Review on the Impact of Financial Institutions’ Systems on SMEs’ Access to Finance
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ABSTRACT

The importance of Small and Medium Enterprises (SMEs) in economic growth is becoming increasingly acknowledged. In Ghana, 85% of manufacturing jobs are provided by SMEs, making up 92 percent of firms and contributing 70% of the country's GDP. Funding is a major barrier for many SMEs, particularly in Sub-Saharan African nations. The formal financial sector in Ghana comprises commercial banks, rural and community banks, savings and loan companies, and non-bank financial institutions. Legislative efforts have been put in place to help SMEs, but financial institutions have been cautious with lending to SMEs due to high default rates and risks associated with the sector. This paper seeks to review the impact of financial institution systems on SMEs access to finance in Ghana. A systematic review of literatures related to requirements and systems of financial institutions on SMEs access to finance in Ghana was conducted with the aid of online research journal websites. Seven articles were identified to be useful to the study, and six factors were identified to impact SMEs access to finance: collateral pledges, conditions attached to bank loans, high transaction costs, inadequate information about SMEs, Commercial Bank’s Profits Orientation and short period for repayment. SMEs in Ghana are not able to access funds due to their small size and lack of assets and capital, and lack the capacity to meet financial institutions. SMEs are important for the growth and development of a nation, but their access to finance is hindered by financial institutions. To address this, policy makers, government officials and legislators should make laws that favour SMEs in accessing finance to reduce requirements and increase access to finance.

Keywords: Financial institutions, SMEs, Access to finance, Ghana.

1 Introduction

The significance of Small and Medium Enterprises (SME) in economic growth is becoming more widely acknowledged. They are frequently referred to be effective and prolific job producers, the beginnings of large corporations, and the energy behind national economic engines. Even in advanced industrial economies, the SME sector employs the most people. In most nations, policy discussions continue to center on the importance of SME participation in the development process. All levels of government have launched programs to support the expansion of SME’s (Feeney and Riding, 2017; Carsamer, 2019).

About 85% of Ghana’s manufacturing jobs are believed to be provided by Small and Medium Enterprises, which are considered to be a defining aspect of the country’s industrial environment (Aekah, & Vuvor, 2018). SME’s are also estimated to make up 92 percent of Ghanaian firms and contribute around 70 percent of the country's GDP. Given their economic importance in African nations, SME's have a critical role to play in promoting growth, creating employment, and aiding in the reduction of poverty. The growth of SMEs may promote both intra- and inter-regional decentralization, and they can be a significant factor in catching up to the economic superpowers of developed global nations with larger economies. More generally, it is believed that the growth of SMEs will hasten the fulfillment of broader socioeconomic goals, such as the reduction of poverty (Naradda et al., 2020).

Around 90% of all business units in Ghana are SMEs, which employ 60% of the country’s workforce (KDI, 2008). They are frequently referred to be effective and prolific job producers, the beginnings of large corporations, and the energy behind national economic engines. The SME sector, not multinational corporations, is the main employer of employees even in established industrial nations (Prempeh, 2015). This is also supported by a study on small businesses in the US conducted in June 2016 by Dr. Charles Ou, who found that there were 23 million small businesses in the country in 2003, which employed roughly half of the workforce in the private sector and generated roughly half of the country's output. Moreover, statistics from the Registrar General of Ghana shows that 90% of
registered businesses are micro, small, and medium-sized businesses (Prempeh, 2015). Since they represent a significant source of revenue and employment, this target group has been designated as the driving force behind the nation’s economic expansion. Yet, information about this group is not easily accessible. According to estimates from the Ministry of Trade and Industry (MOTI), there are 220,000 registered partnerships and 80,000 registered limited firms in Ghana.

