

Original Research Article

LEASING, ALTERNATIVE SOURCE OF FINANCING FOR SMALL & MEDIUM SCALE ENTERPRISES IN GHANA

ABSTRACT

Inadequate funding has been cited as one of the major challenges limiting the performance of most SMEs, from both developed and developing countries alike. Several researches conducted on SMEs access to finance shows massive dependents on loans. While alternative sources such as leasing and factoring are underutilization. Based on the case in Ghana, this paper emphasizes the importance of leasing as an alternative cheaper way of financing SMEs. In furtherance, this paper examines the dynamics of SME leasing in the form of survey and how SME leasing can be improved through state interventions and other finance enhancement techniques for the betterment of SMEs financing. Survey conducted among some selected SMEs and leasing companies in Ghana were used as the benchmark for leasing as an alternative source of funding for SMEs. The results showed that, there is, in general, a strong correlation among the various dynamic factors of leasing in terms of financing options available to SMEs. The leasing sources also exhibited, to a very large extent, dependence among each other.

KEYWORDS: Leasing, Financing, Small & Medium-Scale Enterprises, Ghana

1.0 INTRODUCTION

It has been established that Small and Medium enterprises play significant roles in the economic development of most developed and developing countries in terms of job creation, innovation of new ideas, contribution to Gross Domestic Product and welfare. [1][2][3][4][5][6] [7] [8]. It is therefore in good faith to see various governments and other institutions supporting SMEs in performance of such important role [9] However, the ability of SMEs to improve its performance depends on investing, restructuring, innovation, market expansion, recruiting, maintaining and motivating quality staff, all these requires funding [10], for access to external finance play an important role in implementing all these actions so as to achieve the targeted growth and development of SMEs [11]

It has been established that most businesses rely heavily on external finance sources such as bank loans and equity finance in their business activities, however, SMEs' in developing countries access to external finance are being hampered by market imperfections - not only in times of crisis, but on an on-going basis as a fundamental structural issue, based on uncertainty and asymmetric information between the demand side (entrepreneur) and the supply side (financial intermediary) [12].

SMEs in most developing countries are strongly restricted in accessing the capital that they require to grow and expand, with nearly half of SMEs in developing countries rating access to finance as a major constraint [7]. In recent research by Becks and Cull on the SMEs access to external finance in the sub-Saharan Africa, they established that most SMEs in the region might not be able to access finance from local banks at all, or face strongly unfavourable lending conditions, even moreover following the recent financial crisis [9]. As reported by [10] "Small firms are disproportionately handicapped by a lack of finance, but they receive a stronger boost in growth than larger firms if financing is provided". Some researchers attribute SMEs limited access to credit which they consider as a major hindrance to SMEs growth to the fact that most of the economies of developing countries are poorly developed in the banking sectors [13][14][15].

Insofar, research conducted by [16] revealed a credit gap of well over \$2 trillion for SMEs in emerging markets. The gap for formal SMEs alone was close to \$1 trillion. The estimated credit gap for formal and informal MSMEs worldwide has been revised upwards from \$3.2 to \$3.9 trillion globally, of which \$2.1 to \$2.6 trillion is in emerging markets IFC Enterprise Finance Gap Database (2011). This has been attributed to a number of factors including limited access to capital markets, financial institutions and poor managerial practices [11]. The situation is not different in Africa, financial constraints together with corruption have been cited as the major obstacles to SMEs growth [17][18]. The African Development Bank (AFDB) confirmed in their recent research on access to finance by SMEs in Africa, and reported that, bank funds only accounts for 20% of African SMEs, and that only 9% of the investments SMEs make. In contrast with what pertains in other developing countries in South America and Caribbean was direct opposite, 44% of SMEs there have access to bank credit [19].

Furthermore, it has also been identified by the Association of Ghana Industries (AGI), an umbrella of industries in Ghana which includes SMEs, that inadequate access to credit is the leading factor restricting the growth of small businesses in Ghana [20].

As a result, SMEs in Ghana like most developing countries are compelled to rely on their scanty internally generated funds to finance their business, [18] as that remains the cheaper source of finance as proposed by the Pecking Order Theory introduced by Myers and Majluf, because of the opaqueness of these SMEs, it becomes expensive and unreliable, as a result funds suppliers have no option than to charge higher to avert or reduce the high risk associated with the lending activities [21]. Recent research conducted by [9] on financing SMEs in Africa countries also attributed the limited access to finance from formal financial institutions among other factors to the fact that, