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DISSERTATION

A STRATEGY FOR COMMERCIAL BANK INTERVENTION INTO MICRO-ENTERPRISE FINANCING : THE CASE OF ECOBANK GHANA LIMITED

BY

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DECLARATION

I hereby declare that this dissertation is the result of my own research carried out under the supervision of Dr. A.D. Amarquaye Laryea, Lecturer, Department of Economics, University of Ghana, Legon. All references cited have been duly acknowledged. I therefore accept responsibility for any lapses in this document.

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DEDICATION

TO FAUZIA AND NAPAGA

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I am doubly indebted to the African Capacity Building Foundation (ACBF) for granting me a second scholarship to pursue the MBA Programme in Banking and Finance at the Centre Africain d'Etudes Supérieures en Gestion (CESAG) in Dakar, Senegal, the hub of Business Management studies in Francophone West Africa. I already benefited from a similar scholarship from the ACBF to pursue a Master of Arts degree in Economic Policy Management (EPM) at the University of Ghana, Legon.

My gratitude goes to Dr. A.D.A. Laryea of the Department of Economics of the University of Ghana for sparing time out of his tight schedule as lecturer to supervise this research work.

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Any lapses, in form and content, that may be found in this work is entirely my responsibility.

ALHASSAN Ziblim Al-Hassan

October 2004

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ABBREVIATIONS

APRACA - Asian and Pacific Region Agricultural Credit Association

BCEAO - Banque Centrale des Etats de l'Afrique de l'Ouest

BEAC - Banque des Etats de l'Afrique Centrale

FUSMED - Fund for Small and Medium Enterprise Development

NPP - New Patriotic Party

PNDC - Provisional National Defence Council

SME - Small and Medium Enterprise

Susu collectors - Savings collectors (known as tontiniers in the Francophone countries)

EXECUTIVE SUMMARY

The importance of small and medium enterprises in job creation, economic growth and for that matter poverty reduction cannot be gainsaid. In spite of the general recognition of the importance of these enterprises in economic development and the extensive financial reforms undertaken in the 1980s and 1990s in many African countries to improve small and medium enterprise financing, these businesses, particularly micro-enterprises, continue to suffer from lack of credit.

While numerous sources of small business finance abound such as governments, non-governmental organizations, development finance institutions, banks, savings and loan companies, credit unions, etc., results from these sources in support of micro-financing are mixed even though empirical case studies show that credit to small businesses can be assured without the traditional collateral and other guarantees demanded by financial institutions.

A stable macroeconomic environment is a pre-condition for a successful financing of micro-enterprises on account of the fact that inflation, high interest rates and a fluctuating exchange rate erode the fortunes of business firms and lending institutions with devastating effects on small firms in particular. Whereas it has been established that supply of credit remains the binding constraint facing small businesses and start-ups, research findings show that effective demand exists for SME finance **(Aryeetey et al 1994).**

This study assesses the credit facilities of Ecobank Ghana Limited to small and medium enterprises (SMEs) with particular emphasis on micro-enterprise financing. Surveys were conducted of existing SME clients of Ecobank Ghana to find out their characteristics as well as their perceptions regarding bank lending to them. The surveys also sought to establish Ecobank Ghana's lending portfolio for SMEs and micro-enterprises and the constraints inhibiting the bank's lending to small enterprises.

Our study shows that Ecobank Ghana Limited has an existing financing package for SMEs. This consists of structured products that have been tailored to the needs of SMEs. We observed in a sample of 30 out of 345 firms (which included all categories of firms) that 73 per cent had received Ecobank's loans to SMEs. On the other hand, we found that Ecobank's lending overwhelmingly favoured large corporate firms with 74.8 per cent of the entire lending portfolio of the Commercial Banking Department in 2002 going to the large firms, 22.6 per cent to medium enterprises and 2.6 per cent to small enterprises.

It was observed that the credit approval and appraisal requirements and procedures of the bank were centralized and quite stringent. This could be traced to the generally unstable macroeconomic environment that Ghanaian banks have witnessed in the past two decades and hence the banks' strong desire to protect themselves from the high risk in lending.

On the basis of the results from our surveys the study recommends a number of measures that can help Ecobank to reduce risk and transaction costs and increase its lending to SMEs and micro-enterprises. These measures include an internal restructuring of Ecobank's SME unit to make it independent and give greater autonomy to branches in terms of loan approval. We also propose measures such as the expansion of the bank's Product Programs and streamlining credit appraisal methods to meet small business financing needs.

Four successful case studies, the APRACA scheme of Indonesia, Barclays Bank of Ghana's Cocoa Credit Scheme, Bangladesh's Grameen Bank Model and the Tamale Women's Savings and Credit Project are examples of alternative creditworthiness criteria that Ecobank could take inspiration from towards improving credit to SMEs and intervening in the microfinance market. Other recommended measures include a multi-institutional approach that encourages dialogue and cooperation between government, banks and other stakeholders in the microfinance sector. Such dialogue should involve policy reforms, the provision of incentives, training and risk protection (insurance) for borrowers and lenders to enhance the access of credit to small businesses.

RESUME

L'importance de la place qu'occupent les micro entreprises dans la création d'emploi, la croissance économique et par voie de conséquence, la réduction de la pauvreté ne serait plus à démontrer. Malgré cette place importante de la micro-entreprise dans l'économie, qui est d'ailleurs généralement reconnue, et les multiples actions entreprises par les pays africains dans les deux dernières décennies pour reformer leurs systèmes financiers en vue d'améliorer le financement des Petites et Moyennes Entreprises (PME), l'on constate toujours que ces entreprises continuent de souffrir d'un manque de financement.

Pendant que les sources de crédit en faveur de la petite entreprise abondent et proviennent d'organisations gouvernementales et non gouvernementales, d'institutions de financement du développement, des banques, des caisses d'épargne et de crédit, etc., l'octroi de financement reste encore mitigé ; alors que des études empiriques ont montré que le crédit à la petite entreprise peut se réaliser sans les traditionnelles garanties recommandées par les institutions de financement.

Un environnement macro-économique stable est une condition préalable au financement de la micro-entreprise. A noter que l'inflation, les taux d'intérêts élevés, la fluctuation des taux de change affectent la situation financière des entreprises et des établissements de crédits, en particulier les PME. Pendant que les recherches ont établi qu'il existe une réelle demande de crédit de la part des PME, elles ont également montré qu'un problème majeur reste posé au niveau de l'offre de crédit **(Aryeetey et al 1994).**

Notre étude examine les facilités de crédit d'Ecobank Ghana en faveur de la PME, en particulier en faveur de la micro-entreprise. Nous avons conduit une enquête auprès d'un échantillon de ses clients de la catégorie des PME pour établir leurs caractéristiques ainsi que leur appréciation sur les financements que leur octroie Ecobank. Une autre enquête a été menée auprès d'Ecobank elle-même pour évaluer 1) son portefeuille de crédit aux PME et micro-entreprises et 2) les contraintes à son action de financement de ces entreprises.

Notre étude montre que la Banque a dans ses actifs un portefeuille existant de crédits aux PME qui sont des produits adaptés aux besoins de cette catégorie de clients. Sur un échantillon de 30 petites enterprises tiré d'une population de 345 entreprises (comprenant toutes les catégories), nous avons remarqué que 73 pour cent d'entre elles, c'est à dire 22 entreprises, avaient reçu des credits d'Ecobank Ghana. D'ailleurs, il a été remarqué que 74,80% du portefeuille de credit du Service Commercial d'Ecobank Ghana en 2002 a été accordé aux grandes enterprises, 22,60% aux moyennes enterprises et 2,60% du portefeuille destiné aux petites enterprises.

Notre étude fait remarquer que les procédures d'appréciation et d'approbation des financements de la Banque sont rigoureuses et centralisées. Cela découle des deux dernières décennies d'instabilité financière du secteur bancaire ghanéen, d'où la tendance des banques à minimiser leurs risques.

Sur la base des résultats de nos enquêtes, nous recommandons un certain nombre de mesures qui pourraient aider Ecobank à réduire ses risques et coûts de transaction et d'accroître ainsi le volume de crédit aux micro-entreprises. Ces mesures portent sur des propositions de restructuration interne, notamment de la Division en charge de la micro-entreprise et de la délégation d'un pouvoir plus élevé aux agences en matière d'accord de crédit. Nous recommandons d'autres mesures relatives à l'élargissement de la gamme de produits adaptés aux PME et à l'allègement des procédures d'appréciation et d'octroi de crédit.

En outre, nous proposons à Ecobank quatre études de cas qui constituent des exemples réussis de financement de la micro-entreprise dont elle pourrait s'inspirer. Il s'agit de :

- APRACA scheme of Indonesia,
- Barclays Bank of Ghana's Cocoa Credit Scheme,
- Grameen Bank of Bangladesh,
- Tamale Women's Savings and Credit Project.

Ces études ont établi, chacune, des critères servant de modèle pour l'appréciation de crédit à la petite entreprise.

Par ailleurs, nous recommandons une concertation multi-institutionnelle entre Gouvernement, banques et les divers acteurs du secteur de la micro-finance pour discuter des engagements politiques du gouvernement à prendre en faveur de la PME, de l'intéressement des banques aux PME, de la formation des acteurs et de la garantie des pourvoyeurs de fonds.

CHAPTER I

1.0 INTRODUCTION

1.1 Background

The financing of small and medium-sized enterprises (SMEs) has attracted considerable discussion and research and still remains a concern for governments, non-governmental organizations, entrepreneurs and financiers such as banks among others. The International Labour Organization (ILO) estimates that 60 per cent of the labour force of developing countries is involved in the informal small business sector and employs up to 500 million people worldwide.

In Ghana, small scale industrial activities span a wide range of activities including food processing and other agro-based industries, tailoring, bakeries, wood-related industries, shoe-making and shoe repairs, manufacture and repair of metal products, motor fitting and body work repairs, electric repairs, black- and goldsmithing, handicrafts, pottery, printing and diversified industries **(Sowa et al. 1992)**.

The vast majority of Africans live in poverty. With a population of close to 750 million people, over half subsist on less than $1 a day. Africa is the world's most donor dependent continent and most heavily indebted region with over 11 per cent of the world's debt, less than 2 per cent share of international trade and producing only 5 per cent of world income. Over the past thirty years it has become depressingly apparent that traditional development approaches have not created the intended economic change in Africa **(PRIDE AFRICA-2002)**. Africa is the only region of the world where poverty has increased over the past thirty years.

Ghana, like many developing countries, has experienced growing and deepening poverty over the 1980s and 1990s with an intensification of vulnerability and exclusion among some groups especially in the north and central region of the country **(Ghana Poverty**

Reduction Strategy Paper- 2003-2005). It is estimated that 40 per cent of the population live below the poverty line.

SMEs have been recognized as having an immense potential to contribute towards poverty reduction. **Sowa et al.** observed that small and medium-sized businesses are a good source of private employment in Ghana and even for some in public employment they provide a useful income supplement as a second job.

Various governments after Ghana's independence have pursued policies to revamp the small and medium scale industrial sector with the view to improving the living conditions of the people. The Economic Recovery Programme (ERP) under the PNDC Government saw the introduction of the Fund for Small and Medium Enterprise Development (FUSMED) as part of the Programme of Action to Mitigate the Social Cost of Adjustment (PAMSCAD) to provide credit to SMEs through World Bank funding. The GHANA VISION 2020 identified the private sector as the engine of growth. Some of the attempts at small business finance included the Business Assistance Fund (BAF) and Government directives for the use of 20 per cent of the District Assemblies' Common Fund to assist individual entrepreneurs and small business groups. The declaration of the GOLDEN AGE OF BUSINESS and the creation of a Ministry for Private Sector Development in 2001 by the NPP Government is the latest attempt by the state to resuscitate the private sector.

In spite of these initiatives the fact remains that SMEs still face enormous obstacles in accessing the needed finance especially from banks. Banks find the SME or microfinance sector particularly unattractive due to the high risk involved in their financing. However, in an era of increasing competition for large customers in the banking industry, banks need to seek new market niches such as providing credit to small and micro-enterprises.

This study lays emphasis on micro-lending by commercial banks with particular reference to Ecobank Ghana Limited. The Ecobank Group with its sub-regional coverage extending over West and Central Africa can make an immense contribution to poverty reduction in the sub-region if it intervenes in the micro-finance sector. This study intends to assess Ecobank Ghana's credit to the SMEs and propose an intervention into the financing of smaller scale businesses.

