

UNIVERSITY FOR DEVELOPMENT STUDIES

THE IMPACT OF MICROFINANCE INSTITUTIONS ON THE DEVELOPMENT OF
SMALL AND MICRO ENTERPRISES IN THE TAMALE METROPOLIS

ELISHA KUKUA

A DISSERTATION SUBMITTED TO THE DEPARTMENT OF BUSINESS STUDIES,
FACULTY OF EDUCATION, LAW AND BUSINESS STUDIES, UNIVERSITY FOR
DEVELOPMENT STUDIES, IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE AWARD OF MASTER OF ARTS DEGREE IN BUSINESS PLANNING AND
MICROFINANCE MANAGEMENT

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By

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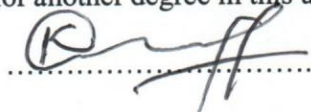


DECLARATION

Student

I hereby declare that this dissertation is the result of my own original work and that no part of it has been presented for another degree in this university or elsewhere:

ELISHA KUKUA



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(CANDIDATE)

(SIGNATURE)

(DATE)

Supervisor

I hereby declare that the preparation and presentation of this dissertation were supervised in accordance with the guidelines on supervision of dissertation laid down by University for Development Studies.

ABUBAKARI ABDUL-RAZAK

.....

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ABSTRACT

Microfinance is a term used by many in different domains to fight poverty. Poverty is a syndrome that is affecting the developing countries and especially in sub Saharan Africa. This thesis is focused on three specific objectives: The first of them is to investigate whether MFIs help their clients and/or customers in developing small or medium size businesses. The second aim is to find out whether SMEs can secure micro-financing with ease and on reasonable terms. Finally, this thesis is to determine the challenges SMEs face in their relationship with MFIs together with the evaluation of non-financial services offered by MFIs to their clients. In order to accomplish the task, we had to gather data from primary and secondary sources in areas within the Tamale metropolis. The primary data were gathered from questionnaires and interviews. The population was drawn from two different groups; the management and staff of Bonzali Rural Bank Ltd, representing the Microfinance Institutions (MFIs) and some selected SMEs in Tamale. We made use of closed and open ended questions. The responses were analyzed using SPSS software to produce percentage frequency tables. From the information that we have, it is realized that MFIs has a positive impact on the development of their clients businesses. Microfinance Institutions (MFIs) provide their members with financial and social intermediation services to help improve their businesses. Securing micro-financing by SMEs is determined by the stage or level of development in which the business is. Businesses that are viewed as growing had it easy to get a loan. But the main criteria used were the ability to pay back and to meet the set requirements to obtain a loan. Another requirement for accessing a loan from the MFIs is fixed tangible assets such as land being used as a guarantee. We noticed that the poorest of the poor were not included in designing and implementing their policies. The entry requirements are



difficult for the poorest to meet thus they do not enjoy the services of MFIs. We can say that the poorest are those who are not involve in any income generating activities, but lack basic amenities that are essential for life.



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It is important to acknowledge that this piece of work has been put together because God has given me the wisdom, energy and good health to do this. God has been so merciful to me and my family and has given me the grace to complete this work and I will not be ungrateful to God, but give Him praise for this blessing.

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Special mention is however made of my beloved brother of blessed memory (Brother Sampson, Kukua) who literally took me in his arms and guided me morally, intellectually, physically and financially from my infancy till the 17th day of March, 2013 when he departed for eternal rest. All I say is "I thank God you passed by". It is not about how long you stayed with us, but it is all about the great impact you made on us individually and as a family. You still live in our hearts.

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DEDICATION

I dedicate this piece of work to the eternal memory of my brother, *Sampson Kukua* of blessed memory.



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LIST OF ABBREVIATIONS AND ACRONYMS

MF	Microfinance
MFIs	Microfinance institutions
OFIs	Other financial institutions
SMEs	Small and medium size enterprises
UN	United nations
NGOs	Non-governmental organizations
SPSS	Statistical package for social scientists
NBSSI	National board for small scale industries
GIPC	Ghana investment promotion center
FAO	Food and agriculture organization
POT	Pecking order theory
BRB	Bonzali rural bank
SHG	Self-help group
MDGs	Millennium development goals
MOTI	Ministry of trade and industry
N/A	Not applicable
BoG	Bank of Ghana
MASLOC	Microfinance and small loans center
FELBS	Faculty of Education, Law and Business Studies
UDS	University for Development Studies
ANOVA	Analysis of variance



CHAPTER ONE

INTRODUCTION TO THE STUDY

1.1: Background of study

The home of 'modern' microcredit (Bangladesh) started in 1976, when Professor Muhammad Yunus, an economics professor, gave a \$27.00 loan to a small group of village women, without demanding collateral. The women defied expectations by not only repaying the loan but developing a sustainable business and starting savings accounts (*Loth, 2002*). Today, this simple economic model has expanded globally to involve millions of borrowers and savers with the potential to improve and sometimes initiate the development of small, medium and in the long run, giant businesses across the globe, especially in developing economies in order to raise the poor from their predicaments.

Microcredit is the name given to small loans made to poor people who are regarded as bad financial risks, by conventional banks, as they have insufficient savings or assets to obtain a loan. The Virtual Library on Microcredit takes the definition of microcredit beyond the confines of 'money' and declares in its conceptual framework that it is also about 'information' that is timely and appropriate in the form of strategies, tools, grassroots organizations and the education of the population on development issues related to microcredit.

Robinson (2001) in the Microfinance Revolution excludes the 'poorest of the poor' from the definition of microfinance because for a variety of reasons they are unable to engage in economic activity and cannot be the responsibility of the financial sector. Instead she states that they need access to a 'tool box' of subsidized poverty alleviation instruments. The exclusion of the 'poorest of the poor' sets up a dichotomy between 'financial systems' and 'poverty lending approaches.' The



former is based on sustainable institutions, for example the Indonesian rural financial institutions and the later on subsidized institutions, for example the Grameen Bank. The creation of SMEs generates employment but these enterprises are short live and consequently are bound to die after a short while, causing those who gained job positions to lose them and even go poorer than how they were. It is not until recent that microfinance had gained recognition through the efforts of the Nobel Prize winner Prof. Muhammad Yunus of the Grameen Bank in Bangladesh. It should be noted that microfinance is not a panacea but it is a main tool that foster development in developing countries (Chiyah et al, 2010). It is known worldwide that the poor cannot borrow from the traditional banks due to the lack of collateral security. Microfinance is therefore seen as a tool used by development agencies and other interested parties to raise the standard of living of the poor, by providing credit to establish small scale businesses to such an appreciable level, to increase their incomes, commensurate with their status in society. These improvements in the lives of people are in a nutshell to alleviate poverty, and according to this project, it will be seen from the point of the development of small and medium size enterprises (SME's) and focusing mostly in Tamale.

The UN millennium development goal to alleviate poverty by the year 2015 is far from fetch despite the enormous works that microfinance institutions are doing to contribute in this domain (Hiderink and Kok, 2009). The main challenge facing the poor is to gain financial power to enable them boost their income generating activities (Yunus, 2003).

Sustainable microfinance organizations whether self-managed cooperatives, professionally managed microfinance institutions (MFIs) or formal financial institutions, need to provide long term, high quality microfinance services to the



productive poor in order to enhance a sustainable business environment in the long run. This means microfinance must be accessible to small business owners in order for them to embark on expansionary missions of their entities. At the same time microenterprises must become financially self-sufficient as permanency in the community is a powerful incentive for repayment (*Donaghue and Zotalis, 2002*). Today a diversity of microfinance organizations has found ways to make lending to the productive poor sustainable, which in the long run encourage the establishment of small businesses by people who hitherto could not have done so, and also improve the performance of the existing businesses.

The MFIs and other financial institutions (OFIs) providing microfinance services have set in motion a process of change from an activity that was subsidy dependent to one that is a viable business. It has shattered the myth that poor households cannot and do not save, as well as discovered that the poor are creditworthy and financial services can be provided to the poor on a profitable basis at low costs without relying on collateral. It has also triggered a process toward broadening rural financial markets and strengthening the human capital of the poor, particularly women, at the household, enterprise and community level. Sustainable delivery of microfinance services on a large scale in some countries has generated positive developments in microfinance policies and practices among all stakeholders, such as governments, central banks, microfinance service providers and external funding agencies.

1.2: Thesis statement

Access to finance remained a dominant constraint to small scale enterprises in Northern Ghana as a result of credit constraints pertaining to working capital and raw materials. This stems from the fact that SMEs have limited access to capital



markets both locally and internationally, in part because of the perception of higher risk and informational barriers for smaller firms just to mention a few. As a result, SMEs often cannot obtain long-term finance in the form of debt and equity. These difficulties of SME's to obtain credit make entrepreneurs reluctant in pushing forward the agenda of business development and hence their negative effect on the development of SME's in Ghana. The evidence of entrenched levels of poverty across the length and breadth of the developing world indicates that there has been very marginal impact of MFI's on SME development. The low levels of development, low growth of businesses and the increasing levels of poverty in the northern sector are all factors arising from insufficient financial capital to enhance business growth. This study however seeks to investigate extensively the impact of credit (Microfinance Services) on the development of Small and Medium term Enterprises in Tamale.

1.3: Research questions

This research is guided by the following questions:

1. What are the procedures entrepreneurs follow in order to access SME loans for developing their businesses?
2. How have the terms of credit from MFIs inimical to the development of SME's in Ghana?
3. What are the challenges SMEs encounter when accessing funds from the MFIs?
4. How have those challenges impacted on the development of SME's?
5. How sufficient are loans received from MFI's to enable entrepreneurs develop their businesses?



6. What are the non-financial supports MFI's offer in the development of SME's?
7. What facilities and services do MFI's provide to SME's?

These questions shall be the focus of this research.

1.4: Objectives of Research

This study is intended to investigate the problems and opportunities that small businesses face in their development efforts, with a particular interest in the role that micro-finance institutions may be playing and gaining a more general understanding of the challenges facing the development of small firms in Ghana. The specific objectives in this study are:

1. To determine the role microfinance institutions play to help its clients in developing small or medium size businesses,
2. To identify what non-financial supports MFI's and NGOs provide to the development of small businesses,
3. To determine the challenges confronting SME's in accessing finance from MFI's, and identify the impact of micro financial products on the human and social development of SME clients,
4. To determine what facilities and services MFI's provide to SME's.

