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MICRO CREDIT AND PROMOTION OF SMALL AND MEDIUM ENTERPRISES IN INFORMAL SECTOR OF GHANA: LESSONS FROM EXPERIENCE

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ABSTRACT

SMEs in developing countries play significant role in the economic activities of those nations. SMEs provide income for many low income households especially in the informal sector. Notwithstanding their contributions, SME entrepreneurs face serious financial challenges which have led to poverty among them. For SMEs to overcome their financial challenges, Micro Finance Institutions have emerged with the view to providing micro credit and other financial products for SMEs. .Also, Public micro credit was given to SMEs as subsidized loans. Unfortunately, that programme has collapsed. To revive public support for SMEs and low income households the government of Ghana introduced in 1993, Act 328, which established Non Bank Financial Institutions (NBFIs) to support SMEs and low income households. Donors, also, supported that programme, in 2003, under the Ghana Poverty Reduction Strategy (GPRS).

Generally, SME activities in Ghana are dominated by women who constitute 75 per cent of total entrepreneurs. Notwithstanding their low earnings, SMEs have to repay borrowed funds with high interest of 3 per cent per month or 34 per cent per annum. The low income and high interest rate have led to high default rate among SMEs borrowers. The study showed that among SME entrepreneurs who repay credit on monthly basis there is a default rate of 2. 8 per cent where as those who repay annually have default rate of 6.5 per cent. It would be necessary for Micro Finance Institutions to extend other products such business advisory products and social products to SMEs to raise their productivity and improve upon their performance. An observation is that only Micro Credit would not take SMEs out of poverty in developing countries.

Keywords: Micro, Credit, Enterprise, Default, Policy, Donor, Entrepreneur Financial, Interest.

1. INTRODUCTION

The search for investible capital by entrepreneurs of Small and Medium Enterprises (SMEs) in Ghana is an arduous and frustrating task. That has affected the growth of businesses in informal sector. SMEs operating in the informal sector in Africa; employ about 70 percent of the total working population in urban areas. Again, SMEs are involved in 90 per cent of the economic activities in Ghana. This implies that SMEs contribute significantly to the economic progress of Ghana.

Notwithstanding the fact that SMEs contribute to economic growth, they could hardly access financial products from universal banks as a result of their inability to meet conditions associated with the administration of bank products. For that matter, SME entrepreneurs use both informal and formal micro credit sources to raise credit, for investment. SMEs that are not able to access adequate funds either get stunted, or collapse. That has increased poverty levels of low income households involved in SME businesses in the informal sector. The emergence of Micro Finance Institutions, Public funds for SMEs and Donor support programmes has made micro credit support for SMEs activities.

Microfinance could be defined as the provision of financial products such as, micro savings, micro credit, micro withdrawal, micro money transfers, and micro insurance and so on, to the poor entrepreneurs who operate in the informal sector and low-income households. Microfinance products are grouped into three components namely, financial products, social products and business development or advisory products

On the hand SMEs are defined differently by various institutions in Ghana; using different variables. For example, the National Board for Small Industries (NBSSI) defines it by using employment and capital assets of an enterprise. Based on those variables, small scale enterprise is one with not more than 9 workers, and has plant and machinery assets (excluding land, buildings and vehicles) not exceeding GHS 10 million (US$5million). On its part the Ghana Enterprise Development Commission defines small business as one with capital assets not exceeding GHS10million (US$5 million).

The rural nature of the study area led to the separation of the respondents into SMEs in agricultural and non-agricultural SME entrepreneurs. This dichotomy was deem appropriate as many studies in the area have left out the SMEs in the agricultural sector who are poor and face special operational challenges.. In terms of gender participation, women and men constituted 75 per cent and 25 per cent respectively. That is explained by the fact that generally, men consider several economic activities in the informal sector as women biased. In addition, men prefer selling their labour for wages and salary in other, to earn regular income instead of operating in the informal sector.

