

# The Role of Microfinance Institutions (MFI's) in Providing Credit Facility to Small And Medium Scale Enterprises (SMEs) (A Case Study)

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**ABSTRACT:** *Small businesses face a number challenges in their life time, much of which stems from lack of funding and regular, adequate supply of it. The emergence of Microfinance Institutions (MFIs) was hailed as a timely intervention but recent events have proven to paint MFIs to be causing more harm to the SME environment than earlier anticipated. This research sought to investigate and make the necessary recommendations so that, both businesses could co-exist profitably.*

**KEYWORDS:** *microfinance, loans, interest rates, policy.*

## I. INTRODUCTION

In the Sub-Saharan African region, Ghana has a very bad poverty picture, with over 60% of our citizens residing in the rural areas. Many communities in the country are marked deprived (areas lacking basic social amenities like health facilities, education, water electricity and others). Many policies and strategies have been implemented in the past in attempting to solve the poverty menace in the developing countries including Ghana. Most recently for example, many governments are incorporating microfinance in their policies and strategies to reduce poverty and also to achieve the Millennium Development Goals (MDGs) of reducing extreme poverty by the year 2015 [5].

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## II. STATEMENT OF THE PROBLEM

In this research, I examined the extent to which the role of microfinance institutions (MFIs) can go to help respond to one of the key challenges facing small and medium scale enterprise (SMEs) in Ghana. That is the lack of affordable and regular funding.

## III. RESEARCH OBJECTIVES

1. Find out how Micro Finance Institutions (MFIs) help Small and Medium Enterprises in development.
2. Discover the key assessment indicators MFIs consider in advancing loans to SMEs.
3. Find out the challenges MFIs faces in the assessment, administration and management of loan facilities to SMEs.

## IV. RESEARCH REVIEW AND METHODOLOGY

Funding is key to the development of Small and medium scales enterprises in Ghana. Government, international bodies have invested financial and human resources in establishing the right mix and models appropriate for providing capital for SMEs.

For example the Ghana Business Assistance Fund was initiated to help in this effort.

Additionally, the Ghana Investment Fund under the Ghana investment Fund Act (Act 616) was passed to establish a fund to provide for the grant of credit facilities by designated financial institutions to companies [3].

Helms posit that, 'with appropriate regulation and supervision, each of these institutional types can bring leverage to solving the microfinance problem'.

As contained in its Industrial Statistics, The Ghana Statistical Service considers firms with less than 10 employees as Small Scale Enterprises and their counterparts with more than 10 employees as Medium and Large-Sized Enterprises. The GSS in its national accounts considered companies with up to 9 employees as Small and Medium Enterprises.

However, the National Board of Small Scale Industries (NBSSI, 1999) in Ghana applies both 'the fixed asset and number of employees' criteria. It defines a Small Scale Enterprise as 'one with not more than 9 workers, has plant and machinery (excluding land, buildings and vehicles) not exceeding 10 million cedis (US\$ 9,506.00 using 1994 exchange rate)'. The Ghana Enterprise Development Commission (GEDC, 2003) on the other hand uses a '10 million Cedis upper limit definition for plant and machinery'[1].

According to the National Board for Small Scale Industries [4] SMEs is defined in Ghana by applying both the "fixed asset and number of employees" criteria. It defines a small-scale enterprise as a firm with not more than 9 workers, and has plant and machinery (excluding land, buildings and vehicles)

not exceeding 10 million Ghanaian cedis and micro with employee less than five.

#### **A. RESEARCH PARTICIPANTS AND SAMPLE SIZE**

Participants of the research were from the MFIs, and SMEs. The reason for adding three SMEs to the sample category is the fact that, MFIs have unbroken link with SMEs. In other words, SMEs are part of the linkages which constitute MFIs food chain. Additionally two (2) consultants were interviewed for this research. In all, twenty-six (26) personnel were interviewed for the research. The reason for this size was partly because of time, resources and the type of information required. Moreover, a larger size would have been most difficult to analyse within the limited time frame. In all the four stakeholders, senior management, consultants and officers were selected. This was as a result of the fact that, these were the personnel which had access to the information required.

