IMPACT OF INTERNAL AND EXTERNAL FACTORS ON SMALL AND MEDIUM SCALE ENTERPRISES’ ACCESS TO FINANCE IN GHANA

by

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ABSTRACT

The economy of Ghana has grown at an average GDP per capita of 5.5% in the last twenty years. The African Development Bank reports that private businesses contribute about 22% and 44% of Ghana’s real gross domestic product and gross national income, respectively. In spite of their contribution to economic growth, private businesses (dominantly comprising small and medium scale enterprises) face the challenges of access and cost to credit (especially from banks). Recent government policy documents like the Private Sector Development Strategy and Ghana Poverty Reduction Strategy have sought in one way or the other to mitigate the challenge of access and cost of credit faced by small and medium enterprises (SMEs). In another vein, increase in incomes following improving economic conditions, has resulted in an increase in the general demand for goods and services. Comprising a greater percentage of businesses in Ghana, SMEs are taking advantage of the growing domestic market to expand their scale of operations or output in order to meet the needs of the market while increasing profitability. To finance the expansion, most SMEs turn to banks for loans. This dissertation deals with SMEs’ access to finance by looking at the impact of monetary policy and money market variables, banking industry and bank-specific factors as well as SME-specific factors.

Chiefly, analysis in this research is underpinned by the credit channel of monetary transmission mechanism. Theory of financial intermediation, structure-conduct-performance (SCP) paradigm and the financial restraint model are also employed in the analyses.

Pertaining to the impact of monetary policy on cost of credit (lending rate), multiple regression, granger causality and vector error correction models are used to analyse monthly data of monetary policy and money market variables. The period of analysis spans 10 years.
(i.e. 2002 to 2011). This period covers 5 years before and after the official adoption of inflation targeting in Ghana. The results show that apart from inflation, all other explanatory variables are statistically significant at 1%. The past values of monetary policy rate and Treasury bill rate were found to be better predictors of changes in the base lending interest rate. Additionally, although crowding-out by the government cannot be denied, its severity may have been overdramatized in previous research. Furthermore, it was estimated that it takes about 3 months for the lending rate to fully adjust to shocks from explanatory variables. Using concentration ratios and Herfindahl-Hirschman Index (HHI), banks were found to be moderately concentrated. The banking industry is one of monopolistic competition and banks are scale inefficient. Under the SCP paradigm, the results suggest that high lending interest rate may be as a result of collusion among the few large banks that dominate the industry. Suboptimal use of scale may stem from congested banking infrastructure in urban areas.

Primary data from 10 out of 27 licensed banks and 340 SMEs were collected using questionnaires. The data was primarily analysed using descriptive statistics such as percentage, mean, cross tabulation and mode while results were displayed using pie charts, bar graphs and scatter plots. Principally, analysis of the survey involving banks yielded the detailed definition of an ideal SME client and terms of loan agreement from the banker’s perspective. It was found that banks prefer the use of movable assets to immovable assets as collateral. Also, relationship banking does not help in procuring loans at lower interest rates although it speeds up the application process and lengthens the maturity period.

It is recommended that the government reduce its borrowing from the money market and use moral suasion to encourage banks to reduce interbank lending interest rates. Hellmann et al (1997)’s use of deposit rate control and protection of first-mover into current geographically excluded areas are also recommended as a means of encouraging deposit mobilization and outreach of financial services by banks.