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The Role of Banks in Financing Small and Medium Scale Enterprises in Ghana- A Case Study of Universal Banks in Sekondi-Takoradi

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Abstract
Bank finance has been found as an important source of funds for most firms. This study examines the role banks play in addressing the finance gap facing SMEs in Ghana. Through a questionnaire survey, data was gathered from sampled Banks and SMEs in Sekondi-Takoradi. The data revealed that banks see SMEs as a profitable segment. Also bank finance enhances the profitability of beneficiary SMEs. This has encouraged a trend of increased bank involvement with the SME sector. However, SME specific factors, high interest rates, collateral requirements, lack of quality information, delays in judicial proceedings and difficulties in disposing collateral restrict further bank involvement with SMEs and the latter's freedom to access bank finance. The authors conclude that all relevant stakeholders must contribute to fostering the trend by helping to mitigate the constraints through the implementation of deliberate policies that enhances trust between banks as lenders and SMEs.
Key words: Role of Banks, Financing, Small and Medium Enterprises, Sekondi- Takoradi, Ghana

1.0 Introduction

Financing small firms has critically attracted the attention of researchers, policy makers, and practitioners alike. Many studies in academia have focused on this crucial topic of financing preference for firms all over the globe. However, most of the theories developed to explain financing preferences have focused on large firms. Empirical studies have concentrated on large firms Zingales (2000). Few studies on the capital structure of SMEs have concentrated on developed economies Sogorb-Mira, (2005). Prior Ghanaian studies have mainly dwelt on the problems SMEs face in accessing various sources of finance Abor and Biekpe, (2009).

Similarly, Policy makers in most market oriented economies have concentrated efforts on evolving and implementing policies and programs targeted at enhancing the ability of SMEs and their entrepreneurs to generate as well as access funding. In the UK, for instance, the Department for Business, Enterprise and Regulatory Reform (BERR) has set itself the key target of helping to build an enterprise society in which small firms of all kinds thrive and achieve their potential Deakins and Freel, (2009).

In order to ameliorate the constraint of access to credit in Ghana, the NBSSI set up the Investment and Credit Department to help ease the financial problem facing the sector Boachie- Mensah & Marfo-Yiadom, (2005).

Also, practitioners and investors are in the search for potentially high-growth oriented firms to invest both in their equity and debt. Thus, the Venture Capital Trust Fund (VTCF) was set up in 2004 under Act 680 to facilitate funding for SMEs in Ghana. However, notwithstanding the aforementioned strides by these different stakeholders in the economy, access to funding for SMEs continues to be one key obstacle facing most entrepreneurs. This problem is more acute for SMEs in less developed economies than their counterparts in both emerging and advanced economies. Beck (2008) argued that Banks in developing countries tend to be less exposed to SMEs, provide a lower share of investment loans, and charge higher fees and interest rates.

To circumvent this problem, entrepreneurs raise funds from friends and relatives leading to inadequate working capital and investment funds, which threaten survival and impede growth.

Moreover, countries do not report an overall financing gap for SMEs. The reason they give is that they not have financing problem when it comes to entrepreneurial/innovative SMEs, precisely because they do not fit the mould applied in traditional SME financing. Since innovative SMEs tend to be new to the market or seeking financing for a new type of product or service, and usually have negative cash flows and untried business models, they represent a higher risk to banks and cannot be assessed in the same manner as traditional SMEs or large firms OECD, (2006).

In Ghana, SMEs with high growth potentials will seek more external finance especially long-term debt in financing their growth Aryeetey *et al.* (1994) and Abor and Biekpe (2006). Again Abor and Biekpe (2009) observed that short term debt represent an important financing source for SMEs in Ghana.

In spite the vitality of funding for SMEs, relatively little research exists on, why and how banks finance SMEs in Ghana. Few topics have focused on the demand side of access to debt finance and even fewer exist on SMEs debt finance from supply side. In respect of this, a dyadic survey to examine the obstacles to credit as perceived by providers of funds (commercial banks) and SMEs could help to further share light on the findings of existing studies Olawale & Asah, (2011). It is in the light of this gap in literature that motivated the researchers to undertake this study.

This study intended to focus on banks and the role banks play in providing external funding for potentially high-growth oriented firms at their early stages of evolution. It also looked at banks loan management and credit risk. The crucial question to ask is how can banks identify less risky clients and what volumes of their loan portfolios can prudently be allotted to the different client segments. One of such client segment is the SMEs.

1.1 Research Questions

- To what extent are banks involved with SMEs?
- How do banks identify potential SMEs and their entrepreneurs for lending purposes?
- What are the impacts of bank lending on SMEs?

1.2 Research Objectives

The overarching objective of this study is to identify the role banks play in providing funding for SMEs and their entrepreneurs and to identify the impact such loans have on the banks and SMEs.

Specific objectives include ascertaining:

- The extent of banks involvement with SMEs.
- How banks identify potential SMEs and their entrepreneurs for lending purposes
- The impact bank loans have on SMEs.

