Challenges Faced by SMES in Accessing Credit in Tamale

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Abstract

It is a fact that small scale enterprises in Ghana face numerous challenges in their quest to contribute to the socio-economic development of the country. As a result, SMEs often are unable to grow to become big firms.

This research was conducted to assess the challenges faced by SMEs in accessing credit in Tamale as well as examine what can be done by SMEs to help mitigate these challenges. Previous work related to the topic was reviewed as literature. Quantitative approach was adopted and a self-structured questionnaire was designed and used to gather data from 200 SMEs operators in the Tamale Metropolis. Descriptive analysis was used to generate graphs, charts and tables to explain and answer the research questions and it was established that some of the challenges facing SMEs in the Tamale Metropolis include financial constraints, lack of managerial skills, lack of equipment and technology, lack of collateral and the fear of taking risk among others and again transaction cost of SMEs lending are high and the demand for collateral by banks and Micro Finance as well as the delay in the processing of loans is also a major challenge in credit access.

The study concluded by recommending that, loan acquisition processes ought to be shorter and simple

Keywords: Financial constraints, information asymmetry, entrepreneurial capacity, loan acquisition, managerial skills.

1. Introduction

Small and medium enterprises (SMEs) are enterprises that employ no more than 29 workers, with investment in plant and machinery not exceeding the equivalence of $100,000.Small enterprises are noted to provide 85% of manufacturing employment in Ghana (Steel and Webster, 1991; Aryeetey, 2001). SMEs constitute about 90% of total business units in our country which account about 60% of the employed labour force in Ghana (KDI, 2008). This constitutes the basis of economic development and a very good foundation for national economic growth and development. SMEs have contributed tremendously to 70% GDP to the Ghanaian economy which account for about 92% of businesses in Ghana. Small and medium enterprises are very important source of employment for the teeming number of the unemployed category of people in the Ghanaian economy and the world at large. It is also very significant in the provision of basic services in complementing government efforts for economic growth. In order for SMEs to effectively and efficiently carry out their operations and the expansion, there is the urgent need for the provision of adequate finance which is always available and accessible in a form of credit for economic growth and poverty reduction (Beck, Demirguc-Kunt & Levine, 2003).

However, these SMEs are not without challenges, they are faced with problems including financial constraints, low capacity of personnel to mention but a few. The situation of inadequate capital based on most SMEs in Ghana to meet the collateral requirement of these credit institutions is a major constraint. Many financial institutions are not able to provide adequate amount needed as collateral to guaranteed credit and to ensure that loan is covered in case of defaults to the survival and growth of SMEs (Binks et al., 1992).

Also, SMEs do not have qualified personnel for business operation and transaction. They do not have the necessary skills and experience to deliver effectively and efficiently in order to increase production and business expansion.

In this review, it becomes very obvious that several factors including Lack of education and high level of illiteracy has affected the growth of SMEs in Ghana and Tamale in particular and account for constraints of SMEs in accessing credit as posited by many researchers.

2.0 Literature Review

2.1 Definitions

In Ghana, the Ghanaian Enterprise Development Commission defined a small industry as one requiring a loan of not more than GHC25 (if the borrower's equity were 30 percent including land and building). The Bank of Ghana, which operated a Credit Guarantee scheme (CGS), defined a small scale business by its sales volume (turnover) and by size of its investment in plant and equipment. To qualify for the CGS, an enterprise must have annual turnover not greater than GHC30 (three hundred thousand cedi's) and plant and buildings valued at not more than GHC 10 in 1988. The National Board for Small Scale Industry in Ghana defined Small scale enterprise as a company having an asset valued at GHC1 (excluding land, building and vehicle) and employ 9 persons or less (Okraku and Croffie, 1997).

In Cameroon, the center for Assistance to Small and Medium Scale Enterprises (CAPME) defined SME as a company that is wholly owned and managed by the Cameroonian, owned capital of at least 52 percent in the business, has a turnover equal to or less than 1,000 million CFA, total investment not exceeding 500 million CFA, and short term outstanding cash credit not exceeding 2 million CFA in 1989 (Enquobahrie, 1997, p.88). In Sierra Leone, the National Development Bank (NDB) defined, SME as those with total investment of between Le500, 000 and Le1million excluding cost of land but including working capital. While the National Industrial Development Finance Company (NIDFC) defined SME as a business with a capital not exceeding US$5,000 and with employees not exceeding 16 in 1991 **(Rogers-Wright, 1997).** Therefore, it has become clear even in Ghana the changing pattern of the definition of SMEs in response to the changing environment. The more stable the economic environment, the more lasting the definition would be; the definition used in this study consider small scale enterprise as any business with capital base between GHC100 and GHC 0 and employing one to fifteen employees on the average. This choice of definition is accepted base on definition given by Bank of Ghana.

