FINANCING SMALL AND MEDIUM SCALE ENTERPRISES IN GHANA: A STUDY OF SMES IN THE TECHIMAN MUNICIPALITY

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ABSTRACT

It is believed that access to financial resources is a major concern for small and medium enterprises. Hence, small and medium businesses face a major challenge in their quest for growth and development. The study sought to evaluate the funding arrangements available to small and medium enterprises in the Techiman municipality. A descriptive survey design was used for the study, and data were obtained from 98 operators of small and medium enterprises, using questionnaires. The study established that personal savings was the main source of start-up fund for the small and medium enterprises. Further, inadequate working capital and low patronage of services were the main challenges faced by the small and medium enterprises. In spite of the numerous sources of start-up fund available to small and medium enterprises in the Techiman municipality, these businesses principally relied on personal savings as their mainstay. Therefore, it is recommended that the Government of Ghana should encourage small and medium enterprises in the municipality to patronise more government financial schemes.

Keywords: Financing, Small and medium enterprises, Techiman municipality, Ghana.

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Introduction

Access to finance has been identified as a dominant constraint facing SMEs (Lader, 1996). A World Bank study found that about 90 percent of small enterprises surveyed stated that credit was a major constraint to new investment (Parker et al., 1995). Levy (1993) also found that there is limited access to financial resources available to smaller enterprises compared to larger organizations and the consequences for their growth and development. This stems from the fact that SMEs have limited access to capital markets partly due to high cost of credit based on high risk, competition between public and private sector for funds, insufficient client information, and lack of collateral among others. In sub-Saharan Africa, most small businesses fail in the first year due to lack of support from government and traditional banks (Biekpe, 2004).

The expectation has been that after the initial take off of the small scale enterprises, the Small business should be able to raise funds from the formal sector especially Micro Finance Institutions (MFIs) or banking industries to expand its operations, but this has not been the case for a number of reasons including the perception that SMEs are high risk borrowers due to insufficient assets and low capitalisation; inability of the SMEs to prepare acceptable or viable business plans; poor record keeping, especially of financial operations in which owner(s) draw money than expected from the business either for personal or family use (Inang & Ukpong, 1992; Iniodu & Udomesiet, 2004). Consequently, commercial banks are generally biased towards large borrowers who provide better business plans, more reliable financial information, better chances of success and higher profitability for the banks. Besides, many governments and international financial institutions have tried to address the problems of high transaction costs and risk by creating subsidized credit programmes and or providing loan guarantees. Such projects have often fostered a culture of non-payment or failed to reach the target group or achieve financial self- sustainability (UNCTAD, 2001). This unequal access to finance by SMEs and large enterprises has undermined the role of small scale businesses firms in the economic development of African countries at large and the Ghanaian economy in particular. Even though previous studies on financing SMEs were carried out in some parts of Ghana, there is inadequate literature on financing SMEs in the Techiman municipality. As such, this study sought to assess the financial arrangements for the SMEs in the Techiman Municipality.

Literature review

There is a universal agreement that the performance of small and medium enterprises is important for both economic and social development in developing countries (Abor & Quartey, 2010). According to Advani (1997), small and medium enterprises provide a number of benefits, thus, small and medium enterprises have been noted to be one of the major areas of concern to many policy makers in an attempt to accelerate the rate of growth in low-income countries. However, it is an indisputable fact that for many potentially dynamic, small and medium-scale businesses, one conspicuous constraint is the lack of access to finance for either working capital or asset acquisition or both (Afrane, 2003; Aryeetey, 2005). They need loans to purchase machinery or equipments, rehabilitate their workshops, purchase raw materials for production, execute contracts, obtain vehicles to carry raw materials and goods to the marketing centres among others.

With regard to sources of finance, Fraser (2005), in the UK Survey of SME Finance, reports that some 2.9m SMEs (80%) had used external finance in the previous three years and that the main sources of finance for start ups are personal savings (65%), bank loan (10%) and friends or family loan (6%). He also found that approximately 900,000 businesses (24%) used term loans and that obtaining finance was reported as a major problem for start up by some 10 percent of businesses. In a similar way, Howorth (2001) also investigated sources of finance in the pecking order: entrepreneurs tend to seek finance first from their own resources, and then friends and families, and then from other sources such as banks. Indeed, money from family and friends is often essential to unlock support from commercial institutions.