1.2 Statement of Problem

A study of the Fund for Small and Medium Enterprise Development by **Aryeetey et al. (1994)** following the far-reaching financial reforms undertaken under Ghana's Economic Recovery Programme revealed that reforming financially repressive policies had little immediate effect on the conditions that inhibited banks from financing small enterprises since a large number of SMEs had considerable difficulty in gaining access to credit.

It was also observed that commercial banks' profit orientation may deter them from supplying credit to SMEs because of the high transaction costs and risks involved. As a result, there is a mismatch between formal sector or institutional lending and the financial needs of small businesses in the informal sector. While SMEs lack access to bank credit, their requirements exceed the limits of informal agents. Filling the 'credit gap' may thus require incentives for the banking sector to develop smaller clients or lenders and the establishment of conditions and support for informal and semi-formal institutions.

The main issues arising from these observations include: what can be done to reduce the high transaction costs and risks of the small enterprise sector to attract commercial bank lending?; how can the gap between formal and informal lending institutions be bridged to increase credit to small businesses?

This study intends to address this mismatch between the credit requirements of micro-enterprises and commercial bank lending.

1.3 Rationale and Relevance of the Study

This research project is carried out as part of the requirements leading to the award of an MBA in Banking and Finance which was established by the BCEAO, BEAC (the central banks of West and Central African States respectively) and Banque de France (the French

Central Bank). The MBA Programme is offered by the Centre for Advanced Studies in Business Administration (CESAG) in Dakar, Senegal with sponsorship from European Union, the World Bank, the African Capacity Building Foundation among others with teaching partnership from New York University, the Bank for International Settlements, the Bank of Ghana, Universite Paris Dauphine and INSEAD at Fontainebleau in France. This research is undertaken alongside a three-month internship (July-September 2004) which I undertook at the Commercial Banking Department of Ecobank Ghana Limited (EBG). The internship is designed to enable students to practically apply the skills acquired after eight months of course work in Banking and Finance and at the same time undertake a researh project aimed at addressing a problem identified at the internship site. To this end, this study proposes strategies to tailor Ecobank's credit to the needs of small businesses.

There is an extensive literature and research on small business issues. Most of the works have been preoccupied with the lack of development and finance for Small and Medium-Sized Enterprises (SMEs). This present study does not depart from this general objective. But whereas the bulk of the research emphasize on SMEs as a broad spectrum of enterprises, this study fills a gap in the literature by focusing on the financing of smaller scale businesses or what is often referred to as micro-enterprises in the literature in which the very poor of the society are involved. Any meaningful fight against poverty should aim at improving the activities of these people through especially the provision of credit to small businesses.

Also, the study draws the attention of commercial banks to the need to lend to the micro-enterprise sector. This is not a benevolent call for bank charity to micro businesses. Rather, it is a proposal for a prudent consideration of a highly potentially profitable sector which has hitherto been neglected by banks.

1.4 Objectives of the Study

The Study has the following objectives:

1. To examine Ecobank Ghana's credit standards to small and medium scale enterprises in terms of loan size, type and volume.

2. To establish the case that micro-finance is a profitable option for commercial banks such as Ecobank Ghana Limited.

3. To make recommendations for Ecobank's intervention into micro-lending.

1.5 Hypothesis

The micro finance sector is a potentially profitable option for intervention by Ecobank Ghana Limited.

1.6 Methodology and Data Sources

This study draws on primary and secondary data from the Commercial Banking Department of Ecobank Ghana Limited, Ecobank's customers (enterprises), Ghana National Board for Small Scale Industries (NBSSI), the Private Enterprise Foundation, the Ministry for Private Sector Development and other sources. We conducted interviews of selected Ecobank staff and customers.

A structured questionnaire incorporating factors on the constraints SMEs face in sourcing commercial bank loans was personally administered on a sample of 30 small and medium-sized business firms (Appendix I). The sample is deliberately targeted at Ecobank's customers in the Accra and Tema areas. It is not a random drawing from the general population of SMEs. It is designed to give a picture of the characteristics of the SMEs that have been given loans. The sample was biased towards the urban centers where Ecobank operates.

A second questionnaire (Appendix II) designed for the management staff of Ecobank's Commercial Banking Department sought to find out the bank's policy objectives and portfolio towards small business lending as well as the constraints involved.

1.7 Scope of the Study

The scope of this work is limited first of all in time (it was undertaken within 3 months) and general coverage: it is limited to Ecobank Ghana Limited. Without being purely an academic work it is severely restricted in volume. The well-known difficulties in accessing financial data especially from banks, limits the depth of this study and any comparative study that could have been made with other banks to enrich the research. The study nonetheless makes concrete proposals for Ecobank Ghana's intervention into small business financing.

1.8 Organization of the Study

This project work contains five chapters. Chapter I outlines the general introduction which includes the background, objectives, statement of the problem, hypothesis, methodology and limitations of the study. Chapter II will review the existing literature and empirical works on SME and micro-enterprise financing. Chapter III examines Ecobank Ghana's credit facilities available to small and medium scale enterprises. Chapter IV presents the findings and analysis of the study. Chapter V concludes the study with recommendations for Ecobank Ghana to intervene into small business financing.

CHAPTER II

2.0 REVIEW OF EXISTING LITERATURE

Much of financial theory has been traditionally devoted to the investment and financing decisions of large corporate firms to the neglect of small firms. According to Ibbotson Associates (USA) the bulk of business research is focused more on large corporate firms than small firms. But perhaps even more worrying is the imbalance between the financing of large and small firms which is skewed in favour of the former.

In this section, we shall review existing literature on small business finance. We consider the theoretical basis underlying this imbalance by looking at corporate financial decision making and the risk-return relationship. Other issues reviewed include the sources of micro-enterprise finance, the problems involved in institutional lending, the macroeconomic environment as it relates to credit to SMEs, a consideration of the supply and demand for SME finance and a presentation of some best practice case studies in the micro-finance literature.

2.1 Traditional Business Structure and Finance

Conventionally, businesses are organized into three types: (1) small ventures (owned and managed by a single individual) also called sole proprietorships, (2) partnerships where several people may join to own and manage the business and (3) corporations which are generally owned by a large number of shareholders or investors. Unlike sole proprietorships and partnerships, corporations separate the management of the business from its ownership. Thus although the stockholders own the corporation, they do not manage it.

2.1.1 Definition of a Small Business

There is no precise definition of a small business enterprise. Apart from defining small businesses by their management and ownership structure as above, they are also defined based on their asset size or capital base. According to the World Bank, a small and medium enterprise (SME) is an economic entity with fixed assets (including land) not exceeding US$ 1.5 million **(P. Hammond, 1995)**. Going by this definition, it would be realized that only a few companies have this level of fixed assets in Ghana and for that matter Africa. For this study we shall retain a working definition of a small and medium enterprise using the following fixed asset sizes:

- All enterprises with total fixed assets of US$ 100,000 or less are considered micro or small enterprises.

- Enterprises with fixed assets including land between US$ 100,000 and US$500,000 are medium enterprises.

- Enterprises with fixed capital assets of more than US$500,000 are large enterprises.

Research has shown that the smaller the enterprise, the more difficult it is to access finance **(Aryeetey et al 1994)**. In this same study it was found that there was a 2:1 probability that an SME application for a bank loan would be rejected and a 3:1 probability for micro-enterprise. Whereas corporations easily attract funds from financial institutions such as banks and through public listing on organized stock exchanges or over-the-counter (OTC) market and other sources, small businesses rely much on owner incomes, customers' advances and supplier's credit and very little on bank credit.

2.2 Corporate Financial Decision-Making

According to **Brealey and Myers (2000)**, corporations face two broad financial questions: What investments should the firm make? and How should it pay for those investments? The first question involves spending money *(the investment or capital budgeting decision)* and the second involves raising that money *(the financing decision)*. In making investment decisions a basic principle that guides firms is that the return on funds invested should be more than they cost (and this is irrespective of the type or size of the firm). Corporations will therefore only invest in assets that will bring them the maximum return and raise money for the financing of those investments where the cost of capital or funds is cheapest. A third question that has engaged the attention of firms and gained prominence in the finance literature is *dividend policy:* should the firm's excess cash or profit be reinvested or returned to the owners (shareholders)? The dividend policy decision is considered in the literature as a financing decision.

Whereas the dividend decision does not concern small firms, given their ownership structure, the investment and financing decisions affect all firms regardless of their size and ownership. Our concern here is that when small business entrepreneurs make financing decisions, they are confronted with a myriad of obstacles in obtaining investment funds to grow their businesses.

2.2.1 The Risk-Return Relationship

The risk in an investment is defined as the uncertainty surrounding the cash flows or returns that are generated from the investment. It can be measured by the variance in actual returns around an expected return. The higher the uncertainty (or variance) in the returns, the higher the risk involved. The expected return on an investment is the benefit that the investor expects to gain on the investment.

a) The Capital Asset Pricing Model (CAPM)

In the mid-1960s, **William Sharpe**, **John Lintner** and **Jack Treynor** illustrated the risk-return relationship in a model they called the *Capital Asset Pricing Model* as follows:

$$R = R_f + \beta(R_m - R_f)$$

or

$$R - R_f = \beta(R_m - R_f)$$

Where, R = the expected return on investment, R_f = risk-free rate, β = Beta, (where $\beta > 0$) which defines the risk associated with the investment, R_m = expected return from the market portfolio, $R - R_f$ = expected risk premium on an investment and ($R_m - R_f$), the market risk premium (the return on a market portfolio above the risk-free rate).

b) The Significance of beta (β) - A Measure of Risk

The risk of a security is meaningless if it is held in isolation. The market risk of a security is determined when it is held in a diversified portfolio of securities or investments, which boils down to measuring how sensitive the security is to market movements. This sensitivity is called beta (β). Stocks (investments) with betas greater than 1.0 tend to amplify the overall movements of the market. Stocks with betas between 0 and 1 tend to move in the same direction as the market, but not as far **(Brealey and Myers).** The risk-free rate is defined as the expected return from government treasury bills, which is the least risky investment with a beta of 0 and a risk premium of 0. The market portfolio has a beta of 1 and a risk premium of R_m-R_f.

The Capital Asset Pricing Model enables us to estimate the expected returns on investments whose risk or beta is not zero or one. The Model assumes that there are no transaction costs, all assets are traded and investments are infinitely divisible (i.e you can buy any fraction of the asset). It also assumes that everyone has access to the same information and that investors therefore cannot find under- or overvalued assets in the marketplace **(Damodaran, 2001)**.

The model stipulates that in a competitive market, the expected risk premium on an investment varies in direct proportion to beta or its risk as represented on the security market line. That is, riskier investments will only be undertaken if they offer commensurate returns. For example, the expected risk premium on an investment with a beta of 0.5 is half the expected risk premium on the market. Also, the expected risk premium on an investment with beta of 2.0 is twice the expected risk premium on the market.

All corporate entities including banks are guided by this risk-return relationship in their financial decision making process. The lack of funding for SMEs generally and micro-enterprises in particular can be understood within this context since they have high risk or betas. Banks will not lend to small businesses if the risks in doing so are higher than the returns. One easily understands why banks in Ghana in the late 1990s invested more in

Treasury bills (which are risk-free assets) and reduced lending to enterprises when the Treasury bill rate reached a peak of 42%. The issue is how to reduce the risks or increase the returns in the micro-finance sector to make it attractive to commercial banks.

2.3 Sources of SME and Micro-enterprise Lending

A number of institutions supply microfinance services including governments, Development Finance Institutions (DFIs), Non-Governmental Organizations (NGOs), Commercial, Development, Community and Rural banks, Venture Capital firms, informal sector lenders such as savings and loans companies, credit unions and associations and savings collectors known as *susu* collectors in Ghana or *tontiniers* in the francophone countries and sometimes referred to in the literature as 'mobile bankers' **(Aryeetey and Steel, 1995)**. But as indicated before, small businesses have for a long time relied on owner savings and reinvested profits as a source of finance.