2.2 Challenges Facing Small and Medium Term Enterprises

SMEs face a variety of constraints in their start-up and operations. They are not able to absorb large fixed cost and absence of economies of scale and scope in key factors of production. It is a fact that access to finance remains a dominant constraint to small scale enterprises in Ghana. It is reported that 38% of the SMEs surveyed mentioned credit as a constrain (Parker et al, 1995). This stems from the fact that SMEs have limited access to capital market, both locally and internationally. This is in part because of the perception of high risk, information barriers and higher costs of intermediation for small firms. As a result, SMEs often cannot obtain long-term finance in the form of debt or equity.

SMEs in developing countries are considered to be too unstable by banks to invest in. Due to this instability, the banks consider SMEs to have high risk and the costs these banks suffer to monitor the activities of the SMEs are high. Hossain (1998), Bhattacharya, et al. (2000) and Sia (2003) identify that banks are reluctant to lend to SMEs since investing in SME activities is considered by banks to be very risky. They find it risky in the sense that if invested in, and in an event of unfavourable business conditions, they have low financial power, assets, and easily go bankrupt (Sia, 2003).

Also in terms of short term funds, the cost of borrowing from banks is very high and this also prevents SMEs to borrow from this institutions but these costs to borrow are sometimes subsidized by the government (Meagher, 1998). The application process for a short term funds is long and difficult for SMEs to meet up with the demands (Hossain, 1998). The collateral demanded by banks for a loan is based on fixed assets and which are very high in other to hinder these businesses to acquire loans. They cannot afford these collaterals which include; estates, and other fixed assets valued usually at 200% of the loan (Meagher, 1998).

The major setback that prevents SMEs to get funding from external sources is the problem of information asymmetry. That is the magnitude of the deviation of the correct information that is needed by the lending institution (Bakker, Udell, &Klapper, 2004). Banks use cash flows and profitability to measure or to assess the worthiness of a business. This is a very expensive and, not a good method to measure the credit strength of SMEs. Production and distribution in the rural areas is influenced by social factors that are often neglected by enterprises in developing

countries (Otero et al 1994: 13). Agriculture dominates rural activities in developing countries and is dependent on the weather conditions for its output. An enterprise in this sector is considered risky because its outcome is undetermined.

Similarly, SMEs have problems gaining access to appropriate technology and information on available techniques. The associate constraints on capital and labour as well as uncertainty surrounding new technologies restrict incentives to innovation. Research shows that 18% of the sampled firms and 18.2% mentioned old equipment as one of the four most significant constraints to expansion (Aryeetey et al (1994) and Parker et al, 1995).

In addition, SMEs generally use simple technology which does not require highly skilled workers. However, where skilled workers are required, an insufficient supply of skilled workers can limit the specialization opportunities, raise costs, and reduce flexibility in managing operations.

Again, high start-up costs for firms, including licensing and registration requirements impose excessive and unnecessary burdens on SMEs. High costs of settling legal claims and excessive delays in court proceedings adversely affect SMEs operations. Also, lack of protection for property rights limits SMEs access to foreign technology.

Furthermore, the entrepreneurial capacity required to effectively and efficiently handle the production process rights from inputs procurement to the product marketing stage is one of the major problems facing SMEs. Even though SMEs tend to attract motivated managers, they can hardly compete with larger firms. There is a scarcity of management talent which has a magnified impact on SMEs. There is also lack of support services since consulting firms lack the appropriate cost effective management solutions for SMEs. Again, absence of information and time to take advantage of existing services results in weak demand for them.

In addition, there is lack of cohesiveness among the wide range of SMEs which limits their capacity to defend their collective interest and their effective participation in civil society. Associations providing the voice for the interest of SMEs in policy-making process have had a limited role compared to those of larger firms. Many of the associations are yet to complete the transition of their goals of protection to competiveness.

