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The Impact of Microfinance on the Development of Small Scale Enterprises in the Ledzorkuku-Krowor Municipality in the Greater Accra Region of Ghana

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ABSTRACT
The fundamental objective of this study is to assess the impact of Microfinance on Small and Medium Enterprises (SMEs) in Ghana, using a case study of the Ledzorkuku-Krowor Municipal Assembly. Simple random sampling technique was employed in selecting the 70 SMEs and 30 MFIs that constituted the sample size of the research. Structured questionnaire was designed to facilitate the acquisition of relevant data which was used for analysis. Descriptive statistics which involves simple percentage graphical charts and illustrations was tactically applied in data presentations and analysis. The findings of the study reveal that significant number of the SMEs has the knowledge of the existence of MFIs and some acknowledge positive contributions of MFIs loans towards promoting their growth. Other than financial support, it is recommended that microfinance institutions should at all-time give professional advices to SMEs since proper professional advice will inform the lending microfinance institutions whether the amount the SME requested for is too much for the project or less. Seminars and workshops should be organized by the microfinance institutions to educate SMEs on their policies and judicious use of funds for SMEs and what it takes to assess loans. Also, the microfinance institutions should initiate more developmental projects in order to win the confidence and trust of the SME's.
Keywords: Microfinance, Loans, Small and Medium Enterprises (SMEs), Ledzorkuku-Krowor Municipal Assembly

1. Introduction

The fall foul of formal banking support on Small Scale Enterprises is of economic deterrent to new businesses and expansion of the existing ones. About only 5-6% of the population is reported to have access to formal banking facilities (Basu et al., 2004). Small Scale Enterprises (SMEs) in Ghana mostly have limited access to credit facilities, deposits and other financial services provided by formal financial institutions such as commercial banks. For this reason, banks find it difficult in dealing with Small Scale Enterprises thinking they might default in payment. This is because most SMEs are not able to provide the necessary collateral securities demanded by the formal final institutions. For this reason, SMEs turnout to secure loans from microfinance institutions. Quansah (2012) et al found out that Micro Finance Schemes are instrumental in transforming lives of the poor.

According to the Ministry of Trade and Industry, as at August 2011, figures from the Registrar General's Department suggest that 88 percent of registered businesses in the country are in the small scale and medium enterprise (SSME or SME) sector of the Ghanaian economy. If these figures are something to go by, then it means about 90 percent of the Ghanaian economy is dependent on this sector, creating jobs for hundred and thousands of Ghanaians.

Though these businesses play a significant role in shaping the economic growth of many nations, they mostly fall short of adequate management expertise, the lack of access to resources and financial institution due to lack of collateral security, poor accounting documentation, credit worthiness to mention a few. In all these with strains, there are notable small businesses that have grown to become major businesses within the Ghanaian economy, such as UT Bank and Karma Group of companies just to mention a few.

1.1 Statement of the Problem.

Access to finance remains a dominant constraint to small scale enterprises in Ghana. There have been credit constraints pertaining to working capital and raw materials. Aryeetey et al. (1994) reported that 38% of SMEs surveyed mentioned credit as a major constraint of financing their businesses. This stems from the fact that SMEs have limited access to capital markets, in part because the high cost of borrowing, and rigidities of interest rates has also made financing of small scale enterprises very difficult in Ghana. Most SMEs also lack the necessary collateral to obtain loans from financial institutions, therefore resulting in SMEs not often obtaining long-term finance to finance and expand their businesses.

Besides other constraints on finance, most owners and managers of small scale enterprises in Ghana are faced with lack of technical knowhow, skilled labour, managerial competence in handling business enterprises and also lack of business ideas. As a result their growth prospect remains stagnant. There is also the problem of having access to modern technology since most firms use old machinery, and have problems with finding replacements parts to purchase.

