A World Bank study conducted by Oxford University in collaboration with the Economics Department of the University of Ghana in 1992 used a different classification: micro 1-4 workers; small 5-29 workers; medium 30-99 workers and large 100 and above employees while a report by Centre for Scientific and Industrial Research (CSIR) for the World Bank suggests that a definition of SMEs as enterprises employing not more than 30 people, including apprentices and permanent employees. In addition, each bank in Ghana has its own definition of SMEs and their classification. Though they all emphasize turnover they differ in the amount used. According to the World Bank, classification, are based on number of employees, value of assets and investment levels. The World Bank uses number of employees as its main classification criterion but with regional variations. In Africa, World Bank uses 200 as the cut off number for SMEs employees.

The SME sector employs and provides income to a significant fraction of the Ghanaian population. It is however bedeviled with many challenges. According to Mensah, (2004) cited in ' A Review of SME Financing Schemes in Ghana' SMEs are usually characterized by the following: • Dominated by one person, with the owner or the manager taking all major decisions; • The management skills of the entrepreneur are generally weak making it difficult for such enterprises to prepare strategic plans for enterprise development; • Highly volatile working capital and difficulty in accessing finance; • Lack of technical know-how, use of obsolete technology, and reliance on manual labour; and • The use of family and unpaid labour (through the use of apprentices).

## 2. 3 COMMON CHARACTERISTICS OF SMEs

The SME sector in Ghana is an embodiment of most of these economic activities in the country. It is a medium of most items produced, distributed and consumed. By their mode of operation they exhibit certain characteristics that differentiate them from the large scale enterprise units.

These characteristics include: i. SOLE PROPRIETORSHIP OR ONE-MAN BUSINESS

In Ghana, most business activities are very small, consisting very often of only one person or sometimes an individual and the family. According to Mead & Liedholm (1998: p. 62), it involved unpaid family members support in many cases, trainees and apprentices “ add a significant share of workers in some location, particularly in West Africa”. They are therefore for income generating activities and as a means of livelihood. Their activities range from trading and retail establishments to manufacturing and services.

ii. EMPLOY SIMPLE TECHNOLOGY THAT IS FLEXIBLE TO ABSORB CHANGE

Traditionally, SMEs have shown a propensity of being able to adopt and internalize the technology being used by them.

iii. PRODUCE BASIC NEEDS ITEMS

SMEs skill in innovation, improvisation and manufacturing in production are well-known. By being able to meet niche requirements, they are able to capture market demand where volumes are not huge.

iv. HIGH EMPLOYMENT CREATION:

SMEs are usually the prime drives of jobs, in an economy. SMEs tend to be labour intensive as a result they are able to generate more jobs for every unit of investment, compared to large scale enterprises counterparts.

#### v. RELY ON IDIGENOUS RAW MATERIALS

SMEs utilize mostly local raw materials (resources) in their production. They also often manage with materials which are available locally.

#### vi. EASE ENTRY AND EXIST

There is no barrier to trade in Ghana, since most of the businesses are very small consisting of one person or sometimes an individual and the family, entry and exist is free.

### 2. 4 RECENT POLICY OF SMEs PROMOTION IN GHANA

The important role SMEs play in the socio-economic development of Ghana cannot be over emphasized. SMEs are imperative in achieving economic growth and development. They are often described as efficient and prolific job creators, the seeds of big businesses and the fuel of national economic engines. In the developed industrial economies, it is the SME sector rather than the multinational companies that is the largest employer of workers (Mullineux, 1997).

In Ghana, the National Industrial Census (NIS) report estimated that 70% of all industrial establishments are in the Small and Medium Enterprises Sector (GSS, 2003) and contribute about 22% to GDP as well as account for about 92% of all businesses in Ghana. It is also estimated that 85% of manufacturing employment and to a larger extent overall employment

growth in the country comes from the Sector. The sector contributes significantly to overall export earnings from the non-traditional exports sector and creates jobs at relatively low capital cost. SMEs thus have a significant contribution to make to Ghana's socio-economic development and growth, and the attainment of its middle income status of \$1, 000 per capita per annum by the year 2015 (<http://www.msmemoti.org/index.htm>).

Interest in the role of SMEs in the development process continues to be in the forefront of policy debates in most countries. Governments at all levels have undertaken initiatives to promote the growth of SMEs (Feeney and Riding, 1997).