2.0 Literature Review

2.1 Introduction

This chapter reviews relevant literature with the aim of establishing the framework for the study. The first part focuses on the theoretical literature germane to the study topic namely The Agency theory by Jensen and Meckling, (1976), The Pecking Order Theory by Myers and Majluf (1984) and the concept of risk and its impact on Return on Assets.

2.2. The Agency Theory

The Agency theory of Jensen and Meckling (1976) was based on the conflict between shareholders and management of the firm and debt holders. Lending and borrowing are financing agreements that create financial obligations on the two parties. Thus, the supply of funds to businesses is influenced by contracts that create appropriate incentive for both the supplier and user of funds. The ideal contract in the researcher's perspective is one that is based on trust instead of risk. Such scenario will induce the agent (borrower) to act in the best interest of the supplier of funds. If such contracts are created, the supply and demand for funds will be brought into balance since there is mutually beneficial relationship between the supplier and the user of funds Mensah, (2004). In this way it is the researcher's proposition that any existing financing gap would be mediated.

Since SMEs are mostly owner-managed, they are not likely to be impacted significantly by the conflict between shareholders and managers Sogorb-Mira, (2005). However, the agency conflict between the owners and debt holders may be particularly severe for SMEs Abor & Biepke, (2009). It is palpable that agency problem occur between lenders, as principals, and borrowers, as agents because the contracting parties cannot easily observe or control each other and because contracts cannot be enforced without incurring costs. Thus, contractual frictions can arise because of moral hazard, adverse selection or asymmetric information.

Consequently, gathering, processing and analyzing of quality information provides the means for developing a profile of a borrower's creditworthiness while financial contracting attempts to reduce the incentive/agency problem between the lender and borrower. The information gathering process is crucial to the traditional lending functions namely: Originating, Funding, Servicing and Monitoring. The originating and monitoring functions require practical knowledge about the borrowers as captured by the 5Cs of creditworthiness. These are Character (honesty and ethical reputation), Capacity (cash flow), Capital (real net worth), Collateral (security) and Conditions (venerability to economic fluctuations) Sinkey, (2002).

The agency paradox is thus applicable in lending situations especially where default risk constitutes a major challenge. Given this knowledge, the Agency Theory played important role in the design and execution of this research.

2.3 The Pecking Order Theory

The Pecking Order Theory developed by Myers & Majluf (1984) states that companies prioritize their sources of financing (from internal financing to equity) according to the principle of least effort, or of least resistance, preferring to raise equity as a financing means of last resort. Hence, internal funds are used first, and when that is depleted, debt is issued, and when it is not prudent to issue any further debt, equity is issued. This theory maintains that businesses adhere to a hierarchy of financing sources and prefer internal financing when available, and debt is preferred over equity if external financing is required.

2.4 The Concept of Credit Risk and its Impact on Banks

One of the most important aspects of a bank's financial management is risk management, which is comprised of strategic and capital planning, asset-liability management, and management of business and financial risks

Greuning and Iqbal, (2008). A prudent risk management practice is crucial to ensure the bank's profitability and stability. Generally, the main elements of risk management in banks are identifying, measuring, monitoring and managing various risk exposures Greuning and Iqbal, (2008). In order to ensure these elements are effectively implemented, the banks should follow the risk management process and system, which among others include establishing appropriate risk management environment and sound policies and procedures, maintaining an appropriate risk measurement, mitigating and monitoring processes, and ensuring adequate internal controls Khan and Ahmed, (2001).

Oldfield and Santomero (1997) investigated risk management in financial institutions. In this study, they suggested four steps for active risk management techniques:

The establishment of standards and reports;

The imposition of position limits and rules (i.e. contemporary exposures, credit limits and position concentration);

The creation of self-investment guidelines and strategies; and

The alignment of incentive contracts and compensation (performance-based compensation contracts).

Loans that constitute a large proportion of the assets in most banks' portfolios are relatively illiquid and exhibit the highest credit risk Koch and MacDonald, (2000). The theory of asymmetric information argues that it may be impossible to distinguish good borrowers from bad borrowers Auronen, (2003), which may result in adverse selection and moral hazards problems. Adverse selection and moral hazards have led to substantial accumulation of non-performing accounts in banks Bester, 1994; Bofondi and Gobbi, (2003). The very existence of banks is often interpreted in terms of its superior ability to overcome three basic problems of information asymmetry, namely ex ante, interim and ex post Uyemura and Deventer, (1993). The management of credit risk in banking industry follows the process of risk identification, measurement, assessment, monitoring and control. It involves identification of potential risk factors, estimate their consequences, monitor activities exposed to the identified risk factors and put in place control measures to prevent or reduce the undesirable effects. This process is applied within the strategic and operational framework of the bank.

Credit risk arises from uncertainty in counterparty's ability or willingness to meet its contractual obligations. Bessis (1998) also includes a decline in the credit standing of counterparty as part of credit risk. Credit risk management covers both the decision making process, before the credit decision is made, and the follow-up of credit commitments, plus all monitoring and reporting processes Miller, (1996).