The following are the main sources of micro-lending:

2.3.1 Governments

Market Failures: The Basis for Government Intervention

The intervention of Government into micro-enterprise financing can be explained in the wider context of what is referred to as market failures. The free market, left to itself, may fail to produce efficiency **(Meir Kohn, 2000)**. When the market does not provide efficient outcomes for the society, economists say that the market has 'failed'. This provides a rationale for government intervention into the market to rectify the faults of the free market and to improve the efficiency of the financial system. Because markets fail, governments around the world believe that unless they intervene, profitable new ventures are likely to fail for lack of finance.

Economists have identified different types of market failure including:

a) The existence of monopolies or the failure of competition:

For the market to produce efficient outcomes there must be competition which allows individuals in the market to obtain the satisfaction from goods and services for the least amount of money possible. When monopolies exist there is no competition. The market fails because monopolists tend to restrict production of goods or provision of services and increase prices for them above the natural market level under competition. Governments intervene in the marketplace to regulate the output and prices of monopolies to prevent public exploitation.

In the past, a few banks have dominated the loan market and thus creating a monopoly in lending to business, which tended to favour large businesses. Perhaps government directives for bank supply of credit to small businesses in the past can be understood in this context.

b) Public goods:

Public goods have two characteristics for which the market fails in their provision. First, once a public good is provided for a group of people, there is no additional cost associated with its consumption by an additional individual or group of individuals. What is more, the additional consumption does not reduce the quantity of the public good. Public goods are therefore said to be non-rival. Secondly, once they are provided for one person, it is difficult- if not impossible- to prevent their enjoyment by other people. They are thus said to be non-exclusive. Examples of public goods are national defense, public education and street lights.

Because the benefits of public goods are almost always less than the cost of producing them, the free market system does not provide them. This provides an economic basis for government intervention to provide such public goods.

Since the risks inherent in the provision of small loans are more than the perceived benefits, banks usually would not supply such loans hence the need for government assisted programmes.

c) Incomplete markets:

There are numerous goods and services that have the potential to improve the economic fortunes of individuals and society that are underprovided by the market. In such circumstances, the need or demand for a particular good or service is higher than the available supply of that good or service and hence there is incomplete market. On its own, the market traditionally has tended to undersupply insurance for particular kinds of risks such as loans to small business ventures. In such cases, there are government programmes to complete or supplement the naturally incomplete markets.

d) Externalities:

Externalities are positive or negative unintended by products that firms generate for third parties in their production process. When third parties benefit from the activities of firms, such benefits are referred to as positive externalities. On the other hand, costs suffered by third parties are negative externalities. This justifies government intervention to provide incentives for firms in the form of subsidies to produce more of the external benefits or externalities for the benefit of society. On the other hand, firms are constrained through taxes to reduce negative externalities that affect society. It is in this light that governments provide subsidized finance for young companies.

2.3.2 Development Finance Institutions

Government Failure

Government intervention in the market has its own costs and flaws. In reality, intervention often serves special interests rather than the public good. This can lead to even more inefficiencies than before government intervened. When this happens there is said to be Government Failure.

According to **Meir Kohn**, legislators are beholden to groups and to individuals who support them with votes and money, and they will find ways to show their gratitude. The government itself is a special interest. It is a customer of the financial system and regulation can be used to bias the system in the government's favour.

As a result of lack of impact of investment in state-run programmes and failure of 'trickle-down' development strategies, donor agencies began to initiate their own projects managed independently of government. Nevertheless, these initiatives by International Development Finance Institutions have their own drawbacks. **McKenzie**'s study of the United States Agency for International Development (USAID) and European Development Fund (EDF) financing of six projects in the Sahel region, reports of limited success.

The projects include the following:

- VITA Private Enterprise Program, Chad (USAID)
- Projet d'appui à la création de PME/PMI et à l'insertion des jeunes diplomes, Mali (European Development Fund, EDF)
- CARE Maradi Employment and Income Generation Project, Niger (Government of Niger/USAID)
- Association pour la Productivité, Burkina Faso (USAID)
- The Private Enterprise Credit Agency, Kaolack, Senegal (USAID)
- The Sahel Regional Financial Management Project, Senegal (USAID)

These projects sought to promote employment and economic growth, the development of a limited number of small modern enterprises and to provide credit to many informally run enterprises. Whereas loan recovery rates reached 90% in the EDF project in Mali and the USAID project in Kaolack, Senegal, the projects suffered from low local investor participation and government directives, which kept interest rates low because governments in the Sahel region at the time did not want small business loan programmes to charge market interest rates. **McKenzie**'s study suggests that small businesses can indeed support high interest rates and that access to credit is a much more significant issue for them.

2.3.3 Non-Governmental Organizations (NGOs)

Micro-lending NGOs have a long experience in the micro-finance sector and are engaged in providing financial assistance to small businesses usually with donor support. Classified as non-bank micro-lending institutions, NGOs have the advantage of being able to operate in relatively constrained financial market environments because they are not subject to regulatory interest rate ceilings, high reserve requirements and selective credit policies as are commercial banks. However, **Valenzuela (2004)** observes that these NGOs have started transforming themselves into regulated banks and specialized financial institutions offering micro-deposit facilities and micro-loans. The Catholic Relief Services (CRS) in Ghana and PRIDE AFRICA in Kenya are examples of NGO efforts in micro-lending. PRIDE, a US non-profit organization, has created the largest microfinance network in East and Southern Africa. It has over the last 10 years disbursed over 400,000 loans to micro-entrepreneurs above market interest rates and maintained over 95 per cent repayment rate.

2.3.4 *Commercial Banks*

Commercial banks supply financial products and services which include, accepting deposits, lending, insurance, investment banking (e.g. securities underwriting and broker/dealer transactions). They are new players on the micro-lending market. Until recently savings mobilization and lending constituted the core business of commercial banks. As corporate entities they are driven purely by profit considerations. However, the low profit margins (returns) in the micro-finance sector has not compensated for the relatively high transaction costs (risks) thus resulting in the low participation of these banks in the micro-lending market.

A study by **Baydas, Graham** and **Valenzuela (2004)** notes that until the 1980s, regulatory repression of formal financial markets in most developing countries including interest rate ceilings, high reserve requirements and directed credit lines by central banks, largely precluded established banks from servicing a high cost and riskier micro-enterprise clientele.

Before liberalization of the financial sector, the Bank of Ghana prescribed sectoral credit ceilings to be applied to all banks in lending to various sectors including SMEs. These credit ceilings however had little effect in redirecting actual bank lending toward the priority sectors. Since 1988 the financial sector has been completely liberalized. But as indicated before, the World Bank's attempt at channeling credit through a number of commercial banks to SMEs in the wake of the Economic Recovery Programme did not produce the desired results.

Aryeetey (1994) found in his study of the distribution of total loan volumes approved by commercial banks in Ghana that 74.4% of the loans went to large scale enterprises, 14% to small scale enterprises and 11.6% to traders, the construction sector and individuals. Perhaps the best efforts towards commercial bank lending in Ghana to SMEs has been through the Ghana Commercial Bank's government-assisted credit schemes using its extensive branch network throughout the country. **Baydas et al. (2004)** observe that commitment at the highest levels of the bank hierarchy is necessary to get commercial banks to support micro-finance programmes. But beyond management commitment, banks need to see real financial incentives and risk protection to motivate them to intervene into the micro-finance market.

Commercial banks are said to have comparative advantages when compared to micro-lending NGOs in offering financial services to micro-finance clients that could give them a special edge including the following:

As regulated institutions fulfilling the conditions of ownership, financial disclosure and capital adequacy, they help ensure prudent management of funds

They have physical infrastructure, including a large network of branches from which to expand and reach out to a substantial number of micro-finance clients.

They have well-established internal controls and administrative and accounting systems to keep track of a large number of transactions.

Their ownership structures of private capital tend to encourage sound governance structures, cost-effectiveness and profitability, all of which lead to sustainability.

Because they have their own sources of funds (deposits and equity capital), they do not have to depend on scarce and volatile donor resources.

They offer loans, deposits and other financial products that are attractive to a micro-finance clientele.

2.3.5 Rural and Community Banks

In Ghana, rural banks are created by the State with the aim of providing financial services for the rural population. There are 115 rural banks in Ghana in 2004 (source: Bank of Ghana) and their financing comes from savings mobilization and loans from the Central Bank of Ghana. There are also community banks, which operate like rural banks but with a higher capital adequacy requirement and are found in both rural and urban areas. The original intention of channeling funds to rural activities through rural banks in Ghana has largely been defeated due to poor management, poor portfolio performance and capital inadequacy **(Aryeetey 1994)**. On the contrary, **Soyibo (1994)** notes that community banks have been particularly successful in promoting small and medium scale business financing in Nigeria.

2.3.6 Non-Bank Financial Institutions

Ghana's Financial Institutions (Non-Banking) Law (PNDCL 328 – 1993) authorizes the operations of discount companies, finance houses, building societies, credit unions, mortgage finance companies, venture capital funding companies, leasing and hire purchase companies, and savings and loan companies. These institutions have an advantage in mobilizing funds because they are not strictly bound by the stringent regulatory environment that banks are subjected to.

Steel et al (1994) classify non-bank financial institutions into two categories; semi-formal and informal financial institutions.

a) Semi-Formal Financial Institutions

'Semi-formal' financial institutions are subject to some registration or other regulations. They are small free-standing units which are not integrated with the formal banking system. They include savings and loan companies (S & L), credit unions and savings collectors. Savings and loan companies number more than 200 in Ghana today. Operating mainly in the urban centers and privately owned, their financing comes from client savings mobilization.

b) Informal Financial Institutions

Informal financial institutions or sources include saving and lending activities that operate outside the scope of the banking law and other financial sector regulations of government. These include, money lenders, susu collectors, susu groups or ROSCAs (Rotating Savings and Credit Associations) and different kinds of mutual assistance groups that collect or lend money. Susu collectors serve the needs of low-income earners interested in short term working capital such as market women and traders by collecting their clients' savings on a daily basis. In some rural areas, savings mobilization by susu collectors may be the only accessible means of accumulating funds for investment for some clients. **Aryeetey and Gockel (1991)** observed that savings mobilized informally in urban areas of Ghana constituted about 45% of total financial savings mobilized in those areas.

On certain conditions informal financial institutions can grant advances to their clients even though they are less significant as lenders for business than they are for consumption. This is attributable to the nature of their liabilities which are generally very short term in nature and because people save with them mainly to accumulate a lump sum to purchase a consumption item.

Steel et al. are of the view that the profiles of borrowers of non-bank financial institutions do not appear significantly different from those of banks even though they seek to enter into market niches that have been avoided by banks.

c) Venture Capital

One important form of non-bank source of finance is venture capital. Venture capital firms also called Risk Capital provide funds for start up firms and small businesses with growth potential with the aim of gaining a share of the profit or control over such businesses in the future. Managerial and technical expertise is often also provided. There is a well-developed venture capital market in the United States of America in which specialists set up partnerships and pool funds from a variety of investors and seek out fledgling companies to invest in and work with these companies as they try to grow into publicly traded companies. **Brealey and Myers (2000)** estimate that these venture capital partnerships comprising pension funds, insurance companies, individuals and families, endowments and foundations, and corporations together raised about $10 billion in 1997. A survey of Ghanaian firms' financing needs suggest that venture capital funds have not reached a large number of SMEs **(Steel et al)**.

Venture capital finance and other non-bank financial institutions, though not well developed in our part of the world, can be an important financing source for small firms.

2.3.7 Own Sources of Funding and Loans from Relatives and Friends

Firms' own sources of funding form an important part of small enterprise financing in Ghana, especially in the rural areas. Generally, the enterprises in which entrepreneurs are engaged constitute the main sources of income for financing their enterprises. Survey results by the World Bank on small enterprises in Ghana (World Bank Discussion Papers, Africa Technical Department Series, No. 251) reveal an overwhelming importance of equity finance (80%) in these enterprises as is the case in other developing countries. These take the form of reinvested profits and personal savings. **Boapeah (1994)** found in a survey of small rural enterprises in the Ahanta West District of Ghana that between 25 per cent and 50 per cent of profit earnings was reinvested in business. Many small entrepreneurs begin with very small amounts of capital from personal savings and steadily build up their enterprise by reinvesting profits.

Contracting loans from relatives and friends is the first major source of informal external financing outside own sources. In the same survey, **Boapeah** realized that 40 per cent of SMEs' capital needs came from relatives and friends.