2. MICRO CREDIT IN GHANA: HISTORICAL PERSPECTIVE

Historically, microfinance is relatively a new financial concept.in Development literature it came to prominence in the 1970s. The 1980s became the turning point in the history of microfinance, when it became established that Microfinance Institutions could provide small loans and savings services profitably, on a large scale. Therefore, the term “microcredit” came to prominence in development practice.

According to official records, the genesis of micro savings and micro credit in Ghana, indicated that, in the 1930s, the colonial government introduced legislation for the formation of cooperative societies among rural farmers as a source of credit to peasant farmers in rural areas where poverty was prevalent. During that period, provision of Micro Finance Services by governments and donors in Ghana was mainly in the form of subsidised rural credit programmes which often resulted in high loan defaults, high loss and inability to reach poor rural households.

Coincidentally, during the same period, some White Fathers who were in the northern part of Ghana, where the incidence of poverty is very high, introduced the formation of credit unions (CUs) throughout the parishes where they were stationed. The effectiveness of CUs in addressing poverty in the parishes of the White Fathers led other churches and communities to set up village credit unions whose membership was open to entire communities. Since that period, credit unions have grown to over 400 unions in both urban and rural Ghana. The unions operated by, encouraging members to make micro savings which qualified them to apply for micro credit that attracted concessionary interest rate. Presently, credit unions provide micro credit for investment in SMEs to address poverty. In other words, that marked the beginning of CUs' financial assistance to several micro investors (SMEs) and support for low income households in Ghana. Also, there are some informal credit institutions that support SMEs such as "susu" clubs, Rotating Savings and Credit Associations (RosCAS), Accumulating Savings and Credit Associations (ASCAs), and moneylenders.

3. PUBLIC POLICY INTERVENTIONS MICRO CREDIT PROVISION

Recently, in an effort to address poverty especially in rural Ghana, the government introduced legislative instruments offering support for microfinance. A law was introduced in 1991, Act 328, that introduced Non-Banking Financial Institutions (NBFIs) including Savings companies, Savings and Loan companies, Mutual Fund Companies, Venture Capital just to mention a few.

Generally, NBFI own only five per cent of the total assets in the financial sector. That raises questions of adequacy of funds for those institutions, to achieve their goal of helping low income households and supporting SMEs. Again, how could these deposit oriented MFIs promote assets creation for SMEs? Basically, how could MFIs and SMEs that have different operational goals be mutually supportive? These were some of the issues examined, in the study. Also, the procedure for accessing credit by SMEs was examined. Again, the subsectors for credit investment by SMEs, was analysed. Lastly the study examined the SME revenue generation and credit repayment.

4. CONTRIBUTION OF INTERNATIONAL DONORS IN MICRO CREDIT AVAILABILITY

Several Donors have provided funds for micro credit to SMEs and low income households, The Donors and non-profit making organizations started operating those programmes in 2003 when Ghana introduced a Poverty Reduction Strategy (GPRS). Donors including ILO, IFAD, DANIDA, CIDA, FAO, USAID, GIZ, UNDP, and JICA just to mention a few, supported the effort. Some of the poverty reduction programmers supported through Donor funding included Enhancing Opportunities for Women in Development (ENOWID), Strategy for Strengthening Community Management Programme- that is, Small Credit input supply marketing project (SCIMP), Centre for Action and Development (CAD), Community Life improvement Programme (CLIP). Some Non-Profit Organizations that have emerged on the scene are “Sinapi Aba” Trust, Care International, and Catholic Relief services (CRS), and others.

Notwithstanding, the support from government, donors and informal organizations funds are not adequate for SMEs and low-income households. That was the result of the conditions that were laid down for beneficiaries to fulfill. The MFIS demanded that beneficiaries ought to apply directly to the creditors, attach investment proposals to the applications and demonstration of up to date credit worthiness and accounts of the firm. When those conditions were strictly applied, potential beneficiaries were disadvantaged due to the nature of their business operation. Commenting on those requirements, a National newspaper in Ghana wrote that SMEs in Ghana cannot provide that information to enable them apply for the advertised support because they operate in the informal sector where such documents are not kept.