1.5: Methodology

Both primary and secondary sources of gathering information were used by the researcher in obtaining data for this research. The study targeted all microfinance institutions and SME's operating within Tamale. However, due to the unavailability of time and space, the researcher using scientific methods, selected the Bonzali Rural



Bank Ltd (BRB), Credit enterprise Ltd and Maata-N-tudu Association, all representing MFI's and about fifty-eight SME's for this study. The criteria for selecting samples were; all participants were SME operators/MFI/practitioners in either or both ventures, all SME participants were beneficiaries of microfinance products, and all participants were operating within Tamale. A number of sampling techniques (including simple random sampling, stratified sampling, snowball sampling and purposive sampling) were used to obtain samples for the study. Questionnaires, interviews, surveys, focus group discussions and observations were instruments used to collect data for the research study while data was analyzed using computer software known as the statistical package for social scientists (SPSS) to show tables and percentages in determining the relationship that existed between MFI's and SME's and also to assess the impact of MFI's on SME's.

1.6: Significance/Justification of Study

It is vital to mention that researchers have found this area of study crucial to the development of the socio-economic activities in developing countries and their contributions to the development of small and medium size businesses in Ghana. The research study was basically designed to measure the impact of microfinance institutions on the development of small and medium size enterprises in Tamale and to determine whether microfinance institutions in Tamale have bearing on the escalating growth of SMEs across the various sectors of the Ghanaian economy. The researcher believed that a better understanding of this phenomenon would allow micro finance practitioners and other interested parties in this industry to provide informed regulations and guidelines to regulate the provision of credit to small and medium size businesses in the country to improve business performance. This study



will also enlighten the government and the public on the role MFI's are playing in the SME sector, it will help in informing government decision with regards to SME development in this country (Ghana) and providing information necessary to strengthen the Small Scale Industry in Ghana, achievement of which will impact positively on the socio economic development of the poor (especially the productive poor). This research will therefore focus on MFI's which has not been exploited in terms of its contributions to the development of small and medium size businesses and particularly in the trading and farming domains. Thus it will pave a way forward for potential NGOs wishing to help in the sustainable development of SMEs to understand the difficulties they may come across and how they can succeed in their endeavors.

1.7: Scope and delimitation of study

To cover all the regions in the entire country with this research will be impossible as a result of the limited time frame, resources and amount of pages required for this research. For this reason, the research will be limited to activities in Tamale. The study limited itself to small businesses within central Tamale. This study focuses on the resource needs of developing small and medium size firms, and how micro-finance may be contributing to firms' development, in Ghana. This study adopts the definition of SME's by NBSSI, which defines SME's as enterprises with turnover greater than US\$200,000 and not more than US\$5 million equivalent, GIPC (2011), with inclusion of businesses with a turnover lower than the above threshold. MFI's on the other hand are defined in this research as providers of microfinance services in the country which may either be formal or informal organizations.



1.8: Structure of the study

The report would be categorized into the following chapters:

Chapter one consists of introduction, brief summary, thesis statement, research questions, objectives of research, and significance/justification of research, Scope/delimitation of study and limitations of the study.

Chapter two include review of related literature as follows: Microfinance products and services for SMEs development , SME growth and development, minimal equity requirement, market size, characteristics of the target population, types of micro enterprises, level of business development and the supply of microfinance services to clients.

Chapter three consists of methodology of the study presented as follows: Introduction, research approach, research design, study area, sample and sampling techniques, data collection method, data analysis and conclusion.

Chapter four, Data Analysis is made up of presentation of data, current development of businesses, types of business activities, age of businesses and stages of development, repayments of loans and impacts of loans on business development,

Chapter five relates to the results/findings conclusions and recommendations.



CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

MFIs provide similar products and services to their customers as formal sector financial institutions. The scale and method of delivery differ, but the fundamental services of savings, loans, and insurance are the same. This chapter explores a wide range of literature that has been done in relation microfinance and its effects on human and business development.

2.1 The concept of microfinance

Microfinance is defined as a development tool that grants or provides financial services and products such as very small loans, savings, micro-leasing, micro-insurance and money transfer to assist the very or exceptionally poor in expanding or establishing their businesses. It is mostly used in developing economies where SMEs do not have access to other sources of financial assistance (Robinson, 1998). In addition to financial intermediation, some MFIs provide social intermediation services such as the formation of groups, development of self-confidence and the training of members in that group on financial literacy and management (Ledgerwood, 1999). There are different providers of microfinance (MF) services and some of them are; nongovernmental organizations (NGOs), savings and loans cooperatives, credit unions, government banks, commercial banks or non-bank financial institutions. The target group of MFIs are self-employed low income entrepreneurs who are; traders, seamstresses, street vendors, small farmers, hairdressers, rickshaw drivers, artisans blacksmith etc (Ledgerwood, 1999).



2.2 Microfinance products and services for SMEs development

According to Bennett (1994) and Ledgerwood (1999), MFIs can offer their clients who are mostly the men and women who could be below or slightly above the poverty line a variety of products and services. The most prominent of their services is financial, that they often render to their clients without tangible assets and these clients mostly live in the rural areas, a majority of whom may be illiterates. Formal financial institutions do not often provide these services to small informal businesses, run by the poor as profitable investments. They usually ask for small loans and the financial institutions find it difficult to get information from them either because they are illiterates and cannot express themselves or because of the difficulties to access their collateral (farms) due to distance. It is by this that the cost to lend a dollar will be very high and also there is no tangible security for the loan. The high lending cost is explained by the transaction cost theory.

Borrowers may incur cost ranging from cost associated in screening group member (group borrowing), cost of forming a group, cost of negotiating with the lender, cost of filling paper work, transportation to and from the financial institution, cost of time spent on project appraisal and cost of attending meetings, etc (Bhatt and Shui-Yan, 1998). The parties involved in a project will determine the transaction cost rate. They have the sole responsibility to reduce the risk they may come across (Stiglitz, 1990).

Microfinance triangle comprise of financial sustainability, outreach to the poor, and institutional impact (Christabell, 2009). The provision of financial services to the poor is expensive and to make the financial institutions sustainable requires patience and attention to avoid excessive cost and risks (Adam and Von Piske, 1992). The deliveries of MF products and services have transaction cost consequences in order to have greater outreach. Some microfinance institutions visit their clients instead of



them to come to the institution thereby reducing the cost that clients may suffer from (FAO, 2005).

The loans demanded by smaller enterprises are smaller than those requested by larger ones but the interest rates remain the same. This indicates that, per unit cost is high for MFIs targeting customers with very small loans and possessing small savings accounts (Robinson, 2003). Microfinance clients admit that convenience is more important to them than return (Schmidt and Zeiting, 1994).

Low-income men and women have a serious hindrance in gaining access to finance from formal financial institutions. Ordinary financial intermediation is not enough to help them participate, and therefore MFIs have to adopt tools to bridge the gaps created by poverty, gender, illiteracy and remoteness. The clients also need to be trained so as to have the skills for specific production and business management as well as better access to markets so as to make profitable use of the financial resource they receive (Bennett, 1994). In providing effective financial services to the poor requires social intermediation. This is "the process of creating social capital as a support to sustainable financial intermediation with poor and disadvantaged groups or individuals" (Bennett, 1997). Some microfinance institutions provide services such as skills training, marketing, bookkeeping, and production to develop enterprises. Social services such as health care, education and literacy training are also provided by some MFIs and both enterprise development and social services can improve the ability of the low-income earners to operate enterprises either directly or indirectly (Legerwood, 1999). The services provided to microfinance clients can be categorized into four broad different categories:

Financial intermediation or the provision of financial products and services such as savings, credit, insurance, credit cards, and payment systems should not require



ongoing subsidies. Social intermediation is the process of building human and social capital needed by sustainable financial intermediation for the poor. Subsidies should be eliminated but social intermediation may require subsidies for a longer period than financial intermediation.

Enterprise development services or non-financial services that assist micro entrepreneurs include skills development, business training, marketing and technology services, and subsector analysis. This may or may not require subsidies and this depends on the ability and willingness of the clients to pay for these services.

Social services or non-financial services that focus on advancing the welfare of micro entrepreneurs and this include education, health, nutrition, and literacy training. These social services require ongoing subsidies and are always provided by donor supporting NGOs or the state (Bennett, 1997; Legerwrod, 1999).

2.3 SME growth and development

The purpose or goal of any firm is to make profit and growth. A firm is defined as an administrative organization whose legal entity or frame work may expand in time with the collection of both physical resources, tangible or resources that are human in nature (Penrose, 1995). The term growth in this context can be defined as an increase in size or other objects that can be quantified or a process of changes or improvements (Penrose, 1995). The firm size is the result of firm growth over a period of time and it should be noted that firm growth is a process while firm size is a state (Penrose, 1995). The growth of a firm can be determined by supply of capital, labor and appropriate management and opportunities for investments that are profitable. The determining factor for a firm's growth is the availability of resources



to the firm (Ghoshal, Halm and Moran, 2002). Enterprise development services or business development services or nonfinancial services are provided by some MFIs adopting the integrated approach. The services provided by nonfinancial MFI services are; marketing and technology services, business training, production training and subsector analysis and interventions (Ledgerwood, 1999). Enterprise development services can be sorted out into two categories. The first is enterprise formation which is the offering of training to persons to acquire skills in a specific sector such as weaving and as well as persons who want to start up their own businesses. The second category of enterprise development service rendered to its clients is the enterprise transformation program which is the provision of technical assistance, training and technology in order to enable existing SMEs to advance in terms of production and marketing. Enterprise development services are not a prerequisite for obtaining financial services and they are not offered free of charge. These charges are subsidized by the government or an external party since to recover the full cost in providing the services will be impossible by the MFI. The enterprise development services may be very meaningful to businesses but the impact and knowledge that is gained cannot be measured since it does not usually involve any quantifiable commodity. It has been observed that there is little or no difference between enterprises that receive credit alone and those that receive both credit packages and integrated enterprise development services (Ledgerwood, 1999).

2.4 Minimal equity requirement of SME's

Firms rely mostly on informal sources of finance for start-up capital for their businesses since credit markets are limited. A majority of the start-up capital is from personal savings and borrowed money from friends and relatives. Minimal amount



of funds as start-up is borrowed from the formal institutions such as banks. The granting of loans is much easier to large firms than small ones (Gary and Guy, 2003). MFIs consider clients ability to repay debt and assess the minimal sum small scale businesses can contribute as equity before offering a loan. This is to say a business should not be financed entirely with borrowed money. When a business is in the start-up phase, it requires at least a certain amount of resources for the MFI to consider the application for a loan. In a situation where the firm is unable to provide the said equity capital, some MFIs require household items to be pledge as a security before the loan can be granted. These MFIs also apply some sort of financial and psychological measurements and when they consider that correct to any prospective borrower it is then that the loan can be granted. It is generally said that people care more on things that they have worked for or items that they own (Zeller, 2003). This and other reasons explain why MFIs deem it necessary for borrowers to have minimal equity contribution before applying for a loan. The source of the minimal equity capital is known by the MFIs because the client may be at high risk of non-respecting the terms of repayment had it been the funds were borrowed from somewhere. This means that a business with little borrowed capital with good market standing will have an upper hand in getting financial assistance from the MFIs (Ledgerwood, 1999).