High loan loss, varying degrees and volumes of default can greatly impact on the profitability and going concern of banks. For, instance, by the year 1980, there were 14,435 banks in the United States. By the year 2000, the number dropped dramatically to between 4,430 and 9,785 (OCC-USA).In Ghana, two major banks have failed, namely BHC and Co-operative bank. Several rural banks in Ghana have also failed including Kyidom, Sefwi, Bekwaiman, Subinso, Lang Abar, Hum, Tweaman and Amansam Appiah, (2001).

Thomson (1990) also found higher ratio of loans to total asset, higher rate of non-performing or bad loans and higher losses per unit of loan as key factors culminating to bank failure. Again, Appiah (2001) studied eight failed banks in Ghana and identified poor loan quality, persistent loan losses as partly responsible for the failure of all the eight banks.

2.5 Financial Constraints Facing SMEs

Hinson (2004) has noted that "before the passage of the Universal Banking Law, banking was conducted along such narrow scopes as commercial, developmental or merchant banking. With the passage of the Universal Banking Law however, all types of banking can be conducted under a single corporate banking entity and this greatly reorganizes the competitive scopes of several banking products in Ghana".

The extant literature is clear on the fact that SMEs mostly have problems accessing funds from finance providers to finance fixed assets and working capital for their operations Tucker and Lean, (2003). The main financial challenge facing SMEs is access to affordable credit over a reasonable period. This is determined by the financing needs of SMEs and the action of investors Tagoe et al. (2005). This constraint indeed seems to hamper investment and innovation, and thus growth, employment and welfare Balling et al., (2009).

The presence of the 'finance gap' is mainly a result of the existence of information asymmetries between finance providers and borrowers Abor, (2005). Information asymmetries refer to the disparity between the information available to businesses seeking capital and suppliers of capital who are typically assumed to be at an informational disadvantage with respect to insiders of the business Stiglitz and Weiss, (1981); Bester, (1987). For example, a borrower who takes out a loan usually has better information about the potential returns and risks associated with the investment projects for which the funds were earmarked than the lender.

Information asymmetry creates problems in the financial system on two fronts, namely adverse selection and moral hazard Mishkin and Eakins, (2009). Adverse selection in financial markets occurs when the potential borrowers who are the most likely to produce an undesirable outcome – the bad credit risks – are the ones who most actively seek out a loan and are thus most likely to be selected. Because adverse selection makes it more likely that loans might be made to bad credit risks, lenders may decide not to make any loans even though there are good credit risks in the marketplace. Moreover, moral hazard in financial markets is the risk that borrower might engage in activities that are undesirable from the lender's point of view, because they make it less likely that the loan will be paid back. Because moral hazard lowers the probability that the loan will be repaid, lenders may decide that they will rather not make a loan Mishkin et al, (2009). Faced with this type of uncertainty, a lender may deny credit, sometimes to firms that are creditworthy but unable to document it (Coleman, 2000).

2.6 Conclusion

This chapter sought to review relevant literature in order to establish the framework for the study. While extant literature emphasize banks reluctance to be involved with the SME sector, recent literature seem to indicate a trend of increased bank involvement with the SME sector. However, institutional constraints are inhibiting further development of this grandiose trend. Consequently, there is the need for a clearer understanding of these constraints; a gap which this work sought to fill.

3.0. Methodology

This study sought to investigate the role of Banks in financing SMEs.

The theoretical framework and principles underlying capital structure that was employed include the Agency Theory by Jenseng and Meckling (1976) and the Pecking Order Model developed by Myers & Majluf (1984).

The study employed both quantitative and qualitative approaches. It helped the researcher to gain in-depth understanding of the issues that influence the funding of SMEs by banks. Again, quantitative method enabled the researcher to identify trends underlying bank finance for SMEs, its impact on SMEs and the credit risk exposure the bank faces as a result. Thus, the quantitative method enhanced generalization based on findings.

A survey was conducted to explore issues relating to bank finance for SMEs. Questionnaires comprising both open and closed ended questions were used. In designing the questionnaire for the survey the researchers sought results that confirmed and strengthened existing theoretical framework and extant literature but also helped to identify new trends and dimensions that initiates and pave the way for new knowledge and concepts.

3.1 Research Design

The research design of this project was a survey, one which determined the level of involvement of Banks in the financing of SMEs in Sekondi - Takoradi. The researchers gathered extensive data from the owners and managers of SMEs who have obtained bank finance. Staff of the department responsible for Business Banking/SME Banking of selected banks operating in the study area also provided information for the study. Questionnaire and interview guides covering the objectives of the research were prepared and used to collect data from the owners or managers of all the sampled SMEs.

For the purposes of this study, the researchers used both primary and secondary sources of data.

3.2 Primary Researches

The primary research is tailored to suit the needs of the research. This research involves the collection of raw data, which forms the main basis for achieving the research objectives. The sources of which include, unpublished documents, research institutes and other agencies. An attempt was made at collecting and analyzing primary data which has gone a long way to validate the findings and conclusions drawn from the research. The qualitative research approach was deemed to be appropriate by the researchers hence its adoption.