5. CHALLENGES FACED BY SMES IN AGRICULTURAL SECTOR IN ACCESSING CREDIT FACILITIES

SMEs in agricultural sector face peculiar challenges in accessing credit facilities have observed that, lack of bank accounts, collaterals, and information regarding the procedure for accessing credits from micro financial institution limit small scale farmers from accessing loans. The complex mechanism of commercial banking is least understood by the small scale farmers and thus limits their access. It is argued that financial lending institutions in developing countries often shy away from giving loans to farmers because of the high cost of administering such loans and perceived high default rates among farmers.

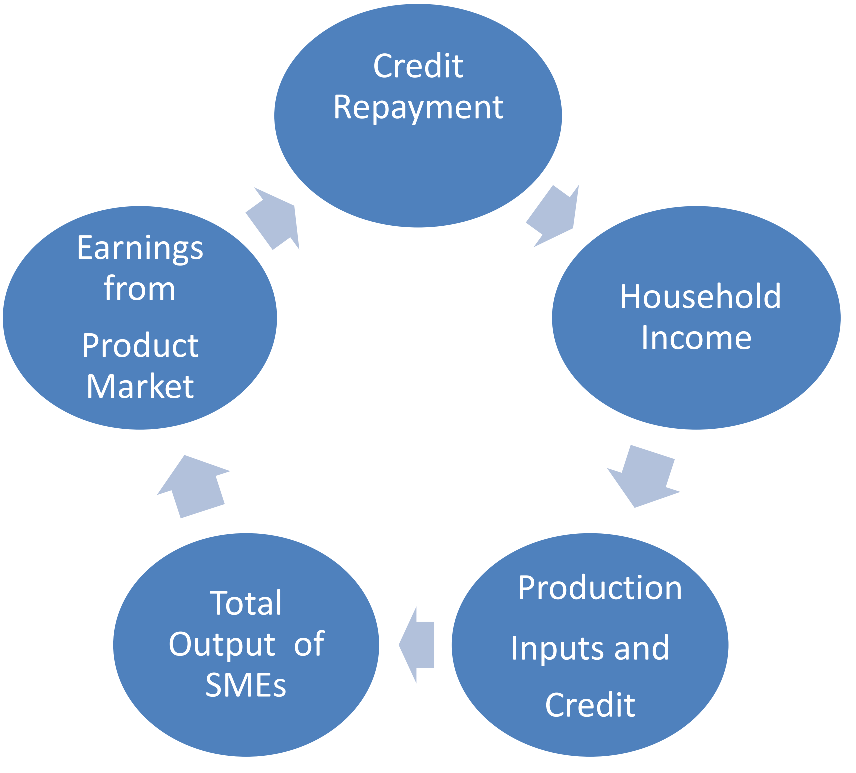
6. CONCEPTUAL FRAMEWORK FOR ANALYSIS: SME CREDIT TRAP

The discussions on the study were centred on a conceptual framework which was designed in a form of a cycle with five stages as presented in Figure 5. The five stages of the cycle include:

i. Production and Credit.
ii. Total Output from SMEs.
iii. Earnings from Product Market
iv. Credit Repayment by SMEs
v. SME Earnings and Household Income.

The development of the framework was to distinguish the stages SMEs go through and the various challenges the face at every stage and their effects on SME activities. It was based on basic economic postulation that, an entrepreneur must have a vision for the business and make decisions on; inputs for production, type of technology, productivity of inputs, output from production, market for output and, earnings from sales, profit and effects on income..

Figure-1. SME Micro Credit Trap



Source: Author's construct

7. ANALYSIS AND DISCUSSIONS

For production, an entrepreneur requires financial resources to set up a business unit, operate and maintain it. The financial resources are required for purchasing fixed assets including land, equipment, sheds and so on. Again, the entrepreneur spends on variables inputs such labour, materials and auxiliary factors of production such as water and energy.