2.5 Market size of SME's

The size of the microenterprise market is estimated by the MFIs to know if it can be benefited from financial services, in case self-reported credit need be confused with the repayment capacity and effective demand. The market for MFIs takes into consideration the type of microenterprise being financed and the characteristics of



the population group (Chiyah et al, 2010). The size of the microenterprise market however depends on the following:

2.5.1 The level of poverty: poverty alleviation is the focal point of microfinance institutions and the poorest form a majority of the population. The outreach of MF services to the poor is measured in terms of scale, the number of clients that is reached and the depth of the clients they reach (Ledgerwood, 1999). Institutions that are contributing in the fight against poverty are very effective in the improvement of the welfare of those under and those just above the poverty line (Hulme and Mosley, 1996).

2.5.2 Geographic focus: MFIs serve both urban and rural areas but their focus is more in the rural areas. Products and services offered by the MFIs are aimed towards meeting the expectations of the target location or area. Those in the rural areas are different from those in the urban areas and the infrastructural development in these areas also matters. Markets are very important for microenterprises irrespective of the area where the firm is located. The difficulty to produce and distribute or deliver the goods because of lack of infrastructure will hinder or retard the growth of businesses thus limiting the financial services that will be demanded. An example of a reduce transaction cost will be the availability of good road network. Grameen Bank is a typical MFI that is successful and it has branches in the same geographical areas where their clients live (Ledgerwood, 1999).



2.6 Types of SMEs

The type of population to be served and the activities that the target market is active in and also the level or stage in development of the business to be financed is determined by the MFIs. SMEs differ in the level in which they are and the products and services offered to them by the MFIs are towards meeting the demands of the market. SMEs are financed differently and the financing is determined by whether the firm is in the start-up phase or existing one and also whether it is stable, unstable, or growing. The type of activities that the business is involved in is also determined and this can be; production, commercial or services activities (Ledgerwood, 1999).

2.7 Existing or start-up microenterprises

In identifying the market, MFIs consider whether to focus on already existing entrepreneurs or on potential entrepreneurs seeking for funds to start up a business venture. Working capital is the main hindrance in the development of already existing SMEs and to meet up, they borrow finance mostly from informal financial services such as; families, friends, suppliers or moneylenders. MFIs see it less risky to work with existing microenterprises because they have a history of success (Ledgerwood, 1999).

Businesses that are financed by MFIs from scratch consider that they will create an impact in the society by alleviating poverty by increasing their level of income. An integrated approach lay down the foundation for start-up businesses to pick up since financial services alone will not help them. They need other services such as skills training and to equip them with all the necessary tools that can hinder them from obtaining loans. Existing businesses with part of their capital being equity is



preferred by most MFIs to work with since the level of involvement is high and consequently lower risk (Ledgerwood, 1999).

2.8 Level of business development

MFIs provide their products and services based on the level of development of the businesses. SMEs can be grouped into three main levels of business development that profits from access to financial services.

- Unstable survivors are groups that are considered not credit worthy for financial services to be provided in a sustainable way. Their enterprise are unstable and it is believe they will survive only for a limited time and when MFIs focus on time to revert the situation by providing them other extra services, it is noticed that costs increases and time is also wasted.
- Stable survivors are those who benefit in having access to the financial services provided by MFIs to meet up with their production and consumption needs. Stable survivors are mainly women who engage in some sort of business activities to provide basic needs such as food, child health, water, cooking for the household, etc. These types of microenterprises rarely grow due to low profit margins which inhibit them to reinvest and an unstable environment due to seasonal changes which makes them to consume rather than to invest in the business.
- Growth enterprises are SMEs with high possibility to grow. MFIs focusing on these types of microenterprise are those that have as objective to create jobs, and to move micro entrepreneurs from an informal sector to a formal sector. MFIs prefer to provide products and services to meet the needs of this



group since they are more reliable and posing them the least risk (Ledgerwood, 1999).

2.9 Type of business activities

The business activity of a microenterprise is equally as important as the level of business development. There are three main primary sector where an enterprise may be classified; production, agriculture and services. Each of these sectors has its own risk and financing needs that are specific to that sector. MFIs are motivated to finance in a particular sector by providing the products and services that are relevant to that sector after analyzing the purpose for the loan, term of the loan, and the collateral on hand for each of the sectors. Some MFIs target only one sector where as others provide products and services for more than one sector. Their actions are determined by their objectives and the impact they wish to achieve (Ledgerwood, 1999).

2.10 The supply of microfinance services to clients

The approach taken by an MFI will depend on the degree to which these MFIs will provide each of these services and whether it follows a “minimalist” approach or “integrated” approach.

The minimalist approach offers only financial intermediation but they can sometimes offer partial social intermediation services. This approach is based on the fact that there is a single “missing piece” for the growth of enterprises and it is assumed to be the lack of affordable, accessible, short-term credit which the MFIs can offer.

The integrated approach takes a more holistic view of the client. This approach creates avenue for a combination or range of financial and social intermediation,



enterprise development and social services. MFIs take advantage of its nearness to the clients and based on its objectives, it provides those services that are recognized as most needed or those that have a comparative advantage in providing. The demand and supply of these services will determine the approach that a MFI will choose and also the circumstances in which it is operating (Ledgerwood, 1999, p. 65).

2.11 Financial intermediation of MFI's

MFIs have a main objective to provide financial intermediation which involves the transfer of capital or liquidity from those who have excess to those who are in need both at the same time. "Finance in the form of savings and credit arises to permit coordination. Savings and credit are made more efficient when intermediaries begin to transfer funds from firms and individuals that have accumulated funds and are willing to shed liquidity, to those that desire to acquire liquidity" (Von Pischke, 1991, p27). It is visually known that almost all MFIs provide credit services. Other MFIs also provide some financial products such as; savings, insurance, and payment services. Each MFI has its objectives and the choice of the financial service to provide depends on the demands of its target market and its institutional structure. Two important considerations when providing financial services are; to respond effectively to the demand and preference of clients and to design products that are simple and easy to understand by the clients and easily managed by the MFI. The common products that MFIs provide include; microcredit, micro savings, micro insurance, credit/debit cards provision, and payment services. These points are briefly described and also show how financial services are provided to SMEs.



2.11.1 Microcredit:

These are borrowed funds with specified terms for repayment. People borrow when there are insufficient accumulated savings to finance a business. They also take into consideration if the return on borrowed funds exceeds the interest rate charged on the loan and if it is advantageous to borrow rather than to postpone the business operations until when it is possible to accumulate sufficient savings, assuming the capacity to service the debt is certain (Waterfield and Duval, 1996). Loans are usually acquired for productivity reasons; that is to generate revenue within a business.

2.11.2 Micro Savings:

Savings mobilization in microfinance is a very controversial issue. There has been increase in awareness among policy makers and practitioners on the vast number of informal savings schemes. MFIs such as credit union organizations around the world have been very successful in rallying clients to save (Paxton, 1996a, p8).

2.11.3 Micro Insurance:

This is one of the services and products that are experimented by MFIs. Many group lending programs offer insurance or guarantee scheme as collateral and the Grameen bank is a typical example of MFI in this scheme. One percent of the loan is required to be presented by the group member as their contribution for the insurance for the loan (Ledgerwood, 1999).

2.11.4 Credit/Debit cards Provision: These are cards that allow borrowers to have access to a line of credit if and when they need it. This card is also use to make



purchase assuming the supplier of the goods will accept the credit card or when there is a need for cash. The card is also called a debit card when the client is accessing his or her own savings (Ledgerwood, 1999).

2.11.5 Payment Services to Clients:

Payment services include cheque cashing and cheque writing opportunities for clients who retain deposits (Caskey, 1994). In addition to cheque cashing and cheque writing privileges, payment services comprise the transfer and remittance of funds from one area to another (Ledgerwood, 1999).

2.12 Determinants of capital structure by SMEs

SMEs have some important aspects that are considered when taking decisions on their financial structure. A firm's history is a more important factor in determining the capital structure than its characteristics. The cost of debt to equity is compared; the increase in risk and the cost of equity as debt increases is also compared before taking the decision. The advantage of debt by SMEs due to tax reduction is also considered. The costs of capital remain unchanged when there is a deduction in taxes and interest charges. This indicates that using cheaper debt will be favorable to the business than using equity capital due to increase risk (Modigliani and Miller, 1958 and 1963). Firms would seek a good portion of their capital structure as debt to a certain level so as to take these tax advantages. An over reliance on debt as capital by SMEs will have a negative effect in the business activity in that it will increase the probability of the firm to go bankrupt (Myers, 1984).

Myers (1977) determines the capital structure of SMEs. The pecking order theory (POT) was used to explain why firms will choose a particular capital structure than



the other. The POT stipulates that SMEs average debt ratio will vary from industry to industry because these industries have varied asset risks, asset type and the requirements for external capital (Myers, 1984). Firms in one industry will have certain aspects that are common to most than to firms in a different industry (Harris and Raviv, 1991). The decisions are made taking into consideration information asymmetry, agency theory, and the signaling theory. The signaling theory describes signs and the effectiveness or how a venture will progress in an uncertain environment (Busenitz et al., 2005). The main idea behind this theory is that there is an information signal that alerts the stakeholders of what is happening in the business (Deeds et al., 1997). The success of a business in the future is determined by the availability of information to the firm. The stakeholders of a business require signals to find the way of the asymmetry of information between what is known and what is unknown (Janney and Folta, 2003). The outsiders get to know about a particular venture based on the signals it sends out. These signals need to be favorable because it is from it that potential investors will be informed and thus show the intention to invest in the venture. The cost of equity will be high when poor signals are noticed by outsiders and this will restrain potential investors (Busenitz et al., 2005). Firms get access to venture capital when they have a good goodwill (Prasad, Bruton and Vozikis, 2000, p168). Good signals to the outsiders of a firm can be described as equal to due diligence with reduced time and input (Harvey and Lusch, 1995).

