





Small enterprises and banking in rural Ghana: Evidence from owners

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ARTICLE INFO

Article history:

Received 12 March 20

Received in revised form 15 April 20

Accepted 22 April 20

Keywords:

Small enterprises; Financing; Rural banking; Rural Ghana

JEL Classification:

G20, N87, R51

ABSTRACT

This study aim is to explore owners of small enterprises' appreciation of bank's role in developing their businesses and the challenges that come along in accessing banking services in the context of Sefwi-Bekwai which is a rural community. Questionnaires were used to solicit information from the owners while descriptive statistics aided the data analysis. The study found that the main source of start-up capital is the owner's funds while saving was recorded as the key benefit of banking. It further revealed that the high-interest rate charged was a barrier in accessing loans and the effect of bank relations was sound financial management for the SME's operations. The paper suggests the need for small enterprise owners in the rural communities to form an association for their benefit in terms of taking advantage of group lending and demanding support and relief from relevant authorities. Improved institutional support would also give small enterprises better access to the information they need for financing and growth.

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Introduction

Small enterprises are a key driver of economic growth in rural Ghana and their development and growth have a bearing on bank's support for their businesses.

There have been a lot of studies on the importance of the development of small and medium enterprises across the globe. The significance of the rural economies to any country's gross domestic product cannot be ignored. There is the need for re-appraisal of the rural economy in Ghana by policymakers and implementers to resource it to avoid excessive rural-urban migration as their inputs in those areas keeps the country running and the need to make life comfortable for them to reduce the big parity between urban and the rural settings. One of the steps to address this situation was the motivation for this study to explore owners of small enterprises appreciation of rural banking on their businesses where many studies have not been done.

In this study, it is aimed to explore owners of small enterprises appreciation on bank's role in developing their businesses and the challenges that come along in accessing banking services in the context of Sefwi-Bekwai which is a rural community. In the methodology of this paper, a field research using questionnaires was used to solicit information from the owners while descriptive statistics aided the data analysis.

The reminder of this study is organized as follows. The next section provides a review of extant literature. The third section introduces methodology and data. Finally, conclusions and implications of the study are presented in the final section.

Literature Review

Rural economy and rural employment mainly hinge on agriculture as the prime sector as 74.9% of the households in this study area is engaged in agriculture. The growth for such economy is dependent among other things is the role and establishment of small and medium-sized enterprises. Ayanda and Laraba (2011) pointed out that small businesses are important engines for the development of rural economies and communities of the world. It has to be said that small enterprises help to meet the basic needs of the community

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with the delivering of goods and services to its inhabitants. Butler (2006) indicated that enterprise is the term that is generally applied to small or medium-sized business.

Nickels, McHugh and McHugh (2019) explained a business as any activity that seeks to provide goods and services to others while operating at a profit. It could be said that wherever there is a human settlement there is the need for some form of business activity to fill a market need of the community's. International Trade Center (2016) reported that small and medium-sized enterprises are the backbone of the Ghanaian economy as they represent about 85% of businesses, largely within the private sector, and contribute about 70% of Ghana's gross domestic product (GDP). In terms of formal sector employment, they account for just over half of all full-time employees, with the percentage likely much higher in the informal sector.

Adusei (2019) stated that access to finance is a key determinant for business start-up, development and growth for small businesses. Butler (2006) affirmed that very few start-up businesses have the luxury of not needing some form of finance, if not the outset of trading, then later as the business starts to expand and grow. Abor and Biekpe (2009) noted that small businesses restricted access to a bank credit may not be directly attributed to their size, but rather information asymmetry. Parker (2004) stated that most start-up finance in developed countries tends to be personal equity (self-finance). IFC (2010) in a study in Cambodia affirmed that entrepreneurs are unable or discouraged from taking out loans due to high collateral requirements, high-interest rates, and delays in processing loans. Locke and Boulanaour (2009) indicated that some of a bank's services include basic products and services that are offered, transactions charges for account services, interest rates and loans.

Rural and community banks in Ghana are the largest providers of formal financial services in rural areas and represent about half of the total banking outlets in Ghana (IFAD, 2008). Nair and Fissaha (2010) stated that rural and community banks are relatively small financial institutions with an average share capital of GH¢136,526 (US\$105, 263), average deposits of GH¢2.3 million (US\$1.77 million), average assets of GH¢3.8 million (US\$2.4 million). Values of the three indicators, however, vary significantly among the individual rural and community banks. Products and services of the rural and community banks are savings, credit, money transfer and payments. Savings products include savings accounts, current accounts, "susu" deposits and fixed deposits. Credit products include microfinance loans, personal loans, salary loans, "susu" loans and overdraft facilities. Money transfer and payments through Western Union, Money Gram and Vigo while government agencies use the rural and community banks service outlets for salary and pension deposits. Prager and Wolken (2008) indicated that community banks in the United States through their prominent role of providing loans and other financial services to small businesses within their local communities has been particularly noteworthy in the United States economy.