Basu (1998) compared bank finance to informal sources, such as from personal resources or families in start-ups by British Asians and he found that, even though bank finance was valuable in preventing under-capitalised ventures, rapidly growing Asian businesses did not rely on bank finance either at start-up or for expansion. This may be attributed to the short-term perspective of banks. Additionally, Basu (1998) notes that fast-growing SME businesses had used personal savings when they started their firm; and adds that Asian entrepreneurs aspiring to grow need to advance beyond the traditional reliance on informal support networks for finance and labour.

In spite of the potential role of SMEs in accelerated growth and job creation in developing countries, a number of challenges affect their ability to realise their full potential. SME development is stifled by a number of factors, including finance, lack of managerial skills, equipment and technology, regulatory issues, and access to international markets (Anheier & Seibel, 1987; Steel & Webster, 1991; Aryeetey et al, 1994; Gockel & Akoena, 2002). The lack of managerial know-how places significant constraints on SME development. Even though SMEs tend to attract motivated managers, they can hardly compete with larger firms. The lack of management talent, rampant in most countries in the region has a profound impact on SMEs. The lack of support services or their relatively higher unit cost can hinder SMEs efforts to improve their management, because consulting firms are often not equipped with appropriate cost-effective management solutions for SMEs. Besides, in spite of the several institutions providing training and advisory services, there is still a skills gap in the SME sector as a whole (Kayanula & Quartey, 2000), simply because entrepreneurs cannot afford the high cost of training and advisory services while others do not see the need to improve their skills due to contentment.

With regard to technology, SMEs frequently have difficulties in gaining access to appropriate technologies and information on available techniques (Aryeetey et al., 1994). In many cases, SMEs utilise foreign technology with a scarce percentage of shared ownership or leasing. They usually obtain foreign licenses, because local patents are difficult to acquire. Regulatory constraints also pose serious challenges to SME development and although wide ranging structural reforms have led to some improvements, prospects for enterprise development remain to be addressed at the firm-level. The high start-up costs for firms, including licensing and registration requirements, can impose excessive and unnecessary burdens on SMEs. The high cost of settling legal claims, and excessive delays in court proceedings adversely affect SME operations. In the case of Ghana, the burdensome procedure for registering and starting business are main issues frequently cited. The World Bank (2006) indicated that it takes 127 days to deal with licensing issues and there are 16 procedures involved in licensing a business in Ghana. Meanwhile, the absence of antitrust legislation favours larger firms, while the lack of protection for property rights limits SMEs access to foreign technologies (Kayanula & Quartey, 2000).

Formerly detached from international competition, many SMEs are now faced with greater external competition and the need to expand market share. Conversely, their limited international marketing experience, poor quality control and product standardisation, and little access to international partners, continue to hamper SMEs' expansion into international markets (Aryeetey et al., 1994). They are also short of the necessary information about foreign markets. A significant problem that SMEs often face is access to capital (Lader, 1996). Lack of adequate financial resources places significant constraints on SME development. Cook and Nixson (2000) observe that, in spite of the recognition of the role of SMEs in the development process in many developing countries, SMEs development is always inhibited by the inadequate availability of financial resources to meet a variety of operational and investment needs.

A World Bank study also found that about 90 percent of small enterprises surveyed stated that credit was a major restriction to new investment (Parker et al., 1995). Levy (1993) also finds that there is inadequate access to financial resources available to smaller enterprises compared to larger organisations and the consequences for their growth and development. The role of finance has been viewed as a vital element for the development of SMEs (Cook & Nixson, 2000). A large segment of the SME sector does not have access to sufficient and appropriate forms of credit and equity, or indeed to financial services more generally (Parker et al., 1995). In competing for the corporate market, formal financial institutions have structured their products to serve the needs of large corporate.

Indigenous businesses are seen as less creditworthy by banks because they are generally small with inadequate corporate and governance structures, relatively short track record of operations and difficulty in meeting the information requirements of banks. To worsen their situation, the operators of indigenous businesses do not have the skills for presenting good business propositions to the banks. Unfortunately, past experiences of banks being saddled with large proportions of collateral of indigenous businesses has not helped the situation. As such, the banking sector generally as having a higher ratio of risk of default. Banks are therefore not sufficiently motivated to finance indigenous businesses which have resulted in the creation of an "intermediation gap" (Dela Torre et al., 2009).

