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Micro-Loans and Micro Enterprises in Ghana: Players, Roles and Challenges

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Abstract

The role of micro-enterprises in developing countries cannot be under-estimated. Access to finance is critical to the growth of micro-enterprises. Contrary to the past, financial institutions in Ghana are now embracing the idea of financing micro-enterprises. The study examines the forms of financial institutions involved in the provision of micro-loans, the role of micro-loans in the micro-enterprises, and the challenges micro-enterprises face in accessing micro-loans. The simple random sampling technique was employed to collect data from 400 micro-enterprises. The study reveals that both mainstream universal banks and microfinance institutions are involved in the provision of micro loans to micro-enterprises. Also, micro-loans have impacted positively on the micro-enterprises in the study. Finally, high interest rates, provision of collateral, requirement to save regularly and short repayment period are the major challenges micro-enterprises face in accessing micro-loans in Ghana.

Keywords: Ghana, micro-loans, micro enterprises, role, challenges

1. Introduction

In recent times, Ghana has emerged as one of the leading countries in Sub-Saharan Africa that is on course to achieve the Millennium Development Goals before the 2015 deadline. The overall poverty level in Ghana reduced from 56 percent in 1992 to 28 percent in 2006 (World Bank, 2006). Studies on industrial development of different countries have shown that micro-enterprises constitute an integral part of the over-all industrial sector and play an active and significant role in the growth and development of these countries. It is believed that small firms can more easily trigger growth in the economy than the large ones due to their numbers and the niches they occupy in the national economy (Bussel, 2001). These enterprises contribute significantly to employment generation and output growth of different countries of which Ghana is not an exception. A World Bank study found that about 90% of small enterprises surveyed stated that credit was a major constraint to new investment (Parker et al., 1995). Access to financial services by self-employed persons in small and micro-enterprises is normally seen as one of the constraints limiting their benefits from credit facilities. However, in most cases the access problem is one created by the institutions mainly through their lending policies (Schmidt and Kropp, 1987). Recently banks and other financial institutions have sought to broaden their loan portfolio, making micro enterprises an attractive customer group. This study therefore attempts to examine the benefits of micro- loans to micro businesses and the challenges of accessing and repaying the loans.

2. Micro enterprises and the economy

Micro enterprises in this study comprises of informal sector businesses with not more than five employees. The role of micro enterprises (MEs) as engines of endogenous development in rural economies is increasingly recognized in development theory and has attracted the attention of policy makers. According to Tacoli et al., (2003), they add value to agricultural products and play crucial roles in the decentralized use and distribution of resources. They augment government efforts to achieve economic growth and poverty reduction in rural and urban areas (African Development Bank, 2005). They have been credited for introducing innovations into the market to serve as a catalyst for societal development (Reijonen and Komppula, 2007). From an obscure experiment in Bangladesh 30 years ago, microfinance has become a worldwide movement as a development activity, a way of helping poor people out

