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## **Rural Banks Financing Of Small And Medium- Scale Enterprises (SMEs): A Case Study Of Juaben Rural Bank**

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**Abstract:** The main objective of this paper is to highlight the importance of Rural Banks in financing Small and Medium- scale Enterprises (SMEs) within Kumasi Metropolis of Ghana, taking cognizance of the contributions of Juaben Rural Bank Limited. In advanced economies, commercial banks are the main financiers of SMEs. However, in Ghana there are a number of macroeconomic, institutional and regulatory challenges that hinder commercial banks from lending to SMEs. In addition, SMEs have high failure rates which make commercial banks reluctant to extend credit to players of the sector. By administering a questionnaire to ninety (90) SME operators and ten (10) staff of Juaben Rural Bank, the paper finds that a lack of collateral security, poorly prepared accounts, poor financial history, limited years of operation, among others are some of the major challenges SMEs face in accessing loans from rural banks. In view of the findings, recommendations are made to the Bank of Ghana, policy makers and operators of SMEs.

**Keywords:** *Rural Banks, Small and Medium Enterprises,*

### **Introduction**

The contribution of Small and Medium-scale Enterprises (SMEs) to the socio-economic development of Ghana cannot be overemphasized. SMEs refers to firms with small market share and mostly managed or run by its owners (Bolton committee, 1971). Nyamekye et al (2009) organized the SME into trade union and organized groups such as Ghana Private Roads Transport Union with Car owners, drivers and attendants organized group. SMEs are found in both rural communities and town; SMEs found in the rural communities are agriculture, fishing and fish processing, rural agro-based (Adu-Amankwah, 1999).

Individual ownership of SMEs, ease of entry, the use of local resource and labour intensive have been identified as the characteristics of SMEs. SMEs complement the efforts of large organization in the provision of jobs to the teeming graduates who complete school yearly in employment so far as employment generation in Ghana is concerned (Fredua, 2007). Carroll (2011) established that SMEs employs about 80% of the labour force in the country.

According to Abor & Quartey (2010), SMEs contribute to the growth of the economy by way of tax revenue. SMEs activities are believed to contribute to about 75% of the country's gross domestic product. SMEs also contribute tremendously to the infrastructural development of Ghana such as the provision of private junior high, senior high and tertiary institutions, construction of bore holes, etc. Aryeetey (2001) also found out that SMEs help conserve foreign exchange. SMEs have contributed to the increase in the exports of non-traditional crops leading to increase foreign exchange.

Notwithstanding the important contribution of SMEs to the Ghanaian economy, the sector is bedeviled with some challenges. Lack of skilled labour force has been identified as one of the challenges of SMEs in Ghana. According to Banking Survey (2013) SMEs are unable to recruit, train and retain skilled labour force needed for their operations in Ghana mainly because of the high cost of skilled labour. Ofori (2009) also cited low level of technology as one of the major constraints of SMEs in Ghana. Lack of equipment and technology, partly due to inadequate capital further restrain SMEs from competing with large scale firms.

The owners of the SMEs lack the requisite skills, knowledge and experience to manage their businesses effectively have been identified as some of the constraints of SMEs (Carrol, 2011). However, the single most important challenge to SMEs has been identified as lack of credit. Mensah (2004) stated that lack of financial credit facilities has always been a major problem to the SMEs of Ghana. It is to address these challenges that the establishment of Rural and Community Banks (RCBs) was hailed by many as the medium through which the financial needs could be addressed. Rural and Community Banks (RCBs) are unit banks which are incorporated under Companies Code of 1963 (Act 179) of Ghana as limited companies provide financial intermediation to its customers (Nair and Fissaha, 2010). The main aim for the establishment of RCBs was to promote rural development with the intention to increase the standard of living of the rural dwellers (Kudiabor, 1974). According to Ackah et al (2014) RCBs grant loans to groups with a maximum of twenty members without collateral security. They stated that members of a group are held jointly liable in the case of default. RCBs also provide savings to its customers. Savings products comprises; regular savings accounts; current accounts; *susu* deposits; and fixed or time deposits. According to Nair and Fissaha, 2010 regular savings deposits stands at about 58% of rural banks total number of clients and 57% of the entire rural banking deposit.