It has been observed that the use of multiple data collection methods, such as observation, interviews, document analysis and questionnaires are very important Patton & Appelbaum, (2003). With the importance of multiple sources of data very vital to the reliability of this research Stake, (1995), two primary sources of evidence were used: questionnaires, and interviews.

Saunders et al. (2007) opined that the method for collecting research data is linked to research approaches adopted. The two data collection methods proved useful in providing detail information needed for the study.

Primary data collection methods that were adopted includes: questionnaire administration, interviewing, observation.

A survey "involves acquiring information about one or more groups of people-perhaps about their characteristics, opinions, attitudes or previous experience by asking them questions and tabulating their answers" Leedy & Ormrod (2005). It is a method that has been used frequently to source information from individuals or group of individuals. The survey questionnaires were self-administered.

The self-administered questionnaire method was employed because of its cost effective nature relative to interviews. Large number of participants can be involved and a lot of data collected in a relatively shorter time and at less cost. With the same length of questions and objectives, Fink (2003) stressed that self-administered questionnaires by mail cost 50% less than telephone interviews and 75% less than personal interviews.

Although participants in this method are more likely to abandon the research in the course of responding, its privacy and anonymity promotes genuine answers. The less pressure on participants was also considered as a better way of convincing respondents to participate fully. With this method, interviewer biases are non-existent Gratton & Jones, (2004). However, problems can arise if questions are unclear, as the respondent cannot check what the researcher intended.

A well-designed questionnaire was therefore important, especially ensuring that it was worded in simple English and an unambiguous manner to avoid this problem. It must be noted that in survey research the validity and reliability of the method must be paramount. Babbie (1990) describes validity as "the extent to which an empirical measure adequately reflects the real meaning of the concept under consideration". He also defines reliability as "a matter of whether a particular technique, applied repeatedly to the same object, would yield the same result each time." Consequently, the good sampling technique used in this study makes it very credible.
However, prior to using the questionnaire for data collection, it was pilot tested. A strategy was adopted in the course of carrying out the research work. The questionnaires were pilot tested on thirty (30) SME owner-managers and (3) banks in the study area. The reasons were;
(i)-To ascertain whether the questions chosen will be relevant in addressing the set objectives of the research, and this led to rephrasing of some of the questions and discarding some of the questions as well.
(ii)-To address errors before the actual questionnaires go out to the real respondents.
(iii)-To make sure the structure, layout and instructions to be followed are clear and finally
(iv)-To assess the average response rate in the use of various medium for data collection.
Prepared closed-ended and semi-open ended questions were developed. The semi-open-ended questions placed no restrictions on how research participants could respond to the questions. Participants responded in their own words and were not constrained to select their responses from a list of choices like the closed ended questions. This allowed respondents to say many things that would not have been said with only closed-ended questions.
Since the research also sought the view of owner-managers' of SMEs and their philosophy towards bank credit as well as its impact on their businesses, there is the possibility of managers being biased, therefore, the researchers prevented the cultivation of lengthy report that could underestimate the validity of the research study.
3.3 Sampling Size
The total sample for the study was 100. This was made up of 90 owner/managers of SMEs and 10 staff of banks operating in the study area. However returned questionnaires were 84 from SMEs representing 93% and 8 from the banks representing 80% of questionnaires administered to the banks and SMEs respectively.
There are over twenty nine (29) banks in Ghana however, in view of this research; only 10 of them were selected by the researchers. They include; Ghana Commercial Bank, Agricultural Development Bank, Barclays Bank (Ghana Limited), Eco-bank (Ghana Limited) and Merchant Bank Ghana Limited, Stanbic Bank, Standard Chartered Bank, World Women Bank, Zenith Bank and the Prudential Bank Ghana Limited. They were chosen because they are the largest indigenous and foreign financial institutions in the country. They all have their headquarters in Accra, the capital city of Ghana. These companies employ quite a substantial number of people. They tend to be in almost all the capital cities in Ghana.

4.0 Data Analysis
Introduction
There were two different populations/groups for the survey namely Banks and SMEs. For the banks, data was collected from eight universal banks located in Sekondi- Takoradi. For the SMEs the survey focused on 84 SMEs in Sekondi-Takoradi. Data garnered were analyzed and discussed using descriptive statistics including frequency tables, percentages, pie charts and bar graphs and interpretations made in reference to the reviewed literature.
Banks' Involvement in SMEs
Separate unit managing SME banking relations
The banks were asked whether they had separate units managing SME banking relations.
Chart 4.0 Units responsible for Managing SMEs Relations.