of poverty (Ditcher, 2006). Proponents of microfinance argue that small loans to poor people could serve as a powerful tool for alleviating poverty (Khan and Rahaman, 2007). This is consistent with the UNCDF's 2009 claim that microcredit for farmers provides a potent tool for expanding economic opportunities and reducing the vulnerabilities of the poor the (UNCDF, 2009). Micro enterprises are important to the economy of Ghana and this is buttressed by the fact that the industrial and business sectors are dominated by a large informal sector. About 70% of the Ghanaian enterprises are micro to small sized and it is estimated that nearly 40% of Ghana's GNP is attributable to informal sector activity. It is believed that small firms can more easily propel growth in the economy than the large ones due to their numbers and niches they occupy in the national economy (Ghana Government, 2003). According to Kyereboah-Coleman (2006), the provision of loans and other financial services to the productive poor who are financially excluded from access to any form of formal credit can help reduce their vulnerability in society. Majority of the world's impoverished cannot be labeled as financially included and micro financing was introduced to level the playing field vis-à-vis access to financial institution and their services. Once the productive poor are empowered financially there are other benefits as well.
It is recognized that sustainable access to microfinance helps to alleviate poverty by generating income. Hulme and Mosley (1996) found growth of income of microfinance borrowers in Indonesia, India, Bangladesh and Sri Lanka. Navajas et al., (2000) studied micro finance in Bolivia and reported majority of clients were below poverty line and similar conclusions were reported by ACCION (2003) in Lima and Peru. However, Khandker (2004) and Zubair (2004) found that micro finance helped in reduction of poverty and vulnerability to domestic violence in Bangladesh. Maggiano (2006) studied the impact of micro finance in Uganda and concluded that there is a measurable impact on social development but no impact on economic development. In Ghana, the findings of a study based on a survey of 100 participants in a microfinance program in Nkoranza in the Brong Ahafo region suggested that the impact of microfinance on both social and economical well being is marginal (Adam and Bartholomew, 2010). Even though microfinance can contribute to economic and social development micro enterprises encounter some challenges when trying to access finance. These include incomplete range of financial products and services, regulatory rigidities or gap in the legal framework, lack of information on both the banks and the micro enterprises. McElwee (2006), assert that micro-operations must overcome a multitude of barriers including difficulties in accessing capital, distribution channels, business support, and markets. Literature in the area show that regardless of size, access to finance is one of the key impediments of micro- enterprises development (Gregory et al, 2005 and Van Auken, 2005). The problem of financing is expected since financial institutions normally perceive micro enterprises as high risk ventures and shy from giving them credit (Tetteh and Frempong, 2006). Madichie and Nkamnebe (2010) also identified lack of access to market information as a major challenge to micro enterprisess. Poor access to market information is epitomized by constraints such as lack of awareness of the benefits of credit facilities emanating from limited education (Anyanwu, 2004).

3. Research methodology

The study employed simple random sampling technique to collect data from 400 micro-enterprises that have accessed microcredit in the last five years in the Kumasi metropolis. The selected micro enterprises have less than five (5) employees. This was to ensure that respondents are actually within the micro level of small and medium enterprises classification. The respondents were owner-managers of the enterprises. Interview was conducted using structured questionnaires together data for the study. Due to low literacy level of the micro entrepreneurs, the questionnaires were self- administered and those who could not read and write were assisted to answer the questionnaires. The personal interviews represented excellent medium for close interaction and rapport between the researcher and the respondents, which enabled the former to elicit more pertinent information and data. The questionnaires administered comprise both open and close ended questions. The open-ended questions in the questionnaires provided ample opportunity and leverage for respondents who wished to elaborate or write at length on some pertinent issues. The analyses of the data were undertaken with the aid of graphs, tables and charts. The study started in October, 2010 and completed in March, 2011.

4. Discussion of Findings

4.1 **Nature of business**

The various business activities micro loans are used for was identified. Out of the 400 business enterprises, Trading accounted for 78%, Non-industrialized manufacturing/agro-processing 9%, Pharmaceutical/Beverages 5% and Services 8%. It should be noted that most micro loans are used for trading. This may be due to the fact that turnover generated in trading activities is faster as compared to other business activities such as manufacturing. This is one of the major reasons why financial institutions lend easily to micro entrepreneurs who are in trading than other business activities. Also, trading activities require lesser capital as compared to enterprises involve in pharmaceuticals/Beverages and manufacturing. Although the service sectors require minimum capital, the turnover generated from its activities is low, hence, accounting for the low percentage of loans accessed by the service sector.