Yoshin, Taghizadeh-Hasary, Charoensivakom and Niranla (2016) asserted that small and medium-sized enterprises play a significant role in the Thai economy and it is important to increase their resilience to provide them with stable finance. Ritchie, Komo and Ngugi (2013) affirmed that small businesses encounter many obstacles that prohibit their growth and even threaten their survival. ADB (2014) affirmed that the lack of collateral is a critical barrier for Thai SME's in raising business funds. Yoshino (2013) stated that new start-up enterprises face increased difficulty in obtaining credit due to a lack of credit history leading to them being perceived as high risk by banks for finance. International Trade Centre (2018) stressed that many SME's reported finance as their biggest constraint to growth, due to high-interest rates, large collateral requirements and a burdensome application process. It further indicated that SME's in Africa face a large financing gap, estimated at more than \$136 billion annually. Unfavourable business environments, inadequate access to finance and high levels of informality are constraining factors affecting the contribution of small enterprises to sustainable development as indicated by the International Trade Centre (2019). IFC (2010) stressed that within the context of Cambodia majority of small and medium enterprises preferred the banks to offer small and medium enterprises information and education through training, advisory and consultancy to successfully build their confidence in accessing finance to improve their businesses.

Research and Methodology

Study Area

The rural community was felt to be important in assessing owners of small enterprises in their appreciation of rural banking to their businesses hence conducted the study at Sefwi-Bekwai a suburb in the Sefwi Bibiani-Anhwiaso-Bekwai Municipal in the Western North Region of Ghana. The population of the Municipality is 123,272 representing 5.2% of the region's total population. Males constitute 49.4% and females represent 50.6%. In terms of economic activity status, 72.4% of the population is economically active while 27.6% are economically not active. Of the employed population, about 62.8% are engaged as skilled agricultural, forestry and fishery workers, 12.2% as service and sales workers, 9.5% in craft and related trade, and 5.4% are engaged as plant and machine operators and assemblers. Of the population about 66.5% are self-employed and it is a predominantly agriculture area with 74.9% of households are engaged in agricultural as recorded during the 2010 Population and Housing Census. (GSS, 2014)

Methodology

This study employed a quantitative approach using a descriptive cross-sectional survey design. Surveys are a primary method of conducting descriptive research since the typical who, when, where, what, and how questions can be asked of participants as pointed by Clow and James (2014). The design helped in identifying the small enterprises of Sefwi Bekwai. Sefwi Bekwai has a population

of 29,748. The target population for the study was all the registered small enterprises within the central business of Sefwi Bekwai within Sefwi Bibiani-Anhwiaso-Bekwai Municipal. The sample size was thirty registered small enterprises which were purposively selected. The determination of the sample size was non-statistical; it was based on the availability of registered small enterprises and their readiness to be part of the study voluntarily. The result of this study is not to generalize due to the sample size but its insight and peculiarity will unearth issues which can be replicated in another deprived rural community for policy decisions.

Data were collected during the late afternoon of a market day. The owners of the small enterprises were interviewed using a structured questionnaire to solicit information from them. Though the questionnaire administration was self-administered the study adopted the face to face interactions with the small enterprise’s owners will filling the questionnaire to resolve any challenges on the question due to the characteristics of the small enterprise’s owners as not all of them are literate. The questionnaire had four sections: Section A collected socio-demographic data; section B contained start-up capital; section C contained benefits and effects of rural banking on small enterprises while section D on financing challenges faced by small enterprises owners. The entire questionnaire contained 20 items. The questionnaire used varied scales for its measurement included open-ended and closed-ended formats. Descriptive statistics were used to analyse the data such as frequencies and percentages.

The study observed the ethical consideration to a research by informing the small enterprises owners on the purpose for the study and were given sufficient time to think about it if they would want to be part of the study voluntarily. The small enterprises owners were assured of confidentiality and anonymity.