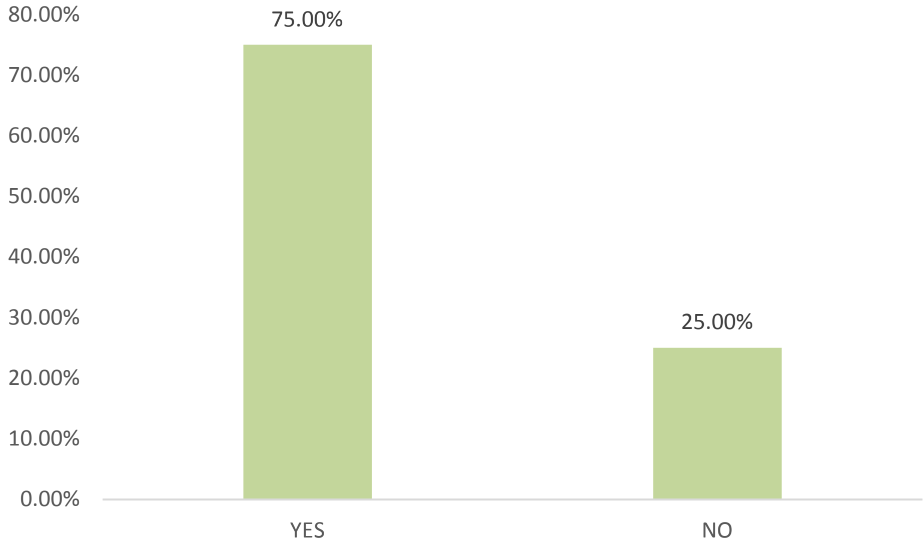


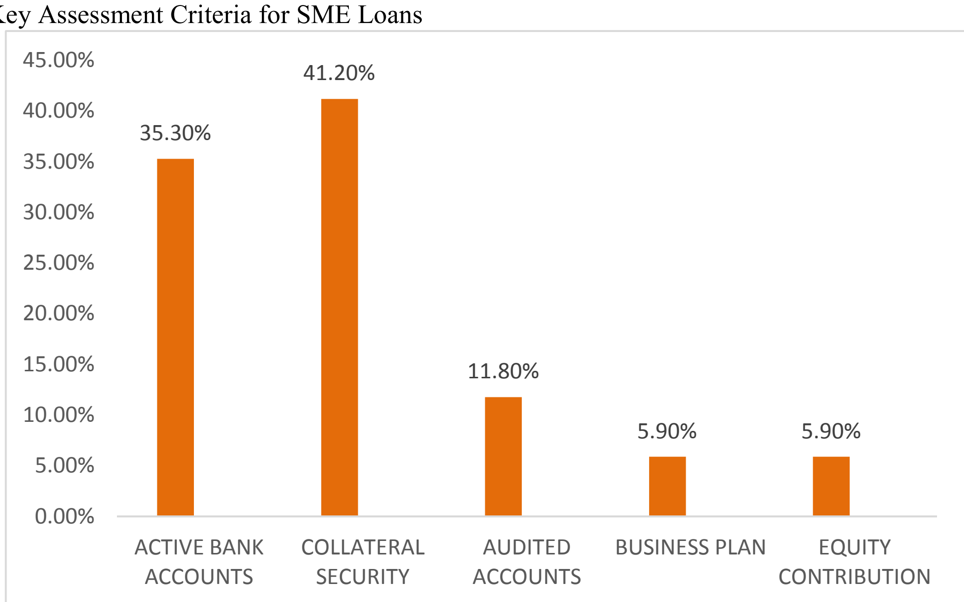
Chart 4.0: Source: Field Data, (2014).

The researchers wanted to find out whether the banks have separate units managing SMEs relations. The findings showed that 6 out of 8 banks representing (75) percent said yes, their bank currently have separate units managing the banking relations with SMEs and 2 out of 8 representing 25% said no. The reason given by the two banks was that every customer has a dedicated relationship officer/manager so they do not have a separate unit managing banking relations with SMEs. This indicates that overall the banks regard the SME segment as important and therefore dedicates specific unit to managing the banking relation. This seems to be the current trend as recent literature demonstrates. For instance, in the 2012 Ghana Banking Survey, it was found that almost all banks in the country have now established SME banking departments and have acquired the capacity to address the peculiar needs of SMEs. Torre et al (2010) in their survey of 48 banks in 12 countries also found that all banks were interested in the SME segment through separate organizational units. However, it is instructive to state that the 25% of surveyed banks that have no separate organizational arrangements managing the banking relations between SMEs is problematic. It is the researchers view that in the absence of such units the banks officers are likely to apply the same assessment and due diligence mechanisms peculiar to large firms in their dealings with SMEs. This may aggravate the finance gap facing SMEs in Ghana.

4.1 Key Assessment Criteria for SME Loans

Respondents from the banks were asked to show the extent to which the following requirements are important assessment criteria for selecting SMEs for loan purposes.

Chart 4.1 Key Assessment Criteria for SME Loans



Source: Field Data, (2014).

Chart 4.1 summarizes the key assessment criteria to determine whether SMEs qualify for a loan. The finding shows that 7 banks representing (41%) said an SME should have a collateral security and six banks representing (35%) percent said the SME should have active bank accounts. Also, 2 banks representing (12%) percent said an audited account is needed. One bank representing (6%) said a business plan is required as assessment criteria as well as one bank representing (6%) said equity contributions are some of the key assessment criteria for SMEs loans.