Another problem of small-scale enterprises is inadequate markets for their products. The small-scale enterprises often experience low patronage for their products because most of them produce low quality products as asserted by Mark Awiah (1996). Most Ghanaians prefer the foreign goods to the local substitutes. Also, most small firms which are in the rural areas are inaccessible due to poor roads network and most times the policies of trade liberation by government poses threat to small-scale enterprises on the market scene (NBSSI, 1994).

SMEs in developing countries face an insurmountable task in accessing finance. Steel and Webster (1991) observed that despite the wide-ranging financial reforms instituted and the existence of the all kinds of financial institutions in the various regions, SMEs face a variety of constraints due to the difficulty of absorbing large fixed costs, the absence of economies of scale and scope in key factors of production, and the higher unit costs of providing services to smaller firms.

Access to finance remains a dominant constraint to small scale enterprises. Credit constraints pertaining to working capital and raw materials are cited by respondents in a survey conducted by Parker and others (1995). Aryeetey et al (1994) reported that 38% of the SMEs surveyed in Ghana mention credit as a constraint; in the case of Malawi, it accounted for 17.5% of the total sample (Daniels and Ngwira, 1993). 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.

Also, it is contained in Dr. Ansah Ofei's Journal that the fear of risk, especially the loss of their (SME operators) wealth prevented them from pursuing a loan. SMEs face more challenges in doing business than large enterprises because of the difficulties in financing start-up and expansion. In most countries, especially developing nations, lending to small businesses and entrepreneurs remain limited because financial intermediaries are apprehensive about supplying credit to businesses due to their high risk, small portfolios, and high transaction cost.

Another challenge that the small and medium scale enterprises faces is demand of collateral by the financial and micro finance institutions. They claim that the availability of collateral plays a significant role in the readiness of banks to meet the demand of the private sector. Collateral provides an incentive to repay and offset losses in case of default. Thus collateral was required of nearly 75 percent of sample firms that need loans under a study, which they conducted on the demand supply of finance for small enterprises in Ghana. The study also indicated that 65 percent of the total sample firm had at various times applied for bank loans for their business. Nevertheless a large proportion of the firm had their

application rejected by banks. For firms that put in loans applications there was almost 2:1 probability that the application would be rejected.

3.0 Methodology

This research aimed at assessing the challenges faced by SMEs in accessing credit in Tamale. The population of the study consists of all the SMEs in Tamale. For the purpose of this study, the sample size constitutes two-hundred (200) SME's in Tamale. The sampling technique employed was convenient sampling. Convenience sampling is a non-probability sampling technique where subjects are selected because of their convenient accessibility and proximity to the researcher. In all forms of research, it would be ideal to test the entire population, but in most cases, the population is just too large that it is impossible to include every individual. This is the reason why most researchers rely on convenience sampling, the most common of all sampling techniques. This technique was preferred because it is fast, inexpensive, easy and the subjects are readily available (Donald and Pamela, 2011). The study employed quantitative research data analysis technique because the focus of the research was to explore deeper into the issues. Primary data for this research comprised responses obtained through questionnaires administered to target respondents under study. One set of questionnaire was developed for all the respondents. The questionnaire was divided into four (4) distinct sections numbered (A) – (D). The first part of the questionnaire sought to ask respondents to provide demographic data such as age, sex, number of years spent in the organization and previous or current positions. The rest of the sections, which is 'B' to 'D', sought to elicit information on the three basic objectives of the study as outlined in chapter one of the study. The set of items was structured using the Likert format with a four-point response scale and some open and closed-ended items. The open questions give the respondent freedom to decide the aspect, detail and length of his answer. Close-ended questions are known to provide control over the participant's range of responses by providing specific response alternatives (Borden and Abbott; 2002). This makes it easier to summarize and analyze the responses. A Likert Scale is a rating scale that requires the subject to indicate his or her degree of agreement or disagreement with a statement. In this type of questionnaire, the respondents were given four response choices. The reasons for the four point Likert scale were to avoid people standing on the fence and to allow for responses to each item on the questionnaire so that no respondent would take a neutral stance. The reasons for using the questionnaire method as an instrument of data collection is based on the fact that it provides a wider coverage of the sample and also it facilitates the collection of a large amount of data (Fraenkel and Wallen, 1993). Validity would was achieved by giving the questionnaire to an expert for assessment. Both quantitative and qualitative data was used for this study. The qualitative data from secondary sources was analyzed using content analysis and logical analysis techniques. Frequency distribution and percentages was used for the quantitative data analysis to determine the proportion of respondents choosing the various responses. Data obtained from field was coded into Statistical Package for Social Sciences (SPSS).Descriptive analysis factors like frequency tables, percentages, pie charts, bar graphs and histogram was generated and their interpretations thoroughly explained and interpreted.

