

Innovative Ways of Gaining Access to Funds for SMEs Setups in Ghana

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Abstract

Small and Medium Enterprises contributes to the developments of private sectors, and the sustainable growth of any economy is very crucial. In both developing and developed economies, small and medium enterprises are considered as a backbone for economic growth and development. SME does do not only contribute to the growth of national GDP but also contributes to the reduction of the unemployment rate. In developing economies such as Ghana, SME's provides 92% of registered companies, providing 85% of manufacturing employment and contributing 70% to the nations GDP. These clearly indicate a significant role SME's play on the nation's employment, income, economic growth and development. Despite all these significance, most SME's in Ghana are challenged with access to finance, in setting up, expanding and sustainability of their businesses. The study found out that; these are commonly due to high interest and collateral rates by most financial institution, documentation requirements by financial institutions, long delay in gaining access to funds by credit institutions, capital cost and also unfavourable terms of credit repayment. This study, therefore, focused on innovative ways of generating capital for small and medium enterprises from non-financial institutions. The study suggested alternative ways of SME's gaining access to funds from non-financial institutions to enable SME's benefit from, investing business smarts, networking opportunities, little or no contractual and collateral strings attached to loans, quick access to credit, and relative patience from investors regardless of their investments.

Keywords: SME's, Ghana, SME's and economic development, Financial Institutions.

1. INTRODUCTION

Small and Medium Enterprises contribution to the developments of private sectors and economic growth is very vital. SMEs play a significant role in promoting economic growth (OECD, 2004). In developing and developed countries, small and medium enterprises are measured as the backbone for economic growth and development. The SME sectors are considered crucial in many economies because they provide job, pay taxes, are innovative and very instrumental in countries participations in the global market.

In Ghana, SME's contributes to the growth of national GDP, reduction of the unemployment rate, poverty alleviation, and plays very significant role in nation's participations in the global market. In developing economies such as Ghana, SME's provides 92% of registered companies, providing 85% of manufacturing employment and contributing 70% to the nations GDP. These clearly indicate significant roles SME's play on the nation's employment, income, economic growth and development (Abor and Quartey, 2010).

Despite all these significant contributions by SME's, most SME owners or entrepreneurs in Ghana are faced with a number of challenges with gaining access to finance, in setting up, expanding and sustainability of their businesses.

The study revealed that major financial constraints faced by entrepreneurs in setting up SME's are commonly due to high interest and collateral rates by financial institutions. Also documentation requirements by financial institutions, adverse time condition in gaining access to fund from credit institutions, capital cost and also unfavourable terms of credit repayment all cause a hindrance. This study, therefore, focused on innovative ways of gaining access to capital for small and medium enterprises setup in Ghana.

The study is as follows; next section two define SMEs in various context, section three discusses on SME's contributions to economic development, part four throws more highlights on the financial system in Ghana, section five talks about sources and types of credit available for SME's in Ghana. Section six also examines constraints faced by entrepreneurs acquiring capital for SME setup. With section seven analysing innovative ways of gaining access to funds for SMEs setups, the final section eight concludes the study.

2. SME's Definitions

Small scale enterprises have numerous standards that define them. However, the most frequently used criterion is the size of the company personnel. The results are quite confusing due to different size ranges used by various official resources to define SMEs. The World Bank since 1976 - has defined SME's as firms with fixed assets (excluding land) less than US\$ 250,000 in value are Small Scale Enterprises. In China, MSMEs are classified as an enterprise with employee size of 1 to 3000 and total assets of ¥ 40 to 400 million and business revenues of ¥ 10 to 300 million with regards to the type of industry. The EU defines MSMEs as a firm with employee size of

250 with a turnover not more than € 50 million or a sum up balance sheet not exceeding more € 43 million total (Khrystyna Kushnir, 2010).

(Tom Gibson and J.H Van dar Vaart, 2008) defines SME as a formal enterprise with an annual turnover, in U.S. dollars of between 10 and 1000 times the mean per capital of gross national income, at parity of purchasing power, within the economy in which it operates.

SME's in Ghana are rural and urban enterprises that engage in activities such as manufacturing, trading, Agro-processing and service sectors. According to Industrial Statistics, the Ghana Statistical Service (GSS) defines Small Scale Enterprises as firms having less than ten employees with Medium and Large-Sized Enterprises defined as having more than ten employees. However, the Ghana Statistical Service considered firms with nine employees as Medium Enterprises.

Defining SMEs in a different criterion is the fixed assets of the organization. National Board for Small Scale Industries (NBSSI) in Ghana employs both the number of employees and the fixed asset criteria in their definition of Small and Medium Enterprises. It outlines the definition of Small Scale Enterprise as a firm with one to nine workers including plant and machinery not taking into accounts building land and vehicles not exceeding a 10 million Cedis.

3. SME's Contribution to Economic development

Small businesses in developed countries are being recognized as the backbone for growth and development due to their vital contributions to economic growth and development (Frimpong, 2013). Empirical research conducted recently reveals that SMEs contributes more than 55% of GDP, with employment adding up to 65% in high- income economies. The contribution of formal SMEs in middle-income economies on employment and GDP estimated 70% more. Also in low and least developed economies, SMEs contributions to employment and GDP, on the side of informal enterprises is low. With 60% of GDP and 70% of total employment, SMEs are considered as the backbone for individuals with a lower standard of living than the informal sector, thus, in these countries, eliminating factors that discourage informal sector (OECD, 2004).

The SME sectors are considered crucial in many economies because they provide job, pay taxes, are innovative and very instrumental in countries participations in the global market. SMEs economic growth and activities are vital due to the comparatively great share of SMEs in many developing economies with World Bank group extensive global resources channeled into small and medium enterprises of these economies (Beck, Kunt et al., 2004).