Concerning MFIs, Melbond financial Services, Multi-Credit, Eden financial services, Moneylink and noble dream were selected. On the other hand, the three SMEs included IQ Printing Press, Redeemer Enterprise and BenEllen enterprise. With MFIs, three (3) personnel were selected for interview. The same number was selected in respect of SMEs.

The three categories of personnel were the accountants, loan officers, and risk analysts. With SMEs, the managers, accountants and one other recommended staff member.

The choice of these workers was informed by their long-time relationship with the with the firm and their position to have access to the information the

research was seeking for. As a result they were best positioned to ascertain the management style of the owner, as well as understanding of the work environment relative to their sources of financing, training schemes and other variables needed for the effective achievement of the research objectives.

With respect to consultants, they have between them twenty (20) in consulting for MFIs and SMEs. These two officers had adequate knowledge and experience to provide needed information as well as appreciate the scope and nature of the research.

**B. DATA COLLECTION METHOD**

In a research of this nature, many methods of data collection were opened to the research. These included interviews, observation and documents. Any of these methods has their strengths as well weaknesses. Observation is a good research method, for example participant observation, in gathering qualitative data. This notwithstanding, the researched concluded that, it is more of a tool for collective behavioural data than the type of hard facts data sought.

In the case of interview, the research found that, it was most appropriate for collecting the required data. The research considered four types of interviews namely; structured interview, unstructured interview, semi-structured interview and group interview.

According to Tagoe, semi-structured interviews were preferred in the collection of primary data among the other forms as a result of the following strengths [4];

- It allows for flexibility. That is questions could be moulded to reflect on a particular organisation and or situation.

- It encourages interaction between participants and the research.
- It gives the opportunity for follow up questions.
- It gives the opportunity for eye contact, reading of faces, motives and manners.
- It provides data with great validity and reliability.

**V. EXPERIMENTAL AND RESULTS ANALYSIS**

**A. RESPONSES FROM MFIS**

The MFIs surveyed for the research are as follows;

- Melbond Financial Services
- Jenubank Microfinance
- Eden Financial Services

At this point the research would give a brief detail about the MFIs surveyed in the research. The purpose of this description is to give the research an idea of the size, capital base, staff strength and financiers of the SMEs concerned.

Table 1.0 Profile of MFIs

MFI PROFILE	Melbond Financial Services	Jenubank Microfinance	Eden Financial Services
Capitalisation	200,000	110,000	250,000
Staff strength	27	10 (4 are on part-time basis)	20
Loans to SMES in 2013/14	350,000	200,000	270,00
Number of SMEs served	120	133	103
Interest rates	5-7%	5-7%	5-7%

Processing fees	3%	3%	3%
Bad loans	15,000 (4.3%)	12,000 (2.6%)	7,000 (4.3%)

Source: Author

What key roles is your institution playing in the development of SMEs (your clients)?

Table 2.0

MFI Research Question	Melbond Financial Services	Jenubank Microfinance	Eden Financial Services
What key roles is your institution playing in the development of SMEs (your clients)?	-Provision of loans -Training services in book keeping, management skills (free of charge) -Writing of business plans. -Micro insurance -Susu savings -Guarantee for land/equipment purchases	-Provision of loans -Training services in book keeping, management skills (free of charge) -Writing of business plans.	-Provision of loans -Training services in book keeping, management skills (free of charge) -Writing of business plans -Car loans

Source: Author

Among the three MFIs sampled, they have given loan facilities to three-hundred and fifty-eight (358) SMEs in the 2013/14 financial year to the tune of eight-hundred and twenty thousand (820,000.00) Ghana cedis. This is a positive sign indicating that, such access help the SMES to acquire equipment and machinery, pay their staff and undertake business activities necessary to strenghten their operations and ensure their economic survival. In the absence of

these loan facilities, there is no doubt that, these SMEs would not have survived the market.

The above notwithstanding, it is obvious from the data that, an interest rate of 84% per annum, is something that puts a lot of strain on the SMEs. Coupled with a processing fee of 3%, it becomes a lot more challenging for most of the SMES. Perhaps, it is upon this high interest rate, that, default rate is at an average of 4.3%, considering the stringent loan collections methods operated by MFIs.