According to Ackah et al (2014) RCBs provide credit facilities to its customers. The credit facilities provided by RCBs include micro loans, personal loans, salary loans, *susu* loans, and overdraft facilities. Salary loans account for about 33% of entire rural bank advances, personal loans is pegged at 24% and microfinance account for about 20% of all rural bank deposits. It is in line with this the study is being conducted to address the challenges SMEs face.

### **Literature Review**

Since Ghana's independence in 1957, the government of Ghana had made several attempts to promote rural development in order to increase the living standard of the rural folks (Kudiabor 1974). Brown (1986) attributed the reasons for the failure of the government to begin the project before 1976. The reasons included high cost of living for farmers, and the lack of coordination between government agencies. According to Nair and Fissaha (2010) before the establishment of the first rural bank in 1976, the main source of credit to the rural dwellers was made available by moneylenders. Small farmers and fishermen complained that the money lenders charged exorbitant interest rates. In an attempt to improve access to finance support in the rural communities the Government of Ghana took measure to address the challenges. As part of measures to address the challenge commercial banks were required to lend at the rate of 20% for credit facilities for agricultural uses. It was in this direction that the Agricultural Development Bank

(ADB) was established in 1965 with the mandate of lending to agriculture and allied industries in rural communities of Ghana.

This was augmented by the opening of commercial banks and ADB branches in rural areas particularly cocoa-growing rural areas. It must be noted that despite these efforts lending to the rural communities remained extremely low. The rural branches were used mainly to effect payment to cocoa farmers whose produce had been purchased by the government. The branches were also used to collect deposits and provide other banking services such as granting of credit. As part of requirement for the granting of loans, collateral securities and deposit accounts were needed for. According to Andah and Steel (2003) many small farmers and fishermen did not have deposit accounts in commercial banks, and had no collateral security for commercial lending. Mensah (2004) and Ranade (1994) also found out that the ADB's credit provision and coverage were inadequate. 27% of ADB branches were in rural communities and lending about 15 percent of its total portfolio to farmers. In view of this situation, the Government of Ghana (GoG) took it upon itself to support the establishment of community banks in rural areas to provide financial services in those areas. Bank of Ghana sent a delegation to the Philippines to understudy the rural banking system in Philippines to enable the government establish rural banks in rural farming and fishing communities.

#### **Establishment and Growth of Rural Banks**

According to Nair and Fissaha (2010) the first rural bank was established at Nyakrom in the Central region of Ghana in 1976. The paid-up capital of 60,660 old Ghana cedis or about US\$52,000 was used to set up the bank. Rural bank was owned by farmers in the rural community through share purchase. The second rural bank was also established at Biriwa, a fishing community in the Central region of Ghana the following year. The Association of Rural Banks (ARB) was instituted in 1980 to facilitate the exchange of information and to improve the performance of the entire rural banks. Between 1980 to 1984 the number of rural banks had reached 106. The rapid growth particularly in cocoa growing area was attributable to the interest among rural communities; introduction of Akafo Cheque operations. With time a code for establishing new rural banks was developed. In 1985, the Bank of Ghana instituted guidelines for the setting up of rural banks. The minimum paid-up capital needed for the commencement of rural bank was GHc 1.5 million. It was mandatory for the Bank of Ghana to acquire 43% of the total shares while the remaining 57% was to be acquired by the general public. The old c 10,000 currently c1 was the maximum value shares that an individual shareholder could purchase. The rural banks provided mainly savings and credit services and products. Salary and pension deposits for civil servants who worked in rural communities were transferred from the capital, Accra to the rural area using rural bank networks. In 1988 deposits in rural banks increased tremendously from old GHc 148,000 (1976) to old GHc 2.3 billion and loan portfolio increased to about US\$4 million. Nonperforming loans was pegged at 5% in 1982 and 70% in 1986. The non-performing loan was attributable to the 1983 drought and fallen prices.

The RCBs were bedeviled with so many challenges. As part of governance structure of RCBs the rural banks were required to have a board of directors in place. The boards of directors were inexperienced, and the selection Criteria was not based on competencies. Secondly, on the issue of employment, the rural banks could attract competent staff because of inadequate resources.