Microfinance institutions in Ghana have proven to be a powerful tool for promoting inclusive economic growth especially in the area of Small Scale Enterprise development and employment as well. Initiatives are aimed at providing soft loans to individuals and small scale enterprises, even though a microfinance institution in Ghana is actually in the stage of infancy, the sector has proven itself to show positive in its growth in Ghana. This institution also aims at helping SMEs to expand their business up to a point of becoming viable ones. But the issue is, are the microfinance's having any impact of the development of SMEs in Ghana? To answer this question, one is to be addressed which is Impact Assessment. This assessment is used to determine the extent to which microfinance institutions are attaining their objectives towards the development of Small Scale Enterprises in Ghana.

2. Literature Review

The issue of what constitutes a small or medium enterprise is a major concern in the literature.

According to Bennett (1994) and Ledger wood (1999) MFIs can offer their clients who are mostly below or slightly above the poverty line a variety of products and services. The most prominent services is financial, that they often render to their clients without tangible assets and these clients mostly live in the rural areas, a majority of whom may be illiterates. Formal financial institutions do not often provide these services to small informal businesses run by the poor as profitable investments. They usually ask for small loans and the financial institutions find it difficult to get information from them either because they are illiterates and cannot express themselves or because of the difficulties to access their collateral (farms) due to distance.

The high lending cost is explained by the transaction cost theory. The transaction cost can be conceptualized as a non financial cost incurred in credit delivery by the borrower and the lender before, during and after the disbursement of loan. The cost incurred by the lender include; cost of searching for funds to loan, cost of designing credit contracts, cost of screening borrowers, assessing project feasibility, cost of scrutinizing loan application, cost of providing credit training to staff and borrowers, and the cost of monitoring and putting into effect loan contracts. On the other hand, the borrowers may incur cost ranging from cost associated in screening group member (group borrowing), cost of forming a group, cost of negotiating with the lender, cost of filling paper work, transportation to and from the financial institution, cost of time spent on project appraisal and cost of attending meetings, etc (Bhatt & Shui-Yan, 1998). The parties involved in a project will determine the transaction cost rate. They have the sole responsibility to reduce the risk they may come across (Stiglitz, 1990).

2.1 Individual

This is a straight forward credit lending model where micro loans are given directly to the borrower. It does not include the formation of groups, or generating peer pressures to ensure repayment. The individual model is, in many cases, a part of a larger 'credit plus' programme where other socio-economic services such as skill development, education, and other outreach services are provided.

2.2 Village Banking Model

Village banks are community-managed credit and savings associations established by NGOs to provide access to financial services, build community self-help groups, and help members accumulate savings (Holt, 1994). They have been in existence since the mid-1980s. They usually have 25 to 50 members who are low-income individuals seeking to improve their lives through self-employment activities. These members run the bank, elect their own officers, establish their own by-laws, distribute loans to individuals and collect payments and services (Grameen Bank, 2000). The loans are backed by moral collateral; the promise that the group stands behind each loan (Global Development Research Centre, 2005).

2.3 Credit Unions

A credit union is a unique member-driven, self-help financial institution. It is organized by and comprised of members of a particular group or organization, who agree to save their money together and to make loans to each other at reasonable rates of interest.

The members are people of some common bond: working for the same employer; belonging to the same church, labour union, social fraternity, etc.; or living/working in the same community. A credit union's membership is open to all who belong to the group, regardless of race, religion, colour or creed.

Microfinance triangle comprise of financial sustainability, outreach to the poor, and institutional impact. There are costs to be incurred when reaching out to the poor and most especially with small loans (Christabell, 2009). The financial institutions always try to keep this cost as minimum as possible and when the poor are in a dispersed and vast geographical area, the cost of outreach increases. The provision of financial services to the poor is expensive and to make the financial institutions sustainable requires patience and attention to avoid excessive cost and risks (Adam &Von Piscke, 1992). The deliveries of MFI products and services have transaction cost consequences in order to have greater outreach. Some microfinance institutions visit their clients instead of them to come to the institution thereby reducing the cost that clients may suffer from. For MFIs to be sustainable, it is important for them to have break-even interest rates. This interest rates need to be much higher so that the financial institution's revenue can cover the total expenditure (Hulme & Mosley, 1996). The break-even rate which is higher than the market rate is defined as the difference between the cost of supply and the cost of demand of the products and services.

3. METHODOLOGY

This research took an inductive approach where data was collected and a theory developed as a result of the data analysis.