Results and Discussion

Demographic Characteristics

The study found that out of the thirty small businesses studied 60% had been in business between one and five years while 20% respectively for businesses operated for six to ten years and eleven years beyond. It could be said that the business experience of an owner of small enterprises comes along with how long the owner has been in business. The mean years of business experience among the small business enterprises owners were four years. It is assumed that owners doing the same thing over and over again could translate to competencies to manage the enterprise better. Businesses need workers to support achieve the mission statement of the business owner hence businesses employ people depending on the nature of the business operations. A dominant 60% employed between one and five workers, 30% of the sample small enterprises employed workers between six and ten while 10% of the sampled businesses employed eleven and more workers for its operations. It is of importance for small enterprises owners to be mindful of the number of workers to employ as it could have an impact on its profitability. The study inquired about the line of businesses of the owners and revealed that 20% for manufacturing, trading accounted for 45% while 35% for service. The various lines of businesses are an indication that the inhabitants of Sefwi Bekwai will not be denied the basic goods and services needed.

Source of Start-up capital

One of the driving forces to start any business is the ability of a person to translate his/her ideas commercially which can happen with financial backing to bring it in operation. The study was interested in how the sampled small businesses came into the business in terms of start-up capital.

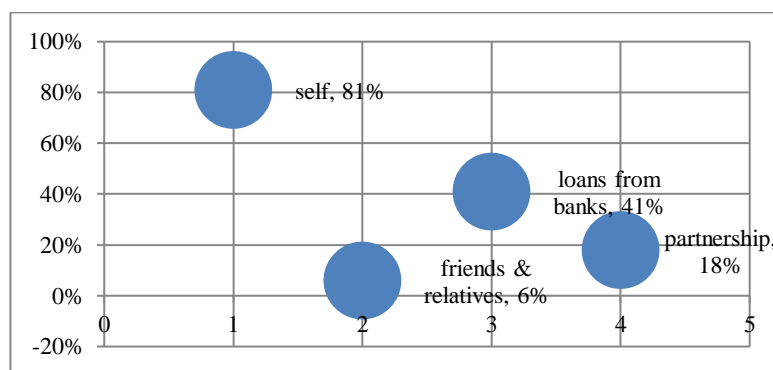


Fig.1: Source of Small Enterprises Start-up Capital

The self as indicated in Figure 1 mean that all the start-up capital came from the person’s income which was used to start the business with a consensus of 81%. The study revealed that 41% of the sampled SME’s indicated that the nature of their businesses demanded financial support that their income and savings cannot be adequate and hence utilized a bank loan as part of its start-up capital. In the rural setting, a lot of business owners are in business because of financial support from their relatives or friends as a potential and a good source of start-up capital. Out of the small businesses sampled 6% of them took advantage of this source. Some of the sampled businesses thought it wise to look for partners who can bring onboard the needed funds to establish a business which accounted for 18%. The result revealed the divergent views and appreciation of the owners in terms of risk and rewards in their source of start-up

capital irrespective of the size and nature of business. The results align with the thoughts of Parker (2004) and Butler (2006) stressing that most start-up capital is self-finance.

Benefits for Small Enterprises using Rural Bank services

It has to be said that locational proximity, knowing someone in a bank, a referral, cost of services and prior personal banking experience will influence the selection of bank for his personal or business operations. Benefits of all sorts abound for small businesses regardless of size or industry. The small enterprises’ owners, when asked about the benefits of using a bank’s services revealed that saving is a dominate issue of which 78% of the sampled businesses agreed with. Credit is critical to the working capital of a small business to push its operations to another level. A sizable majority of 72% saying that saving with a bank is good but if the bank will give the business credit could go a long way to build a business relationship.