Thirdly, there were weak internal controls which led to corruption involving management and staff. Lastly RCBs gave many bad loans coupled with Bank of Ghana's lack of capacity to supervise the rural banks. The above-mentioned challenges led to the introduction of reforms by the Bank of Ghana. Andah and Steel (2003) established that there was a tremendous reduction in agricultural loans, increases in primary and secondary reserve requirements, distressed banks were also closed children, and a stronger role for the Bank of Ghana in examination and control of the banks were taken to address the situation. Nair and Fissaha (2010) established that the World Bank supported Rural Finance Project in 1989. The main aim of the world bank support to; provide technical support for restructuring some RCBs; strengthening the ARB and credit unions; rationalize the roles of the Rural Banking Department of the Bank of Ghana and the ARB; improve the rural credit appraisal capacity of RCBs and financial institutions; and strengthen the Bank of Ghana's capacity to supervise rural banks.

#### **The Association of Rural Banks (ARB)**

According to Nair and Fissaha (2010) the Bank of Ghana supported 30 existing rural banks to form the ARB in 1981, to provide a forum for rural banks. There are nine regional chapters. Initially, the ARB's was required to offer training to different target groups. With the setting up of Apex Bank ARB was no longer required provide the training to RCBs. However, ARB is still responsible for offering training for directors of rural bank. ARB now focuses on advocacy with the government and resolves disputes among its members. According to Nair and Fissaha (2010) the Apex Bank was set up to provide financial, managerial, and technical support to rural banks. A study was jointly undertaken by the World Bank and the Bank of Ghana in 1996. The study recommended the setting up an institution similar to the Rabobank in the Netherlands. In 1998 a feasibility study was undertaken. The study recommended the setting up of apex bank in view of its financially viability. Consequently, the ARB Apex Bank was incorporated in 2000 as a public limited liability company with rural banks as shareholders. Apex Bank was licensed in 2001 and commenced operations in July 2002.

The Apex Bank has six other branches in Ghana aside its head office in Accra. The managing director of the Apex Bank augmented the membership of the board.

#### **Small and Medium Scale Enterprises**

Bolton committee (1971) identified SME as a firm with a small market share and mostly managed or run by its owner(s). The European commission (EC) identified small enterprise as a firm which employs between 10 and 99 employee's while a medium enterprise was identified as a firm which employs between 100 and 499 employees. The United Nations Industrial Development Organization (UNIDO) has also categorized firms in developing countries with 5-19 employees as small firms and firms with 20-99 employees as medium enterprise. The Ghana Statistical Service has identified small firms as firms employing 10 employees and medium scale enterprise as firm employing more than 10 employees. In view of the fact that it is largest sector of the developing economy, SMEs are the vessels through which the economies of developing countries could grow. Carroll (2011) established that SMEs which employs about 80% of the labour force in the country and contributes to about 49% of the country's GDP in 2012 (Ghana Banking Survey, 2013). The National Board for Small Scale Industry also defines small enterprise as an enterprise which engages 10 workers and more and owns plant and machinery valued at USD 2,400, 000. From the various definitions above it could be noted that small

and medium scale enterprises in Ghana employ between 5 to 100 workers. Bolton committee (1971) listed the sectors in the SMEs as manufacturing; construction; mining and quarrying; retailing; miscellaneous; service; motor trading; wholesale trade; road transport; catering etc. The SMEs which is dominated by the private informal sector engages about 86% of the entire population of Ghana (Ghana Statistical Service, 2012). Carrol (2011) pegged the employment at the sector to about 80% and accounting for about 49% of the Gross Domestic Product in 2012 (Ghana Banking Survey, 2013).

Notwithstanding the tremendous contribution of the SMEs to socio economic development, the sector is bedeviled with so many challenges which affect their operations. Among them are registration and licensing requirements. The cumbersome nature of laid down procedures to be followed in registering and commencing SME enterprise in Ghana has also been identified as a challenge. Adu-Amankwah (1999) has grouped the SMEs into rural and urban informal sector. Among the SMEs in the rural communities are Agriculture, fishing and fish processing, rural agro-based processing activities. The following are some informal sector groupings of SMEs in Ghana. The Ghana Private Road Transport Union (GPRTU), Ghana National Chemical Sellers Association, Ghana National Tailors and Dressmakers Association, National Drinking Bar Operators Association, Chop Bar Keepers and Cooked Food Sellers Association, Hair Dressers Association of Ghana, Susu Collectors Association, Blacksmiths and metal workers union, amongst many (Yankson,1992).