It describes the population of the study, sample and sampling techniques, sources of data, methods of data collection and analysis. The main focus is to describe the tools that were used in gathering data and also identified the proper measurement techniques which were employed in gathering data.

In deciding how large a sample should be, the study population has to be defined.

The population of this study entails 235 Small and Medium Scale Enterprises (SME's) and Microfinance Institutions within the Ledzorkuku municipality which was based on available data from the office of the Municipality.

The Microfinance Institutions were casually selected since there were not enough data on most of them.

For the selection of the sample size, the statistical formula below was used:

$$n = \frac{N}{(1+N(e)^2)}$$

Where: n= the sample size, N= total population, e= margin of error

In light of this and with a confidence level of 90 percent and a margin of error of 10 percent, 70 SMEs were selected out of 235 populations whereas 30Microfinance Institutions were randomly selected from the Ledzorkuku-Krowor Municipal Assembly based on available data.

The purposive sampling technique was used to select staff of Microfinance Institutions who could answer the questionnaire. As such the questionnaires were given to the heads of departments and for the purpose of the study; individuals involved in the study were the real owners of the various businesses and not sale agents or sale attendants.

The qualitative as well as quantitative data was collected for the study. Data was obtained from both primary and secondary sources.

Qualitative as well as quantitative methods were used in the analysis of the primary and secondary data collected. The quantitative data were analysed using Statistical Package for Social Scientists (SPSS). This was presented in the form of tables, pie charts, bar graphs.

4. Analysis

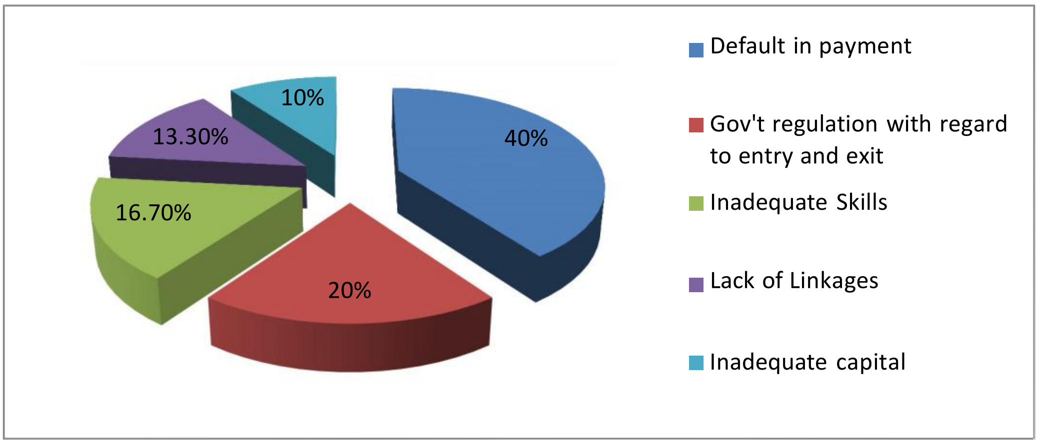
Analysis Of Data Collected From Microfinance Institutions.

Classification of Responses Based On the Challenges Facing Micro Financing In Ghana

Based on the data collected, twelve (12) out of the thirty (30) representing 40% microfinance institutions indicated that high rate of default among their customers is their biggest challenge. Six (6) respondents representing 20%

indicated that regulations regarding entry and exit are a great challenge that fraudulent people can just enter to defraud unsuspecting people and quickly fold up. This is creating the problem of trust of the public. Mismanagement is also a challenge that has bedevilled the institutions as indicated by five (5) respondents representing 16.7%. Four (4) respondents representing 13.3% indicated that there is a minimal linkage between the formal and informal financial institutions. Three (3) representing 10% of the respondents indicated that inadequate capital is also a challenge. This is depicted in the figure below.