New businesses have problems in getting a favorable position in the market. Their existence is determined by their size and age. If it continues to exist, it means it is capable of maintaining its size or it is expanding. This of course goes with time and when they continue to exist, it means resources are acquired or unlimited (Freeman,



1982). This process of gaining stability and to survive makes the firm to gain legitimacy and thus can be trusted as a successful business since it emits positive signals (Singh, Tucker and House, 1986). Firms with unlimited resources at the infancy stage are easy to go bankrupt and die in this early stage (Aldrich and Auster, 1986; Carroll and Delacroix, 1982; Freeman, Carroll and Hannan, 1983; Romanelli, 1989; Singh, Tucker and House, 1986; and Stinchcomb, 1965). Firms that are young and small are incapable of getting the available resources for the proper functioning of its business activities and they are always associated with external organizations in a vertical manner for support (Stinchcomb, 1965). The integration of the young firm with a well-established one gains ground for available resources such as funding and legitimacy (Hannan and Freeman, 1984; Singh et al., 1986). Businesses employing this approach to gain legitimacy are at risk since they are not independent. The other activities will have an influence in the outcome of the other. Its competitors along with others get to know the inner dependent firm which the competitor will use it as its strength. They get to know the weaknesses of the opposing firm but at the same time they will enjoy the benefit of transaction cost. The reduction of costs is due to the fact that they integrate with others to realize their objectives. This is done by gaining the inside of the quality of work, production and ideas within its top level.

It is realized that there is no target equity mix and this is due to the fact that they exist two different kinds of equity. The two are at extremes meaning one at the top and the other at the bottom of the pecking order. These differences are caused by the costs of information asymmetry. External sources of funding have more moral hazard problems and consequently the demand for own or internal finances are of paramount to the firm (Myers, 1984). This moral hazard is explained by the fact that





SMEs are very close entities; that is owned and or controlled by one person or few people (Watson and Wilson, 2002). POT emphasizes; Ang (1991) on the use of owned capital rather than outside capital by SMEs and also explain why SMEs are denied or has a hindering factor in seeking for external sources of finance. World Bank (2000) reiterates the fact that SMEs are more likely to be denied new loans for their businesses than larger firms when in need. They consider SMEs to lack the skills to manage risk and the high transaction costs in lending to them compared to the amount that is borrowed (Hallberg, 1994).

SME lack managerial skills, resources and experience to motivate the potential investors to invest on them. They view them as high risk business concerns and some well to do SMEs may be hindered critical financing (Kanichiro and Lacktorin, 2000). SMEs and providers of debt and equity need to have a cordial relationship to avoid the problem of information asymmetry and conflicts of interests. All SMEs require financing to grow and the source may be internal or external. The external sources constitute loans, equity infusions, subsidies, or government grants. The internal source is income generated from cash flows that are reinvested. Many SMEs are self-financing by friends and family members at the beginning stage of development but when it gets to a later stage in development, external financing become necessary. Banks find it hard to grant loans to SMEs until when they find it have a stable growth. More so they need to have a track record of their activities, sufficient collateral or adequate guarantees. Businesses that are viable and have good market positions during periods of recession will have difficulties in obtaining bank financing.

Credit availability to SMEs depends on the financial structures in place, legal systems, and the information environment. SMEs in countries with more effective

legal system have less financing obstacles since the laws protect property rights and their enforcement are implemented to financial transactions (Beck et al., 2005b).

2.13 Some problems faced by SMEs to acquire capital from formal financial institutions

Formal financial institutions have failed to provide credit to the poor and most of whom are found in developing countries and to be more specific in the rural areas. The reasons given by Von Pischke (1991: 143-168) is that their policies are not meant to favor the poor. The poor are mostly illiterate and banks lack those skills to target these rural customers. In these areas, the population density is very low causing high transaction cost by the financial institutions since they need to move for long distances and also takes time to meet the customers (Devereux et al 1990:11). SMEs in developing countries are considered to be too unstable by banks to invest in. Due to this instability, the banks consider SMEs to have high risk and the costs these banks suffer to monitor the activities of the SMEs are high. Hossain (1998), Bhattacharya, et al. (2000) and Sia (2003) identify that formal financial institutions (banks) are reluctant to lend to SMEs since investing in SME activities is considered by banks to be very risky. They find it risky in the sense that if invested in, and in an event of unfavorable business conditions, they have low financial power, assets, and easily go bankrupt (Sia, 2003). The cost of borrowing from banks is very high and this prevents SMEs to borrow from this institution but these costs to borrow are sometimes subsidized by the government (Meagher, 1998). The application process for a loan is long and difficult for SMEs to meet up with the demands (Hossain, 1998). The collateral demanded by banks for a loan is based on fixed assets and which are very high in other to hinder these businesses to acquire loans. They cannot



afford these collaterals which include; estates, and other fixed assets valued usually at 200% of the loan (Meagher, 1998). The major setback that prevents SMEs to get funding from external sources is the problem of information asymmetry. That is the magnitude of the deviation of the correct information that is needed by the lending institution (Bakker, Udell, & Klapper, 2004).

Banks use cash flows and profitability to measure or to assess the worthiness of a business. This is a very expensive and, not a good method to measure the credit strength of rural SME. Production and distribution in the rural areas is influenced by social factors that are often neglected by enterprises in developing countries (Otero et al 1994: 13). Agriculture dominates rural activities in developing countries and is dependent on the weather conditions for its output. An enterprise in this sector is considered risky because its outcome is undetermined.

2.14 Organization of microfinance institutions

2.14.1 Cooperative financial institution:

This is a financial institution that can be termed semiformal. It constitutes credit unions, savings and loan cooperatives and other financial cooperatives. They are generally identified as credit unions or savings and loan cooperatives and provide savings and credit services to its members. There are no external shareholders and run the same as a cooperative and implementing all its principles. Members who are at the same time customers make the policy of the cooperative. They are either elected or work on voluntary bases. They are not often subjected to banking regulations but have their own regulations and are under the supervision of the ministry of finance of the country. Individual financial cooperatives in a country are often govern by a league that coordinate activities of these credit unions, trains and



assist its affiliates, act as a place where the deposit and provide inter lending facilities and act as a link between external donors and the cooperative system (Schmidt, 1997). They raise capital through savings but to receive loans is not easy. Loans are delivered following the minimalist approach where the requirements for loans are not often difficult to meet by customers; little collateral, character and co-signing for loans between members. These loans are usually loans within the savings of the member (Schmidt, 1997).

2.14.2 Group Lending Institutions:

This method of providing small credits to the poor is most use by microfinance that provides loans without collateral. The interest charge is around not much different from that of commercial banks but far lower than interest charge by individual by money lenders (Natarajan, 2004). The Grameen bank is a typical example of microfinance institution using this method. The repayment rate is very high since each member is liable for the debt of a group member (Stiglitz, 1990). Group formation is made by members who know themselves very well or have some social ties. Loans are not granted to individuals on their own but to individuals belonging to a group; and the group acts as a collateral which is term social collateral. This is to avoid the problems of adverse selection and also to reduce costs of monitoring loans to the members who must make sure the loan is paid or they become liable for it (Armendariz, 1994).

2.14.3 Individual Lending Institutions:

This is the lending of loans to individuals with collateral. Besley and Coate (1995) say despite the advantages of lending to groups, some members of the group may fail



to repay their loan. Montgomery (1996) stresses that this method of lending avoids the social costs of repayment pressure that is exerted to some group members. Stiglitz (1990) highlights that members in group lending bear high risk because they are not only liable for their loans but to that of group members. Navajas et al. (2003) and Zeitingner (1996) recommend the importance of routine visits to the clients to make sure the loan is use for the project intended for. These monitoring is vital but at the same time increases the cost of the microfinance institution.

2.14.4 Self-help groups (SHG) Approach:

This is common among women in the rural areas who are involved in one income generating activity or another (Ajai 2005). Making credit available to women through SHGs is a means to empower them. This group is an institution that helps its members sustainably with the necessary inputs to foster their lives. SHG provides its members with not only the financial intermediation services like the creating of awareness of health hazards, environmental problems, educating them etc. These SHGs are provided with support both financial, technical and other wise to enable them engage in income generating activities such as; tailoring, bee keeping, hairdressing, weaving etc. It has a bureaucratic approach of management and are unregistered group of about 10 – 20 members who have as main priority savings and credit in mind (Ajai, 2005). The members in the SHG have set dates where they contribute a constant and equal sum as savings. These savings are then given out as loans to members in need for a fixed interest rate (Bowman, 1995).





2.14.5 Village Banking [vendingapproach.edu.gh](http://www.vendingapproach.edu.gh)

This is a method of lending to individual members to have constant access to money for their Micro-enterprise daily transactions (Mk Nelly and Stock, 1998). Borrowers are uplifted using this method because they own SME that earn money sustainably. This enables them to acquire a larger loan sum which gives them higher profit when introduced into the business and of course the interest with this high sum is high making the bank financial sustainable. Village banking as of the 90s has gained grounds and certain adjustments are made to suit partner institutions (Nelson et al; 1996). Hatch and Hatch (1998) Village banking loan and savings growth rate increases as the bank continue to exist.

2.15 The triangle of microfinance

The performance of the financial sector in providing financial intermediation for small and medium size enterprises can be evaluated in three vital dimensions: financial sustainability, outreach, and welfare impact (Zeller and Mayer, 2002). They went further to say that this microfinance triangle is the main policy objective of these microfinance institutions which are aimed towards development. The internationally agreed objectives of development are the Millennium development Goals (MDGs). These MDGs are to alleviate poverty and this is done in many dimensions of welfare such as increasing access to education, health, nutrition, women's empowerment and of course basic needs (Morduch et al, 2003). Donor organizations and governments differ in the microfinance objective which is of prominence to them; i.e. financial sustainability, depth of outreach, and welfare impact. This influences their perceptions on the relative efficiency on the different microfinance institutions and how financial policies are designed and evolve



(Stiglitz, 1992; Krahnen and Schmidt, 1994). The financial sector can contribute to the development of SMEs either directly or indirectly. The direct influence is by increasing the access to financial services to the poor. There are three distinguished ways to how access to financial services can influence income generation activities and consumption stabilization of the poor (Zeller et al, 1997). The indirect method is by supporting a sustainable financial system as a prerequisite for social and economic growth.

There has been a paradigm shift in thinking about relevant policies for the development of the financial sector and precisely in the field of microfinance in the 1990s. This shift is as a consequence of the failures of small farmer credit and successes of some few MFI. The financial policy has changed due to this shift and it is based on the assumed lapses between the demand for credit and savings services, and how these services can be access by a specific target group. It was before now more emphases were laid on improving the outreach to small farmers in the 1960s and 1970s, and in the 1980s and 1990s to the poor. This was focused on serving more of the poor (breadth of outreach) and the poorest of the poor (depth of outreach) (Zeller and Mayer, 2002). MFIs were focusing on the poor and in order to have access to or supply of MF services with demand has been constant for MFIs trying to serve clientele outside the border line of formal financial institutions (Von Pischke, 1991).