4.0 Analysis

In terms of type of business respondents are engaged in, it can be seen from the figure below that 25.5% of the respondents are engage in sales of merchandise, 26% are engage in manufacturing followed by provision of service with (28%) whiles 20% are engage in other services. (Note 1)

Every business is faced with some form of challenges, as can be seen from the table 4.1. All 200 respondents indicated that they face major challenges in raising funds for their business. (Note 2)

With regards to the most pressing problems, majority of the respondents 28.5% indicated financing as the major source of problem followed by the fear of risk with 17.5%, regulatory issues and lack of collateral had 15% and 14.5% respectively whiles lack of managerial skills had 13% and lack of equipment and technology had 11.5%. The figure below illustrates further the results. Financing was identified as the most pressing problem this means that most of the SMEs lack the capital start to maintain their business. (Note 3)

From the table it is quite clear that majority of the respondents 59% strongly agree and 41% agree that financial constraint is the main challenge facing SMEs in Ghana but none disagreed.

Also 18% strongly agree and 49.5% agree that factors like economy of the country in addition to financial institutions willingness to help is a challenge facing SMEs access to credit in Ghana whiles 21% disagree and 11.5% strongly disagree with the statement.

Again 28.5% and 28% strongly agree and agree that banks and financial services specific outlook of profitability and credit history of the SMEs firm is a challenge to them in acquiring credit to start up business but 43.5% disagree with the fact whiles none strongly disagree.

Some are of the believe that the transaction cost of SMEs lending are higher which prevent them from having access to credit, 28% strongly agree and 54% agree whiles just 18% disagree this indicate that majority of the respondents share that view.

Moreover 42.5% and 33% strongly agree and agree respectively that the demand for collateral by banks, micro finance and financial services before acquiring loan is one major challenge to SMEs in Ghana as most people don't have the required collateral but 24.5% don't see it that way as they indicated their disagreement.

Again 33% agreed that the major setback that prevents SMEs to get funding from external source is the problem of information asymmetry but majority of the respondents 37.5% and 29.5% disagree and strongly disagree that information asymmetry is not a major challenge.

Also 39.5% strongly agree and 25.5% agree that the delay in processing loans by financial institutions with regard to duration which can linger from several weeks into months but the perception of 35% of the respondents differ as they indicated their disagreement.

Finally 50% of the respondents strongly agree and 30.5% agree to the statement that the entire process for loan acquisition is quite cumbersome owing to the numerous documentations and other clerical process one needs to pass through before securing the loan and this discourage many people from applying for the loan just 19.5% disagree with the statement. (Note 4)

With the numerous challenges facing SMEs, respondents were asked whether the challenges can be addressed and all 200 respondents indicated their agreement that yes it can be solved. (Note 5)

4.4.0 Discussion of Research Findings

Data collected were analyzed based on responses given by respondents. Findings on research objectives were:

4.4.1 To find out the challenges facing SMEs in Tamale metropolis.

When it comes to the challenges facing SMEs in the Tamale metropolis it was established that factors such as financial constraints, lack of managerial skills, lack of equipment and technology, lack of collateral and the fear of taking risk among others.

Also, many are of the believe that factors like the economy of the country in addition to financial institution willingness to help is a challenge facing SMEs access to credit.

Again, transaction cost of SMEs lending are high and the demand for collateral by banks and Micro Finance as well as the delay in the processing of loans is also a major challenge in credit access, moreover financial services specific outlook of profitability and the credit history of the SMEs firm is a challenge to them in acquiring credit to start up or operate their business.

Furthermore, the entire process for loan acquisition is quite cumbersome owing to the numerous documentations and other clerical processes deter many from accessing loans.