Challenges facing MFIs

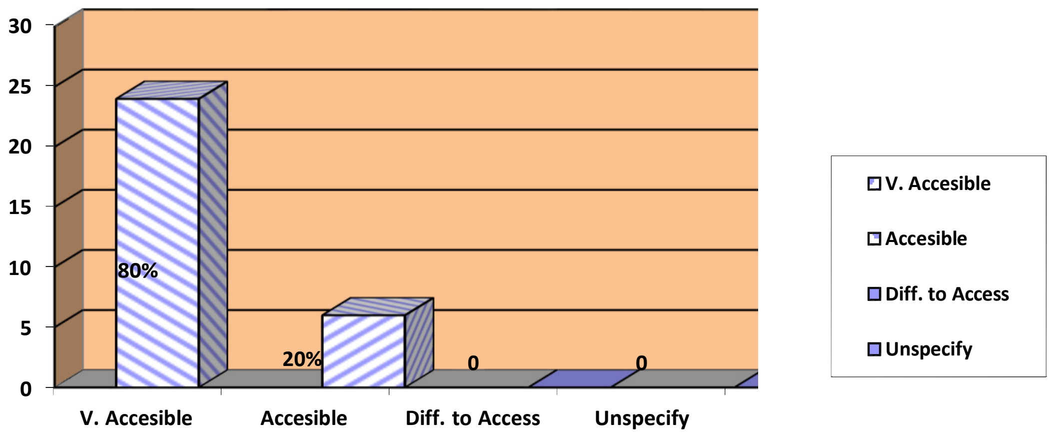


Source; field survey June 2012

Classification of Responses Based On Accessibility of Funds to Small Scale Enterprises from Microfinance Institutions.

Access to loans is one of the major problems facing SMEs in Ghana. The idea of creating MFIs is to provide an easy accessibility to SMEs particularly those who cannot access formal banks loans.

Twenty four (24) out of the thirty (30) respondents representing 80% indicated that funds are very accessible to SME's to start or expand their operations. Six (6) out of the thirty (30) respondents representing 20% indicated that funds are accessible to SME's to use for their operations. Whiles none of the thirty (30) respondents indicated that funds are difficult to access by the SME's. Based on the analysis, it means that microfinance institutions make funds accessible to SME's. This is depicted on the Figure below.



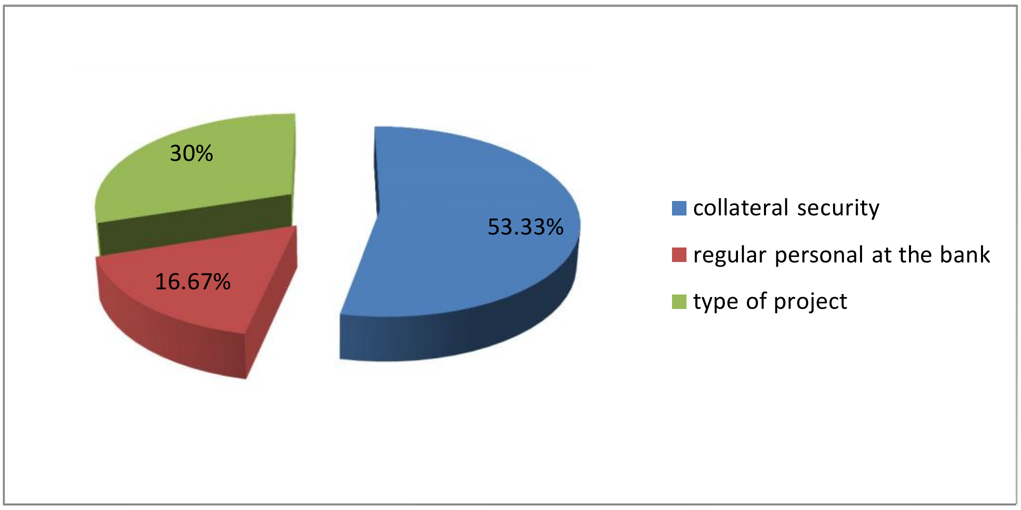
Classification of Responses Based On Criteria for Financing SME's

In Ghana, most SMEs require modest credit to purchase simple machinery and equipment or as working capital to enhance their operations.

Micro Financial Institutions are perceived to base their credit lending abilities on several criteria. The table below shows the responses based on the criteria MFI's use when lending credit to SME's.