Besides financial challenges, Aryeetey (1996) asserts that there are many non-financial constraints that impede the success SMEs. That is, the management and services of SMEs are perceived to be cost deterring and non-value adding. Also, SMEs have not taken full advantage of the government–funded business support services such as the NBSSI which operates in the ten regional capitals under the Ministry of trade and industries and the GRATIS, a basis that provides skill training and basic working capital tools for start-ups. According to Aryeetey (1996), SMEs are also dominated by one person, with the owner/manager taking all major decisions; management skills are weak, thus inhibiting the development of a strategic plan for sustainable growth; SMEs experience extreme working capital volatility; and experience inappropriate marketing strategies leading to improper product, packaging, labelling, pricing, storage and distribution. They also lack banking culture, transparency and openness or involvement of outsiders in their business; and the lack of technical know-how and inability to acquire skills and modern technologies limit their growth opportunities (ibid.).

Materials and methods

The descriptive research design was used for the study; and data for the study were principally collected from primary sources. A list containing the names and contact address of SMEs in the municipality was obtained from the National Board for Small Scale Industries (NBSSI). Then the lottery method was applied to select ninety eight (98) SMEs for the study. Hence, a sample size of 98 (ninety-eight) SMEs was used for the study.

Furthermore, purposive sampling technique was then used to select the managers or operators of the SMEs to participate in the study. The purposive sampling was employed as it is deemed the appropriate means of getting respondents who are knowledgeable and well abreast of the subject matter of interest (Sarantakos, 2005). Questionnaire comprising both close-ended and open-ended questions was used to collect data for the study. The Statistical Product for Service Solution (SPSS version 17) was employed to process the data into frequencies, percentages, and tables for analysis. A lot of consideration was also given to ethical issues when collecting data from the field. Hence, the issues of informed consent of the respondent, confidentiality and anonymity were duly addressed.

Results and discussion

Financial arrangements for SMEs

As indicated in Table 1, 82.7 percent of the respondents indicated that personal savings was their source of fund for the start-up of their businesses, while 12.2 percent of the respondents indicated friends or family members as their source of fund for the start-up of their businesses. However, only 5.1 percent of the respondents indicated financial institutions as their source of fund for the start-up of their businesses.

Table 1: Financial arrangements for SMEs

Variable	Frequency	Percent
Source of start-up fund		
Personal savings	81	82.7
Friends/Family	12	12.2
Financial institutions	5	5.1
Contribution of fund to business growth		
Yes	84	85.7
No	14	14.3
Accessed any government financial schemes		
Yes	13	13.3
No	85	86.7
Accessed Venture Capital Fund		
Yes	30	30.6
No	68	69.4
Access to credit improved		
Yes	19	19.4
No	79	80.6
Saving with any financial institution		
Yes	91	92.8
No	7	7.2
Total	98	100

Source: Field work, 2013

Thus, the majority of the respondents indicated personal savings as their major source of capital for the start-up of their businesses. This confirms what Howorth (2001) and Fraser

(2005) found that the main source of finance for start-ups for SMEs is personal savings. This is because most small businesses lacked access to formal financing, which is a bane to their growth and development. Also, 85.7 percent of the respondents indicated that the start-up fund for their businesses did contribute to the growth of the business, while 14.3 percent indicated that the start-up fund did not contribute to the growth of their businesses. That is, the majority of the respondents benefited greatly from the start-up funds, which led to the growth of their businesses to some extent, but not to their full development.

Furthermore, 86.7 of the respondents indicated that they had never ever accessed any government financial scheme, while 13.3 percent indicated that they had ever accessed some government financial scheme. Thus, the large majority of the respondents had not accessed any government financial schemes in supporting their businesses. This may perhaps be as result of lack of knowledge of extant government schemes for SMEs (Uliwa, 1990), or strict requirements for these schemes, which tend to dissuade SME operators from accessing them. Similarly, 69.4 percent of the respondents indicated that they had never accessed the Capital Venture Fund, while 30.6 percent indicated that they had accessed it. That is, the majority of the respondents never accessed the Venture Capital Fund.