4.2 Types of financial institutions

The study attempted to identify the various forms of financial institutions involved in the provision of micro loans. Main forms of financial institutions involved are the universal (commercial) banks, Micro financial institutions, rural banks and Credit Unions. Out of the 400 respondents 51% took their loans from micro finance institution, 28% from universal banks, 15% from rural banks and 6% from Credit unions as depicted in figure 1 below. From figure 1 below, Micro finance institutions (MFIs) serve majority of micro enterprises in the Kumasi metropolis as shown in figure 1 above. This is as a result of the door to door banking strategy adopted by the MFIs. Also, easy access to loans, less bureaucracy and micro enterprises being the target group for MFIs accounted for their majority in financing this sector of the economy. High bureaucracy, high interest rate and the perception among micro enterprises that the universal banks are for the large businesses deter them from taking loans from banking institutions. The micro-enterprises also do not meet the collateral requirement of the universal banks because of the high risk in lending to this sector. The rural banks are not doing much in the Kumasi metropolis because of the fact that their roots are from the rural areas and that is where they have majority of their customers. The credit unions were from various Christian institutions and they seek to meet the needs of the church members not the general trading public, hence, leading to their low share in the metropolis.

4.3 Amount of micro loans and change of lender

The study also sought to find out the amount of money involved in the provision of micro-loans. The responses were as follows: 36% received above GHS 2,000, 25% received between GHS 100- GHS 500, 15% received between GHS 501-GHS 1,000, 14% received between GHS1001-GHS1500 and 10% received between GHS 1501-GHS 2000 (Note $1= GHS1.65). The amount of micro loans given to micro enterprises mostly exceeds GHS 2,000. This is due to the fact that, most micro enterprises have remained loyal to their lenders as most accessed above GHS 2,000. Those who accessed between GHS 100- 500 are mostly customers who are new to the lenders. In spite of the fact that most micro enterprises have remained loyal to their lenders, 27% of micro enterprises in the study have changed their lenders due to one reason or the other over the past five years as shown in the table 1 below. From table 1 below, 25.9% of micro enterprises changed lenders as a result of unfavourable terms of payment, High interest rate accounted for 22.2%, 18.5% inadequate capital, 18.5% represent the need for additional loan within repayment period, 7.4% as result of collateral requirement and 3.7% constitute a default in the former institution and also for the reason that former lenders are no more in operation (3.7%). Generally, it can be seen that most of micro enterprises change their lenders as a result of unfavourable terms of payment. Terms such as having to pay the loan on a daily basis which made work unfulfilling as their daily proceeds were used in other to keep up with daily repayment. This eventually affects their working capital and hence profit. Some respondents stressed that they at times need additional loan within repayment period for urgent purposes such as to take advantage of scarce goods with high profit margins as well as bulk and cash discounts. Once they have not finished paying the previous loans, their lenders are not willing to give additional loan leading to the need to go in for loans from other lenders, hence resulting in double loans and eventual switch.

4.4 Uses of the loans granted

The study asked respondents to outline the uses of the loan amounts received. Micro enterprises like any other businesses use funds acquired for various activities both business and private related. Respondents were asked about the key expenditure items on which loans granted are applied. Table 2 below shows the response: From table 2 below, 43% of respondents accessed loans to improve their businesses. It was followed closely by the number of people who accessed loans for the purpose of increasing their inventory level (36 %). Micro enterprises which accessed loans for the purpose of purchasing equipment, improving education and starting new businesses were 8%, 4.5% and 3%

respectively. The other uses represented only a small margin of the total population representing 1% for repayment of existing debt and 2% of respondents use it for spouse business.

4.5 Training of micro enterprises

After ascertaining the various uses of the loan amount received, the researchers were interested in finding out whether respondents received training on the utilization of loans before the loans were granted. 37% of respondents were given training whiles 63% of respondents were not given any form of training. Respondents were further probed on the specific type of training given to them by the lender institutions and the result is shown in table 3 below: From Table 3 below, out of the 148 micro enterprises that received training, 35.1%, received training on proper utilisation of the loan, 44 representing 29.7%, had training on saving to meet the repayment schedule, 28 constituting 18.9%, got training on expansion of their businesses with 8 representing 10.8%, receiving education on the terms of the loan and 8 constituting 5.4%, had book keeping training. It can be deduced from table 3 that most financial institutions do not give training to micro enterprises. The training centered on proper utilisation of the loan amount to enable micro enterprises make judicious use of the granted loan in order to pay back the loan as well as meeting the repayment schedule. Again, since most of micro enterprises make repayment on every fortnight or month, there is the need for them to save to meet the repayment schedule and this accounted for financial institutions giving training to micro enterprises on savings. These savings could also be used to defray loan repayment where necessary. Therefore, it was realized that financial institutions are prominently concerned about the repayment of the loans they give out at the expense of training on book keeping, proper understanding of loan terms and expansion of business which are very important to micro enterprises.