Despite the fact that SMEs generally face a number of challenges in their expansion, several empirical studies have identified a significant barrier that many SMEs face, particularly in Sub-Saharan African nations (Ackah, & Vuvor, 2018; Naradda et al., 2020; Bakhtiari, et al., 2020). For instance, according to a firm-level study of over 10,000 enterprises performed by the World Bank in 1999 and 2000 in more than 80 countries, small firms are 39 percent more likely than medium-sized and large firms to cite funding as a major barrier to expansion (32%)

According to several empirical research (Ackah, & Vuvor, 2018, Bakhtiari, et al., 2020), SMEs have very limited access to financing. For instance, a study by Naradda et al., (2020) shows that SMEs' limited participation in the capital market is partly attributable to the perception of higher risk, informational barriers, and higher costs of intermediation for smaller firms. This lack of participation has been linked to SMEs' difficulty in obtaining credit.

Without funding, SMEs are unable to create connections with larger companies, compete on the global market, or acquire new technology (UNCTAD, 2002) cited in Oshora, et al., (2021).

The capability of SMEs to obtain and manage capital has a significant role in how well they can develop, expand, and remain sustainable. The core financing challenge for SMEs is finding the correct kind of funding at a reasonable price to launch and expand the firm. In comparison to other areas, Africa has the highest overall credit gap for micro, small, and medium-sized firms (MSMEs), with the greatest number of SMEs (Abdulsaleh, & Worthington, 2013). In Ghana, there are 115 rural and community banks, savings and loan organizations, non-bank financial institutions, and commercial banks (including merchant banks and development banks), 17 of which run a network of 303 branches around the nation.

Several studies have highlighted how crucial financing is to the expansion and productivity of every type of business, but notably Small and Medium-sized Enterprises (SMEs) (Ackah, & Vuvor, 2018; Osei-Assibey, 2013). Finance acts as a stimulant to support company survival and expansion in both industrialized and developing nations. While credit is a source of startup capital for new businesses, it is also a source of working cash and investment for established businesses. Credit is, in fact, the lifeblood of any firm. Businesses need cash for their operations in order to buy assets, pay staff salaries, and cover operating costs. Having better access to capital helps SMEs increase their capacity for production and boosts their competitiveness on both the domestic and international markets (Bakhtiari, et al., 2020). Hence the government and the private sector have put in place a number of legislative efforts to help SMEs, including the rural financing project and the credit guarantee plan. According to Oshora, et al., (2021), new banks and Non-Bank Financial Institutions (NBFIs) have been established to meet the financial needs of SMEs.

SME customers have recently grown more desirable as banks and other financial institutions have attempted to diversify their lending portfolio. Due to the high default rates and hazards in the industry, Ghanaian financial institutions have historically been wary of lending to SMEs organizations. However, few banks have created clear policies for SMEs target groups that take into account their unique demands and requirements, such as creating allocated financial products and suitable credit management systems. Just a small number of institutions offer loans specifically for SMEs, and many of these are donor-funded. There aren’t many SMEs desks or departments in financial organizations (Prempeh, 2015). For the others, credit officers from the bank’s corporate finance divisions simply conduct lending to micro and small firms, applying the same evaluation and lending standards to SMEs in general. Most credit officers have no past experience lending to SMEs, and none of the commercial banks offer specialist training for credit officers in effective SMEs lending practices (Naradda et al., 2020). Due to this and many other reasons, they are unable to meet the requirements provided by these financial institutions. Therefore, this paper seeks to review the impact of financial institution systems on SMEs access to finance in Ghana.

2 Methods
A systematic review of literatures related to requirements and systems of financial institutions on SMEs access to finance in Ghana was conducted with the aid of online research journal websites. Three electronic databases (including google scholar, academia and research gate) were the source of articles relating to topic under study. While conducting this study, the key words in the search query were directed towards “effects of financial institutions on SMEs in accessing financial support”, “bank requirements and access to finance” and “financing
challenges of SMEs”. After the search results had been filtered to remove duplicates, the articles were received, and their relevance to the inclusion criteria was evaluated by reading their headings, abstracts, and texts.

Inclusion Criteria
Studies that were included for review were relied on the following criteria.