Additionally, 80.6 percent of the respondents indicated that their access to credit had not improved over the past five years, while only 19.4 percent indicated that their access to credit had improved over the past five years. Hence, the chunk majority of the respondents thought that for the past five years, their access to credit had not improved (Lader, 1996). Lastly, 92.8 percent of the respondents indicated that they had been saving with some financial institutions, while only 7.2 percent indicated that they had not been saving with any financial institution. Thus, the large majority of the respondents had been saving with some financial institutions including First National Savins and Loans, National Investment Bank and Ghana Commercial Bank among other financial institutions; yet, these financial institutions had not been the same source from which the majority of them accessed their funding, which means these SMEs might have accessed their financing elsewhere. This is in sharp contrast with what Aryeetey (1996) indicated that SMEs lack banking culture in their operations.

Factors hindering access to formal financing

Furthermore, respondents were asked to indicate some factors that hindered the access of their SMEs to formal financing in the Techiman Municipality. As indicated in Table 2, a number of factors were indicated by the respondents. The results in Table 2 shows that lack of collateral (57%) and lack of financial statement (21%) as well as lack of business registration (12%) were the three main factors hindering access to credit or loans among SMEs in the Techiman Municipality. Besides, the respondents indicated other factors including unavailability of business plan (6%) and unavailability of bank account (4%) as factors hindering access to credit among SMEs in the municipality. This implies that the majority of the SMEs in the municipality lacked collateral for

Table 2: Factors hindering access to formal financing

	N=172*	
Variable	**n**	**Percent**
Lack of collateral	98	57
Lack of financial statement	36	21
Lack of business registration	21	12
No business plan	10	6
No bank account	7	4
Total	**172***	**100**

Source: Field work, 2013 *Multiple responses

loans, financial statements as well as lacked business registration, and these had been a hindrance to their access to credit or loans in the Techiman Municipality. In a similar way, Dela Torre et al. (2009) alluded to the issue of lack of collateral by indigenous businesses as well as inadequate corporate and governance structures which have dissuaded banks from financing indigenous businesses.

Challenges facing SME development in the municipality

As indicated in Table 3, a number of challenges were cited by the respondents. The results in Table 3 shows that close to half of the respondents (49.2%) cited inadequate capital as

one of the main challenges facing SMEs in the municipality, while 30.5 percent cited low patronage of items or services, and 16.9 percent cited difficulty in

Table 3: Challenges facing SMEs in the municipality

Challenge	Frequency	Percent
Inadequate capital	48	49.2
Low patronage	30	30.5
Difficulty in securing loans	17	16.9
Damaging of goods/items	3	3.4
Difficulty of paying back loans		
Yes	59	60.2
No	39	39.8
Total	98	100

Source: Fieldwork, 2013

securing loans from financial institutions as one of the main challenges. However, only 3.4 percent of the respondents cited the damaging of goods or items as one of the main challenges facing their SMEs. Obviously, inadequate capital was the main challenge facing most of the SMEs in the municipality, even though there is the challenge of low patronage of business items or services among others. This is consistent with what Steel and Webster (1991), Aryeetey et al. (1994), Lader (1996) as well as Gockel and Akoena (2002) allude to that SMEs are fraught with financial constraints. Lastly, respondents were asked whether they had any difficulty paying back loans; 60.2 percent of the respondents indicated that they indeed had difficulty paying back their loans, while 39.8 percent indicated that they had no difficulty in paying back their loans. In effect, the majority of the SMEs in the municipality found it difficult in paying back their loans. This is quite expected, as financial constraints, as alluded by Parker et al. (1995) among others, leaves SMEs in a precarious state making them find it difficult to amortise their loans.

Conclusion

The study concludes that even though there are myriads of sources of start-up funds for businesses, the start-up funds for the SMEs in the Techiman Municipality were largely

based on personal savings as well as monies from friends and family members. A number of factors such as collateral constraints and lack of financial statement also hinder the access of the SMEs to formal financing; and were plagued by a number of root challenges including inadequate working capital as well as low patronage of services among others. Therefore, it is paramount for the Government of Ghana to broaden the coverage and encourage the patronise of government financial schemes in areas such as the Techiman municipality among others. Formal financial institutions can also come out with more financial services or products that are focused on SMEs and for that are matter SME-friendly. On the other hand, operators of SMEs can cultivate the habit of frequently registering their businesses and keeping up-to-date records of their business transactions in order to provide accurate data for accessing credit and for municipal planning.

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