A recent policy to promote the growth of SMEs in Ghana was contained in the 2005 report of the second Growth and Poverty Reduction Strategy (GPRS II 2006 - 2009) now Ghana Shared Growth Development Agenda, 2010-2013 framework. The overarching objective of policy was to engender sufficient economic growth that will propel Ghana into a middle-income economy by 2015. To achieve this objective, the driving force of economic growth was the promotion of 27 %, the private sector competitiveness. It was under this broad strategic goal that the enhancement SMEs performances fall.

According to a report from the OECD (2006), the SME was showing positive signs of response to this reform. Similarly, the World Bank/IMF's annual Doing Business Report (2008) has ranked Ghana as a top ten (10) global reformer for two years in a row (2006 and 2007). In addition, Ghana's economic policy on business models has been geared towards divestiture of state-owned enterprises and more of private ownership.

#### 2. 4. 1 REGULATORY INSTITUTIONS

In a developing country like Ghana, the Government is the key regulatory body in the development of SMEs in terms of providing policy guidelines, under which the SMEs operate. The Government Ministries, which have direct regulatory responsibility for the general industrial sector of the economy, had been the Ministry of Finance; Ministry of Environment, Science and Technology, and Ministry of Trade and Industry. The regulatory activities of these ministries were in the areas of formulation and implementation of industrial, economic, science and technology and environment policies. The other regulatory institution was the Ghana Standards Board which has the responsibility to promulgate standards for goods made in Ghana, quality control, ensuring consumer welfare and promotion of industrial efficiency and development.

#### 2. 5 CONTRIBUTION OF SMEs TO DEVELOPMENT OF GHANA

The role of SMEs has become essential specifically, as they are instrumental in creating job opportunities, promoting stability and development of regional economies, enhancing economic efficiency through competition and cooperation, expanding business scope, and producing high value-added products through innovation. This came into limelight in the late 1970s and early 1980s due to the economic recession which led to the decline of industrial 19% growth and employment in many developing countries especially in Africa. Government of such countries adopted new policy approach towards SMEs development. Some of the policies in Ghana include the Economic Recovery Programme, Structural Adjustment Programme and

the Financial Liberation. The contribution of the SMEs to the nation's economy is potentially very great and significant.

According to Ghana's National Industrial Census (NIS), there were a total of 26, 190 MSMEs (The abbreviation MSME and SMEs will often be used interchangeably in the study to represent the same idea of small business) in Ghana around 2003. SMEs, especially micro and small enterprises, were the predominant business units in Ghana, comprising more than 95% of all business units. Some 14, 438, or 54. 5%, of the total number of SMEs, were classified as micro-enterprises based on the classifications set forth by the National Board for Small Scale Industries (NBSSI). In manufacturing, for instance, out of a total of 26, 088 business units, only 251 units were large scale enterprises.

According to Dinye (1991) the roles of SMEs include the following:

- \* They offer a variety of activities which draw labour from the surplus rural labour force and channel them into other productive sectors of the economy;
- \* They generate dynamism, initiative and competition within the economy making it more functional;
- \* SMEs use of the nations idle materials which otherwise would go to waste;
- \* They contribute to community stability, do less harm to the physical environment, stimulate local resource mobilization for investment and generally raise the level of popular participation in the economy;
- \* They induce linkages within the industrial sector and between it and other sectors of the economy.
- \* They depend little on imports and therefore conserve foreign exchange.
- \* They provide a variety of goods and services to satisfy local needs.
- \* They provide outlets for the talents and energies of enterprising individual because of their ease of entry and exit;

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and \* They provide a seedbed for nursing entrepreneurial skills and testing ground for new industrial enterprises.

According to Steel and Webster (1990) in Ghana, SME employment grew by 2.9% per annum (ten times as many jobs than large scale enterprise). The SMEs provide employment to 60% of the work force in Ghana, 55% of employment in Canada (<http://www.cfib.ca/research/reports>), 70% of total employment in the European Union (<http://www.enterprise-europe-network.europa.eu/files/SMEs>) and at least 70% of private sector workforce in South Korea. Table 1 shows the employment distribution of enterprises among SMEs in Ghana. In addition to job creation, SMEs help in wealth redistribution especially among low income groups. SMEs tend to be widely dispersed reaching remote and marginalized settings, hence helping reduce the income gap between urban and rural areas (Albaladejo, 2002).