1. Studies should be written in English
2. Studies should display original data
3. Studies should be a peer-reviewed article

Exclusion Criteria
Studies were excluded if they were systematic reviews and written in a non-English language. Seven articles were identified to be useful to the study. These were Bakhtiani et al., (2020), Prempeh (2015), Ackah & Vuvor (2018), Ansah (2018), Kotane & Kuzmina-Merlino (2017), Aryeetey and Seini (1992) and Agbozo & Yeboah (2012).

Six factors were identified to impact SMEs' access to finance and these were: Collateral Pledges, Conditions Attached to Bank Loans, High Transaction Costs for SMEs, Inadequate Information about SMEs, Commercial Bank’s Profits Orientation and short period for repayment. These were identified by the use of thematic analysis to identify common themes.

3 Results And Discussion
SMEs have not had the anticipated impact on the Ghanaian economy despite all of the efforts and support from succeeding administrations and governments, which is cause for concern. That supports our assertion that SMEs have fundamental issues that have either not been addressed at all or have not been appropriately handled up until this point. According to a review of the literature, access to financing is the real problem. Banking institutions have put in place certain mechanisms that make it difficult or impossible for SMEs to receive financing. The following results and discussions are obtained from the reviewed literature on some financial institution systems that affect access to finance by SMEs in Ghana. The following were obtained: Collateral Pledges, Conditions Attached to Bank Loans, High Transaction Costs for SMEs, Inadequate Information about SMEs, Commercial Bank’s Profits Orientation and short period for repayment.

Collateral Pledges
Access to bank credit by SMEs has been an issue repeatedly raised by numerous studies as a major constraint to industrial growth. A common explanation for the alleged lack of access to bank loan by SMEs is their inability to pledge acceptable collateral.

According to Bakhtiari, et al., (2020), the present system of laws governing land ownership and transfer plainly hinders and partially restricts access to formal financing. First, the quantity of real estate that may be pledged as collateral is constrained since there isn't clear ownership to much useful land in Ghana. Second, the availability of land as collateral has been further constrained by a government restriction on the transfer of family and stool land. Finally, transfer regulation wastefully delays the completion of mortgages and, as a result, access to borrowed money where ownership or a lease is clear and alienable. According to Cuevas et al. (1993), cited in (Bakhtiari, et al., 2020) agreed that from the perspective of the private sector, financial issues outweigh all other expansion-restraining factors.

Prempeh, (2015) asserted that the availability of collateral significantly affects how prepared banks are to satisfy private sector demand. In the event of default, collateral offers an incentive to pay back and reduce damages. Accordingly, approximately 75% of sample businesses who needed loans were asked to provide collateral as part of a research on the availability and demand of financing for small businesses in Ghana. According to the report, 65% of the entire sample firm has at one point or another applied for a bank loan for their company. However, a sizable chunk of the company had its application turned down by banks. There was a nearly 2:1 chance that loan applications submitted by businesses would be denied. Companies are granted loans for substantially less than they asked for. Banks’ primary justification for rejecting applications from companies was a lack of sufficient collateral, which was often provided in the form of landed property. According to Ackah, & Vuvor, (2018), banks can provide alternatives to real estate as collateral, such as guarantors, sales contracts, and liens on funded equipment.

In the event of default, financial institutions are only permitted to recover their money through collateral in the form of assets. Banks' alternatives for protecting the loan assets are limited, if not nonexistent, in the absence of
suitable security. Financial institutions request collateral in an effort to lower the risk of the loans. Since they cannot afford to take any chances with loan default, financial institutions generally turn down funding for SMEs with promising business plans but insufficient collateral. This demand for collateral is consistently imposed by financial institutions.