4.6 Performance of micro-enterprises

The performance of the micro-enterprises run by clients of microfinance institutions was of great interest to the study. Microfinance is expected to reduce poverty through the improved level of income from the micro-enterprises of the clients. The key variables measured included expansion in total assets, improvement in profit margin and the ability of micro enterprises to payback loan granted on demand.

4.6.1 Expansion of Total assets

With regard to the expansion of total assets of micro enterprises, out of the 400 respondents, 33% agree and 13% strongly agree that their total assets have expanded after the acquisition of loans from microfinance institutions to expand their businesses. They stated that the increase in working capital and other enterprise developing services likes production training; subsector analysis and training on customer service are responsible for this development. However, 43% disagree and 11% strongly disagree that their businesses have seen any form of expansion in terms of total assets. They attributed this to high interest rates and lack of support from the microfinance institutions. It is a bit disappointing to find that less than half of the micro-enterprises have not seen dramatic improvement in their micro-enterprises.

4.6.2 Improvement in profit margin

Since profit is a major factor in the measurement of the performance of a business, the extent to which microfinance institutions have helped to improve the profit margin of micro enterprises was ascertained. Out of the 400 respondents, 52% agree and 5% strongly agree that the performance of their micro-enterprises has improved in terms of profit margin. They admitted that even though interest rates are high they are able to beat down cost by taking advantage of bulk puchases because their working capital is high. Increase in their knowledge base in small business management was also mentioned. Unfortunately, 39% disagree, and 4% strongly disagree that their micro-enterprises have seen any significant improvement in profit margin. Once again they indicated high interest rates and high processing charges on loans to be the major factors responsible for this development.

4.6.3 Ability to payback the loan on demand

Another factor for measuring how well micro enterprises were doing after accessing loans was their ability to pay back the loan on demand. From the 400 respondents, 56% agree that they are able to payback the loan on demand, 22% strongly agree, 17% disagree and 5% strongly disagree. The repayment rate of loan among respondents was very high as represented by a total of 78%. This may be attributed to the fact that majority of respondents do not want to loose their lenders and also avoid criticism from the general public that they are debtors or are not able to pay their loans which may affect their reputation. This is possible because financial institutions may obtain court order to auction goods or close down defauters shops. Furthermore, the benefits they received from the loan exceeds the principal plus the cost of the loan, hence, making them able to pay loan within stipulated time. This is in line with the findings of Yunus (1997) that there is high repayment rate among micro enterprises in micro financing and this recovery rate are usually 98 percent.

4.7 Micro Loans and Standard of living

The standard of living of micro enterprises' owners after accessing loans was examined. It is very difficult to measure the effects of micro-loans on the standard of living of clients, but the following variables are useful.

4.7.1 Enough money to spend on food and clothing

In assessing the standard of living of micro enterprises' owners after taking loans, the extent to which they have more money to spend on the basic needs such as food and clothing were ascertained. Out of the 400 respondents, 43% agree that they have enough money to spend on food and clothing,10% strongly agree, 5% strongly and 42% disagree. Though more owners of micro enterprises have a lot of money to spend on the basic needs in life represented by a total of 53%, an encouraging percentage of the owners of micro enterprises represented by total of 47% do not have enough money to spend on food and clothing.

This may be due to the poor returns from the loan investment.