### **Methodology**

The research design used for the study was the case study approach. Case study involves the use of both qualitative and quantitative research. The research design includes hypotheses. The researchers used primary sources of data for the study. The primary data obtained through administered questionnaire was used for the study. The Primary data was gathered from Juaben Rural Bank Ltd and the Small and Medium Scale Enterprises in Kumasi. The researchers personally administered the questionnaires to the Owners of SMEs and the Officials of Juaben Rural Bank Ltd. The administered questionnaire mainly consisted of close-ended and a few open-ended questions. These helped the researcher to analyse the data both qualitatively and quantitatively.

Simple Random sampling was used to select the operators of SME for the study. A sample size of one hundred (100) was used for the study. The respondents comprised ninety (90) operators of SMEs and ten (10) officials from all the Juaben Rural Bank branches were used to conduct the study. A selection of respondents from the Juaben Rural Bank was based on purposive sampling technique. The ten (10) respondents were made up of five (5) senior staff and five (5) junior members.

Data analysis involves reducing the data into manageable size, giving summaries and using statistical inferences. Raw data obtained were edited and errors corrected to ensure consistency and validity. In all hundred (100) questionnaires were administered and received from SME's and staff of Juaben Rural Bank. The data collected was coded to enable the responses to be grouped into limited number of categories and analyzed with the aid of Statistical Package for Social Science (SPSS).

Lastly, the data was presented in a tabular form, graphical and narrative forms. Descriptive statistical tools such as bar graph, pie charts, mean and mode were used to analyze the data collected.

## **Results and Discussion**

The results of this study indicate that 44.44% (40) of the respondents had had their loan application being rejected at least once. They cited lack of collateral security, unprepared accounts, poor financial history, limited years of operation, no business plan, and no reason and not being qualified as some of the reasons for rejection of their loan application. In assessing credit from rural banks, apart from some of the challenges respondents cited, they also indicated that poor past and projected cash flows; inexperience management team or lack of professionalism; Inadequate technologies; Low rate of return on capitals; and Limited knowledge of business opportunities as some of the major problems they face in assessing loans from the Bank. A strong majority of respondents also indicated that it was a requirement for SMEs to save with the banks for a period before they qualify for loans.

Other key findings of the study are that rural bank financing contributed to an increase in Capital, Expansion of businesses, setting up of other businesses and Improvement in the standard of living of SMEs. It also came to light that rural banks offer overdraft, business loan, SME banking, Cash management and business Advice service to SMEs. As a result of the financial service provided to SMEs, there have been increase in SME capital base, Expansion of SME businesses, improvement in services or products offered by SMEs and lastly improvement in the standard of living of SME operators. Finally, the study identified Registration of Business with the Registrar General, past and projected cash flows, Credit History, six months operations with the Bank and Collateral Security as challenges the Bank faced in loaning to SMEs.

### **Challenges rural banks face in lending to SMEs**

The respondents were asked to ascertain the Challenges SMEs they face in extending credit/loans to SMEs. Out of 15 responses representing 150%, 50% (5) respondents stated Ineffective management of SMEs was challenges to rural banks effort to loan to SMEs. 80 % (8) respondents stated High Default rate of SME loan was a challenge to rural banks effort to loan to SMEs. However only 20% (2) respondents stated ineffective monitoring of SME loan pose challenges to rural banks effort to loan to SMEs. When asked to come up with suggestions to curb financing challenges of SMEs, the following suggestions were made.

### **Training on proper Accounting**

Majority of the respondents suggested that SMEs should be trained on proper Accounting of the resources of their businesses. For example, going concern principle in accounting stated that the business will continue into the foreseeable future. It is therefore required that the profits of the businesses are plough back into the business to grow them.

### **Education**

It was also recommended that SMEs should be educated on the proper use of loan they contract from rural banks.

### **Effective management**

Majority of the respondents suggested that SMEs should be encouraged to put in place measures to ensure effective management of their businesses. For example, the business entity concept stipulates that the business is separate from its owners. It is therefore required that expenses of the owners are separated from that the businesses.

## Conclusion

Rural bank financing has contributed to Asset acquisition, increase in capital, expansion of SME businesses, setting up other business and improvement in the standard of living of SME operators. However, it has been noted that SMEs face challenges such collateralization, high interest rate, unprofitable of SME business which prevent them from accessing credit from rural bank. Business documentation such as business registration certificate, financial statements, business plan, Appraisal of assets, cash flow projects required by rural banks also pose challenges to SME access to finance. Appropriate measures should be put in place to address the challenges SMEs face to enable the sector contribute significantly to the growth of the entire economy.

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