Collateral security and Active bank accounts are the two most sought assessment criteria for SME loans. The demand for collateral may reduce moral hazard and adverse selection. Steel and Webster (1992) stated that lack of collateral is a reason given by most commercial banks for not granting loans to SMEs.

4.2 The Banks were asked the extent to which the following factors are important Criteria to Identifying Potential SME clients;

Table 4.1 Criteria to Identifying Potential SME clients

Ranking	1=Strongest ….. 5=Weakest					Total
	1	2	3	4	5	
Client of Existing Big Clients	4 (80.0%)	1 (20.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	5 (100.0%)
Existing Deposit Clients	3 (50.0%)	2 (33.3%)	1 (16.7%	0 (0.0%)	0 (0.0%)	6 (100.0%)
Client in need of credit	2 (40.0%)	1 (20.0%)	2 (40.0%)	0 (0.0%)	0 (0.0%)	5 (100.0%)
Located Near Branches	0 (0.0%)	0 (0.0%)	1 (25.0%)	4(75.0%)	0 (0.0%)	5 (100.0%)
Attached to Staff	0 (0.0%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	4(100.0%)	4 (100.0%)

Source: Field Data, (2014).

The findings from Table 4.1 shows the extent to which factors like "Client of Existing Big Clients", "Existing Deposit Clients", "Client in need of Credit", "Located near Branches" and "Attached to Staff" are important criteria in identifying potential SME clients. It is observed that four banks representing (80%) percent ranked "client of existing big clients" at 1, and one bank representing (20%) ranked "client of existing big clients" at 2. "Existing Deposit Clients" also had three banks representing (50%) of six banks ranked it at 1, two banks representing (33%) ranked at 2 and one bank representing (17%) ranked at 3. Also, "client in need of credit" had 2 representing (40%) banks ranking it at 1, 2, representing (40%) banks ranking it at 3 and1 representing (20%) ranked it at 2. "Located near Branches" had (25%) and (75.0%) ranked at 4. All the four banks which ranked "attached to staff" ranked at 5 which make it the factor with the lowest rank. However, "client of existing big clients", "existing deposit clients" and "client in need of credit" respectively had more banks ranking them high.

Consequently, the most important criteria used by the banks in identifying potential SMEss are client of existing big clients. Thus the big client in a way becomes a guarantee for the SME and this gives security to the bankers. Quality referrals reduce the banks cost in terms of information search and monitoring thereby improving the banks ROA. It is the researchers' opinion that quality referrals enhance trust between lenders (acting as principals) and borrowers (acting as agents). It thus reduces the problem of information asymmetry and the consequent challenges germane to adverse selection and moral hazard.

Table 4.2 Obstacles to SMEs lending

Ranking	1=strongest and 5=Weakest					Total
	1	2	3	4	5	
Lack of Quality information	6 (85.7%)	1 (14.3%)	0 (0.0%)	0 (0.0%)	0 (0.0%)	7 (100.0%)
Credit Scoring is Inadequate	1 (16.7%)	3 (50.0%)	1 (16.7%)	1 (16.7%)	0 (0.0%)	6 (100.0%)
Cannot evaluate SME based on Behavior	2 (28.6%)	1 (14.3%)	3 (42.9%)	1 (14.3%)	0 (0.0%)	7 (100.0%)
Family Management/ Informality	1 (16.7%)	1 (16.7%)	1 (16.7%)	2 (33.3%)	1 (16.7%)	6 (100.0%)

Source: Field Data, (2014).

One of the greatest obstacles of banks' lending to SMEs is the lack of quality information. This was observed when six out of 7 banks (85.7%) ranked "lack of quality information" at 1 and one out of seven banks ranked "lack of quality information" at 2. This was followed by "credit scoring is inadequate" which also has three out of six banks (50.0%) ranking this obstacle at 2 and one out of 6 banks ranking it at 1, as one of the factors that makes it difficult for banks to lend to SMEs. With regard to SMEs not being able to be evaluated based on behavior, two out of seven banks representing (29%) ranked it at 1 and one out seven ranked it at 2.

Lack of quality information was ranked as the most important obstacle to SME lending, followed by credit scoring is inadequate. Thus lack of quality information may deter banks from granting loans to the SME segment. Abhor (2005) have argued that the presence of finance gap facing SMEs is mainly a result of the existence of information asymmetries between finance providers and borrowers. Consequently, information asymmetry in the financial system creates problems on two fronts, namely adverse selection and moral hazard Mishkin et al, (2009). However, it is obvious from the data that inadequate credit scoring and inability to evaluate SMEs based on behavior were also other key factors that hindered Banks' lending to SMEs.

Table 4.3 Main Source of Finance for SMEs

	Frequency	Valid Percent
Personal	21	25.0
Bank loan	55	65.4
Trade credit	4	4.8
Family friends	4	4.8
Total	84	100.0

Source: Field Data, (2014).

Table 4.3 presents source of finance for SMEs sampled and it is observed that a quarter (25.0%) said they use personal financing, 55 representing (65%) said they use bank loans. It is also observed that less than 5 percent (4.8%) use trade credit as well as less than 5 percent said family and friends provide the source of finance for their business. It is evident that bank credit and personal sources are the two most important sources of funds used by SMEs.