5.0 Summary of Findings, Conclusion and Recommendations

Based on the results discussed, the following were provided:

❖ Some of the challenges facing SMEs in the Tamale Metropolis include financial constraints, lack of managerial skills, lack of equipment and technology, lack of collateral and the fear of taking risk among others also factors like the economy of the country in addition to financial institution willingness to help is a challenge facing SMEs access to credit.

❖ Again transaction cost of SMEs lending are high and the demand for collateral by banks and Micro Finance as well as the delay in the processing of loans is also a major challenge in credit access, moreover, financial services specific outlook of profitability and the credit history of the SMEs firm is a challenge to them in acquiring credit to start up or operate their business.

Conclusion

SMEs have very positive and significant impact on the economic growth and prospects of any country and Ghana is

not an exception. However, these SMEs are not without challenges, they are faced with problems including financial constraints, low capacity of personnel to mention but a few.

Recommendations

- SMEs should employ skilled labor force who will add value to their businesses as uncertainties surrounding new technologies restrict incentives to innovation. Where skilled work forces are engaged, there exist specialization of opportunities, reduced costs, and increase flexibility in managing operations of the SMEs.
- Investment in modern technology and state of the art equipment could help transform SMEs to be more productive and competitive with the large firms.
- Loan acquisition processes ought to be reviewed to be short and simple to suit the needs of the customers

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Notes

Note 1.
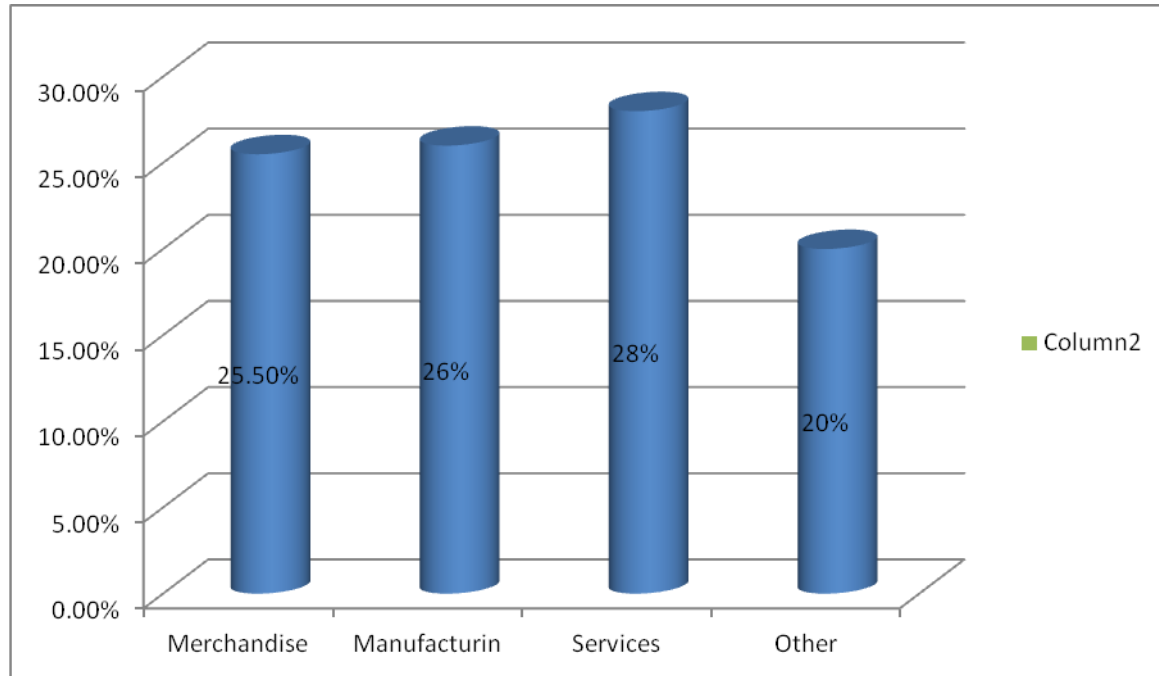
Source: Field survey (2015)
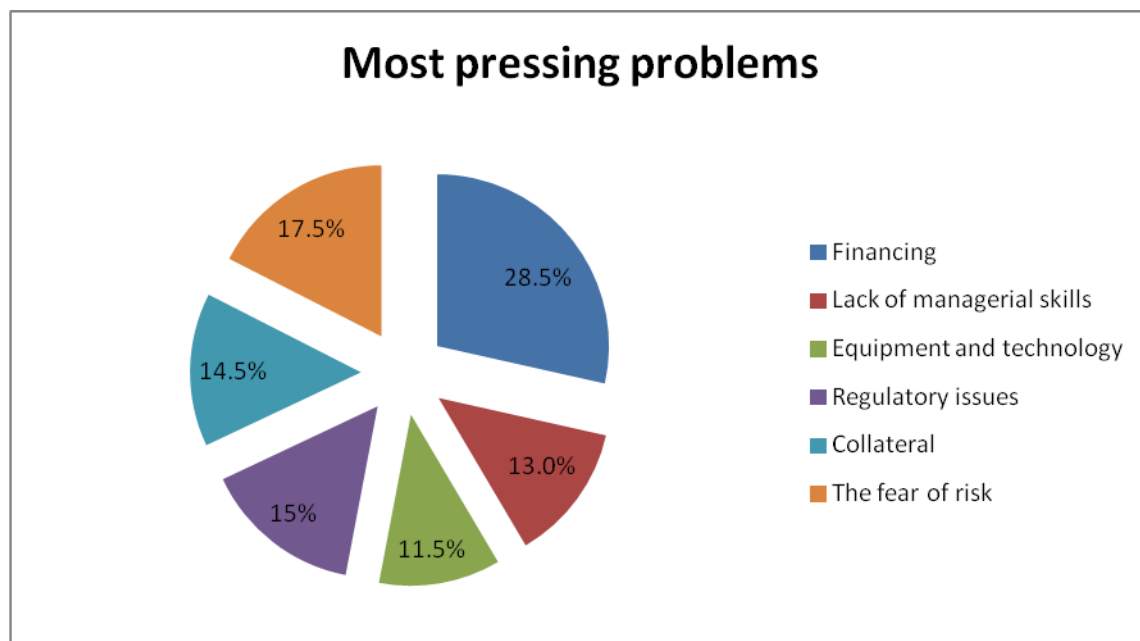
Figure 1: Type of Business