2.3.8 Remittances

Remittances from abroad also known as 'returns on migration' have become an important source of finance for small businesses even though statistics on the exact amounts available for such financing remain vague. These remittances are reported to be over and above Foreign Direct Investment (FDI) and Overseas Development Assistance (ODA) home countries receive from their residents in developed nations. According to a United Nations report (2002) migrants from developing countries including Ghana remitted $88 billion in 2002 to their home countries as against $57 billion in 2001. The Bank of Ghana reports that Ghanaians remitted $1.4 billion in 2002. This does not include money remitted through informal channels.

A critical element in the role of remittances in business promotion is the business environment. Returnees and residents abroad are usually reluctant to transfer funds to business activities in home countries unless they are confident that they can earn a reasonable return and if only there are no administrative and regulatory bottlenecks. The growth in remittances in Ghana over the years is perhaps an indication of the confidence that Ghanaians abroad have in the economy.

2.4 Empirical Case Studies of Micro-finance

Case Study 1 : The Asian and Pacific Region Agricultural Credit Association (APRACA) in Indonesia

As a form of security and to prevent default, the APRACA financial scheme in Indonesia uses group solidarity mechanisms to grant credit, which is self-sustaining. For example, credit is granted to a self-help group from a commercial bank. The group uses part of its funds for internal lending and another part for deposit in the bank as a basis for refinance from the bank. Interest rates on savings and the credit are at market rates and take into consideration, reduction in bank transaction costs. Joint liability for default is substituted for physical collateral.

Case Study 2 : Credit Scheme for Cocoa Farmers – Barclays Bank (Ghana)

The Barclays Bank of Ghana's experience in disbursing loans to cocoa farmers under the FUSMED Project is very useful in considering lending to micro-enterprises. Under this scheme farmers are allowed to choose members with whom they wish to associate and form groups to receive loans. Disbursements are made individually to each farmer against receipt. The availability of future credit is tied to the group meeting its repayment obligations. P. Hammond argues that this peer pressure has been observed to be more effective than any collateral, especially where the availability of facilities for the entire group is linked to repayment by all members. In such a case joint liability is substituted for physical collateral.

Case Study 3 : The Grameen Bank of Bangladesh

The Grameen (Rural) Bank of Bangladesh, founded in 1983 by **Mohammed Yunus**, Professor of Economics at Chittagong University, with the help of an interest-free loan of US$ 3.4 million from the United Nation's Fund for Agricultural Development. Grameen Bank provides micro-credit loans of very small amounts to the rural poor.

A group-lending scheme, the Grameen model has become so successful that it currently operates 1,092 branches in 36,000 Bangladesh villages, providing credit to over two million of the country's poorest people. Having 94 per cent of its beneficiaries as women, the Grameen scheme has a repayment rate of 98 per cent (visit www.grameen-info.org).

Under the Grameen scheme, a small group of members forms the basic unit for receiving a loan and the group is collectively responsible for loan repayment. This joint liability among members reduces the risk of default since one member's failure to repay jeopardizes the entire group's access to future credit. Group lending also has an added advantage of reducing administrative cost in the long term. The success story of the Grameen Bank has challenged the conventional banking wisdom, which holds that the small business sector is a bad risk and that all credit has to be secured against tangible assets.

Case Study 4: Tamale Municipality Women's Savings and Credit Project (TMWSCP)

The Tamale Municipality Women's Savings and Credit Project in Northern Ghana is a tripartite institutional arrangement between Actionaid Ghana (AAG), an NGO, Freedom From Hunger Ghana (FFHG), also an NGO and Bonzali Rural Bank (BRB) in Tamale to provide credit to women in the Tamale Municipality. The project started in 1997 and ended in 2001. Actionaid financed the project with donor funding from the British Department for International Development (DFID) and had the overall management responsibility for the project. FFHG served as technical service providers with responsibility for training bank and project staff and clientele. BRB recruited field agents, provided the operational environment for project implementation and 10 per cent of project funds to be used as a revolving fund to ensure ownership and continuity of the project.

The TMWSCP scheme combined credit with education as its methodology. Solidarity Groups of 4-6 women per group were formed and personally guaranteed each other's loans. The solidarity groups come together to form a Savings and Credit Association (SCA). Each solidarity group then borrows from the rural bank. All members must pay a membership fee that is determined by the group to meet administrative costs. Individual loan requests must first be approved by the members of the same borrower group and presented to the full SCA membership for review and approval. The SCA collects savings from each member each week with the minimum amount determined by the group according to the individual savings capacity of members.

The Tamale credit scheme has been a success. A total of 3641 women have been granted credit well above the projected 3000 target at the beginning of the project. Women have been able to establish their own petty trades and generate income to cater for their families. The savings mobilization, liquidity and client base of the Bonzali Rural Bank has increased. But even more importantly the project has generated internal funds and has continued to guarantee credit to women groups after donor funds have ceased.
The project offers lessons on how institutional collaboration can enhance credit to the poor without collateral and other requirements.

2.5 The Problems Involved in Lending

Meir Kohn (2000) notes that while trade in goods and services may or may not involve promises, lending always does because a lender gives up purchasing power today in exchange for a promise of purchasing power tomorrow. The basic problem is that the promise may not be kept because the borrower may default. Banks as lenders therefore need information on the borrowing firm, which is key to the lending decision. For example, before giving out money, banks will like to know whether the company in question has ever defaulted in the past. Banks will also want to know about other debts the company owes and whether its earnings will enable it to service its loans. If the company does default, what are the assets that can be liquidated to repay the debts?

Getting answers to the above questions entail cost for both the borrower and the lender. The borrower will be required to prepare accounts and business plans to convince the lender of the viability of the project. On the other hand, the lender has the onus to digest the information and check its reliability because the borrower is likely to present positive information and is often reluctant to reveal everything. For example the company will not wish to disclose to the lender, its ideas for new products for fear that they will fall into the hands of its competitors.

Kohn believes that the risk of default need not deter the lender from lending. If the chance of default is small and the potential reward is great, it is all the more worthwhile to go ahead and lend.

2.6 The Macroeconomic Policy Environment and Credit to Small Business Firms

The macroeconomic environment plays a critical role in the success of small enterprise development in general and lending to small businesses in particular. The level of interest rates, the rate of inflation and the exchange rate substantially affect the profitability of both lenders and borrowers. Interest rates represent the cost of borrowing and slow down investment when they go high. Inflation, on the other hand, affects the value of money over time and is a disincentive for lenders. For these reasons, the macroeconomic policies (fiscal and monetary) that are pursued by a country at any point in time have implications for the growth of financial services available to small and medium-sized enterprises. **Helmsing** and **Kolstee** point out that in the past countries' domestic finance policies have played an important role in determining the success of small businesses.

While markets experiencing financial liberalization offer a far more promising opportunity for lending to micro-enterprises, the evidence is that a favourable policy environment is not sufficient to ensure access to credit for SMEs. **Aryeetey** after examining Ghana's experience with the effectiveness of credit allocation policies in channeling resources towards small enterprises observes a consistent decline in the share of sole proprietorships in domestic credit from 1985 to 1995. This was in spite of far-reaching economic and financial reforms in the eighties and nineties.

Oyejide finds that the lowering of entry barriers into banking in Nigeria has led to a substantial increase in the number of banks operating in the country with the phasing out of sectoral credit targeting and interest rate deregulation. In Kenya. **Kirimi Mwarania** found that liberalization of financial markets in the late seventies and eighties led to a rapid increase in the number of financial institutions followed by a credit squeeze in the mid-eighties leading to the collapse of many financial institutions.

When economic conditions worsen, banks' perceptions of the relative risk of loans increases; and since bad economic conditions are often accompanied by high default rates, banks' net worth decreases, along with their willingness to bear risks. On both accounts, banks respond to bad conditions by shifting their portfolio towards the safer activity: investing in Treasury bills **(Stiglitz and Weiss - 1981).**

In 2000, the prime rate in Ghana stood at 45% and the 91-day Treasury bill rate was 42.72%. These high interest rates have been attributed to excessive government borrowing from the public. Banks therefore found a safe haven in Treasury bills as compared to the highly risky private sector.

The general macroeconomic conditions in Ghana today appear to have stabilized. Inflation has fallen from 22.4% at the beginning of 2004 to around 11.1% in June 2004 (Ministry of Finance). The Central Bank's base interest rate is 18.5% while the Cedi has stabilized against the major currencies (the cedi depreciated by 2.1% in the first half of 2004 as compared to 100% in 2000). There has been an increase in competition in the banking industry with a total number of nineteen (19) banks operating in the country as of September. 2004. This seems to augur well for small business financing as banks seek out new small business customers. But as William Steel points out. Ghana has a typical problem in its banking structure in that only the large state-owned bank (Ghana Commercial Bank) has the widespread branch network necessary to reach local SMEs on a large scale

2.7 The Supply and Demand for SME Financing

There is a good reason to attribute the lack of bank lending to SMEs mainly to supply-side factors. In the view of banks, unless there is demonstrable demand by SMEs for loans at prevailing market prices, measures aimed at the supply side will have little effect. However, **Aryeetey et al.** in their study of demand for financing of SMEs observe that lack of credit may be overstated as a constraint because entrepreneurs tend to ignore their own internal management constraints as a hindrance to their businesses. Furthermore, some important sources of SME financing are often not considered as loans such as customers' advances and supplier's credit.

The study reveals that SME demand for finance is overwhelmingly for bank loans. Informal lenders generally cannot provide enough funds and charge too much interest for SMEs while individual equity partners are considered undesirable. It was also observed that growing firms are more likely to demand and receive external finance than stagnant ones. The study concludes that the high rates of application for bank loans among SMEs and their willingness to pay above-market rates of interest indicate a strong excess demand.

2.8 Summary and Conclusion

Small businesses have not only suffered from research neglect but have been deprived of finance when compared to large corporate firms. The lack of financing for small and medium scale enterprises, especially from banks can be attributed to the risk-return dichotomy that underlies corporate decision-making. The risks associated with small business lending far exceed the returns thus creating a disincentive for bank intervention into that market segment.

Besides banks, there are several players in the micro-lending sector namely, governments, development finance institutions, NGOs, non-bank financial institutions and remittances which are assuming an increasing importance as a source of small business finance. Empirically, the results of these institutions and sources in channeling credit to SMEs are mixed. Nevertheless, the Grameen Bank, the Tamale Women's Savings and Credit Project among others offer practical examples for micro-enterprise financing.

The macroeconomic environment under which banks operate is crucial in enhancing credit to micro-enterprises. An unstable macroeconomic environment generates inflation, high interest rates and unstable exchange rate all resulting in high cost of borrowing and lending and low profitability of firms. The effects are more severe on small businesses than the more formal large firms **(Franks, 2000)**. Financial reforms undertaken across Africa to improve the policy environment and hence credit access to small firms have not achieved much.

Research is conclusive that effective demand exists for SME finance contrary to the view held by banks that there are few bankable projects. The supply constraints in small business lending can be removed if banks reassess their lending methodologies and criteria.

CHAPTER III

3.0 AN ASSESSMENT OF ECOBANK GHANA's CREDIT TO SMEs

In focusing on Ecobank Ghana Limited by assessing the Bank's credit to SMEs, it is important to examine the context within which the bank operates namely, the Ghanaian banking industry and the trend of macroeconomic indicators such as inflation, interest rates and the exchange rate as well as the asset and loan portfolio of the industry. These indicators, as we have pointed out before, affect the fortunes of both borrowers (firms) and lenders (banks). We shall also present in this section Ecobank's credit to SMEs, its credit granting procedures and statistics on the lending portfolio by sector and size.

3.1 The Ghanaian Banking Industry

Ecobank Ghana operates within a banking industry characterized by intense competition as banks try to maintain or gain a share of the market. Apart from the Bank of Ghana (the Central Bank) which has supervisory responsibility over the banking system, there are presently nineteen (19) banks in the country. They include:

1. 1st Atlantic Merchant Bank
2. Agricultural Development Bank (ADB)
3. Amalgamated Bank (Amalbank)
4. Barclays Bank Ghana (BBG)
5. Cal Bank (Formerly Cal Merchant Bank)
6. Ecobank Ghana Limited (EBG)
7. Ghana Commercial Bank (GCB)
8. HFC Bank Ghana
9. International Commercial Bank (ICB)
10. Metropolitan and Allied Bank
11. Merchant Bank Ghana

12. National Investment Bank (NIB)
13. Prudential Bank Limited
14. Standard Chartered Bank
15. SG-SSB Bank
16. Stanbic Bank
17. The Trust Bank
18. Unibank
19. Standard Trust Bank

3.1.1 *Developments in the Banking Industry*

The industry saw the entry of two new banks in 2004. First, the HFC Bank, until recently a mortgage finance company, entered in early 2004 and the Standard Trust Bank followed by August 2004. Banks continued to pursue prudent banking practices and policies not only to stay in the industry but also to survive the competition. With the fall in interest rates, which has brought pressure on interest margins, most of the banks focused on growing fee-related transactions and containing operating costs. Recently the industry has witnessed some degree of product development and service enhancements aimed at improving service delivery and customer satisfaction.