Sixteen (16) out of the thirty (30) respondent representing 53.33% indicated that MFI's do require collateral before giving out credit to their client. It has been observed that the demand for collateral security by banks and other financial institutions stifled the growth of the SME's in the country. Five (5) out of the thirty (30) respondents representing 16.67% indicated that before they grant you a loan, one have to be saving with them for at least three (3) months which will then serve as collateral. The type of project undertaken by SME's does guarantee them a loan. The table indicates that 30% of the respondents do give out credit based on one's project. This is diagrammatically shown below.

Criteria for Financing



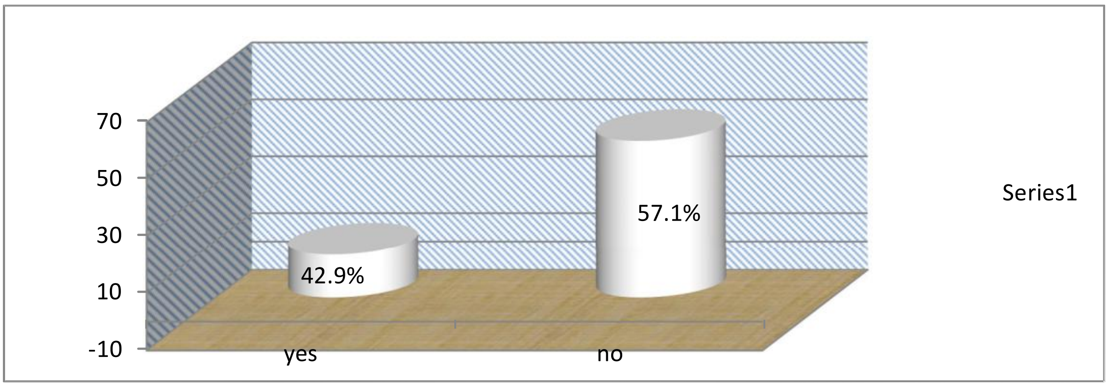
Source; Field Survey June 2012

Analysis Of Data Collected From Small Scale Enterprise.

Classification of responses as to whether SMEs have business plans before commencing business

The response of respondents as to whether they have business plans before they commence business is summarized in the diagram below:

Business Plan



Source; Field Survey June 2012

Information gathered revealed that most SMEs do not have business plans before commencement. From the diagram six (6), thirty (30) respondents constituting 42.9% attested to the fact that they did have business plans before commencement of business whilst forty (40) out of the seventy (70) respondents indicated they did not have business plans before commencing business.

Classification of responses Based on Type of Business

Data on the various types of businesses operated by the SMEs in the Ledzorkuku- Krowor Municipal Assembly were collected.

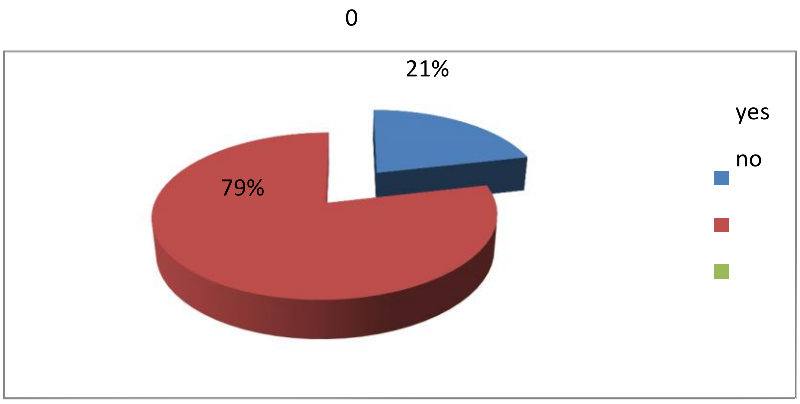
Type of business you operate

RESPONSE	FREQUENCY	VALID PERCENT (%)
Service	**34**	**48.6**
Manufacturing	**22**	**31.4**
Agriculture	**14**	**20**
Total	**70**	**100**

Source; Field Survey June 2012

This table shows that most SMEs are actively engaged in the service sector. Thus from the table thirty four (34) out of the seventy (70) representing 48.6% shows that most SMEs are in the service sector whilst 31.4% and 20% in the manufacturing and Agricultural sector respectively. This is depicted diagrammatically below.