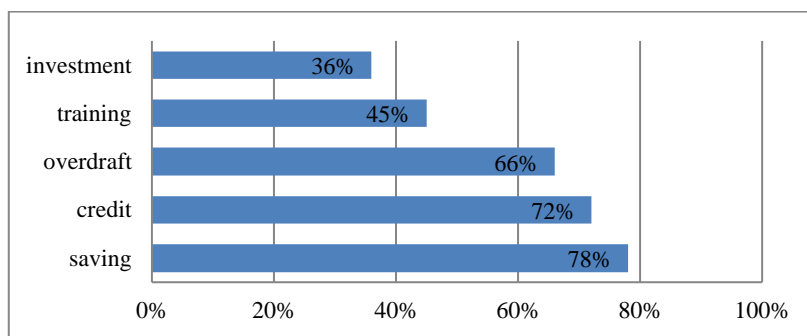


Fig. 2: Benefits for Small Enterprises using Rural Bank services

The training was seen as a way of how the bank’s staffs advise its small enterprises’ owners in the running of their business especially with their finances. Owners representing 45% indicated that it has helped them in their operations. Overdraft facility helps on the short-term financing needs of small enterprises. The small enterprises’ owners were of the view that access to overdraft facility was indeed a priority to them as 66% agreed to it that it is one of the benefits of having a relationship with a bank. Based on the responses by the owners on the benefits derived by utilising bank’s services revealed that their intentions to invest is relatively low with 36%. It has to be said that the services stated in Figure 2 are in line with Locke and Boulanaour (2009) stressing these and more in their study while Prager and Wolken (2008) affirmed the role of community banks in the United States through their financial services to small businesses within their local communities.

Effects of Rural Banks on Small Enterprises

Rural banking plays a major role in terms of intermediation for a rural community and especially the business community. The study was interested in exploring small businesses appreciation on the activities of rural banks and its effect on their business operations. The owners of the small enterprises were asked about their views of the effects of rural banking on their businesses on five thematic areas to indicate yes or no as shown in Figure 3. The owners generally considered that their relationship with the bank has enhanced and improve their ability to run their businesses with a consensus of 91%, even better 97% responded that it has brought about financial discipline and the management of their working capital.

The success of any business irrespective of the size and industry is dependent on the business knowledge of the owner and practices put in place to run the business. Eighty-two percent of the sampled small businesses indicated that indirectly the bank has helped to open to understanding the need to acquire knowledge on their businesses to improve the performance of their businesses thereby its profitability. A higher percentage of 94% of the sampled small enterprises stressed that in terms of funds in running their businesses either in the form of start-up capital or working capital there has been some form of capital enhancement for their businesses. When asked whether their expectations have been met in their dealing with the rural banks so far as their businesses are a concern. It was revealed that 59% were very positive in that their expectations have been met while 41% thought otherwise that their expectations are yet to be met. If the credit needs of a small enterprise are not met implies that it can affect the capital investment of that business which will not help the business to grow. Notwithstanding the diverse views of the sources of the benefits of banking to their businesses, the result supports IFAD (2008) confirming that rural banking is the largest providers of formal financial services in the rural communities. On the other hand, Adusei (2019) opined that the very reason for which banks gives credit facilities for start-ups and working capital is an indication that small businesses benefit from rural banking.

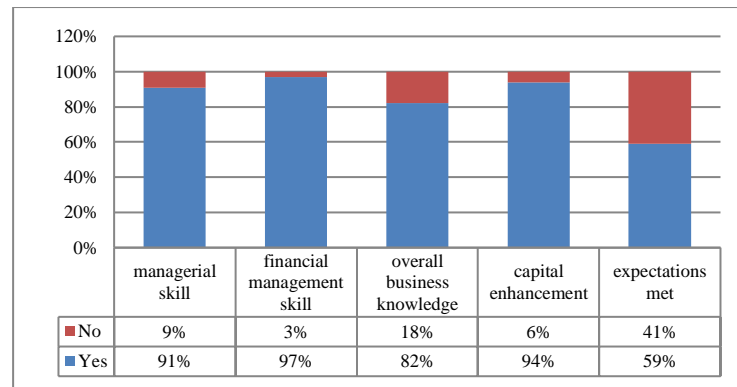


Fig. 3: Effect of Rural Banking on Small Enterprises

Certain transactions cannot be possible without banks and financial services providers. Indeed regardless of the type of business of the owner of small enterprise banks are going to play some role in business transactions be it a business paying its suppliers or debtors paying a business.

Financing challenges of small enterprises

Notwithstanding the contribution of small enterprises to the economies of many countries in terms of creation of jobs, payment of taxes among others still faced financing challenges which are a barrier to enterprises growth.

The study considered four themes associated with financing challenges faced by small enterprises in the study area. Over half of the small enterprises’ owners (52%) were of the view that demands for collateral by the banks are a barrier to access to credit. This is so as some of them do not have assets that they could offer as collateral whereas those who have some assets fall short of the collateral requirements by the banks. The result is similar to the studies of Abor and Biekpe (2009) noting information asymmetry is the issues rather than the size of the small business whiles ADB (2014) affirmed that the lack of collateral is a critical barrier for Thai SME’s in raising business funds.