4 Conditions Attached to Bank Loans

The above was also corroborated by Ansah, (2018) cited in Ackah, & Vuvor, (2018). Small and medium-sized businesses, in his opinion, are unable to evaluate loans due to the restrictions associated with banking procedures. He divided this into two groups: Formal bank procedures: These focus on a small number of reasonably significant transactions and include a variety of strategies for customer pre-screening. They consist of minimum deposits, track records, collateral, and feasibility assessments. Personal connections, familial ties, and commercial relationships are some examples of informal banking practices. Additionally, it is stated in Ansah, (2018) study that SME operators were discouraged from applying for loans due to a fear of danger, particularly the loss of their money.

Banks are strict when reviewing applications for small business finance. AGI vice president Appenteng asserted in 2016 that banks are harsher when analyzing SME loan applications and subjecting them to drawn-out credit procedures. Loans are granted after their intended uses have passed due to the time-consuming procedure of assessing loan applications (Bakhtiari, et al., 2020).

Small companies are ignorant of the factors that financial institutions consider before making loans to their customers. Financial institutions often don't lend to everyone who is willing to pay higher interest rates since doing so would attract riskier borrowers. They follow certain techniques to evaluate a customer's creditworthiness. They finance businesses they think will be able to pay back the debt (Kotane, & Kuzmina-Merlino, 2017). A significant obstacle to providing financial help for SMEs has been highlighted as the incapacity of SMEs to comprehend how banks work and vice versa. Banks like things like certified financial accounts, a convincing business plan, and a bankable offer before financing to small firms. Most small firms are technologically incapable of doing these responsibilities. This makes it difficult for them to get loans. As a result, inadequate or delayed access to bank financing irritates SMEs.

High Transaction Costs for SMEs

Due to the difficulty in funding start-up and expansion, SMEs have greater obstacles while conducting business than large corporations. According to Schiffer and Weder (1991), cited in Kotane, & Kuzmina-Merlino, (2017) small businesses often face more challenges than medium-sized businesses, which likewise face more challenges than large businesses. Due to the high transaction costs associated with small firms, financial intermediaries are wary of providing loans to them in the majority of countries, especially emerging ones like Ghana. Cost of transaction is a factor in SMEs' failure to acquire financing, claim Cuevas et al. in 1993. According to them, "if processing costs for lending are significant, the net margin banks expect from loans operations do not compare well to safe investments represented by government bonds". Kotane, & Kuzmina-Merlino, (2017) likewise hold the same belief that when a lender faces knowledge asymmetry, the problem frequently transforms into the lender's authority in securing repayment. Due to the high likelihood of default and the need to control it, these increase transaction costs. As a result, lenders could refrain from lending to smaller or less well-known clients or, if they do, set severe collateral requirements. They could see customers in ways that contradict the latter's sense of how hard it is to secure formal financing.

A survey conducted by Kotane, & Kuzmina-Merlino, (2017) on “whether lending to SMEs in Ghana was more expensive that lending to larger enterprise in terms of loan screening, loan monitoring and contract enforcement, banks estimate that screening to gather information about the applicant and project, review the feasibility study, do the credit analysis and make a decision, an average of 16 man days for large scale applicant and that of small scale applicants takes 24 man days. Similar results obtained for loan monitoring and contract enforcement suggest that the transaction cost of SME lending were higher than those for large enterprise per loan though a similar study undertaken in 1992 by Arceyetey and Seini on the transaction cost of lending covering sixty bank branches in Ghana suggested that there was no statistically significant difference in the cost of administering loans to smaller and larger enterprises”.

Inadequate Information about SMEs from Financial Institutions
Ackah, & Vuvor, (2018) asserted that major decisions are made in the head office by officials who have little knowledge of the company, while SMEs applying for loans deal with branch workers who have little say in the decision. This is due to the internal arrangement of most banks. This system makes sure that many prospective SME borrowers won’t get the chance to speak with the few skilled project staff members prior to submitting their applications. Due to a lack of unverified information, remote credit officers are very likely to reject many potentially excellent SMEs.

