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Bank finance and export activities of Small and Medium Enterprises

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Abstract

This study examines SMEs' access to bank finance and how that affects their export activities. The study adopts a probit model to assess the empirical relations. The findings of the study suggest that SME access to bank finance improves their likelihood to export. Such finance is critical to cater for the high fixed costs of exporting, international marketing and branding, and meeting higher quality standards required for overseas markets. The results of the study also indicate that older firms, more productive firms, and larger firms are more likely to take the important step of entering into the export market. Policy interventions should therefore be directed at reducing the bottlenecks that prevent SMEs from accessing funding from the commercial banks.

JEL classification: F1; G2

Keywords: Bank finance; Exports; SMEs; Ghana

1. Introduction

Exporting seems to be the most common foreign market entry mode. This is especially true for small firms, where the low resource commitment and high flexibility makes it a favorable way to internationalize (Young et al., 1989; Leonidou and Katsikeas, 1996). It is well established that many firms, especially small firms have significant exporting potential, however, relatively few of them have undertaken actual exporting (Yeoh and Jeong, 1995). This phenomenon could be attributed to firms' difficulty in accessing the needed funds for export.

Financial constraints are cited as an important obstacle to firms' investment in general and in particular to their desire to venture into export business. Recent literature in international trade has focused on the sunk costs that firms have to incur in order to enter foreign markets. These include expenses of gathering information on foreign markets, upgrading product quality, changing packaging, and establishing marketing channels. Greenaway et al. (2005) suggest that an important determinant of firms' investment and participation in the export market is finance. We therefore hypothesis that firms that have better access to financial resources are capable to meeting expenses and costs associated with the export business and therefore are more likely to increase their involvement in the exports market.

The ability of a firm to export a proportion of its sales is increasingly being regarded as an important measure of competitive performance (Buckley et al., 1990). However, the decision to export could be influenced by access to requisite financing. This study contributes to the literature by investigating how SMEs' access to bank finance affects their export market participation. In particular, we focus on SMEs in Ghana. Previous studies on Ghana focused on problems non-traditional exporters face in accessing finance (Buatsi, 2002; Abor and Biekpe, 2006) and how export status influence firms financing choice (Abor, 2007a). This current study aims at filling this research gap by examining the link between access to bank finance and exports of SMEs.

The rest of the paper is organized as follows; Section 2 provides stylized facts on exporting in Ghana. Section 3 describes

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the methodology used in the study. Section 4 presents the empirical results, and finally in Section 5 we conclude the study and provide policy recommendations.

2. Overview of SME development and exports in Ghana

Small and Medium Enterprises (SMEs) have been identified as important contributors to the Ghanaian economic development process. SMEs contribute significantly to the country's national product by either manufacturing goods of value, or through the provision of services to both consumers and/or other enterprises. They represent over 90% of Ghanaian businesses and contribute about 70% to GDP and over 80% to employment (Abor, 2007b).

Ghana has since the 1970s taken a number of initiatives, including the setting up of key institutions such as the Office of Business Promotion and the Ghana Enterprise Development Commission (GEDC) to promote SMEs in the country. The implementation of the Economic Recovery Programme (ERP) in 1983 broadened the institutional support for SMEs. The National Board for Small Scale Industries (NBSSI) was also established within the Ministry of Industry, Science and Technology to address the needs of small businesses. The NBSSI established an Entrepreneurial Development Programme, intended to train and assist persons with entrepreneurial abilities into self-employment. In 1987, the industrial sector also witnessed the coming into operation of the Ghana Appropriate Technology Industrial Service (GRATIS). It was to supervise the operations of Intermediate Technology Transfer Units (ITTUs) in the country. GRATIS aims at upgrading small scale industrial concerns by transferring appropriate technology to small scale and informal industries at the grass root level. ITTUs in the regions are intended to develop the engineering abilities of small scale manufacturing and service industries engaged in vehicle repairs and other related trades. They are also to address the needs of non-engineering industries (Kayanula and Quartey, 2000).

Notwithstanding the important role of SMEs to economic growth and job creation, they are confronted by a number of challenges that tend to limit their growth and development. The most significant institutional weakness facing dynamic SMEs is their lack of access to external finance. Repressive financial policies in the past, especially low interest, and a monopolistic banking system minimized the interest of banks in developing the SME market. To reverse the consequences of these practices, a combination of financial liberalization and institutional reform was in order (Aryeetey et al., 1994). In view of the relatively low level of response from the private sector to early ERP reform measures, the focus was on the liberalization of various sectors, including the financial sector under the Financial Sector Adjustment Programme (FINSAP). Under the FINSAP, direct institutional measures aimed at supporting small enterprises were also put in place. With World Bank assistance, the Programme of Action to Mitigate the Social Costs of Adjustment (PAMSCAD) created a special fund to assist microenterprises, and the Fund for Small and Medium Enterprises Development (FUSMED) was initiated to increase the amount of credit available to SMEs through commercial and development banks. This was based on the presumption that poor availability of credit from formal sources was one of the major reasons why the private sector investment had not grown as expected. A major argument was that small firms with good growth potential were being discriminated against (Aryeetey et al., 1994). At the same time, however, the effectiveness of many similar SME credit was being called into question (Webster, 1991).

Other constraints include lack of managerial skills and training, lack of equipment and technology, regulatory issues, and limited access to international markets (Steel and Webster, 1991; Aryeetey et al., 1994; Gockel and Akoena, 2002). SMEs normally have difficulty attracting highly motivated managers because of the fierce competition with large companies on the labor market for such skilled and talented personnel. This has to do with the quality of management. Also, SMEs are not able to afford the high cost of training and advisory services while others do not see the need to upgrade their skills. In terms of technology, SMEs often have difficulties in gaining access to appropriate technologies and information on available techniques (Aryeetey et al., 1994). In most cases, SMEs utilize foreign technology with a scarce percentage of shared ownership or leasing. They usually acquire foreign licenses, because local patents are difficult to obtain. Regulatory constraints also pose serious challenges to SME development and although wide ranging structural reforms have led to some improvements, prospects for enterprise development remain to be addressed at the firm-level. The high start-up costs for firms, including licensing and registration requirements, can impose excessive and unnecessary burdens on SMEs. Further, the high cost of settling legal claims, and excessive delays in court proceedings adversely affect SME operations. In the case of Ghana, the cumbersome procedure for registering and commencing business are key issues often cited. The World Bank Doing Business Report (2013) indicated that it takes 12 days to start a business, 19 days to export, 1.9 years to resolve insolvency and 487 days to enforce a contract.

Though previously insulated from international competition, many SMEs are now faced with greater external competition and the need to expand market share. However, their limited international marketing experience, poor quality control and product standardization, and little access to international partners, continue to impede SMEs' expansion into international markets (Aryeetey et al., 1994; Kayanula and Quartey, 2000). They also lack the necessary information about foreign markets.

3. Literature review

Banks make a wide variety of loans to a wide variety of customers for many different purposes. However, small businesses often encounter difficulties when applying to providers of finance for credit to support fixed capital investment and to provide working capital for their operations (Tucker and Lean, 2003). SMEs' access to bank loans is mainly affected by both demand and supply constraints. The demand constraints refer to factors that make it difficult for SMEs themselves to seek external finance from financial institutions such as poor quality of potential projects that qualify for funding and the inability of SMEs to draft convincing business plans and pro-forma