A guarantor is a financial term describing an individual who promises to pay a borrower’s debt if the borrower defaults on his or her loan obligation. Guarantors pledge their assets as collateral against the loan. Getting a guarantor was a challenge as 68% of the small enterprises’ owners indicated as a loan requirement by some of the banks. Within the study area considering the implications as a guarantor, most of the potential guarantors are likely to be family members. Even as a family member you need to understand the commitment as once agree to guarantee a loan as you will be liable to pay the loan if the person fails to pay. Appreciation of the effect of interest rates on business is one of the keys to business survival.

The small enterprises’ owners indicated as shown in Figure 4 that high interest charged on loan is the greatest challenge in accessing credit with 89% consensus. High-interest rates imply that banks will charge a bit more for business loans meaning that a business has to use more of its earnings to service the loan thereby decreasing profits. On the other hand when interest rates are low meaning businesses can borrow more for growth and expansion as the cost of borrowing will be a bit lower. The result supports the view of Yoshino (2013) was of the view that due to lack of credit history start-up enterprises cost of borrowing is high. Moreover, the International Trade Centre (2018) stressing that the high-interest rate by the banks does not help the growth of small businesses.

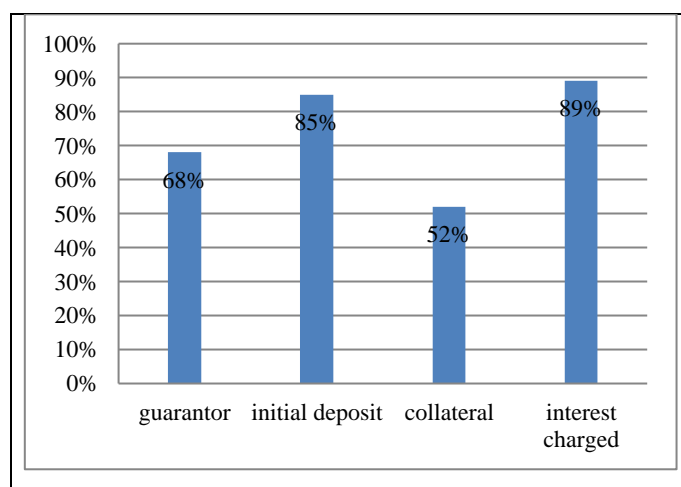


Fig. 4: Financing challenges of small enterprises

A significant majority of 85% were of the view that the higher initial deposit demanded by the banks for a business loan discourages them to access bank loans. The initial deposit refers to an amount of money to be kept in once account to serve as a security or collateral for a loan in the context of this study. The banks have a case here since more deposits can lead to more loans as this will increase the bank's lending capacity while to the small enterprise owner a huge drain on the start-up or the working capital depending on the percentage of the loan to be kept in the account of the potential borrower that is the owner. Ritchie et. al., (2013) affirmed that small businesses encounter many obstacles that prohibit their growth and even threaten their survival. Unfavorable business environments, inadequate access to finance and high levels of informality are constraining factors affecting the contribution of small enterprises to sustainable development as indicated by International Trade Centre (2019).

Conclusions

The rural economy is critical in the lives of the inhabitants in their everyday activities. It is of essence that businesses must exist in the suburb to meet their basic needs. It is fundamental to state that successful businesses have the potential to enhance rural community development through activities such as manufacturing and commerce to meet inhabitant needs. Its ripple effect is that it will lead to spending with a possibility of people paying tax which will help develop the community. It is refreshing to state that small enterprises have the potential to foster economic growth, helps builds social stability and contributes to social development.

The study suggests that trading is a prominent business line among the sampled businesses. Indeed a significant majority of them has been in business for at least four years and have a workforce of one to five. The study concluded that under the sources of start-up capital small enterprises owners adopted the ranking of sources of finance by adopting the pecking order theory considering the cost and control reasons why they will prefer internal finance before considering external finance in entrepreneurial finance with more than one-fourth of the sampled small enterprises confirming using internal finance. It was evident that access to credit was a prominent factor why small enterprises make use of banking services for both start-ups capital and working capital whereas sizable majority also confirming savings drives them to used banking services. The study concludes that the small enterprises' owners affirmed that the bank's effect on their operations has enhanced and improved their ability to run their businesses better and has brought about financial discipline on the management of their working capital.

The paper suggests the need for small enterprises owners in the rural communities to form an association for their benefit in terms of taking advantage of group lending and demanding support and reliefs from relevant authorities as financial needs of small businesses are diverse and context-specific. Improved institutional support would also give small enterprises better access to the information they need for financing and growth. The need for small enterprises to have an operational business plan as a footprint is imperative. Furthermore, owners of small enterprises must put their house to be attracted to potential investors and possibly help alleviate local investors concerns.

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