4.7.2 Improvement in self- respect

The extent of improvement in the respondents self-respect was also analysed. Out of the 400 respondents, 49% agree that their self respect has improved, 7% strongly agree, 41% disagree and 3% strongly disagree. It is clear that a total of 56% of micro enterprises' owners are able to earn self respect as result of the advice they give to others because they are able to meet the basic needs in life and expand their business.

4.7.3 Educational level of family

Another factor used to access the standard of living of micro enterprises' owners was how they were able to meet the educational needs of their family. From the 400 respondents, 46% strongly agree and 7% strongly agree that after accessing the loan, the educational level of the family has improved, 40% disagree and 7% strongly disagree. Those who agreed buttressed it with the point that their profit margin has increased which in effect increased their money in hand to cater for their family's educational needs. On the contrary, 47% of respondents believe that even without the loans the educational level of their family will improve as better education is what they are willing to give their children as parent.

4.7.4 Responsible towards business

Another way the standard of living of micro enterprises owners' were assesessed was to determine the percentage of micro enterprises owners who had more responsibility towards their business. According to the data collected,out of a total of 400 respondents, 49% agreed that the loans they assessed helped increase their responsibility rate. 27% strongly agreed. 22% disagreed and only 2% strongly disagreed. It can be seen that most micro enterprises owners agreed that they had become more responsible towards their business after accessing the loans. Those who agreed made a total of 76%. They attributed this to the fact that accessing loans means having to pay back. Therefore it is requisite of the micro enterprises owners to use the loans judiciously in order to pay back and still make profits. Therefore, they have to inculcate the repayment of the loan into their normal business routine and taking better decisoin has enable them to expand their business through increased profit margin. On the other hand, a total of 24% of micro enterprises owners disagreed that accesssing loans made them more responsible. They did not attribute their sense of responsibilty or lack there of to the management of the loans they were able to access.

4.8 Major challenges in accessing micro loans

One of the main objective of this research is to find out the challenges facing micro enterprises in accessing and repayment of loans. The main challenges mentioned by most micro enterprises were lack of collateral, inadequate capital, high interest rate, longer time to get a loan, shorter repayment period, shared responsibility for loan debt(if group), high installment payment and lastly the requirement to save regularly. These challenges are shown in table 4 below. From table 4 below, most micro enterprises stated high interest rate as the main challenge. This was cited by 24.9% of the total. After the high interest rate comes the issues of regular savings and the repayment period being too short. Both challenges had response rate of 17.5% each. Also another challenge most complained about was the high installment payment. 50 (14%) of micro enterprises stated this as a challenge. Lack of collateral, lengthy time it takes to access loans, inadequate capital and lastly shared responsibility for loan debt represents 7.9% ,7.3% 5.8% and 4.4% respectively. It is further noticed that, most micro enterprises had multiple challenges some of which inter-relate in so many ways. High interest rates have been a problem for most micro enterprises and this has been proven by this research as it was a leading challenge for most micro enterprises. The reason why financial institutions charge high interest rate is because the transaction cost for micro enterprises are high. Hence financial institutions charge their rates ahead of the market rate in order to be able to defray cost, resulting in high interest rates. High interest rates is also a problem beacause it affects other aspects such as high installment payment when repayment period is too short. This is due to the fact that it causes the cost of loans to increase and this leads to high installment payment which has to be paid within a short repayment period. This finding is in conformity with the view of Yunus (1997) that micro financial institutions charge higher interest rate than market interest rate to cover transaction cost.

Without covering these cost, micro financial institutions may not be sustainable and it will impede on their outreach.

5. Conclusion

It is interesting to note that provision of micro-loans is receiving greater attention, with universal banks, rural banks, credit unions and other micro-finance institutions heavily involved in rendering this service. From the discussion, there have been mixed results. In terms of expansion of assets, more than 50% of the micro-enterprises do not depend on micro-loans to expand their businesses, though more than 50% admit that their profit margins have gone up upon the receipt of micro-loan from financial institutions. This means that for a greater contribution to be made, micro-enterprises should be equipped with high level of training on how to run their businesses. This would augment the success of such businesses, yield greater impact and improve repayment of micro-loans, which is so paramount to any financial institution involved in the provision of loans.