In the 1960s and 1970s the government was the main actor in the provision of these services to the population, and parastatal development banks and agricultural credit projects of prime concern. The new approach to microfinance started in the mid 1980 due to the awful failures of development banks and the good outcome of some microfinance innovations to serve the poor (Adams, 1998). Some institutions cropped



up with permanent financial institutions that became sustainable by building up a cost effective MFI. These institutions with the innovative approaches recognizes that risks and high transaction costs which results partly from information asymmetries and moral hazards are the core causes of the difference between demand and supply for financial services (Stiglitz and Weiss, 1981).

The main objectives of microfinance institutions are prioritized differently by different authors. Researchers like Otero and Rhyne, (1994); Christen et al., (1995) argues that increasing access to reach the poorest of the poor (depth of outreach) and sustainability are compatible objectives. Although Hulme and Mosley (1996), Lapenu and Zeller (2002), with others argue that they may be a trade-off between augmenting outreach to the poorest and attaining financial sustainability. This trade-off is as a result from the fact that MFI transaction costs have a high fixed cost element which makes unit cost for smaller savings and smaller loans high as compared to larger financial transactions. This rule of reducing unit transaction costs with larger transaction size generates the trade-off between better outreach to the poor and financial sustainability, regardless of the borrowing technology used (Zeller and Mayer, 2002). The financial sustainability of the financial institutions and outreach to the poor is two of the three policy objectives of the contemporary developments in the field of microfinance. Welfare impact is the third policy objective that relates to the development of the financial system and precisely on economic growth and poverty alleviation and food insecurity.

Innovation in the institutional domain and the expansion of microfinance institutions rely on public intervention and financial support. The state and donor transfers such as international NGOs subsidizes the costs of most microfinance institutions reaching a greater number of clients below the poverty line. These costs include the



opportunity costs of forgoing other assistance to public investments such as in primary education when limited funds are used for microfinance (Zeller et al.1997). The subsidy dependent index Yaron (1992) has become the universally accepted measure to quantify the amount of social costs involved in running the activities of a financial institution. Zeller and Sharma (1997) argue whether public sector development are economically or financially sustainable and to find out that they compared social costs with social benefits to know which one will have a greater impact on the society.

The crucial triangle of microfinance is a triangle that reflects the three policy objectives of MF of outreach, financial sustainability and impact. Some of these objectives contribute more impact and at the same time inadequate outreach. The other objectives may produce limited impacts but are very much financially sustainable (Zeller and Mayer, 2002). The impact of finance can be increased through complementing non-financial services such as SMEs or marketing services, or training of borrowers that raise the profitability of loan financed projects (Sharma and Buchenrieder, 2002). The MF impact assessment studies reviewed suggested that the poorest amongst the poor can gain from microfinance by having a constant consumption through the management of their savings and borrowing habits.

It is noted that the management of loans for productive purposes with the aim to raise income and assets is effectively done by those just below or just above the poverty line. An increase in financial services will have a positive outcome in the welfare of the poorest but not necessarily to lift them from poverty because of the lack of access to market, technology, and other factors that raise production.

The microfinance triangle illustrated in the figure above consist of an inner circle that represents the different types of institutional innovations such as employment of

costs reducing information that improves financial sustainability. Institutional innovations that contribute to improving the impact are designing demand-oriented services for the poor and more effective training for the clients. Outreach to the poor such as more effective targeting mechanisms or to introduce lending technologies that attract a particular group of clients. The outer circle presents the socio-economic environment as well as the macroeconomic and the sector policies that in one way or the other affect the performance of financial institutions (Zeller and Mayer, 2002).

2.16 Theoretical links between microfinance and SME development

Accessing credit is considered to be an important factor in increasing the development of SMEs. It is thought that credit augment income levels, increases employment and thereby alleviate poverty. It is believed that access to credit enables poor people to overcome their liquidity constraints and undertake some investments such as the improvement of farm technology inputs thereby leading to an increase in agricultural production (Hiedhues, 1995). The main objective of microcredit according to Navajas et al, (2000) is to improve the welfare of the poor as a result of better access to small loans that are not offered by the formal financial institutions.

Diagne and Zeller (2001) argue that insufficient access to credit by the poor just below or just above the poverty line may have negative consequences for SMEs and overall welfare. Access to credit further increases SME"s risk-bearing abilities; improve risk-copying strategies and enables consumption smoothing overtime. With these arguments, microfinance is assumed to improve the welfare of the poor.

It is argued that MFIs that are financially sustainable with high outreach have a greater livelihood and also have a positive impact on SME development because they guarantee sustainable access to credit by the poor (Rhyne and Otero, 1992).



Buckley (1997) argue that, the indicators of success of microcredit programs namely high repayment rate, outreach and financial sustainability does not take into consideration what impact it has on micro enterprise operations and only focusing on “microfinance evangelism”. Carrying out research in three countries; Kenya, Malawi and Ghana, Buckle (1997) came to the conclusion that there was little evidence to suggest that any significant and sustained impact of microfinance services on clients in terms of SME development, increased income flows or level of employment. The focus in this augment is that improvement to access to microfinance and market for the poor people was not sufficient unless the change or improvement is accompanied by changes in technology and or technique. Zeller and Sharma (1998) argue that microfinance can aid in the improvement or establishment of family enterprise, potentially making the difference between alleviating poverty and economically secure life. On the other hand, Burger (1989) indicates that microfinance tends to stabilize rather than increase income and tends to preserve rather than to create jobs. Facts by Coleman (1999) suggest that the village bank credit did not have any significant and physical asset accumulation. The women ended up in a vicious cycle of debt as they use the money from the village banks for consumption purposes and were forced to borrow from money lenders at high interest rate to repay the village bank loans so as to qualify for more loans. The main observation from this study was that credit was not an effective tool to help the poor out of poverty or enhance their economic condition. It also concluded that the poor are too poor because of some other hindering factors such as lack of access to markets, price stocks, unequal land distribution but not lack of access to credit. This view was also shared by Adams and Von Pischke (1992).



A study of thirteen MFIs in seven countries carried out by (Mosley and Hulme (1998) concludes that household income tends to increase at a decreasing rate as the income and asset position of the debtors is improve. Diagne and Zeller (2001) in their study in Malawi suggest that microfinance do not have any significant effect in household income meaning no effect on SME development. Investing in SME activities will have no effect in raising household income because the infrastructure and market is not developed.

Some studies have also argued that using gender empowerment as an impact indicator; microcredit has a negative impact (Goetz and Gupta, 1994; Ackerly, 1995; Montgomery et al, 1996). Using a “managerial control” index as an indicator of women empowerment, it came to conclusion that the majority of women did not have control over loans taken by them when married. Meanwhile, it was the women who were the main target of the credit program. The management of the loans was made by the men hence not making the development objective of lending to the women to be met (Goetz and Gupta, 1994). Evidence from an accounting knowledge as an indicator of women empowerment concluded that women are marginalized when it comes to access to credit (Ackerly, 1995).



CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter seeks to present the methodology used in carrying the research study. Sources of gathering information used by the researcher in obtaining data for this research were mainly primary and secondary sources. The study targeted all microfinance institutions and SME's operating within Tamale. However, due to the unavailability of time and space, the researcher using scientific methods, selected the Bonzali Rural Bank Ltd, Credit enterprise Ltd and Maata-N-tudu Association, all representing MFI's and about fifty-eight SME's for this study. The criteria for selecting samples were; all participants were SME operators/MFI/practitioners in either or both ventures, all SME participants were beneficiaries of microfinance products, and all participants were operating within Tamale. A number of sampling techniques (including simple random sampling, stratified sampling, snowball sampling and purposive sampling) were used to obtain samples for the study. Questionnaires, interviews, surveys, focus group discussions and observations were instruments used to collect data for the research study whiles data was analyzed using computer software known as the statistical package for social scientists (SPSS).

3.2 The Population

The Ministry of Trade and Industry (MOTI), in 1998 estimated that the Ghanaian private sector consists of approximately 80,000 registered limited companies and 220,000 registered partnerships (Mensah, 2004). Current data is however not readily available. According to the Ghana microfinance website, there are about 586



microfinance institutions in Ghana distributed as follows: 137 rural banks, 380 credit unions, and 50 financial NGO's and 19 savings and loans companies. Subject to the above available data, the population for this study is estimated at about 60,000 SME's and about 300 MFI's from Tamale. This study targeted both microfinance institutions and SME's in Tamale, of which samples were drawn from for the research study.

3.3 Sampling

The study used fifty eight (58) SMEs and three (3) MFIs selected as the representative sample for this research. These participants were selected from the Tamale central business district with diverse business backgrounds. The sampling techniques used in this study were simple random sampling, snowball sampling and purposive sampling. These sampling techniques are illustrated in two major categories as follows:

1. Sampling technique used in arriving at a sample for SMEs
2. Sampling techniques used in arriving at a sample for MFIs.

3.3.1 Sampling technique used in arriving at a sample for SMEs

Simple Random Sampling

The simple random sampling technique was used to select fifty-eight (58) SMEs mainly from the Tamale central business area as respondents of the research study. This sample of 58 SMEs was selected due to the limitation of time and space needed for this research study. Sampling was done by allotting numerical values to SMEs available at the Tamale central business area where about two hundred (200) SMEs were identified for balloting to arrive at a selected sample of fifty-eight (58) SMEs as



the final SME sample for the study. These respondents were selected mostly from the central business area in Tamale with regards to whether they were beneficiaries of small scale loans or not. Only respondents who were beneficiaries to these small scale loans were allowed to respond to the questionnaires that were presented to them.

3.3.2 Sampling techniques used in arriving at a sample for MFIs.

Simple random sampling

Bonzali Rural Bank Ltd, Credit enterprise Ltd and Maata-N-tudu Association as the micro finance service providers whose services were examined in line with business performance visa vie credit provision to small scale businesses in Tamale were selected using the simple random sampling technique. As in the case of the SMEs, all MFIs operating in Tamale were targeted as the population for the study. Ten (10) micro finance institutions were further identified and allotted numbers of which three (3) institutions as named above were finally selected randomly via balloting as sample for the study. Only three micro finance institutions were selected for this study due to the limitation of time available to the researcher and also the limiting number of pages required for this research study. It is also important to state however that the choice of these institutions for the research was due to the fact that policies, programs and financial products they offer the SME sector are quite representing in such a way that Small scale business operators at all levels of development could be considered for financial assistance irrespective of business strength.

Snowball Sampling



The study sought to locate other micro finance practitioners at a variety of institutions aside the Bonzali Rural Bank Ltd, Credit enterprise Ltd and Maata-N-tudu Association. Thus, a snowball sampling strategy, sometimes referred to as network or chain sampling (Miles & Huberman, 1994; Patton, 2002), was employed, whereby participants were asked to refer other individuals whom they knew to be practitioners of micro finance in Tamale. The researcher in seeking the inputs of other practitioners of MFI's contacted a number of people in the microfinance industry via the network or chain sampling. This was used to obtain information in relation to their experience and opinions on the topic of this research study. This method was chosen because experts in the industry could easily be identified through such networks.