SG-SSB and Barclays Bank Ghana pioneered the introduction of telephone banking in 2002. SSB's *SikaTel* allows its customers a 24-hour-7-days-a-week access to a wide range of financial information such as the bank's product line, account balances and statement/ check book requests. Barclays also introduced telephone banking but this is restricted to its Prestige banking clients. SG-SSB again launched Priority Banking, which is similar to Barclays Prestige Banking and is aimed at providing first class banking services for its clients.

GCB also launched an e-banking product – *Commernet* – which enables customers to have instant access to the status of their accounts from their homes and offices. Added to this was the introduction of the electronic payment system – *Mondex* – jointly by Ghana Commercial Bank and Agricultural Development Bank. Similarly, Ecobank Ghana, The

Trust Bank and CAL Bank also jointly introduced the *e-card* onto the market. Ecobank was the first to introduce a Visa Electron Card in Ghana in 2003, which allows the customer access to about 860,000 Automated Teller Machines (ATMs) worldwide.

3.1.2 Financial Performance of the Banking Sector (2002)

The banking industry's financial performance in 2002 could be described as one of volume growth but reduced earnings. Whilst the industry's Balance sheet grew significantly by 30% – higher than the 15% growth in 2001, the industry's earnings (profit after tax) declined by 7% as against a 9% growth recorded in 2001. Whilst this was due primarily to the fall in interest rates during the year, it is also indicative of how sensitive the industry is to interest rates changes.

However, the strong balance sheet growth did not translate into increased earnings in 2002 as a result of the fall in interest rates. Interest income and expense declined by 13% and 25% respectively. Accordingly net interest income (which is the most significant component of total income – 70% in 2001) declined by 7% in 2002.

Not surprising though, fees & commissions jumped by 44% as most banks focused on fee-based income as a result of the pressure on interest margins. This is a very significant increase compared to the 7% growth recorded in 2001 - (Source: Ecobank Ghana Limited).

The industry's intensive deposit mobilisation efforts backed by innovative liability products resulted in a significant increase in the industry's deposits. Total deposits grew by 32% in 2002 as against the 12% growth recorded in 2001 with all industry players without exception contributing to this growth.

Total deposits of the banking industry in August 2004 stood at ¢16,277.44 billion. The total loan portfolio of the entire banking sector was ¢8,863.21 billion with total industry assets being ¢25,411.63 billion (figures calculated from bank statistics in BUSINESSWEEK, August 1-8, 2004).

The Ghana Commercial Bank is the largest and the biggest lender to private enterprise commanding 19.8% of the total loan portfolio as of August 2004 while Unibank holds 0.35%. (See Appendix III for detailed statistics of banks in Ghana).

For the past five years, the total assets of the industry has hovered around $2 billion (about ¢18,000 billion) which **Philip Kwasi Buabeng**, Director of the National Banking College, considers to be woefully inadequate to stimulate the growth of the Ghanaian economy. This is attributed to the fact that only 5% of the 20 million Ghanaians have bank accounts.

With the liquidation of the Bank for Housing and Construction and Ghana Co-operative Bank recently, customers are concerned about the financial health of banks more than ever before. For this reason, banks' level of capital adequacy, the proportion of their loan portfolios that are bad or doubtful and the size of their shareholders funds have become very important.

3.2 Trends in Inflation, Interest Rates and Exchange Rate in Ghana

Ghana has witnessed macroeconomic instability over the last two decades. In 1983, the Cedi/Dollar exchange rate was ¢90=$1. By 1993, the Cedi depreciated by 800% to ¢720 = $1 and by October 2004 the exchange rate stood at ¢9,110 = $1, depreciating by more than 1200% over the last ten years.

Inflation, which stood at nearly 123% in 1983, came down to 13.8% in 1999 but rose again to 40% in 2000. The year-on-year inflation declined from 22.4% in January to 11.2% in August 2004 after reaching a low of 10.5% in March of the same year while the local currency depreciated marginally (2.1%) during the first half of the year. Consequently, the Monetary Policy Committee, which is responsible for ensuring price stability, revised the prime rate twice: from 21.5% to 20% in the first quarter of 2004 and then to 18.5% in May 2004 thus moving down interest rates on treasuries and bank lending (ECOBANK MARKET FOCUS – APRIL/MAY 2004).

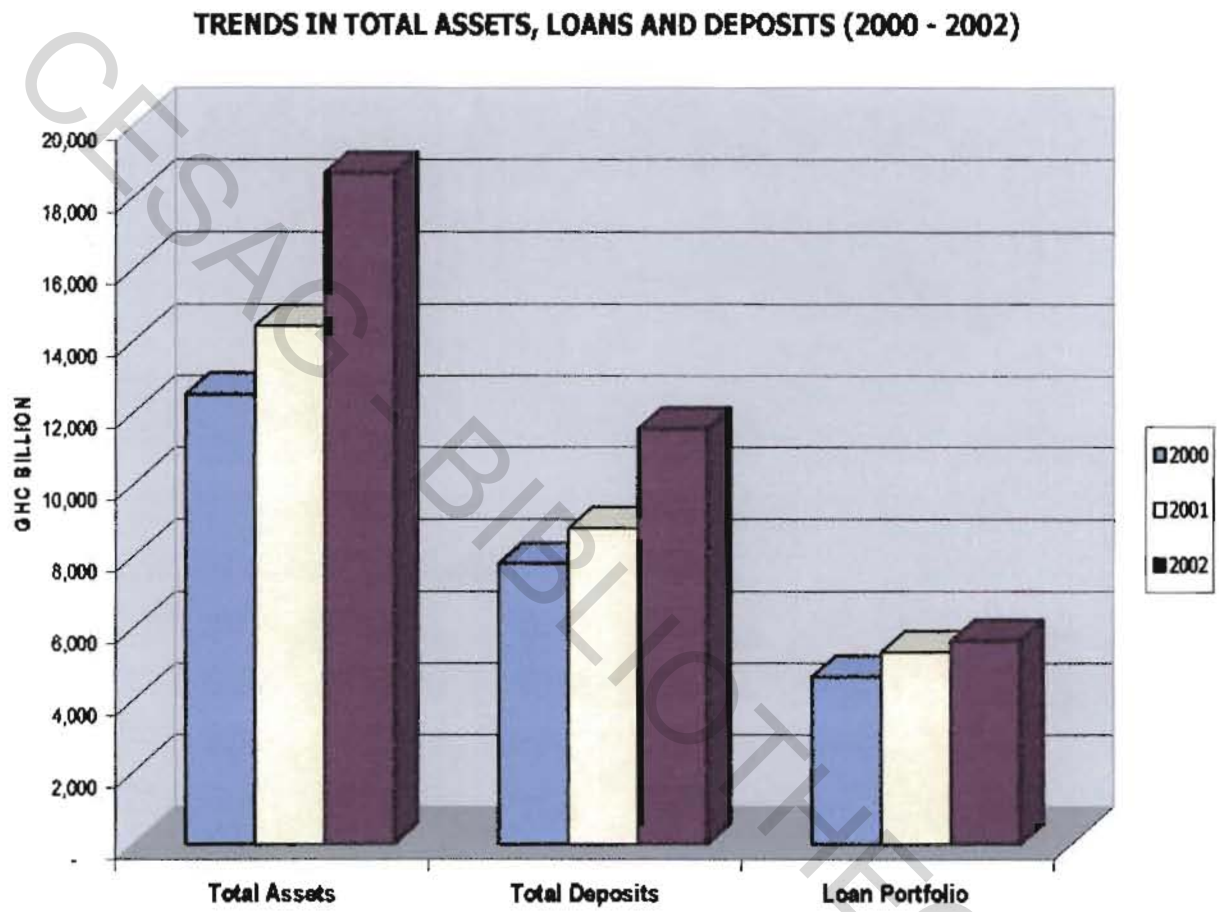
Table 1 Trends in inflation, interest rates and the exchange rate in Ghana (1997-2004)

Year	1997	1998	1999	2000	2001	2002	2003	2004
Inflation	21%	16%	13.8%	40%	23.4%	15.2%	26.8%	11.1%*
Interest Rates	45%	37%	34%	42%	30%	38.5%	31%	18.5%*
Cedi/$ depreciation		4%	33%	100%	4.32%	12%	3.8%	2.1%*

Source: UK Trade and Investment (Economic Review) - 2004/ Bank of Ghana Quarterly Economic Review – August 2004

* Figures are half-year estimates.

Figure 1: Trends in Assets, Loans and Deposits



3.3 Brief Profile of Ecobank Ghana Limited

Ecobank Ghana Limited is a subsidiary of Ecobank Transnational Incorporated (ETI), a bank holding company incorporated in the Republic of Togo in 1985, which has eleven other subsidiaries and fifty-seven branches across West and Central Africa. Ecobank Ghana Limited was established in 1990 and has grown to become the leading Merchant Bank in the country. It comprises the Bank itself and three wholly owned subsidiaries: Ecobank Investment Managers Limited, Ecobank Stockbrokers Limited and Ecobank Leasing Company Limited. These subsidiaries offer non-bank financial services such as stock-broking, leasing and investment advisory services to clients. The bank operates five branches in Accra, Tema, Kumasi, Takoradi and Tarkwa. It was also licensed as a universal bank, which allows it to broaden its scope in the provision of financial services to its individual, corporate, government and non-government customers.

3.3.1 Ecobank Ghana's Mission Statement

Ecobank Ghana's Mission Statement is 'to be the number one provider of financial solutions, offering quality and value to its customers. To achieve this, the bank's strategy is on business expansion, effective branch network, efficient product marketing, human resource development and the use of modern technology to achieve greater operational efficiency'.

3.3.2 Ecobank Ghana's Performance (2000 – 2003)

In 2003, Ecobank registered a strong Balance Sheet growth of 27% from ¢1.4 trillion to ¢1.79 trillion as at December 2003. Deposits also grew by 26% from ¢1.07 trillion to ¢1.35 trillion. By the end of 2002, capital including reserves increased to ¢137.1 billion from ¢102.5 billion at the end of 2001 and ¢79.7 billion at the end of 2000.

Table 2 - Some Key Statistics of Ecobank Ghana (August, 2004)

Item	Amount (In ¢ Billion)/ Percentage
Total Assets	1,682.25
Loans and Advances	623.97
Investments	328.46
Deposits	1,269.64
Shareholders' Funds	151.17
Total Income	227.50
Net Interest Income	127.82
Commissions and Fees	99.67
Operating Expenses	(100.68)
Profit Before Tax	107.61
Advances/Total Assets	37.09%
Advances/Deposits	49.15%
Provision for Bad Debts/Advances	2.13%
Capital Adequacy	8.99%
Return on Assets	3.56%
Return on Equity	39.63%
% Share of Industry Deposits	7.80%
% Share of Industry Loans	7.04%
% Share of Industry Assets	6.62%

Source : BUSINESS WEEK (August 1-8, 2004), a Ghanaian weekly business newspaper

3.4 The Commercial Banking Department (CBD)

The Commercial Banking Department is the implementing wing of Ecobank's credit to small and medium scale enterprises. The department provides a wide array of banking and financial services to SMEs but it also provides medium to long-term loans to companies. It has been the Bank's policy to extend credit to the small business sector since its inception in 1990. In furtherance of this objective, the department has since the year 2000, developed structured product programs (PPs) to suit the credit needs of this market segment.

The department has a Head, supported by a Senior Credit Analyst and two Credit Analysts on the one hand and a Senior Relationship Officer and Relationship Officers at the Head Office and the branches, on the other. While the Credit Analysts undertake credit appraisal of enterprises, which apply for loans, the Relationship Officers are responsible for credit initiation with customers and the nurturing and maintenance of existing accounts. They are in constant contact with customers on the ground for the day to day monitoring of the accounts of these customers. This reflects the new relationship banking concept the bank has adopted to meet the changing needs of its customers.