8. PRODUCTION PROCESS IN INFORMAL SECTOR

Although every entrepreneur requires financial resources for operation, SME entrepreneurs face many challenges in that direction. Those challenges make it difficult for SMEs entrepreneurs to set up business unit and operate them successfully.

In terms, of acquisition of inputs, SMEs face serious challenges in acquiring land which is a major input for operation. In urban areas, there is a severe competition for land which is used for construction of buildings, shelters for economic activities. This has led to intensive use of urban space especially in the Central Business District. (Kessey and Felix, 2013).Consequently, there is overcrowding in urban areas, high land rent and illegal economic activities at places not meant for them, in that case SME entrepreneurs are worst offenders because of their peculiar situation.

Again, some socio- cultural practices and institutions in Ghana affect SMEs negatively in land acquisition. For example, Akan tradition indicates that land is not sold to whoever needs it for any purpose. It is either rented out or leased to the potential occupant, after 'drinks' have been offered to the landowner. Similarly, in some parts in Northern Ghana, females are not permitted to own land, the culture has it that males have title to land and give them out to females who are siblings or wives. This submission on land inhibition portrays the extent to which SMEs with limited capital could acquire sizeable pieces of land for operation either in urban or rural areas. The high rent on land has put off some potential SME investors in pursuing their vision, especially in the agricultural sector. SMEs in agriculture and agri-business in rural areas face challenges in labour engagement, which stems from the out migration of young men and women to urban areas in search of jobs. That has depleted labour force in rural areas of Ghana. The low supply of labour to SMEs has increased the wage rate for labour areas where they are available.

With reference to other inputs such machinery for SME operations, the weak financial base of SMEs prevents them to acquire modern machinery. For that matter, many SMEs operate with rudimentary equipment, with low productivity. Many do not have investment in other fixed assets including buildings or sheds. Consequently, several SME entrepreneurs operate in their homes (Afrane and Ahiable, 2011), while others operate in sheds built by Local Authorities and rented out to the SMEs, other operate in open area spaces and walk ways at the mercy of the weather. At the end of a day's operation some SMEs keep their movable materials to lockable stores and pay monthly rent to their owners. Those who cannot afford the rent cover their equipment and ware with polythene sheets, tie them up and leave them in the open.

In terms of ownership, SME entrepreneurs operate their businesses as sole proprietors, with their household members as major source of labour. Others use apprentice system as source of labour but that is only a temporal solution as the apprentices pass out and leave to establish their businesses as master/mistress crafts persons. These points to the fact that entrepreneurs in both agricultural and non-agricultural businesses require sizable amount of money to enable them acquire basic inputs to operate as beginners or maintain existing businesses. How could these SMEs acquire the relevant financial resources for operation? This is a serious challenge which compels SMEs to borrow from the micro credit market.

9. SME ENTREPRENEURS IN THE MICRO CREDIT MARKET

To address their financial challenges, SMEs, mobilize financial resources from informal and formal money market. The study showed that for start-up capital, 68 per cent of entrepreneurs generated funds from informal sector such as own savings; combination of own savings and savings from other household members as well as loans from local money lenders who charge very high interest rate. The inadequacy of financial resources from the informal source, has led SME entrepreneurs to the formal money market where they borrow from Micro Finance Institution and organisations.

In the formal money market, SMEs' success is influenced by fund availability and accessibility. Availability of funds depends on the amount of money the institutions have earmarked for credit provision to potential beneficiaries. Although, micro credit is available in Ghana, accessibility of SMEs to credit is major challenge. SMEs in agricultural sector face peculiar challenges in accessing credit due to the risky nature of investment in that sector. For example, official record in Ghana indicates that in 1983 rural banks in Ghana recovered only five per cent of the total loans disbursed to farmers due to prolonged drought. Similarly, many SMEs are unable to meet the requirements laid down for credit acquisition.

The study revealed the 80 per cent of SMEs received credit from formal private micro credit institutions as against 20 per who receive credit from government sub vented institutions and Donor programmes as Table1 indicates.