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Figure1. Types of financial institution

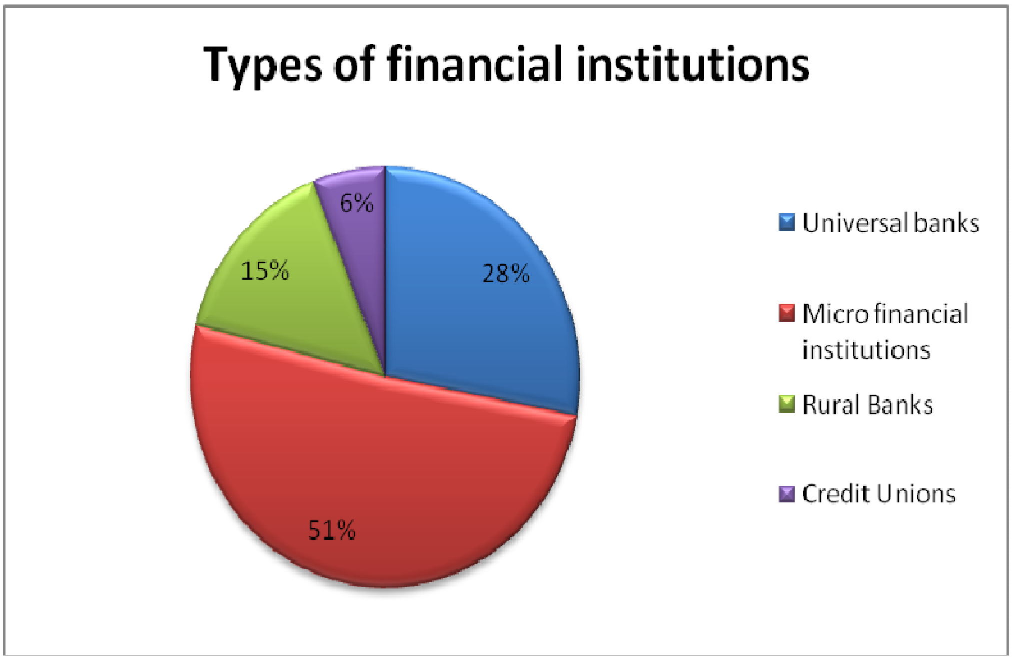

Table1. Reasons for changing financial institutions

Reasons	Frequency	Percentage (%)
High Interest rate	24	22.2
Inadequate loan amount	20	18.5
Need additional loan within repayment period	20	18.5
Default in the former institution	4	3.7
Unfavourable terms of payment	28	25.9
No more in operation	4	3.7
Requirement of collateral	8	7.4
Total	108	100.0

Table 2: Uses of loans granted

Uses	Frequency	Percentage (%)
Inventory	144	36
Equipment	26	6.5
Education	18	4.5
Improve home	6	1.5
Medical	4	1
Repay debt	4	1
Improve business	224	43
Spouse business	8	2
New business	12	3
Special event	6	1.5
Total	400	100

Table 3: Types of Training

Training	Frequency	Percentage (%)
Book keeping	8	5.4
Saving to meet the repayment schedule	44	29.7
Education on the terms of the loan	8	10.8
Proper utilisation of the loan	52	35.1
Expansion of the business	28	18.9
Total	148	100.0

Table 4: Challenges facing micro enterprises in accessing and repayment of loan

CHALLENGES	FREQUENCY	PERCENTAGE (%)
Lack of collateral	27	7.9
Inadequate capital	20	5.8
High interst rate	85	24.9
Longer time to get loan	25	7.3
Shorte repayment period	60	17.5
Shared responsibility for loan debt(if group)	15	4.4
High installment payment	50	14.7
Requirement to save regularly	60	17.5
Total	342	100