3.4.1 Ecobank Ghana's Definition of an SME

The Bank defines an SME as any limited liability company, enterprise, partnership or business entity with a networth (i.e. Stated Capital + Income Surplus + Capital Surplus) ranging from ¢50 million to ¢1 billion – i.e. between $5,488 and $110,000 (Exchange rate, $1= ¢ 9,110).

The following categorization is made between micro-, medium and large scale enterprises for the bank's lending purposes:

- Micro-enterprise – Up to $50,000 with maturity of one year
- Medium Scale - From $50,000 - $500,000 with maturity of three years
- Large Scale - From $500,000 -$1,000,000 with maturity of three years or more

3.5 Credit Facilities Available to SMEs

By policy, the Commercial Banking Department provides Consumer (individual) and Commercial (enterprise) clients with short-term facilities known as Product Programs (PPs). The Institutional Banking Department handles the provision of long-term loans to large corporate clients even though these clients also benefit from PPs that suit their needs.

The Product Programs are approved using simplified credit criteria based on the bank's risk asset acceptance criteria developed for selected sectors or businesses operating under similar schemes and transactions with minimum dependence on financial data. This mode of approval is used for most small businesses that are unable to provide adequate or reliable financial information to the bank for analysis.

For businesses and projects that can provide annual accounts audited by acceptable auditing firms, the bank adopts a Credit Appraisal System similar to that used by large corporates based on a detailed analysis of both quantitative (financial analysis) and qualitative data (business, industry, economic analysis). The company's track record and due diligence reports obtained from trading partners and other bankers are key in determining whether credit should be given to any business.

3.5.1 Medium to Long Term Loans

The Commercial Banking Department provides medium and long-term credit facilities with maturities of between three to five years apart from short term facilities that are granted to small companies. These loans are of sizes that are even beyond the approval limit of the department and on which credit appraisals are painstakingly done.

3.5.2 The Product Programs

Ecobank's Product Programs are pre-approved structured transactions tailored to the financial needs of certain categories of the bank's customers notably SMEs. They are aimed at developing innovative financial mechanisms that will enable the bank engage in small and medium sized business lending in a cost-effective manner and to simplify the credit process by providing self-liquidating advances to customers. The products vary in maturity, amount and nature. The following are some of the Product Programs currently available:

- ***General Distributorship Product Program***

Some corporate customers, mainly Multinationals, have numerous distributors throughout the country. These distributors face short falls in their working capital requirements. Ecobank provides them with revolving short-term loans to enable them bridge finance their working capital needs and to promptly pay for goods and services. The overall limit of this product is $4.5 million and the maximum amount available per distributor is $300,000 with a maximum maturity of 12 months.

- ***Cash Collateralised Guarantee***

As part of the conditions guiding the supply of certain specified goods and services, the buyer might decide to pay upfront, part of the contract sum in the form of an advance payment or mobilization fee to facilitate delivery under the contract. In return for this payment, the buyer will require the supplier to furnish him or her (the buyer) with an Advance Payment Guarantee (APG) equivalent to the advance payment. The Cash Collateralised Guarantee is designed such that Ecobank issues bill bonds, performance bonds and advance payment guarantees on behalf of its clients who are in a position to provide 100 per cent cash collateral (or 50 per cent cash collateral and corporate guarantee where applicable). It is meant for customers who do not have approved lines of credit. It has an overall limit of $10 million and a single credit limit of $2 million (for fully cash collateralized) and $1million (for partially cash collateralized-50 per cent minimum) and a maturity of 12 months.

- ***Cash/Government Security-Backed Product***

This involves the provision of credit (short term loans, advances in current account) against customers' treasury bills, bonds or cash deposits with the bank. This makes it possible for customers to hold their investments in treasury bills and bonds and at the same time obtain bridge financing from the bank. This is suitable for start-ups or relatively new companies without any track record.

- ***Cash Collateralized Import Finance Letters of Credit (L/Cs)***

This PP targets clients who do not have formal lines of credit and are in a position to provide 100 per cent cash collateral to back their request for import L/C facilities. The product has a tenor of one year and a global credit limit of US$ 32 million and a single limit of US$ 2 million.

- ***Cash/Government Securities and USAID Loan Portfolio Guarantee (LPG) Product***

Under this program, the USAID provides guarantee for the loans granted to some of the bank's clients with total assets not exceeding US$250,000. Beneficiary companies under this product should be 100 per cent privately owned, controlled and operated. The total facility extended to any beneficiary does not exceed US$150,000 under this PP.

- ***Local Purchase Order (LPO) Contract Financing Product Program***

With this product, Ecobank provides short term financing of up to one year to clients who supply goods and services to reputable and creditworthy institutions acceptable to the bank. It also includes applicants who provide contract services to especially the mining and construction sectors. Ecobank finances a maximum of 70 per cent of the LPO/Contract not exceeding US$250,000.

- ***Receivables Financing Product Program***

Very much like the LPO financing, Ecobank provides short term financing against the receivables of its customers engaged in the supply of goods and services and execution of small to medium scale contracts for reputable institutions and international organizations and agencies. Ecobank, after confirmation of the acceptance of the invoice covering supply of the goods, discounts up to 80 per cent of the value of the receivables but not exceeding US$ 250,000. This facility has a maturity of 180 days.

3.6 Credit Granting and Approval Procedures

The credit approval process begins with credit initiation where requests for credit are received through applications from SMEs or are sought out by relationship officers. The relationship officers undertake information gathering on the customers (enterprises) regarding their management, industry, financial highlights, company history and banking relationship. This forms the basis for a credit appraisal to be conducted by the credit department.

The credit appraisal process takes into account the risk factors, industry analysis, management quality and the purpose of the facility being requested.
After going through the screening process, a facility approval form is prepared for approval by the Risk Management Department. The Legal Department reviews the required documentation and confirms proper execution.

Credit approval is based on an approval system comprising three credit officers (one of whom should have a credit limit for the amount approved) at the Branch Credit Committee (BCC) level or at the Senior Credit Committee (SCC) level if facility amounts exceed the country limit as stipulated by the Group Credit Policy.

3.6.1 Creditworthiness Criteria

To assess the credit worthiness of a firm, Ecobank often relies on the firm's cash flow statements, balance sheet, income statement and bank statements. It also looks at the long term potential of the firm, its sales contracts and demand for the company's products. Ecobank evaluates the creditworthiness of SMEs based on the following criteria:

- The borrower must be in business for a minimum of three years.

This is to assure the bank that the borrower has a minimum track record and experience or commitment in the business. The bank however grants loans to a limited number of start-ups in viable sectors of the economy.

- There should be satisfactory bank or trade checkings on the business.

To be sure of the credibility of the borrower, the bank seeks the opinion of other banks, suppliers and clients of the borrower before it grants credit.

- Management expertise

The bank considers a firm's management reputation and competence in judging whether it deserves a loan. The bank will usually look at a firm's repayment ability in the form of projected revenues, up-coming sales contracts, industry potential, cash flow management and loan repayment track record. Management competence is crucial in turning the firm's fortunes around.

- Adequate collateral

The bank requires borrowers to provide adequate collateral which will serve as security to back loans in case of default. The type of collateral demanded varies substantially at Ecobank, from property through Treasury bills and stock or inventory receivables to cash.

- Meeting the bank's Risk Assets Acceptance Criteria

The bank evaluates the risk of a business based on what it calls the Risk Asset Acceptance Criteria (RAAC) which covers an industry analysis of the firm taking into account parameters such as net sales, cash flows, market reputation, quality marketing goods and other factors.

Table 3 - Loan Portfolio Distribution by Sector - 2001

Sector	Amount (US$ '000)
Agribusiness	33
Exports	679
Construction / Plant Hire	1,948
Manufacturing	1,396
Trading	3,554
Services	1,561
TOTAL	**9,171**

Source: Commercial Banking Department, Ecobank Ghana Limited

The loan portfolio distribution table above (Table 3) shows the direction of the bank's lending, which is largely in favour of trade, construction, services and manufacturing sectors. The agricultural sector is grossly undersupplied in view of the high risk associated with it.

Table 4 below indicates the likelihood of loan loss and risk by sector. The entire amount of $66,000 voted for the agribusiness sector is classified as provisions (loans that are likely to go bad). Manufacturing, trading and exports remain the priority sectors for the bank's lending.

Table 4 - Loan Loss and Portfolio at Risk by Sector

Sector	Loan at Risk (US$ '000)	Provision* (US$ '000)
Agribusiness	66	66
Exports	None	None
Construction/Plant Hire	237	37
Manufacturing	None	None
Trading	None	None
Services	21	4

*Amounts indicated represent provisions on classified loans which the bank is not expected to write off. Source: Commercial Banking Department, (EBG).

Table 5 - Lending by Sector/Firm Size (2002)

Sector/Firm Size	Amount allocated	% of Sector Portfolio
Agriculture		
- Small scale	$6,000	7%
- Medium scale	$83,000	93%
- Large scale	-	-
Manufacturing		
- Small scale	$156,000	4%
- Medium scale	$1,200,000	24%
- Large scale	$3,100,000	72%
Trade		
- Small scale	$189,000	3%
- Medium scale	$2,000,000	30%
- Large scale	$4,700,000	67%
Services		
- Small scale	$103,000	2%
- Medium scale	$1,700,000	28%
- Large scale	$4,400,000	70%

Source: Commercial Banking Department, Ecobank Ghana Limited

Table 5 shows a picture of loan distribution based on firm size and by sector. Out of a total of $17,637,000 (¢128.9 billion) disbursed in 2002 by the CBD, a disproportionately small amount of $454,000 or ¢3.3 billion (2.6% of the total amount) went to small scale enterprises, $3,983,000 or ¢29.1 billion (22.6% of total amount) was disbursed to medium scale enterprises and $13,200,000 or ¢96.5 billion (74.8%) went to large scale enterprises. (Exchange Rate : $1= ¢7,312.24).

Table 6 - Creditworthiness ratings for small firms by sector - Commercial Banking Department (Ecobank Ghana)

Sector	Level of interest or receptivity
Agriculture (medium size acreage)	25%
Small manufacturers	30%
Import/Export	20%
Retail/Small wholesale	12%
Small services companies	5%
Professionals	5%
Small Transport business	3%
Total	**100%**

Source: Ecobank Ghana Limited

3.7 Summary and Conclusion

Ecobank operates in a banking industry characterized by intense competition, a limited asset size and low savings culture among the population partly due to poverty and partly because of low sensitization about the need to save. The industry was also confronted with an unstable macroeconomic environment in terms of unstable prices, volatile interest rates and a fluctuating exchange rate in the eighties and nineties.

Ecobank's credit has been grossly skewed towards medium to large scale enterprises under an appraisal process that is stringent in terms of information requirements largely driven by the Bank's risk consciousness. On the other hand, the bank has developed structured products that are adapted to the specific needs of SMEs with more flexible credit assessment criteria. The portfolio for SME lending as portrayed by the product programs is relatively small when compared to medium and long term loans granted by the bank.

CHAPTER IV

4.0 FINDINGS AND ANALYSIS

The findings of the study are presented in this section as follows:

1. ***Results from surveys conducted***

We present the characteristics of the firms surveyed and their concerns and perceptions regarding access to bank credit as well as Ecobank's views about constraints it faces concerning lending to small and medium enterprises.

2. ***SME lending in the institutional structure of Ecobank***

The place of credit to small business firms at Ecobank is looked at.

3. ***The credit granting process in terms of credit appraisal and approval***

We present the nature of lending procedures and the demands or requirements for obtaining a loan and their suitability for SMEs.

4. ***The loan size, volume and maturities available to small businesses***

Ecobank's lending portfolio and the proportion allocated to the SME sector as well as loan amounts and maturities are presented here.

4.1 Findings from Surveys

From our surveys, out of 345 customers of the Commercial Banking Department in August 2004 (this comprised small, medium and large firms), 30 small to medium enterprises were interviewed, which we consider to be a representative sample of the bank's small enterprise clients. Seventy-three (73) per cent of those interviewed (22 firms) had consistently received loans from Ecobank under the structured Product

Programs, mostly to meet their working capital needs. Loan amounts varied between \$2,000 and \$12,000 which are well within micro-lending limits. In one case, the enterprise received loans under \$1,000. Ecobank appears to have adopted a step-by-step approach to granting loans to SMEs. Where an enterprise has shown good loan repayment performance, it is likely to get more loans from the bank rather than the bank seeking out new and unknown clients.