Table- 1. Sources of Micro Credit and Beneficiary

Sources of Funds for Micro Credit.	**Beneficiary(Per cent)**
Private Non-Profit Making Micro Credit Institutions	9.3
Private Micro Finance Company	
Government of Ghana Agency	70.8
	1.2
Donor Support Programmes	
	18.7
-Total	100.

Source: Field Study.

The study examined the interest rate on various credit borrowed by SMEs. Interest rates paid on credit have median interest rate of 3per cent per month and median of 34 per cent per annum. That interest rate is higher than the rate charged by Rural Bank in Ghana. However, the institutions are supposed to be supporting low income SMEs, in the informal sector.

Table-2. Total Credits Disbursed and Interest Rate.

Agency	**Interest rate per month (%)**	**Interest rate per year (%)**
Private Non Profit Organizations	5	60
Private Micro Finance Company.	4	48
Government Sub vented Agency	1.6	20
Donor Support Agency	2	24

Source: Field Study

The Private Non-Profit Organization and Micro Finance Companies charge higher interest rates of 60 per cent per annum while Government Sub vented Agencies and Donor Support Programmes charge maximum of 24 per cent per annum. Public institutions and Donor Agency charge lower interest rates due to the fact that part of their administrative cost, such as wages and salaries, is covered by government subvention. Again, they were established with public funds to support SMEs and low income households in the informal sector under specific instructions for operation. .

On their part, Private Non-Profit Organizations and Micro Finance Companies claim that they do not operate to make profit they as high as 60 per cent per annum. Despite that those institutions charge higher interest rates, many SMEs take credit from the form reasons of fund availability, accessibility, reliability and certainty as those factors make borrowing from the private sector favourable to SMEs The implication is that SMEs take expensive credit from the private micro finance institutions, which might not be obvious to them. For example, payment of interest on monthly basis conceals the financial burden the SMEs are made to bear for credit servicing. In the long run the private micro finance companies generate high accumulated surplus from their clienteles, for reason of high interest payment that has made it possible for some Micro Finance Companies to amass adequate base capital to enable them change their status to Savings Companies or Savings and Loans Companies.

As are result of future repayment of credit raised, the study investigated into the subsectors of investment as growth of investment is influenced to a large extent by the subsector where the investment was directed. The analysis of the subsectors for SME investment is presented in Table 3.

10. INVESTMENTS OF CREDIT IN SUBSECTORS

The study revealed that 54 per cent of the credit raised is invested in already existing businesses, 23 per cent is invested as start-up capital, and 15 per cent of credit is used for household support and about 8 percent spent on personal needs of SME entrepreneurs. The implication of that revelation is that about 23 per cent of the acquired credit is spent on household activities instead of economic activities.

The study indicates that SME investment is highly skewed towards trading activities which is a reflection of the macro economy of Ghana. Official statistics indicate that growth rate of different sectors of Ghana’s economy (2005-2012) are agriculture 3.4 per cent, manufacturing 2.3 per cent (industry, 6.1 per cent including oil and petroleum) and service sector 7.2 percent (wholesale and retail 7.3 per cent). It would be observed that that official statistics indicate that the service sector is the fastest growing sector with particular emphasis on wholesale and retail sub sectors.

Table- 3. Credit and Investment Sectors of Informal Economy

Sector	**Male**	**Female**	**Mean**
Manufacturing	8	7	7.5
Services	12	17	14.5
Trading	60	68	64
Agro-Business	20	8	14
Total	100	100	100

Source: Field Survey.

Obviously, high turnover of service sector makes investment of credit in that sector a preferable. Also, the preference for trading at the expense of productive activities such as manufacturing and agro- business is influenced by the fact that many investors consider growth of those areas of investment. Generally, the present structure of investment leads to unemployment, by virtue of the fact that service sector has low labour absorptive capacity hence, unemployment in the general economy. This is supported by a situation where about 66 per cent of employable youth are unemployed in Ghana. This section has discussed SME operation, the credit market and subsector distribution of credit in economic activities. That was linked to sale of SMEs output in the product market.