**B. LOAN CRITERIA OF MFIS**

The MFIs surveyed, used the Susu saving criteria in assessing the viability of a client’s ability to pay back loans. By their procedures, the MFIs allow clients to save for a period of two-three months before allowing them to apply for a loan facility. The strength of this method is that, the amount of money saved by the clients becomes the collateral for the loan being asked for.

The research also observed that, MFIs used the book keeping records of clients as a basis for granting loans. Besides assessing the strength of their books as a basis for loans approval, the perceptive view they hold is that, SMEs, which keep good books even if they are making losses, are deemed ‘credible’[8].

The MFIs also indicated that, the purchase of equipment has a soft benefit. That is, it serves an advertising node, which attracts SMEs.

The question of capacity of SMEs to service their loans, came up strongly among players in the MFIs industry. The conventional wisdom among them, these days, is to look at the bank balance, assets, and loans being services by an SME in question. On

paper, this sound good but in practice, it has exposed many MFIs. This, as the research established, is largely as a result of lack of central database of SMEs loan portfolios. Many SMEs takes loans from several MFIs and have as such become indebted. This has led to a practice where SMEs takes loans from a particular MFI to service the other instead of operating a successful business and using the accruing profit to service pending loans.

Furthermore, the MFIs contend that, SMEs are volatile, weak, and too mobile and poses a lot more risk, hence their long neglect by conventional banks. Another issue MFIs complained about was that, 'once they have nurtured the SMEs to sustainable levels' of profitability, the conventional banks quickly snatch them, hence their inability to fully benefit from their investments in grooming the SMEs [9].

One other critical thing that MFIs have sought to achieve it build personal relationships with their SME clients. The business case benefit of this venture is helping them to professionally create a profile of their clients. To them, the character and reactions of their clients is critical to the success of their operations. In the absence of good books, the profiling of the SMEs owners becomes their guide in assessing loan applications.

### **C. MFIS CHALLENGES IN LOAN ADMINISTRATION**

Despite the fact that, most MFIs have resolved to deliver financial solutions to SMEs, there are a number of challenges they face in the administration of loans to SMEs. These challenges are protracted and long standing. Perhaps, they are part of the reason conventional banks have either shunned SMEs

or MFIs have resulted in over-pricing risk to make up for their high operational costs.

The research envisages that, with proper books, MFIs would be able to ascertain cash inflows and established the capacity of SMEs to honor their loan obligations. As many MFIs have come to accept, this is not the case. In situations where proper bookkeeping exists, each is markedly different from the other. That is to say, there is no consistency in book keeping across the SMEs landscape.

There are three hundred and fifty-four (354) registered MFIs as of July, 2011, (Bank of Ghana, 2012). These excluded the equally large number of unregistered MFIs and Susu collection firms, which give loans at interest of the blind side of the Bank of Ghana [2]. Many of them in their haste for market shares, and large profits, due to large interest rates and low operational costs, have resulted in poor credit assessment procedures. As such, SMEs have continued in their poor book keeping practices.

Of the three MFIs surveyed, they confirm that, as many as 37% (on average) of their clients have relocated over the period of the payment of their loan obligations. In such an environment, there is no doubt that, such relocations whether deliberate or unintended increases the cost of loan administration.

The issue of poor management skills by SMEs has been complicated by the reluctance of SMEs to adopt and improve upon their skills. Sole proprietors seem they have no answerable authority and have thus resolved to manage their business as they see fit without recourse to proven business methods in marketing, use of technology, and or management skills. Division of labor is an alien concept to them.

This leads to inefficiency and waste in their operations. Thereby biting into their profit margins.

Of the SMEs surveyed for this research, none of the sole proprietors have had formal education beyond the basic level. Their appreciation of business is to buy and sell and make profit. The concept of business planning is 'alien' to them. Furthermore, they were deeply suspicious of 'book' in their businesses.

#### **D. RESPONSES FROM SMES**

SMEs surveyed are unanimous about the support of MFIs to their operations in the areas of financing and most recently, education and allied services. All the SMEs surveyed get on average, 85% of their funding from MFIs. It is thus worth to note that, without MFIs, most SMEs could not survive the business environment. Considering the fact that, SMES provides 87% of employment among the labour force, it goes without saying that, MFIs are critical to the survival of the economy.