The results are not surprising since our sample was targeted at enterprises, which had an existing banking relationship with the bank already. Our study revealed the general reluctance of SMEs to disclose financial information and the varying degrees of the sizes of the firms. Only five (5) enterprises out of the 30 gave information on their sales figures (of different dates). The sales figures were:

Firm 1 - ¢9.4 billion (2001)
Firm 2 - ¢621 million (2003)
Firm 3 - ¢174 million (2001)
Firm 4 - ¢460 million (2003) and
Firm 5 - ¢1.5 billion (2002)

A striking feature of the firms interviewed is that they have been in existence for a long time. Only one firm started business two years ago. The rest are between seven to twenty-three years of existence with one established forty years ago. The average age of the firms is 13 years. The high average age of firms surveyed suggests that Ecobank is much more inclined to lend to existing and growing firms instead of start-ups or new businesses. This stems from the bank's risk consciousness in its lending policy over the years rather than from a strategic decision in favour of well-established firms.

The number of firms interviewed and their distribution according to business line is presented below:

Table 7 - Firms Interviewed by Sector

Sector of Operation	Number of Firms Interviewed
Textile Distribution	12
Consultancy	5
Small Manufacturing	5
Construction and Civil Engineering	3
Communication/ Information Technology	1
Salt Distribution	1
Transport Business	1
Commercial Cleaning	1
Agriculture (Cattle Rearing)	1
Total	**30**

Source: from Survey

From the point of view of small and medium scale enterprises, banks do not want to take the risk of lending to small businesses. In their view, bank requirements for credit are too stringent for them to meet especially in terms of information. They also see the collateral demanded by banks to be above what they can meet. On the whole, small firms believe that banks do not understand their needs and what they do. As a result banks have poor perceptions of their creditworthiness and hence are reluctant to grant them credit.

Ecobank considers factors inhibiting the bank's lending to small and medium sized enterprises as follows:

- Lack of reliable financial statements by the SMEs
- High cost of loan monitoring
- Unwillingness of SMEs to settle their indebtedness to the bank

- Delayed payments from government agencies
- Unco-operative attitude by some banks in sharing information on customers

There is an informational gap between banks and small entrepreneurs. Unless this information gap is bridged, the financing problem will continue to exist. While small entrepreneurs attribute their credit constraints to the stringent demands by banks, bankers believe that small firms have rather few 'bankable' or viable projects. Aryeetey suggests that there might be fewer creditworthy projects than entrepreneurs believed, but considerably more than banks thought, especially if appropriate appraisal, supervision and security methods were used.

Ecobank recognizes the need to build expertise in the activities that they finance. In this regard, the Commercial Banking Department organizes capacity building workshops for selected SMEs to improve their capacities in business planning and financial report preparation. This is key to the success of small business ventures and the bank's own business.

4.2 The Institutional Structure for SME Lending

Lending to SMEs has been part of Ecobank Ghana's lending structure with the Commercial Banking Department assuming the responsibility of providing credit to these enterprises. The adoption of structured financial packages such as the Product Programs for SMEs shows the bank's commitment to meet the financing needs of this market segment. The fact remains that SME lending still occupies a less important place in the bank's overall lending portfolio and even more so when it comes to micro-enterprise financing. The processing of medium and long term loans takes the bulk of the department's working time.

Ecobank Ghana's operations are urban based mainly in the Accra metropolis and the four urban towns of Tema, Kumasi, Takoradi and Tarkwa.

4.3 The Credit Appraisal and Approval Process

The credit approval process itself is simple as described earlier requiring the endorsement of three officers with at least one officer having authority over the credit limit. But perhaps in tightening up its procedures to improve performance, the bank has centralized credit analysis and decision making of loans at the head office. Even though branch officers are active in customer account performance monitoring and deposit mobilization, they have little authority to approve loan applications without reference to the bank's head office. Even when the credit is initiated at the branch, it has to be reviewed at the head office. Credit officers at the head office are thus over burdened with loan processing, which slows down the approval of loans.

The credit appraisal procedure, on the other hand, is a long process requiring a lot of documentation especially because the department is preoccupied with lending to medium and large scale companies and partly in response to the bank's risk management consciousness. The Product Programs, which are meant for SMEs emanate from the branches and are less frequently treated though they are easier to process. A Product Program has a turnaround processing and approval time of 48 hours while a CA (credit appraisal on a medium to long term loan) can take up to 7 days.

The fact that the department's lending is skewed towards large corporate firms means that a lot more credit analysis is required on the financials and other information requirements of these firms unlike the relatively easy procedures involved in the product programs.

The bank's requirements for loans are based on the general criteria applied to large firms such as collateral in the form of property and submission of three consecutive years' financial statements including the immediate past year (if company has been in business already) or projections of cash flows (if the business is new).

The bank has however adopted innovative means of securing loans granted to SMEs through the use of cash deposits, government securities such as treasury bills and bonds and stocks or receivables as a form of collateral. The type of collateral demanded depends on the type of facility.

4.4 Loan Size and Volume

The loan portfolio of the Commercial Banking Department nearly doubled from \$9,171,000 in 2001 to \$17,637,000 in 2002. In the same year the CBD disbursed a total number of 386 loans with 112 loans going to medium and small businesses. But as already shown in Table 4, out of the total portfolio disbursed by the Commercial Banking Department in 2002, only a meagre 2.6 per cent went to micro-enterprises, 22.6 per cent to medium scale enterprises and as much as 74.8 per cent to large scale enterprises. Whereas the general loan portfolio has increased, lending to the small enterprise sector has not expanded.

It is noteworthy that the loan sizes under the Product Programs are suitable for SMEs and within the department's approval limit of \$250,000. The maturity of loans to small businesses varies between 180 days and one year under the PPs. It could be argued that such short-term working capital facilities are good for the firms as it will help them to grow. However, another view holds that this is likely to work against the long-term capital needs of small firms and also pose repayment problems.

On average, loan sizes granted by the department are above the requirements of the SMEs. For example, the average loan size processed by the CBD in September 2004 was \$400,000, which falls beyond our definition of small-scale enterprises. This partly confirms **Roger Teszler's** observation that commercial banks tend to lend to the top segment of SME financing while NGOs in Africa are more active at the lower end of the micro-enterprise and minimalist lending market.

CHAPTER V

5.0 CONCLUSIONS AND RECOMMENDATIONS

5.1 CONCLUSION

Summary

An assessment of Ecobank Ghana's lending structure revealed that the Bank has an existing financing package for SME lending and grants loans out of its own deposit mobilization. The findings on the ground show however that commercial bank lending in Ghana, as far as the evidence with Ecobank reveals, is still largely skewed towards large corporate firms. The bank's tremendous growth in capital, deposits and balance sheet between 2000 and 2003 as indicated earlier, has not reflected in lending to small and medium enterprises. In 2002, the Bank reserved only 2.6 per cent of its lending portfolio for the small and medium size business sector. This suggests that the bank is still far off from intervening in the smaller business sector.

Unstable macroeconomic conditions in the past have perhaps led banks in Ghana to become more risk conscious resulting in their tightening of security safeguards against risk hence their insistence on collateral, which is often out of the reach of many small firms. This may explain the stringent credit procedures Ecobank has developed in its lending. Nevertheless, the bank has developed special products for SMEs but these products need to be expanded and given a prominent place within the bank's set-up.

The survey sample was deliberately targeted at mainly Ecobank's customers. It is therefore not surprising that a high percentage of firms have been observed to have received loans (73%).

Small entrepreneurs believe that banks misunderstand their business. This could be attributed to the communication gap that exists between banks and SMEs. Small entrepreneurs cite the usual problems of lack of collateral and information requirements demanded by banks as the reasons for their lack of access to credit. Ecobank, on its part, points to the non-payment of loans by some SMEs, lack of reliable financial information and high cost of small loan monitoring as some of the factors that inhibit the bank's lending to small businesses. This brings to the fore, the importance of training for SMEs to improve their projects aimed at enhancing their creditworthiness on the one hand and for banks to adopt alternative methodologies for lending to SMEs on the other. Ecobank's Product Programs and training workshops for small and medium sized enterprises are in the right direction but more needs to be done to enhance the bank's credit delivery to the SMEs and micro-enterprises.

The current intense competition in the Ghanaian banking industry and the modest macroeconomic gains made recently, augur well for the industry and the economy as a whole and should serve as an incentive to banks to lend to micro-enterprises.

5.2 RECOMMENDATIONS

5.2.1 What Strategy Should A Commercial Bank Adopt To Intervene Into The Micro-Finance Market?

We make recommendations for Ecobank to increase and expand its lending to small businesses based on the above conclusions. The recommendations recognize the fact that lending to small borrowers must be profitable. To increase small enterprise credit and reduce lender risk will necessarily involve internal management restructuring that will lead to improved appraisal of risk, the development of other tools and methods for containing risk and some risk sharing procedures. In recognition of the fact that credit to small businesses requires joint action by several players in the micro-finance sector, we propose a multi-dimensional and multi-sectoral strategy that will allow for the reduction of the risks inherent in micro-enterprise finance and be appealing to Ecobank Ghana Limited to intervene into that market segment. Essentially, such a strategy envisages critical roles, individually or jointly, by banks, governments, NGOs, informal financial institutions and micro-entrepreneurs themselves.

a) The Role of Government

Creating a climate in which entrepreneurs and firms, including banks, can do good business is crucial to encouraging the types of investment and credit to small businesses. In this regard, government has a fundamental obligation to ensure that investments are not arbitrarily disrupted or investors robbed of their returns through adverse economic conditions. Government therefore needs to create a stable macroeconomic environment through sound policies to stabilize prices, interest rates and the exchange rate. This will greatly reduce the cost and risk of doing business and encourage banks to lend to firms.
Government is also required to ensure the soundness and strength of financial institutions and the financial system as a whole by establishing legal and regulatory structures that will promote the competitiveness of the system.

The Government needs to enter into dialogue with commercial banks and other players in micro-finance to get their commitment to develop the small and medium enterprise finance market seriously. This should be backed by a programme of incentives, training and risk protection. Banks in particular need to be certain about government's macroeconomic policy direction especially as it relates to interest rates, inflation and the exchange rate. This will encourage them to intervene into the micro-enterprise market.

With particular reference to micro-enterprises, government should help foster the growth of small businesses through back-up funding for venture capital and set up business and enterprise development training for micro-entrepreneurs. This can be done in conjunction with non-governmental organizations and will go a long way to improve the creditworthiness of micro-enterprises for commercial bank credit.

By enabling a dynamic small enterprise sector, government can strengthen opportunities for these enterprises to grow while reducing their vulnerability to economic risks.

b) The Role of The Micro-Entrepreneur

Micro-entrepreneurs owe it a duty to themselves to reduce the risks of their businesses to make them attractive enough for bank lending. Small business operators need to do a critical self-assessment aimed at improving on their managerial skills. Bringing professionalism to bear on the operations of small business firms is crucial in making them more credible and 'bankable'. The acquisition of basic management, accounting and bookkeeping skills by micro-entrepreneurs can greatly enhance their creditworthiness. But even more importantly, small business managers who have received loans from banks before need to demonstrate reliability and integrity in terms of timely repayment of such loans.

The formation of cooperatives or groups by small and micro-entrepreneurs is another important tool that can be used to enhance small business creditworthiness. The group solidarity and risk-sharing that is involved in working together will make micro-enterprises more credible in the eyes of commercial banks and put them in good stead for credit. Apart from enhancing their chances for bank credit, micro-enterprises, by working together, can pool resources in the form of mutual funds from which they can draw for their own investments.

c) The Role of Ecobank Ghana Limited

1. Creating an Independent and Decentralized Unit for Micro-lending

There is the need for further demonstration of Ecobank's commitment to SME and micro-enterprise lending at the top management level and integrate it into the bank's institutional mission. Micro-lending programmes need to be inserted into the larger bank structure in such a way that they have relative independence and, at the same time, have the scale to handle thousands of small transactions efficiently. Such independent micro-enterprise unit will have retail centers at the bank's branches with its own lending policies and information systems. It is gratifying to note that as the leading technology driven bank in Ghana, Ecobank is well placed to process small micro-credits to reduce transaction costs.