11. SMES IN PRODUCT MARKET

Basically, after production the SMEs have to take their goods for sale the market. Often, total output from SMEs for sale at the taken to market is small in quantity. For that reason, SMEs face some economic challenges as they are ‘price takers’ on the market. This implies that environment in the market dictates the price in the market. The situation suggests that SMEs can only increase their earnings from if the increase their output. However, as SMEs that is impossible in the short sun and in some case in the long run. This submission is bases on the fact that SMEs have to improve their operations with respect to raising adequate financial resources for expansion of capital, base, purchase of sufficient input, improvement of technology, quality of products and attractive packaging of goods. In sum, with SMEs current system of operation, they are noncompetitive and disadvantaged on the market. The conclusion is that, given the present situation, SMEs in Ghana would not be in the position to generate much revenue from the market. Again, the quality and packaging of some SME products place them out of the export market.

12. SMES SALES AND REVENUE GENERATION

According to the challenges SMEs face in production and marketing of products, thy hardly earn enough revenue to operate their businesses, since the explicit cost of production is high and revenue from sales is low the investors have to work extra hard to avoid collapse of their businesses. Analysis of SMEs earnings shows that they are small.

Table- 4. SME Earnings Before and After Credit Application per month

Income Range	Before	After
GHC50-GHC100	77	42
GHC101-GHC250	18	48
GHC251- GHC300and above	5	10
Total	100	100

Source: Field Survey

The earnings were grouped into three namely low earnings (GHC50-GHC100) per month, medium earnings (GHC101-GHC250} per month and high earnings (GHC251- GHC300and above). per month. The study applied the before and after analytical tool for assessment. The results as presented in Table 4 indicate that before application of credit 77 per cent of the respondents were in the low earnings bracket, 18 per cent in the medium earnings bracket and 5 per cent in the high earning bracket. However, after application of credit, the low earners reduced by 35 percentage points, the medium and high level earners increased by 30 percentage and 5 percentage points respectively. All things being equal, one could conclude that credit has positive effect on earnings of the borrowers. A critical issue is how repayment of credit affects earnings of SMEs entrepreneurs.

13. EARNINGS AND CREDIT REPAYMENT

The analysis of earnings from SME operations showed that median, earning of several SMEs is GHS 103 (US$5150) per month or GHS1, 236 (US$ 618) per year. That earning is low by all standards. Notwithstanding the low earnings, SME have to repay borrowed capital with interest rate of 3 per cent per month or 34 per cent per annum. That depressed the earnings of SMEs. That situation was measured by the state of default among SMEs entrepreneurs the study showed that among entrepreneurs who repaid credit on monthly basis there was a default rate of 2.8 per cent. While the entrepreneurs who repay credit on yearly basis had a default rate of 6.5 per cent. Those rates of default affected the financial institutions negatively; which has compelled them to tighten the processes of credit acquisition, though their goal is to assist the poor. This analysis has showed that SMEs entrepreneurs generate earnings which are not adequate to raise their household incomes to take them out of poverty .The cycle indicates that given the environment in which SMEs operate then after going through the credit cycle they would have to go back to the Micro Credit Institutions to borrow for survival This implies that if a breakthrough is not introduced along the cycle the SMEs would continue to depend on Micro credit to for survival if they have to remain in business and the cycle continues.

14. KEY FINDINGS

This study focused on SME activities in the informal sector and the effect of Micro Credit on those businesses .Some main observations that emerged from the study were that; SMEs are involved in 90 per cent of the economic activities in Ghana. This implies that SMEs contribute significantly to the economy of Ghana.

With respect to land as an input for economic activities SME entrepreneurs face peculiar challenges introduced from financial and socio cultural angles. That affects mainly women involved in agriculture Inadequacy of funds from informal money sector to establish and operate SME businesses has compelled them to raise credit from the formal Micro Finance Sector where they borrow at interest rates of 3 per cent and 34 per cent per month and per annum respectively.