Purposive Sampling

This type of sampling is a non-probability sampling technique which was used in order to obtain information from people with specialized knowledge on the subject under study. The researcher contacted some managers of MFI's with the use of purposive sampling techniques. Such respondents were identified by the researcher through their (respondents) contribution to the growth and development of SME's by providing micro financial services, who then informs the researcher of another individual with similar attributes to provide relevant information to this research and interviewed by the researcher to get more detail information on the impact of micro finance services on SME's. Care was however taken to ensure that the weaknesses of this particular technique did not affect the quality and reliability of the information obtained.



3.4 The Data

Data is collected by various means such as questionnaires, interviewing, surveys and focused group discussions among others, following a strict procedure and prepared for statistical analysis through the aid of sophisticated statistical computer packages.

Both primary and secondary data form the basis of this study.

Primary data were collected using self-administered questionnaire and an interview guide. Secondary data on the other hand were gathered through the review of literature related to the study. These data were collected from sources such as books, article publications, journals and internet sources.

3.5 Data collection Method

Research may come from six sources: documents, archival records, interviews, direct observation, participant-observation and physical artifacts. The researcher chose to use few sources to answer the research questions of the study. These are interview using questionnaires and other sources of data collection such as surveys and focus group discussion.

Data is to test the validity and to provide answers to the research questions. Data was collected through primary and secondary means.

The primary sources include questionnaires, which rely on observation, interviews and records of information of interest.

For secondary data, this was taken from articles, textbooks and already prepared materials from libraries, Small and Medium Size Enterprises, as well as websites of various MFI's in Ghana. These pieces of information were gathered with much regards to the particular subject area of investigation as far as this research study is concerned.



3.5.1 Questionnaires

Questionnaires were administered to randomly selected microfinance institutions and small business owners. For the microfinance institutions, the researcher had to choose those that are found in the Tamale metropolis and because of limited time available for this research, three (3) MFI were selected. These institutions are the Bonzali Rural Bank Ltd, Credit enterprise Ltd and Maata-N-tudu Association in Tamale. For the small businesses, the field representative was instructed to go to the central business area in Tamale where clients of MFI's are mostly found, together with other small businesses without access to such credit facilities that we chose and ask if they belong to a MFI or a credit union in their locality. And if they did, they need to show their membership card before they were given the questionnaires to fill. This was to ensure that we are dealing with small businesses that have a relationship with credit providers.

3.5.2 Interviews

The interview was selected as the primary method for data collection in this research. The interview method was seen as the widely used data collection method in the study because it has the potential to elicit rich, thick descriptions. Also, it gives the researcher an opportunity to clarify statements and probe for additional information. The researcher's logic for using this method of data collection is that a concise and better way to generate data is to interact with people (thus, talk and listen to them), thereby getting the exact meaning of the interviewers experiences in their own words.



3.5.3 Interview Process

The researcher sent individual interview questions to prospective participants via a field representative describing the purpose of the study, inviting their participation, and requesting a convenient date and time for an interview. The researcher also called the prospective participants on phone to confirm their participation in the interview, who agreed to be interviewed. The interviews took place between November, 2011 and February, 2012. Before the interview commenced, the interviewee was given a copy of the University's introductory letter required for participation in this study. All interviews were conducted physically by the researcher. At the end of each interview, the interviewee was asked to complete a critical incident instrument, which had been prepared by the researcher. The interview was conducted using an interview guide. Respondents who were selected for the interview were those who could not read and write or for other reasons who could not answer the questionnaires. The interview was conducted on one on one basis and the responses of the interviewees were recorded in a field book and a tape recorder. This was done to facilitate cross checking of responses from the respondents.

3.5.4 Survey

Potential participants were contacted. Of those who were contacted to participate, five individuals declined. The 15 individuals who agreed to participate were sent a questionnaire delivered by hand and were given some 20 minutes to complete the forms and returned same to the researcher. The questionnaire was designed to collect profile data and also asked participants their purposes for giving out micro finance services to small businesses operators. In keeping with the qualitative research



tradition, the surveys used in the present study included some open ended questions that sought to tap into personal experiences and shed light on participants' perceptions. For the purposes of the present study, surveys had a distinct place in the study's methodological design and served as a useful complement or adjunct to other data-collection methods.

3.5.5 Critical Incidents (observation)

The researcher selected critical incident instruments with the intention of corroborating interview data and, further, to allow the uncovering of perceptions that might not have been revealed through the interviews. The critical incident instrument was developed by the researcher and further refined by his advisor. The critical incident instrument was given to the participants in this study at the end of each interview by the researcher. The instrument asked respondents to think about whether the impact of the micro finance services that were offered to the small businesses made significant impact on them or not. Specifically, participants were asked to briefly describe the incident, indicating who was involved, what micro finance product was giving to that client, and what influence it had on the growth or otherwise of the business. Participants were given a self-addressed envelope and were requested at the end of the interview to return completed critical incidents to the researcher as soon as possible. The researcher received 11 completed critical incidents from among the 15 participants.

Although the researcher had hoped for a greater response, when analyzed, the returned critical incidents served as a "validity check" on some aspects of the data uncovered in the interviews.



3.5.6 Focus Group

Focus groups or group interviews possess elements of both participant observation and individual interviews, while also maintaining their own uniqueness as a distinctive research method (Morgan, 1997). A focus group is essentially a group discussion focused on a single theme (Kreuger, 1988). The goal is to create a candid conversation that addresses, in depth, the selected topic. The underlying assumption of focus groups is that, within a permissive atmosphere that fosters a range of opinions, a more complete and revealing understanding of the issues will be obtained. In the open-ended format that was used, the researcher asked the group to explore two issues. The researcher identified two women groups who benefited from MFI facilities as a group and use such groups as respondents in a focus group discussion. The two main issues that were tabled for discussion were 1; what ways do MFI's assist in the growth and development of their businesses and 2; what challenges do they encounter with the introduction of MFI's into their businesses.

3.6 Data Analysis

The challenge throughout data collection and analysis was to make sense of large amounts of data, reduce the volume of information, identify significant patterns, and construct a framework. The formal process of data analysis began by assigning alphanumeric codes according to the categories and descriptors of the study's conceptual framework. In analyzing this qualitative research design, the researcher prepared large flip chart sheets. These sheets were color coded and taped on the wall. Each sheet identified the descriptors under the respective categories of the conceptual framework. As the process of coding the transcripts proceeded, new flip chart sheets were prepared to capture other themes as they emerged. Before cutting



and pasting coded participant quotations, the researcher shared samples of coded interviews with his colleague. Discussion with his colleague confirmed the researcher's designations. The researcher also prepared written narratives on each of the sheets after all the data had been assigned. These narratives were helpful in cross-checking the data and served as a secondary analysis. As a final step, to see whether there were any variables that would account for similarities or differences among participants, the researcher tested the coded data on the sheets against the frequency charts prepared for each finding and the numerically coded profile data on the participants. The coding process fragments the interview into separate categories, making one to look at each detail, whereas synthesis involves piecing these fragments together to reconstruct a holistic and integrated explanation. The researcher's approach was to come up with a number of clusters, patterns, or themes that were linked together, either similarly or divergently and that collectively described or analyzed the research phenomenon. The researcher essentially followed a three-layered process in thinking about the data. In the first place, he examined and compared threads and patterns within categories. Secondly, he compared connecting threads and patterns across categories. Finally, the current work was situated with respect to prior research and was compared and contrasted with issues that had been raised by the broader literature. These three layers were not separate, but were interrelated and iterative throughout the synthesizing process. Based on analysis and synthesis, the researcher was able to move forward and think about the broader implications of this research. To this end, he formulated several conclusions and developed various practical and research-related recommendations.

The quantitative data collected from the study was also analyzed by the use of computer software, known as Statistical Package for Social Scientists (SPSS), which



was used for data entry. After data entry and cleaning up, exploratory statistical data analysis was conducted using frequency distribution tables and also regression analysis tables together with a graph to summarize and display the respondents' views on the questions under study. The SPSS software was used to generate other tools such as tables and percentages, based on the data collected. These data analysis tools were used to evaluate the relationship between micro credit and business development and growth, as well as measuring the impact of microfinance services (financial and non-financial) on SME development.

3.7 Conclusion

In conclusion, this chapter provided a detailed description of this study's research methodology.

Qualitative research methodology was employed, together with a few quantitative tools to illustrate the phenomenon of the impact of micro finance on the development of small businesses in Ghana, using Tamale as a reference point. The participant sample was made up of 58 small business operators and 3 micro finance institution, randomly selected. An additional 5 participants were contacted, who happened to be micro finance practitioners whose views were incorporated in the study. A number of data-collection methods were employed, including individual interviews through questionnaires, critical incidents, survey and a focus group. The data were reviewed against literature as well as emergent themes. Credibility and dependability were accounted for through various strategies, including source and method triangulation. A process analysis enabled the key themes from the findings to be identified. The intent was that this study would make a contribution to the understanding of the impact of micro finance services to the development of businesses in Ghana.



Additionally, it is hoped that this study will be of value to micro finance and business policy developers to come up with policies that would enhance the cooperation of businesses and micro finance service providers for their mutual benefit and contribute to national development in the end.



CHAPTER FOUR

ANALYSIS OF DATA

4.0 Introduction

This chapter seeks to analyze and present the findings of an empirical component of a study undertaken on a wide range of issues on the role micro-finance institutions may be playing in the development of SMEs and gaining a more general understanding of the challenges facing the development of small firms in Ghana. The data have been analyzed by using tools such as frequency distribution and cross tabulation, which have been supported by tables and figures for easy understanding and conclusions.

However, the presentation covers aspects on the socio-demographic characteristics, microfinance accessibility by SMEs and the consequences on its performance and poverty reduction; impact of micro financial products on the human and social development

4.1 Socio-Demographic Characteristics of Respondents

A total of 39 respondents comprising of 53.8% (21) males and 46.2% (18) females aged between 18 and 60 years were interviewed during the course of this research. 43.6% (17) of the respondents' age fell between 18-25 years. About 53.8% (21) of the entrepreneurs were between 36 to 45 years and 2.6% (1) was about 46-60 years. Also, 28.2% (11) of the SME operators are in their growing stages of the business life cycle, 15.4% (6) of the respondents were found to be well established in business with steady production while 5.1% (2) of the entrepreneurs started business within this year. Besides, 10.3% (4) of the businesses were defunct but in need of renewal.



4.2 The Role of MFIs in Developing SMEs

To assess the role MFIs play in developing SMEs in the Tamale Metropolis, the researcher sought the views of the major players in the industry in order to have a comprehensive view on the matter.