**Commercial Bank's Profits Orientation**

Despite SMEs strong interest in credit, commercial bank's profits orientation may deter them from supplying credit to SMEs because of the higher transaction cost and risk involved. First, SMEs loan requirement are small so the cost of processing the loan tend to be high relative to the loan amounts. Second, it is difficult for financial institutions to obtain the information necessary to assess the risk of new unproven ventures especially because of the success of small firms often depends heavily on the ability of the entrepreneur. Third, the probability of failure for new small ventures is considered to be high (Agbozo, & Yeboah, 2012)

Ackah, & Vuvor, (2018) however indicates that there are practical limitations to other loan security options except real and transportable property. For instance, taking a security interest in liquid assets is easy, and the foreclosure process is significantly speedier than it is for real and mobile property. However, many debtors, particularly merchants, don’t have the practice of storing money in liquid accounts; instead, they either transfer it to the black market or reinvest it in their company. Another option would be for banks to accept borrowers' assignments of contractual advantages. Although this arrangement is well-known in Ghana, banks do not favor it since they would rather not enter into additional contracts.

**Short period for repayment**

Loans are occasionally only approved for part of the total amount requested, and the payback period is short. Moreover, Ackah & Vuvor (2018) point out that the bulk of commercial bank loans made available to SMEs are typically for terms that are too brief to allow for the repayment of any sizable investment. From the reviewed literature, it can be seen that most of these systems and requirements made by financial institutions are not possible for SMEs to meet. They are comprehensive and requires a lot of money, connections and relationships with higher ups. Even though SMEs are requesting for money or funds, they still need a lot of money to be able to access funds. This, which is not possible by SMEs. SMEs are small for a reason and hence cannot afford to have certain assets and capital. The definition of SMEs in Ghana is numerous. The Ghana Statistical Service (GSS) classifies businesses with less than 10 workers as small-scale enterprises and those with more than 10 employees as medium- and large-sized organizations in its Industrial Statistics. Ironically, the GSS classified businesses with up to 9 employees as SMEs in its national accounting (Bakhtiari, et al., 2020).

An alternate criterion for classifying SMEs has been the value of the company’s fixed assets. However, the National Board for Small Scale Industries (NBSBI) in Ghana uses both the "fixed asset and number of workers" criterion from Issue 39 of the International Research Journal of Finance and Economics. A small-scale enterprise is one that employs no more than 9 people and has plant and machinery valued at no more than 10 million Ghanaian cedis (excluding land, buildings, and cars). On the other hand, the Ghana Enterprise Development Commission (GEDC) defines plant and machinery as having a maximum value of 10 million Ghanaian cedis. It is crucial to note that there is an issue with how fixed assets are valued. Second, such definitions are frequently rendered obsolete by the ongoing devaluation of the local currency relative to major trade currencies (Prempeh, 2015).

In defining small-scale enterprises in Ghana, Steel and Webster (1991), and Osei et al (1993) used an employment cut-off point of 30 employees. Osei et al (1993), however, classified small-scale enterprises into three categories. These are:

1. Micro - employing less than 6 people;
2. Very small - employing 6-9 people;
3. Small - between 10 and 29 employees.

A more recent definition is the one given by the Regional Project on Enterprise Development Ghana manufacturing survey paper. The survey report classified firms into:

- Micro enterprise, less than 5 employees;
- Small enterprise, 5 - 29 employees;
• Medium enterprise, 30 – 99 employees;
• Large enterprise, 100 and more employees

Instead of defining SMEs in terms of both asset base and employee count, this study defined SMEs in terms of the number of workers. This was done since it was not feasible to learn about the SMEs' asset base prior to making a sample decision. So, in this study, businesses with less than 99 employees were considered SMEs. This definition is in line with those offered by the EC, UNIDO, and Ghana's National Board for Small Scale Industries (Prempeh, 2015).