Formal credit for SME entrepreneurs come from both private and public sectors. About 77per cent of micro credit is invested in manufacturing sector, While 23 percent of credit secured by SME entrepreneurs is spent on social activities.

Basically, SME activities are dominated by women who constitute 75 per cent of total entrepreneurs, therefore any support that goes into SMEs operations are indirectly for women, who are bread winners in many low income households.

In the market, SMEs are disadvantaged anywhere they sell their goods as they are 'price takers,' by virtue of the fact that their output is small. Therefore they are not competitive on the market in terms of quantity and quality of the products they put on sale. Consequently, the revenue they generate is low. Low income among SMEs has raised the default rate among Micro Credit beneficiaries.

The study indicated that, application of credit to SME operations, reduced the low earners by 35 percentage points, the medium and high level earners increased by 30 percentage and 5 percentage points respectively. All things being equal, one could conclude that credit has positive effect on earnings of the borrowers.

The study showed that earnings from SME operations gave median, value of GHS 103 (US$51.50) per month for several SMEs and GHS1,236 (US$ 618) per year, for few of them. Those earnings are low by all standards. Nevertheless SMEs have to repay borrowed funds with interest rate of 3 per cent per month or 34 per cent per annum. That depressed the earnings of SMEs further. Those income levels affected Micro Credit repayment. The study indicated that among the SME entrepreneurs who repaid credit on monthly basis there was a default rate of 2.8 per cent while those who repay annually had default rate of 6.5 per cent.

15. RECOMMENDATIONS

Although, the government of Ghana has formulated legislation and policies to promote SMEs the interest charged by, Non-Banking Financial Institutions (NBFI) operating in the informal sector should be regulated to reduce the financial burdens they put on SMEs.

The Bank of Ghana should critically examine the financial records of any Non-profit organization that applies for certificate to its status to Savings Companies or Savings and Loans Company with the view to examining their sources of capital.

Again, activities of MFIs should be monitored by Bank of Ghana, to assess their profit portfolio, its management and application of profit. If their profits are not recycled in the informal sector then interest rate should be charged on MFI profit for direct reinvest in the informal sector through trade associations in that sector. It was observed that SMEs do not have adequate fixed assets and utilities for operation. For that matter, the environment within which SMEs operate should be improved by public and private agencies that operate among there. For that to be effective SMEs should be supported in kind but not in cash as the study has shown that 23 per cent of credit goes into social expenses. SMEs should be trained to improve the quantity and quality of their products to make them accessible to the International market.

SMEs should be encouraged to open savings accounts. That would permit them to receive statement of account from banks. They could use the statements as collateral for credit acquisition. That would make banks provide some financial documentation for SMEs.

16. CONCLUSION

By virtue of low earnings, SMEs find it difficult if not impossible to extricate themselves from financial handicap associated with their businesses. That has made them overdependent on Micro Finance Institutions notwithstanding the high interest rate they charge.

Some Micro Finance Institutions that were established to support SMEs and low income households in the informal sector have eventually increased their capital base and have eventually changed their status. Once the change the status, they operate in urban areas as financial companies to increase their profits or margins.

In sum, Micro Finance Companies and Institutions are the main source of formal credit for SMEs in Ghana. However, Micro Finance Companies/Institutions have denied SMEs other products that Micro Finance companies provide, such as business adversary product and social products. Also, the amount of savings SMEs have to make to qualify for credit is large. Similarly, number of months clients have to save in order to qualify for loan is quite long, so MFIs should review them in the interest of low income customers.

As government is interested in promoting SMEs in informal sector, control of Micro credit provision by MFIs in that sector should be revisited to prevent them from milking the SMEs dry. Again, it has to be appreciated that apart from financial challenges, SMEs face other challenges such as inconvenient working environment, low functional education for effective business management, inappropriate technology and labour intensive nature of their operations just to mention a few. Therefore, the need for a holistic national policy on the

informal sector and, micro finance to address its multi-faceted challenges cannot be overemphasized.

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