In Ghana, a small and medium enterprise sector provides almost over 85% of manufacturing employment. And this is a significant step in both job creation and poverty reduction (Abor and Quartey, 2010).

Whiles contributing to employment and job creation, small and medium enterprise turns out to be a major contributor to the national GDP and national income. Over 70% of Ghana GDP is from small and medium enterprises. SME's turns out to be a major national revenue stream since over 92% of the registered business in Ghana fall under this category. These entities provide value added manufacturing products and service to various market segments and customers (Abor and Quartey, 2010, Berry et al. 2002; Gumede, 2000).

4. The Financial System in Ghana

Institutional units and markets that usually cooperate in a complex method with the aim at organizing funds for investments and making availability of facilities that includes system of payment for financing commercial activities are known to be a financial system.

In Ghana the financial sector currently consists of informal, semi-formal and formal institutions. Banks and non-banking financial institutions are being supervised and regulated by the Bank of Ghana. Banks in Ghana consist of commercial, investment, merchant, ARB Apex, Rural and community Banks. Non-bank financial institutions are made up of credit unions, venture capital companies, Finance houses, savings and loans companies, discount houses, leasing companies and building societies.

In addition to non-bank financial institutions are insurance and re-insurance companies, brokerage firms, non-governmental organizations (NGO's) and MFIs.

5. Sources and Types of Credit available for SME's

The types of credits available for most SME's in Ghana are from various sources which are classified based on several factors such as internal and external, formal and informal (Bondinuba, 2012).

One method of financing is the Equity method which is the term commonly used to describe ordinary share capital of a firm. Ordinary shares in the firm entitle the holders to all distribute profits after the holder of debenture and preference shares have paid (Jim Riley, 2012). They usually include business angels, capital market, family relatives and friends, fund promoters and venture capital.

Another method of financing is debt based financing which refers to money raised through some loan usually from universal banks, NGOs, microfinance and non-bank intermediaries for a single purpose over a

particular period, with collateral attached.

6. Constraints Faced by Entrepreneurs acquiring Capital for SME setups

Lack of access to loans also serves as a major constraint for setting up of SME's globally. Problems related with accessing of credits in Ghana comes as a result of relatively high-risk profile that SMEs possess in Ghana, which make most financial institutions hesitant in providing financial support. Furthermore, high-interest rate and demand for collateral by financial institutions is very high which discourage most SME's to access loans from a financial institution (Abeeku and Bamfo, 2012).

In addition, SME owners have to wait for a long period before their loan is being accessed. Also, small and medium enterprise owners complained about the fact that they do not receive the amount applied. Documentation requirement from the financial institution also possess as a barrier for credit facility assessment (Davenport, 1967).

7. Innovative ways of gaining access to Funds for SMEs set-ups

The study of this paper suggests that entrepreneurs should invest their personal savings into the setup of their business. This process is relatively a cheap style of funding and is readily available. The entrepreneur here is seen as having total control over the business, gives a good signal to financial providers and investors.

In addition, entrepreneurs can borrow money from friends and family who are willing to support financially to the business or directly to the entrepreneur. This method is fast and reliable compared to financial institutions, with flexible contractual strings attached and interest rate.

Using credit cards is also the easiest way of accessing credit within SME's. The entrepreneur only has to pay for the related business expenses on the card within credit free period. Also, using retained cash or profit that is made by the business is another important source of fund for SME's. Furthermore, Share capital is another way of funding SME setups. The founders of SME's invest in the share capital of the company. The founder is responsible for all the share capital of the company, retaining total control over the business operation.

Another strategic way for entrepreneurs to succeed in setting up their business is to use leverage trade credit by negotiating with some of their suppliers. Instead of paying cash outright for their raw material they can go agreement with their suppliers for payment delay.

Finally, gaining financial assistance from business angels is crucial in SME's setting up. Despite the fact that the entrepreneurs will lose some control over the business, business angels invest network opportunities, business smart and also they are relatively tolerant on their investments. They are wealthy entrepreneur individuals who invest capital and take high personal risk with the aim of owning part of the company's equity.

8. CONCLUSION

Entrepreneurs' capability of starting SME's depends mainly on their financial capabilities. This study, therefore, underlined strategic ways of gaining access to fund for SME setups in Ghana. The definition of SME's in Ghana mainly focuses on the size of employees and firms revenue. The study further took a dive into contribution of SME's to economic growth. It also examined the financial system in Ghana, sources and credits available for SME's in the country.

Constraints faced by entrepreneurs in gaining access to funds for business setups highlighted. The study recommends that for entrepreneurs to be able to transform their business ideas into success, strategic ways of gaining access to fund for SME's setup should be well examined.

The study suggests that using innovative ways in gaining access to funds by entrepreneurs is fast, time convenience, affordable, reliable way of doing business, investing business smarts, network opportunities and also hassle free way of doing business from financial institutions. These can motivate most SME owners in setting up and expanding their business in Ghana and most developing countries.

ACKNOWLEDGEMENTS

My foremost sincere gratitude goes to God Almighty for His guidance and protection throughout this study. Secondly, to my supervisor Prof. Yun-Fei Shao for her exemplary and constant guidelines in making this studies a success. Also, grateful for National Science Foundation of China under grant No. 71172095, with their research support.

Deepest regards to the entire teaching and non-teaching bodies on University of Electronics Science and Technology of China for their immense academic support.

Finally, to Mrs. Diana Adwoa Asare, for her great suggestions in completing this study

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Journal of Finance and Economics - Issue 39: 218-228

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