Type of Business



Source; Field Survey June 2012

About 97.2% respondents had knowledge of the existence of MFIs but due to circumstances like high Interest rate, Collateral security, Bank policies and the bureaucratic nature and procedures of the MFIs tend to hinder the rate at which they borrow and transact business with these MFIs. Because of these factors, most SMEs do not borrow from them but rather resort to personal savings, family funds to start their business which has become a major challenge to the growth of Small and Medium Enterprises. This is diagrammatically presented in a chain.

5. Summary of findings

The main objective for embarking on this study was to assess the impact of microfinance on the development of small scale enterprise in Ghana and the following findings were made:

The microfinance institutions do not care about the finances of SME's but grants loans to them when they think the SME has enough collateral to secure the loan. For that matter they do not provide any financial advice and monitoring to their customers. This confirms the existing literature by Tucker and Lean, (2003) and OECD (2006).

Even when Small and Medium Enterprises are given credit, they are often granted short-term loans and therefore they have no option but to depend on short-term and informal credits in financing their long-term needs such as acquiring new equipment. Existing literature by (Riding & Short, 1987) also attests to this fact.

The views of the SME's are not factored in the formulation of credit policies of the microfinance institutions hence the SME's do not feel part of it. Because of that it does not favour the SME's interest and this has been one of the greatest causes of failure of the credit management policies hence the default.

High interest rates and the other fees are making it very difficult for the SME's to make any meaningful profit so as to be able to repay their loans.

The type of collateral security preferred by the microfinance institutions make it impossible for some SME's to qualify for the loan. Also, most of the SME's could not provide the required collateral security and hence cannot go for loan from the microfinance institutions.

5.1 Conclusions

In controlling delinquency and defaults, rescheduling and refinancing are not recommended because it just hides the problem from you which means you may even end up with an even greater problem of delinquency. It is very important to note that lending to microfinance institutions may still incur bad debts even with sound credit management policies and procedures. Therefore, it is advisable to use a measured approach and select the most appropriate method to recover the debt while maintaining the relationship with your client.

Microfinance institutions should not be looking at security as a substitute for the proper assessment of a lending proposition. Security should be the last consideration in assessing a lending proposition. However, in practice, it often comes much higher up the list because it is a form of insurance that sometimes allows the lending microfinance institutions to sleep at night.

The demand of fees as an additional security also makes SMEs not being able to repay the loans. This shows that the microfinance institutions are causing more harm than good.

Loans should be given for productive purposes not for occasions that will not add anything to the productivity of the SME's. Loans that are not given for any productivity becomes very hard for the SME's to repay since it does not generate any money that will be used to repay the loan.

5.2 Recommendations

In the light of the findings and observation about the effects of collateral security on lending, the researcher wishes to make the following recommendations:

1. Management of microfinance institutions should incorporate SME's views or inputs into the formulation or review of their credit management policies. This will enable microfinance institutions to know the peculiar needs and problems of SMEs since they are deprived and need special attention.
2. Interest rate charges on loans given to SME should be relatively lower than that of the commercial banks since they are deprived and there is the need to bridge the gap. This will encourage them to go in for more loans and will be able to repay promptly to alleviate their condition.
3. The microfinance institutions should embark on vigorous monitoring of the SMEs that have received loans so as see to it that the loans are being used for its intended purpose. This will put the SMEs on their toes to work hard to succeed in the business in which the money is invested so as to be able to repay the loan.
4. The microfinance institutions should at all times give professional advice to SME's. This will help them know whether the loan they applied for can finish the project. Proper professional advice would come from

proper appraisal of the loan and this will inform the lending microfinance institutions whether the amount the SME requested for is too much for the project or less.

5. Seminars and workshops should be organized by the microfinance institutions to educate SMEs on their policies and judicious use of funds for SMEs and what it takes to assess loans. Also, the microfinance institutions should initiate more developmental projects in order to win the confidence and trust of the SME's.

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