Ghanaian SMEs can be divided into urban and rural businesses. Enterprises that are "organized" and "unorganized" can be found in the first category. The unorganized ones are primarily made up of craftsmen who operate in open areas, temporary wooden buildings, or at home and employ few or no paid workers, whereas the organized ones tend to have staff and a registered office and are typically wholly owned by a person. They usually rely on apprentices or family members. The majority of rural businesses are run by family groupings, lone artisans, and women who produce food from local crops. According to sources cited in "Ackah, & Vuvor, (2018)," the main activities within this sector include "soap and detergents, fabrics, clothing and tailoring, textile and leather, village blacksmiths, timber and mining, bricks and cement, beverages, food processing, wood furniture, electronic assembly, agro processing, chemical based products, and mechanics" (Bakhtiari, et al., 2020).

The self-employed in this sector often have low levels of education and training. The majority of these companies are family-run, and there is minimal distinction between personal and corporate funds to the point where the owner's or operator's personal account is the same as the company's. Tiny and medium-sized enterprises (SMEs) in Ghana are a diverse group, ranging from small workshops producing textiles, metal components, and furniture to medium-sized machinery manufacturers as well as service providers including restaurants, consultancy, and software companies. Some are classic "livelihood" businesses content to stay small, while others are creative and growth-oriented (Kotane, & Kuzmina-Merlino, 2017).

From the above definitions and classifications, we can see that SMEs do not have the capacity to meet the requirements of financial institutions. There it is recommended to find other means of obtaining finance, since from this review we can see that financial institutions are not the best choice for financing Small and Medium Enterprises (SMEs). Due to this, the following literature will look at some Government institutions and Development partners.

**Government institutions and development partners to help SMEs**

Governments have set up groups to assist SMEs because of the continued financing shortage. Several initiatives have been established by governments and development partners to promote the flow of credit to SMEs above and beyond what is offered by exiting private sector banking institutions. The problem is that most SMEs are unaware that these organizations even exist. Government proposals to increase the flow of funding to SMEs, either independently or with support from donor groups (Kotane, & Kuzmina-Merlino, 2017). The following were included in the schemes:

• Business Support Fund: In the 1990s, SME enterprises received direct government loans through this fund. The initiative was largely regarded as having been used politically because the bulk of the loans were given to those who were thought to be government supporters.

The Ghana Investment Fund Act (Act 616) was formed in 2002 with the goal of creating a fund to assist the supply of lending facilities to enterprises by certain financial institutions. Nonetheless, the proposal was never carried out.

• Under the Export Development and Investment Fund (EDIF) program, businesses with export efforts may borrow up to $500,000 over five years at a reduced cedi interest rate of 15%. Although the scheme is managed by banks, the EDI board maintains stringent oversight over it, approving each bank's request for a credit line. Mensah (2004) is referenced by Kotane and Kuzmina-Merlino (2017)

**Guarantee Facilities**

Under Section 13 of the Loans Act of 1970 (Act 335), the Government of Ghana (GoG) may provide government guarantees to any foreign financiers who wish to make a financial advance to any Ghanaian organization and who are compelled to do so under the terms of the facility. Government obligations might arise through guarantee facilities. Borrower is in charge of paying back the facility, not the government. The facility crystallizes and turns into a liability due from GoG if the borrower is unable to pay back the loan and the
Government is forced to settle it as a guarantee. The only government-backed loan guarantee scheme now in effect is administered by Exim Guarantee Corporation, which is mostly owned by the Bank of Ghana (Mensah, 2004).

5 Limitations
The study did not cover a wide range of literature and hence the assumptions and conclusions may not be representative.

6 Conclusion
SMEs are important for the growth and development of a nation. But this can be impeded by the inaccessibility of finance by SMEs. Most financial institutions are the culprit for this. From this study, it can be concluded that financial institutions have put systems and measures in place which prevent SMEs from accessing finance. This study has put to light, the need for a reformation in the banking and financial sector of Ghana regarding lending money and providing financial assistance. It is noticeable that SMEs are indeed small and hence there should be an understanding that certain businesses are not able to meet all the requirements provided by the financial institutions no matter how hard they try. Hence, policy makers, government officials and legislators should make laws that favour SMEs in accessing finance. This will reduce the outrageous requirements from financial institutions, thereby increasing access to finance.

References