4.3Documents requested by banks as part of the loan application process

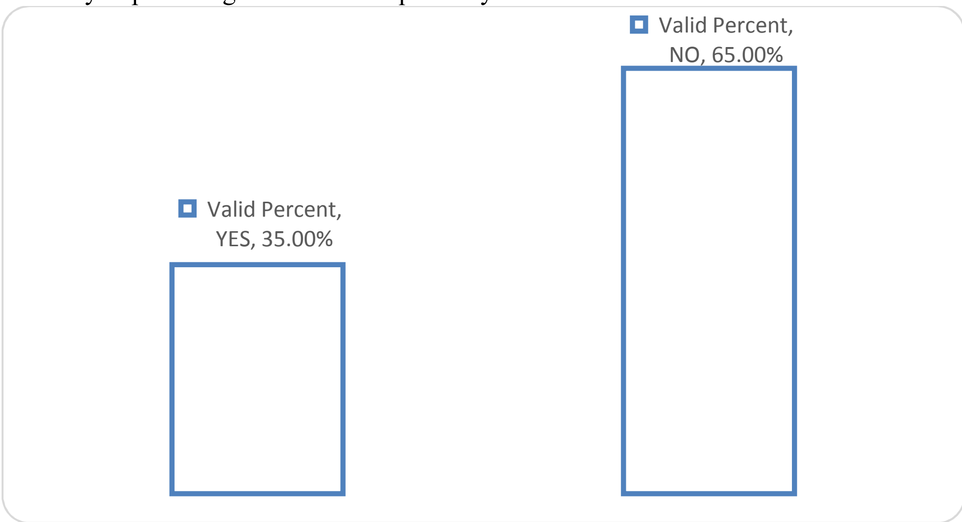
Table 4.4: Documents requested by Banks

	Responses		Percent of Cases
	N	Percent	
Formal application for Financing	25	20.5%	31.2%
Certificate of Business Registration	36	29.5%	45.0%
Business Plan/Proposal	22	18.0%	27.5%
Personal Bank Statements	28	23.0%	35.0%
Cash Flow Projections	6	4.9%	7.5%
No Documentation	2	1.6%	2.5%
Voters ID and Passport Pictures	2	1.6%	2.5%
Fixed Assets Documents	1	.8%	1.2%
Total	122	100.0%	152.5%

Source: Field Data, (2014).

The table presents documents banks request as part of loan application process from SMEs. It is observed that 36 responses representing (29.5%) said certificates of business registration are requested by banks as part of the loan application process. The findings also show that 28 out of 122responses representing (23 %) said banks request for personal bank statement. Also, (21%) said formal application for financing. Other documents requested by banks from SMEs as part of the loan application process were business plan/proposal (18.0%), cash flow projections (5%), voter ID and passport pictures (1.6%) and fixed asset documents (0.8%). In fact 2 representing 1.6% said no documentation was required when sourcing bank finance. This possibly represent those have been active clients of the banks over a long period of time and have been in the bank's good books. Three most requested documents were certificate of business registration, personal bank statement and formal application for financing.

Chart 4.3: Difficulty in providing Documents required by Banks



Source: Field Data, (2014).

From the chart (35%) said there were difficulties in providing some documents that were required by banks as part of the loan application process. On the other hand, (65.0%) of SMEs said, there were no difficulties in providing any document that was required by the banks as part of the loan application process. It is in the researchers' view that 35% represents a significant number of SME loan applicants and this is problematic since it prevents the SMEs from accessing bank loans.

4.4: Constraints to Accessing Credit from Banks

Table 4.5: On a Scale 0f 1-5 Rank the Important Constraints to Accessing Credit from Banks

Ranking	1=Strongest 5=Weakest					Total
	1	2	3	4	5	
Collateral	25 (49.0%)	15 (29.4%)	6 (11.8%)	3 (5.9%)	2 (3.9%)	51 (100.0%)
Delay in Release of loans	13 (24.1%)	12 (22.2%)	11 (20.4%)	11 (20.4%)	5 (13.0%)	54 (100.0%)
Paper work /bureaucracy	11 (20.8%)	10 (18.9%)	16 (30.2%)	7 (13.2%)	9 (17.0%)	53 (100.0%)
High Interest Rate	29 (54.7%)	11 (20.8%)	4 (7.5%)	4 (7.5%)	5 (9.4%)	53 (100.0%)
Loan Arrangement Fees	5 (10.5%)	5 (10.5%)	8 (17.0%)	13 (27.7%)	16 (34.0%)	47 (100.0%)

Source: Field Data, (2014).

Table 4.5 explains important constrains to SMEs when accessing credit from banks. On a scale of 1 to 5 where one is the strongest and five the weakest. It was observed that more than half of respondents ranked high interest rate at 1, two out of 10 (20.8%) ranked high interest rate at 2, and less than 8 percent (7.5%) ranked it at 3 as well as less than 8 percent (7.5%) ranked it at 4. Again, close to one out of 10 (9.4%) ranked high interest rate at 5. Moreover, close to half (49.0%) of the respondents ranked collateral at 1. This was followed by close to three out of 10 (29.4%) who ranked collateral at 2, and less than two out of 10 (11.8%) ranked collateral as the third most important constraints that hinders SMEs access to loans.