4.2.1 Small and medium scale businesses in Tamale

A good majority of the respondents 71.8% (28) were involved solely in trading of manufactured goods and raw materials. 15.4% (6) of the respondents were mainly artisans and only 2.6% (1) was a farmer. Small and medium scale businesses in Tamale ranged from Shea butter processing, hard wares to selling of vehicle and machinery spare parts, artisan works and selling of provisions. Results from one way analysis of variance shows that there is no significant relationship between type of business and access to credit ($P=0.72$). This means that access to credit of SMEs is independent of the nature of goods and services on sale.



Table 4.1: Type of small businesses

variable		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Farming	1	2.6	2.7	2.7
	Trading	28	71.8	75.7	78.4
	Artisan works	6	15.4	16.2	94.6
	Others. if others please specify	1	2.6	2.7	97.3
	Both farming and trading	1	2.6	2.7	100.0
	Total	37	94.9	100.0	
Missing	System	2	5.1		
Total		39	100.0		

Source; (Field Data, 2013)

4.2.2 Sources of startup capital

About three-quarters (76.9%) of the businesses in this study were self-financed by the owners and/or management staff and 20.5% (8) of the businesses started with borrowed capital. Only 2.6% (1) of the respondents claimed business was unproductive.



Table 4.2: Sources of startup capital

variable		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Own savings	30	76.9	76.9	76.9
	Borrowed	8	20.5	20.5	97.4
	capital				
	N/A	1	2.6	2.6	100.0
Total		39	100.0	100.0	

Source; (Field Data, 2013)

4.2.3 Access to credit

Majority of the businesses surveyed 76.9% (30) applied for loans for business purposes but 23.1% (9) never applied for a loan. 48.7% (19) of the entrepreneurs relied on MFIs for credit while 5.1% (2) resort to the conventional commercial banks for loans. Those who took the loans from both the MFIs and the banks were 7.7% (3). However, in both instances, beneficiaries 59% (23) admitted that getting loan was difficult. Results from one way analysis of variance ($P=0.001$) shows that interest on loan was also significantly related to access to credit as ($P<0.05$). This means that credit granted at SME level is dependent on interest. Entrepreneurs go in for loans irrespective of interest charged on them.



Table 4.3: Source of credit for business expansion

variable		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	MFI	19	48.7	70.4	70.4
	Bank	2	5.1	7.4	77.8
	N/A	3	7.7	11.1	88.9
	Both MFI and bank	2	5.1	7.4	96.3
	MFI and overdraft	1	2.6	3.7	100.0
	Total	27	69.2	100.0	
Missing	System	12	30.8		
Total		39	100.0		

Source; (Field Data, 2013)

4.3 Non-financial supports MFI's and NGOs provide to the small businesses

A wide range of non-financial services were offered by the MFIs to their clients. Research results indicate that the MFIs had provided 5.1% (2) of the respondents with trainings and workshops to enhance their skills in a number of areas. These areas included community mobilization and organization, credit management and health education. On the average 35.9% (14) of the SMEs membership was generally taken through credit management and 5.1% (2) of the clients benefited from health education. These trainings were intended to provide clients with skills in credit management, book keeping, health education and sanitation issues.



Table 4.4: Non-financial services offered by the MFIs

variable			Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Workshop and training		2	5.1	10.5	10.5
	Health education		2	5.1	10.5	21.1
	Credit management		14	35.9	73.7	94.7
	credit enterprise ltd		1	2.6	5.3	100.0
	Total		19	48.7	100.0	
Missing	System		20	51.3		
Total			39	100.0		

Source; (Field Data, 2013)

4.4 Challenges confronting SME's in accessing finance from MFI's

To assess the challenges SMEs face in accessing loans in the Tamale Metropolis, the researcher sought the views of the major players in the industry in order to have a comprehensive view on the matter.

4.4.1 Conditions for getting loans

The research results revealed that loans provided to the SMEs by the MFIs were tied to stringent financial conditionality. About 51.3% (20) of the clients confirmed the difficulty they went through before getting credit from MFIs while 59% (23) were denied credit since they could not meet the conditions attached to the loan. Conditions attach to loans by the commercial banks was not different. 51.3% (20) of



entrepreneurs who opted for bank loans were denied since they could not provide the needed collateral while 23.1% (9) of those who accessed the credit were unable to pay back the loan. Collaterals usually demanded by these institutions ranged from compulsory savings and group guarantors. In the case of banks, documents of a fixed asset like a house is demanded before one could access loan. The relationship between access to credit and condition for loan was found not to be significantly related since ($P>0.05$). This means that not all the entrepreneurs met the condition before accessing credit.

Table 4.5: Conditions for getting loans from the MFIs / Banks

variable	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Collateral and fixed deposit	4	10.3	12.5	12.5
Savings, guarantors and collateral	20	51.3	62.5	75.0
Group savings and co-guarantor-ship	3	7.7	9.4	84.4
Pay-in-slip and guarantor	1	2.6	3.1	87.5
N/A	4	10.3	12.5	100.0
Total	32	82.1	100.0	
Missing System	7	17.9		
Total	39	100.0		

Source; (Field Data, 2013)



4.4.2 Interest rates on loans

Despite the fact those clients of MFIs and numerous beneficiaries do complain about the interest rates charged on loans. 53.8% (21) of respondents (mostly those who have enjoyed the credit) confirmed that the interest on loan was affordable. Although, the confirmation of loan affordability did not translate into increase loans by the Banks to customers since 25.6% (10) of the respondents claimed interest on loan was very high. Although there was a significant relationship between the interest rate and loan repayment in the area since ($P=0.002$), shows that interest on loan was significantly related to loan repayment rate as ($P<0.05$). This means interest on loans to SMEs is independent on repayment .despite high interest on loans to SMEs, micro finance institutions were able to recover loans advanced to clients.

Table 4.6: Is interest on the loan affordable?

variable		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	yes	21	53.8	61.8	61.8
	No	10	25.6	29.4	91.2
	N/A	3	7.7	8.8	100.0
	Total	34	87.2	100.0	
Missing System		5	12.8		
Total		39	100.0		

Source; (Field Data, 2013)



4.5 Regression Analysis between Increase of Capital and Role in Business

Expansion Process

Table 4.5.1: Regression Analysis between increase of capital and role in business expansion process (model summary)

Table 4.7: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.082 ^a	.007	-.029	1.683

a. Predictors: (Constant), Increase of capital

b. Dependent Variable: Role in business expansion

Table 4.5.2: Regression Analysis between increase of capital and role in business expansion (ANOVA)

Table 4.8: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.533	1	.533	.188	.668 ^a
	Residual	79.333	28	2.833		
	Total	79.867	29			

a. Predictors: (Constant), Increase of capital

b. Dependent Variable: Role in business expansion



Table 4.5.3: Regression Analysis between increase of capital and role in business expansion (coefficient values)

Table 4.9: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.556	1.168		3.044	.005
	Increase of income	-.444	1.024	-.082	-.434	.668

Figure 1: Dependent Variable: Role in business expansion

Normal P-P Plot of Regression Standardized Residual

Dependent Variable: Expansion of Business

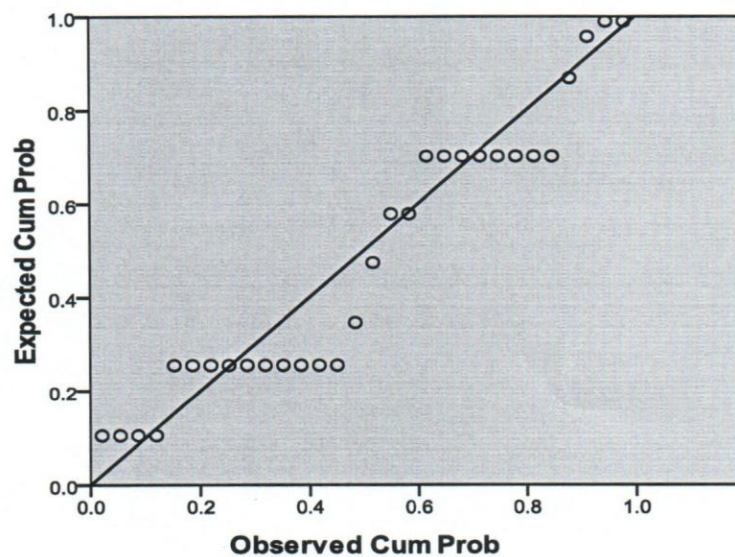


Figure 1: Regression analysis between increasing capital and role in business expansion

From the above regression analysis, the researcher tried to find out the impact of micro finance loans on the growth of businesses of SMEs. Here the researcher's null hypotheses is that there is no relationship between the increase of capital and the growth of businesses of the SMEs and the alternative hypothesis states that there is a relationship between the increase of capital and the growth of businesses of SMEs. The researcher used the SPSS software to obtain the calculations. The results of bivariate regression analysis are shown in the above table 4.5.1. The table labeled Model summary shows that R square for the regression model is 0.007. R square shows the amount of variation in one variable that is accounted for by another variable. In this case respondents perceptions of capital increase account for 0.7 percent of the total variation in the growth and expansion of businesses. The ANOVA table shows the F ratio for the regression models. This statistics assesses the statistical significance of the overall regression models. The larger the F ratio, the more variance in the dependent variable is explained by the independent variable. The F ratio 0.188 indicates that the model is less significant at the 0.668 alpha levels.

From the regression coefficient table, the column labeled "Unstandardized Coefficients" reveals the unstandardized regression coefficient for increase of income, as 1.168. The t-test tells us whether the regression coefficient is different enough from zero to be statistically significant at the level (0.005).

According to the above analysis, our null hypothesis is rejected, which indicates that relationship exists between these two variables that can be seen in the above observed cumulative probability curve, (fig.1).



4.6 Facilities and services MFI's provide to SME's.

To assess the facilities and services MFIs provide to SMEs in the Tamale Metropolis, the researcher sought the views of management of the MFIs in order to have a broad view on the matter.

4.7 The need for financial and non-financial services

A wide range of financial and non-financial services are provided by the MFIs to clients. Some of the services include credit, Savings, Insurance and Transfer Payment services. Indeed 100% (5) of the MFIs sampled for this study confirmed that special products are designed for the SME sector. 20% (1) of the institutions confirmed that these special services are intended to facilitate proper SME management while 40% (2) claimed that they are designed for education on social problems and how to solve them. Another reason advanced by 20% (1) of the respondents was that the MFIs needed to enhance business activities of their numerous clients in order to ensure that businesses are viable.