Note 2

Table 2:   SME's facing Challenges

Challenges	Frequency	Percentage (%)
Yes	200	100
No	---	----
Not sure	---	----
Total	**200**	**100**

Source: Field survey (2015)

Note 3

Source: Field survey (2015)

Figure 2: Most pressing problem

Note 4

Table 4.5: Statements on challenges facing SMEs

	SA	A	D	SD	Total
1. **Financial constraint is the main challenge facing SMEs in Ghana.**	59% 118	41% 82	---- ----	---- -----	100% 200
2. **It is true that factors like economy of the country in addition to financial institutions willingness to help is a challenge facing SMEs access to credit in Ghana.**	18% 36	49.5% 99	21% 42	11.5% 23	100% 200
3. **Banks and financial services specific outlook of profitability and credit history of the SMEs firm is a challenge to them in acquiring credit to start up business.**	28.5% 57	28% 56	43.5% 87	---- ----	100% 200
4. **Transaction cost of SMEs lending are higher which prevent them from having access to credit.**	28% 56	54% 108	18% 36	----- ----	100% 200
5. **The demand for collateral by banks, micro finance and financial services before acquiring loan is one major challenge to SMEs in Ghana.**	42.5% 85	33% 66	24.5% 49	----- ----	100% 200
6. **The major setback that prevents SMEs to get funding from external source is the problem of information asymmetry.**	---- ----	33% 66	37.5% 75	29.5% 59	100% 200
7. **The delay in processing loans by financial institutions with regard to duration which can linger from several weeks into months.**	39.5% 79	25.5% 51	35% 70	---- ----	100% 200
8. **The entire process for loan acquisition is quite cumbersome owing to the numerous documentations and other clerical process one needs to pass through before securing the loan.**	--- ------	50% 100	30.5% 61	19.5% 39	100% 200

Source: Field survey (2015)

Note 5

Table 3: Responses on solution to SMEs problems

Challenges	Frequency	Percentage (%)
Yes	200	100
No	---	----
Total	**200**	**100**

Source: Field survey (2015)