The rest of the ranks had less than 6 percent (rank 4 (5.9%), rank 5 (3.9%)). Delay in release of loans had less than three out of 10 ranking it at 1 (24.1%), at 2 (22.2%), at 3 (20.4%) as well as at 4 (20.4%). Less than two out of 10 (13.0%) also ranked delay in release of loans at 5. Paper work/bureaucracy as a constraint in accessing loans by SMEs also had three out of 10 (30.2%) ranking it at 3, two out of 10 (20.8%) ranking it at 1 and less than two out of 10 (18.9%) also ranked it at 2. Loan arrangement fees also had more than three out of 10 (34.0%) ranking it at 5 and more than two out of 10 (27.7%) ranking it at 4. Which makes loan arrangement fees the least when it comes to constraint that restricts SMEs from accessing loans from their banks.

It is observed that High Interest Rate, Collateral and Delay in release of loans are the most important constraints that limit SMEs freedom to obtain loans from banks. High interest rate ranked the highest. The research shows that high interest rate is a barrier to SME access to bank loan. However, prior studies including Aryeetey et al (1994) have found that interest charges did not influenced SME access to bank lending. It seem to the authors that such conclusion is based on the supply (bank) side since the position posited by Aryeetey et al (1994), is not collaborated by the authors' finding from the SMEs position (demand side).

4.5 Conclusion of the Findings

Contrary to extant literatures position, that banks are not interested in financing SMEs, surveyed banks in general, are keenly interested to have SMEs as clients. Many banks have set up separate units managing the banking relations between the banks and the SMEs while others have reorganized their internal systems to better serve the SME sector. However, a significant number of banks (25%) still do not have separate organizational arrangements managing SME banking relations. This is problematic since it may lead to the application of due diligence systems applicable to large firms with its attendant negative impact on SMEs. Majority of the banks pursue SMEs as an attractive business proposition. Consequently, surveyed banks are highly involved in the SME segment. This holds good promise since it contributes to closing the finance gap facing SMEs in Ghana.

About 50 percent of surveyed banks have more than half of their loan portfolio allotted to the SMEs and the segment contributes about 50 percent to the total interest income of the surveyed banks. The data collected from the banks could not provide any clear trend in terms of whether collateral required and interest charged on SME loans are higher than interest charged on corporate and consumer loans. However, there were several constraints that militate against the surveyed banks further involvement with the SME sector. Some of these constraints include SME specific factors as well as other legal and contractual factors.

Moreover, it can be concluded from data collected from SMEs that bank finance was the most important sources of funds used by SMEs and that more than 95 percent of loans acquired by the SMEs were used for the purpose for which it was obtained. Therefore there is a low incidence of moral hazard associated with bank lending to SMEs. Provision of collateral was required by banks before loans could be granted to SMEs. However, personal guarantee and other forms of movable properties were accepted by most banks in place of the traditional landed property as collateral. Again, inabilities to provide collateral and proper financial records were the two most important factors that led to the rejection of loan application by SMEs. High interest rate was the most important constraint that limits SMEs freedom to obtain loans. Also there was high level incidence of owner-manager phenomenon among surveyed banks.

4.6 Recommendations

It is evident that most of the surveyed banks have established separate units to manage SME bank relations. It is in this light that the authors deem it appropriate to recommend for the allocation of resources to provide training to the SME clients in areas including improved management of loans, financial reporting and improved attitude to loan repayment. When this is done, banks can further reduce the occurrence of loan default by tailoring their loan repayment packages to match cash flows of the beneficiary SMEs.

It was also found that banks were willing to lend to SMEs who were clients of existing big clients of the banks. In the light of this, it is recommended for SMEs to liaise with their suppliers and major (institutional) customers to help recommend them to their banks so as to help them access bank loans.

High interest rate was found to be the major constraint to SME freedom to access loans. It is thus, recommended for the pursuance of sound macroeconomic policy that would result in reduced interest rate. This will encourage borrowing and investment – most importantly for SMEs and help close the finance gap SMEs faces.

Again, banks argued that SME loan default were as a result of specific factors related to SMEs. This calls for a holistic understanding of the SME sector so that relevant stakeholders including policy makers could address any inherent weaknesses associated with the sector. This could thus help formalize the sector and enhance the quality information needed by banks in the area of credit risk management.

Finally, the researchers recommend for the adoption of a dynamic approach to the lending process. Repayment arrangements must be made in such a way as to meet the cash flow of the SME concerned. The process of amortizing SME loan repayment must not be encouraged. Other forms of loan repayment arrangements such as 'bullet' and 'balloon' arrangements must be adopted given the pattern of cash flow of the SME concerned. This together with constant monitoring, banks can highly reduce the incidence of moral hazard associated with bank lending.

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