Table 4.10: Why the need for credit with education

variable		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	To facilitate proper SMEs	1	20.0	25.0	25.0
	To enhance business activities	1	20.0	25.0	50.0
	Education on current social problems and how to find solution	2	40.0	50.0	100.0
	Total	4	80.0	100.0	
Missing	System	1	20.0		
Total		5	100.0		

Source; (Field Data, 2013)

4.8 Reasons for the provision of savings, insurance and transfer payment

The objectives for the provision of services like savings, insurance and transfer payments are many and diverse. 40% (2) of the institutions claimed micro financial services are provided mainly to help finance small businesses while 20% (1) claimed the intention for the provision of micro financial services is mobilisation of funds to help build the capital base of the various institutions. Though 20% (1) of the institutions thought the work they do is service to mankind and the society.



**Table 4.11: Reasons for the provision of credit, Savings, Insurance, Transfer
Payment services**

variable	Frequency	Percent	Valid Percent	Cumulative Percent
Valid To serve customers better	1	20.0	25.0	25.0
To help finance the SMEs	2	40.0	50.0	75.0
Mobilisation of funds and help build the capital base	1	20.0	25.0	100.0
Total	4	80.0	100.0	
Missing System	1	20.0		
Total	5	100.0		

Source; (Field Data, 2013)

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

Notwithstanding the numerous microfinance institutions, small businesses still face the challenge of inadequate capital. Credits offered are small loans, called micro credit. Micro credit is touted as one of the many proposed solutions to inadequate capital for SMEs and numerous books are available to support this assertion. This research found it difficult to go along with this philosophy and this thesis aimed to go into the impact of microfinance institutions in the development of SMEs, how microcredit is delivered, what its benefits has been to SMEs and difficulties of accessing credit. This is a brief recap of the research results and how they stand up to the research questions. In this final chapter of this research, the researcher reviews the study using the following thematic areas;

1. Summary of findings;
2. Conclusions drawn from such findings and;
3. Recommendations made thereon.

5.2 Summary of findings

This study established that the provision of microcredit to entrepreneurs increased their incomes as a result of their engagement in viable trading activities which empower them (entrepreneurs) to meet their periodic loan repayment, savings and also for other personal expenditures.

Most of the respondents confirmed that micro financial services have had an impact on their lives as entrepreneurs.



Respondents did mention that micro finance helped them in developing their businesses by providing them with financial resources.

Respondents used the credit to expand their businesses while some saw growth in business as a result of capital injection. Some of the entrepreneurs used the credit to stabilize consumption and enhance their standard of living. The research further discovered that the microfinance institutions factor into their savings and credit delivery systems, the compulsory savings model which is well organize and tend to serve as character reference point for these financial institutions. The ability of a client to access more credit in the future is hinged on how much savings he/she has made over the period of the loan agreement.

The study also establishes that majority of SME's start their businesses with their own capital whiles MFI's provide additional funds to enable them grow.

Compared with the commercial banks, the research finds that SME financing is largely drifted toward MFI's, whiles few SME's are capable of accessing credit from both MFI's and commercial banks. In both instances, respondents admit the growing difficulty to access credit from financial institutions, be it micro finance institutions or commercial banks as a result of the challenges of meeting credit requirement demanded by these institutions.

The study also reveals that these MFI's and sometimes NGO's do provide social services to groups and communities within their catchment areas either as part of their corporate social responsibilities or as part of services provided to their customers.

This study identifies stringent loan conditionality and exorbitant rates of interest charged on loans as the main challenges confronting SME's in accessing credit from MFI's.



The credit facilities accessed by the beneficiaries are paid back on weekly basis. Repayments normally commence just a week or in some cases a month after the initial loan disbursement and continue on a weekly basis thereafter. This makes the whole deal looks like a consumer loan rather than a business loan and changes the nature of the risk taken by microfinance institutions.

It must be noted that, whilst having several installments is not unusual for consumption loans made by commercial banks, it is typical for loans made for investment in businesses (Adjei, 2010). This study finally recognizes the fact that cost of borrowing from the microfinance institutions are quite inimical to business growth due to the increasing rate at which interest rates are growing.

5.3 Conclusions

The overall conclusion is that microfinance services empower entrepreneurs in particular in terms of provision of startup capital, consumption stability and power in decision making generally. It was evident that there were respondents who either did not have adequate credit or the capacity to get adequate credit, or therefore did not make good use of loans. Therefore, micro financial services need to empower SMEs in particular in terms of provision of startup capital, consumption stability and power in decision making generally in order to make small scale businesses economically viable.

5.4 Recommendations

Most of the institutions are motivated by the desire to combat poverty when they extend credit to clients in order to empower them economically. This credit has become so popular that the funds available have become insufficient for many



prospective borrowers. Indeed, most poor people do not get the chance to borrow from the schemes due to stringent collateral issues. Except for donor funded NGOs, most credit institutions do not get support to run credit scheme for the poor, hence relying on their own mobilized funds. In so far as these credit institutions are complementing government efforts in poverty alleviation in the country, the government of Ghana through the Central Bank (BoG) should regulate the activities of these institutions and provide an assistance if the need be.

Microfinance institutions do not recognize lending to SMEs as a poverty reduction strategy. Informed by the intent to maximize profit, they recognize clients as business partner. During this research respondents complained about small loan size, high interest rates, weekly repayment schedule and lengthy form filling. Clearly, from the stand point of the respondents addressing these issues would provide an enabling environment for them to be empowered to do business as they hope to accumulate income, enroll and maintain their children in school live healthy life styles and improve their general wellbeing. When much of these are achieved, the credit institutions would have made a significant impact, leading to poverty reduction among the people in Tamale.

Considering the business oriented approach by the microfinance institutions to offer credit, government intervention approach in this critical area is very important. Government has already taken a giant step by establishment in 2006 of independent government funded Microfinance and Small Loan Center (MASLOC) as a step towards poverty alleviation in the country. By this move, government would greatly compliment efforts of all actors in the fight against poverty in Northern Ghana. Finally, financial institutions with strong and dedicated social mission should also receive government support in their quest to reduce poverty in Ghana.



5.5 Recommendations for further Studies

Due to the boundaries set by the formulated objectives of this study, the following issues were raised for further investigation. Future studies could focus specifically on the microfinance schemes in Tamale to determine their specific rates of interest charged on loans advanced to SMEs.



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APPENDIX A

Questionnaire to small scale business operators in the Tamale

Dear Respondent,

I am a Master of Arts Student in University for Development Studies, Tamale undertaking a research on “The Impact of Micro Finance Institutions on the Development of Small and Medium Scale Industries in Tamale”

Your assistance in filling out the questionnaire will help this study achieve its objectives. I would like to assure you most sincerely that whatever information supplied by you through these questions will strictly be confidential and used for the research purpose only. Thank you.

Yours faithfully,

Elisha, Kukua

1) Gender. a) Male..... b) Female.....

2) Your age is between

- a) 18-35yrs b) 36-45yrs c) 46-60yrs d) Above
60yrs

3) Which of the following best describes the current development of your business?

(a) Newly started (b) Young, but with established production and customers

(c) Growing (d) well established, with steady production and customers (e)
Mature, but in need of renewal



4) What type of business?

- a) Farming b) Trading c) Artisan works d) Others.

If others Please specify.....

5) What percentage can you estimate to be the startup capital for your business?

- a) Own savings.....b) borrowed capital.....c) If borrowed

please give the source.....

6) How long have you been in business?

- a) 0-1year.....b) 1-5 years.....C) 5-10years.....d) above

10years.....

7) Have you ever applied for a loan ("borrowed capital") to finance your business?

- b) Yes..... No.....If yes where?

MFI.....Bank.....others.....

If you have applied for a loan for your business, please answer the following questions, 8-12.

8) Was it easy to be given a loan? a) Yes b) No

9) What criteria does the MFI"s use to offer loans?

.....

10) Are the criteria easy to be met? a) Yes..... b) No

11) Have you had problems in paying back your loan? a) Yes..... b)

No.....

12) If you have had problems in paying back the loan, what has happened to resolve them?

.....

13) How did you finally pay it?

.....

14) Is interest on the loan affordable? a) Yes..... b) No.....

15) Do you or can you conclude that MFI has helped you in developing your business?

a) Yes b) No.

Explain.....

Apart from financial services offered by MFIs, what other services do they (MFIs) provided to help develop your business?

.....

16) Would you like to obtain another loan if need be and why?

.....

17) Give your personal views on the services provided by the microfinance institution?

.....



APPENDIX B

Questionnaire to some Microfinance Institutions in the Tamale

Dear Respondent,

I am a Master of Arts Student in University for Development Studies, Tamale undertaking a research on "The Impact of Micro Finance Institutions on the Development of Small and Medium Scale Industries in Tamale"

Your assistance in filling out the questionnaire will help this study achieve its objectives. I would like to assure you most sincerely that whatever information supplied by you through these questions will strictly be confidential and used for the research purpose only. Thank you.

Yours faithfully,

Elisha, Kukua

1) Does your MFI have special products and services designed for SMEs (Loan scheme, training and education etc)?

Yes No.....

Please explain how.

.....

2) What are your objectives for these products (credit, Savings, Insurance, Transfers Payment services) and services?

.....

3) Do you have preferences for particular sectors of the economy (agriculture, fishing, artisan, retail trade, dairy etc) and why?

.....



4) How can you assess the level of awareness of this product, based on the number of customers demanding the product?

.....

5) After years of the initiation of these products and services, how can you evaluate its performance based on the primary targets you had put in place. (Number of customers, amount of loan, interest rate, rate of repayment etc.)?

.....

6) How precisely do you help your customers in the development of their businesses?

.....

7) What innovations are you putting in place to increase the depth and breadth of these products and services?

.....

8) What is the percentage of recovering SME loans in your institution?

.....

9) Are there any other actors seriously involved in the development of SMEs (NGOs, Government, Banks etc.) in Tamale?

10) Do you receive reports of complaints from customers in relation to interest rates charged on borrowing?

.....

11) Any other comments please?

.....



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Your Ref:



P.O. Box 1350

Tamale-GHANA

July 04th, 2011

TO WHOM IT MAY CONCERN

Dear Sir/Madam,

LETTER OF INTRODUCTION – ELISHA KUKUA (UDS/MBM/0019/10)

Mr. Elisha Kukua is pursuing an MA programme in Business Planning and Microfinance Management at the Graduate School, University for Development Studies. He is in his final year and has started working on his thesis entitled *"The Impact of Microfinance Institutions on the Development of Small and Medium Size Businesses in Ghana: A Case Study of the Bonzali Rural Bank Limited, Ma-Ta-Ntudu Association and their clients in the Tamale Metropolis"*.

We shall be grateful if all the necessary assistance is offered him in the collection of data for his thesis.

Your cooperation is highly anticipated.

Yours faithfully,

Dr. Israel K. Dzomeku
Dean

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