#### **E. SMES CHALLENGES IN LOAN ACCESSING**

From the forgoing analysis, it may be wrongfully assumed that, the relationship between MFIs and SMEs is a win-win situation. That is not the case in reality. SMEs complain of high interest rates. This is not so difficult to ascertain as the research considered the rate, which is at 7% per month. SMEs pay as much as 84% on interest per annum. In a particular case, BenEllen, asserts that, it paid 9% interest rate per month in its first year of operation. This brought interest payment to 108% /annum because the business was deemed, 'highly risky'[6]. The business

began to receive normal rate of interest in the second year, when it had managed to accumulate high savings and paid off outstanding loans.

Additionally, SMEs complain of long waiting times. This disrupts their operations as results of the nature of their businesses. Some on these SMEs operates on market days and thrives on seasonal goods. So, when the season is due and loan delay, they are left in the cold to meet the needs of their customers. On average, SMEs complain that, waiting periods have increased from a few weeks to as long as 14-weeks. It is worth noting that, the prompt access to capital is as important as the capital itself. When capital delays, SMEs lose business opportunities and consequently, loses market share to competitors.

Besides the high interest rates charged by the MFIs, SMEs complain of short payment periods. The challenge is that, the short duration of the payment periods prevents them from turning their capital around adequately [7]. The difficulty is that, businesses like BenEllen, sells much of it foodstuff on credit to salaried workers ho pay on monthly basis. As such as payment starts the two weeks after loan approval, the business could only make one round of profits.

## **VI. DISCUSSIONS AND CONCLUSIONS**

The research established that, 85% of operating capital of SMEs surveyed, was sourced from MFIs.

SMEs face high interest rates of 84% per annum from MFIs. This as a result, has hampered their ability to build capital, expand their businesses and hire skilled personnel.

### A. FINDINGS ON MFIS

MFIs, contribute not less than 85% of loans to SMEs surveyed for this research. This funding goes a long way to smooth out the operations of SMEs and allows them to compete and take advantage of emerging business opportunities in their respective areas.

MFIs undertake training services for SMEs in the areas of bookkeeping, basic management practices, and marketing and client management. These services come at free of charge, but it is for only the customers of the respective MFIs.

Some MFIs provides training in business planning, and proposal writing for high potential SMEs. These services come at fee and it's for those seeking for additional funding from government agencies such as the National Board for Small Scales Industries (NBSSI).

Additionally, MFIs provides micro insurance and guarantees for land and equipment for SME clients. Normally the guarantee for equipment comes at a fee.

This research has clearly demonstrated that, MFIs are key to solving the funding challenges of SMEs. This notwithstanding, these funding comes at a huge cost to SMEs in the area of high interest rates. Additionally, it comes at the expense of building capital and business expansion.

Additionally, the research points out challenges both MFIs and SMEs face in dealing with each other. Some of these challenges as the research points out, are regulatory others administrative. This gives room for other research to probe how the regulatory and administrative challenges could be handled.

### VII. CONCLUSION

- Microfinance Institutions play a key role in the funding of SMEs. These funding go to purchase equipment and or for operational activities. Despite these efforts, the loans come with high interest rates, which sometimes hamper the potential of SMEs to expand and hire skilled personnel.
- The research established that, 85% of operating capital of SMEs surveyed was sourced from MFIs.
- SMEs face high interest rates of 84% per annum from MFIs.
- MFIs withhold deposits as collateral and further demand for assets as collateral for loans when they are not satisfied with the level of savings by clients.
- MFIs, contribute not less than 85% of loans to SMEs surveyed for this research.

### B. RECOMMENDATIONS

- MFIs should reduce interest rates to accommodate struggling SMEs
- MFIs should not take on more clients than they have the capacity for.
- There should be a credit reference bureau for SMEs to contain the culture of multiple loans from different MFIs by SMEs
- There should be an industry wide common accounting systems for SMEs
- There should be a common 'know-your-client' system in place for all MFIs.
- By way of regulation, there should be mandatory insurance of loans for SMEs.

## VIII. FUTURE WORKS

Managerial Challenges of Small Businesses in the Ghanaian Environment

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