It will be appropriate to create an independent unit with the sole responsibility to process and approve SME loans so as to detach it from the medium and long term lending structure. This would greatly ease the current work-load on the Commercial Banking Department and allow for increased lending to the small business sector. Perhaps Ecobank may be inspired by the experience of Standard Bank of South Africa, where special units were established, one for SMEs and one for micro-enterprises. William Steel (1995) observes that this enabled the Standard Bank to turn a profit on micro-loans of less than $2000 while charging 45 per cent interest.

It is important to decentralize responsibilities for SME loans. Branch staff should be motivated to take up part of the decision making for loans to small businesses. Targets should be set for branch managers and those who meet them are rewarded by giving a portion of the profits that accrue to them as bonuses. At the same time, local staff may be penalized or sanctioned by reducing the portion of mobilized funds that they can use for small business loans. Decentralization of decision-making and responsibility for approval and supervision of loans to the branch level reduces transaction costs in that information on small businesses is easy to obtain and relatively cheap. Experience with bank lending to SMEs indicate that lenders using more decentralized systems for loan processing and supervision have less fear for default, more confidence in their project analysis judgements and better-performing loans **(Valenzuela, 2004).**

2. Adapting Credit Appraisal Methodologies To Small Business Needs

Micro-lending is costly because of the small size of their loans and processing them under the traditional mechanisms of the bank will not be profitable. Ecobank therefore needs to acquire appropriate financial products and methodologies to service the small, medium and micro-enterprise sector and adopt financial innovations that allow for a cost-effective analysis of creditworthiness, the monitoring of a large number of clients and the adoption of effective collateral substitutes.

Successful micro-finance institutions have often adopted what is known in the literature as 'character-lending' instead of collateral, where creditworthiness assessment is based on the borrower's character including personal preferences, motivation, timely settling of past financial obligations and a record of fair dealings with customers, suppliers, employees and the community at large. Micro-finance generally requires primary emphasis on personal character and experience and much less on project viability and security (Duggleby, 1992).

Ecobank could also develop alternative means of securing loans including:

- Co-signers or personal guarantors
- Sales contracts
- Liens on equipment financed and
- Substantial equity by the borrower.

3. Risk-Sharing With Informal and Semi-formal Lenders and Encouraging Linkages with Micro-finance Institutions

Lack of adequate and reliable collateral and unfamiliarity with complicated loan application procedures and paperwork limit small business access to formal finance from banks. An intervention into micro-lending will require that Ecobank learns to share risks with informal and semi-formal lenders by using some of the screening mechanisms of these institutions:

- The informal system tends to remove strict collateral requirements and bureaucratic and administrative channels, which are incompatible with small scale loans.

- The intimate relations that exist between borrowers and lenders do not only offer a major source of information on the creditworthiness of borrowers but also serve as a motivating factor in the quick repayment of loans.

Another way of overcoming the financing problem is to encourage linkages between the bank and micro-finance institutions (MFIs). This allows the Bank to provide funds to micro-lending institutions for on-lending thus easing out the capital limitation facing most MFIs **(Satta, 2002).** At the same time, the bank can take advantage of MFIs' ability and flexibility in reaching out to more small businesses.

4. Expanding Ecobank's Product Programs

Ecobank Ghana's Product Programs respond to diverse and dispersed needs of many small firms at the same time but which is currently limited in supply. The PPs allow the bank to provide a wide array of products to different types of small businesses as they are tailored to specific needs of SMEs. Refining and expanding the Product Programs will allow for increased access to finance by many more small businesses.

5. Developing Insurance Schemes for Bank Loans and Small Borrowers

Apart from providing loans for businesses and building the capacities of people to manage these businesses, providing insurance packages to protect businesses has emerged as an equally important component of micro-finance and poverty reduction programmes. The bank, together with insurance companies, might consider the development of risk insurance schemes for loans taken. This might require the borrower to share the cost of a policy to insure a bank loan with an appropriate repayment structure. Insurance protection will make banks more comfortable to lend to small businesses.

APPENDIX I

QUESTIONNAIRE FOR SMALL AND MEDIUM SCALE ENTERPRISES

This questionnaire is designed strictly to solicit information on access to credit by small and medium scale enterprises for academic purposes and confidentiality of information is therefore assured.

....

ALHASSAN ZIBLIM AL-HASSAN

(STUDENT, MBA IN BANKING AND FINANCE)

1. Name of Firm..
2. Type of Firm (major product) ....
3. Location ....
4. When was firm established? ....
5. What is the form of ownership of your firm?

   (Tick where applicable)

   a. Sole proprietorship
   b. Partnership
   c. Limited Liability
   d. Others, specify

6. What is the present Turnover/Size of your firm?

7. What is the source of your capital?

    a. Bank loan
    b. Money Lender
    c. Own Savings
    d. Family
    e. Friends
    f. A combination of the above, specify

8. How do you rank the importance of Capital/Finance to your business (Tick where applicable)

    a. Most important
    b. Quite important
    c. Least important

9. Have you ever applied for a bank loan? YES/ NO

10. Has your application for bank loan ever been rejected? YES/ NO

    If YES, why was it rejected? Choose one of the following reasons

    a. Lack of collateral
    b. Poor management
    c. High interest rates
    d. Inadequate financial information
    e. Administrative delays in processing loan applications
    f. Other reasons, Specify

11. Have you been limited by credit in your operations? YES/ NO

12. What type of capital is your biggest constraint?

    a. Working Capital

b. Fixed Capital

13. Have you ever received any financial help from a Government agency NGO?

    YES/ NO

14. Have you ever received any technical advice from any agency? YES/ NO
    If YES, specify.

APPENDIX II

QUESTIONNAIRE FOR MANAGEMENT – COMMERCIAL BANKING (ECOBANK GHANA LIMITED)

The purpose of this questionnaire is to solicit information on access to credit by small and medium scale enterprises on purely academic grounds and confidentiality of information is therefore assured.

…………………………………………

ALHASSAN ZIBLIM AL-HASSAN

(STUDENT, MBA IN BANKING AND FINANCE)

1. Name of Officer ……………………………………………………………..
2. Position/Rank ……………………………………………………………...
3. How many branches does your bank have in the country? ………………………………………………………
4. How many of your branches are urban and how many are in rural areas? ………………………………………………………………………………………..
5. Can you please provide information about the scale and type of lending you give to the following category of firms:
   a. Micro-enterprise (Please indicate ceiling and maturity) ……………………………………………………………………………
   b. Medium Scale Enterprise (Please indicate floor and maturity) ……………………………………………………………………………..
   c. Large Scale Enterprise (Please indicate floor and maturity) ……………………………………………………………………………...

6. Does your organization provide loans to micro and small enterprises?
(A range of $100,000 or less is defined. Please feel free to redefine your range)
YES/ NO. If NO, does your organization have any plans to lend to this category of firms in the future?

7. What are the different loan facilities offered by your bank?
....
....
....

8. What are your key loan approval criteria to SMEs?
....
....

9. In your opinion what are the issues/factors currently inhibiting your bank's lending to SMEs?
....

10. Approximately what percentage of your loan portfolio falls into the following loan categorie
    a. Micro or Small Scale ($100,000 or less)
    b. Medium Scale ($100,000 - $500,000)
    c. Large Scale (over $500,000)

11. What is the current size of the commercial lending portfolio? ....

12. What is the total number of loans? ....

13. What is the average size, number and maturity of loans to the micro-enterprise sector?

14. Please indicate your lending portfolio according to the following sectors:

   a. Agriculture (indicate amount and percentage of portfolio)
   b. Manufacturing (indicate amount and percentage of portfolio)
   c. Trade (indicate amount and percentage of portfolio)
   d. Services (indicate amount and percentage of portfolio)

APPENDIX III

IMPORTANT STATISTICS OF THE GHANAIAN BANKING INDUSTRY - AUGUST 2004 (Figures in ¢billion)

ITEM/NAME OF BANK	1st Atlantic Bank	ADB	Amalbank	Barclays	Cal Bank	Ecobank	GCB
Total Assets	412.74	2,993.74	300.95	3,784.20	585.63	1,682.25	5,071.90
Loans & Advances	161.01	865.35	43.85	N/A	217.9	623.97	N/A
Investments	89.49	909.75	95.96	N/A	172.27	328.46	N/A
Deposits	253.11	1,518.19	266.39	2,771.40	335.95	1,269.64	3,183.80
Shareholders Funds	27.49	463.84	11	389.48	71.06	151.17	472.9
Total Income	37.92	327.39	22.84	613.50	76.47	227.5	758
Net Interest Income	14.74	204.37	12.12	474.4	33.51	127.82	578.3
Commissions & Fees	10.52	113.77	10.72	199.10	20.12	99.67	144.8
Other Income	12.65	9.24	N/A	11.05	22.84	N/A	37.9
Operating Expenses	-20.31	-145.71	-15.81	N/A	-36.19	-100.68	N/A
Profit Before Tax	2.06	87.53	3.82	328.71	32.87	107.61	215.2
Advances/Total Assets	39.01%	28.91%	14.57%	42.12%	37.21%	37.09%	34.59%
Advances/Deposits	63.61%	57.00%	16.46%	57.51%	64.86%	49.15%	56.10%
Provision for Bad Debts	8.59%	11.01%	7.32%	3.28%	3.42%	2.13%	8.59%
Capital Adequacy	6.66%	15.49%	3.66%	10.29%	12.13%	8.99%	9.32%
Return on Assets	0.50%	2.63%	0.66%	5.64%	3.53%	3.56%	1.84%
Return on Equity	7.50%	16.98%	18.04%	54.79%	29.10%	39.63%	19.75%
% Share of Industry Deposit	1.56%	9.33%	1.64%	17.04%	2.07%	7.80%	19.57%
% Share of Industry Loans	1.82%	9.77%	0.49%	12.17%	2.46%	7.04%	19.80%
% Share of Industry Assets	1.62%	11.78%	1.18%	14.89%	2.30%	6.62%	19.96%

APPENDIX III CONTINUED.

ICB	Merchant	NIB	Prudential	Standard Chart.	SG-SSB	Stanbic	Trust Bank	Unibank
218.31	993.24	1,042.38	615.22	1,829.20	2,089.75	417.75	624.28	96.24
34.61	367.18	373.33	138.55	N/A	746.28	102.78	178.42	30.05
112.91	146.45	468.88	173.28	N/A	610.6	125.35	208.95	21.09
166.44	797.55	345.11	305.91	2,817.90	1,263.21	303.00	391.75	73.56
31.2	101	131.7	30.14	407.4	326.4	81.94	47.33	8.21
21.43	124.49	138.1	58.61	555.98	350.44	45.45	87.19	12.58
411.13	49.71	74.91	34.54	333.92	232.27	25.98	55.92	6.61
4.179	36.14	22.07	18.59	134.62	100.2	13.35	21.82	4.03
6.118	38.65	41.13	5.48	87.45	17.97	6.11	9.44	1.94
-14.05	-57.73	-64.56	-39.94	N/A	-181.74	-30.07	-44.05	-10.96
6.53	16.38	42.39	14.28	296.77	114.53	12.42	35.92	0.81
15.85%	36.97%	35.81%	22.52%	36.84%	35.71%	24.60%	28.58%	1.23%
20.80%	46.04%	108.18%	45.29%	50.06%	59.08%	33.92%	45.55%	40.86%
2.45%	9.87%	8.88%	3.17%	1.00%	7.46%	2.88%	4.04%	2.69%
14.29%	10.17%	12.63%	4.90%	10.64%	15.62%	19.61%	7.58%	8.54%
2.07%	1.65%	3.15%	1.94%	N/A	4.21%	2.01%	3.10%	78.00%
14.49%	16.22%	24.97%	39.51%	N/A	26.94%	10.23%	40.91%	9.15%
1.02%	4.90%	2.12%	1.88%	17.32%	7.77%	1.86%	2.41%	0.45%
39.00%	4.14%	4.21%	1.56%	N/A	8.42%	1.16%	2.01%	0.34%
86.00%	3.91%	4.10%	2.42%	15.07%	8.22%	1.64%	2.46%	0.38%

Source: BUSINESSWEEK, 1-8 August 2004
*Statistics on Metro & Allied Bank, HFC Bank and Standard Trust Bank are not available

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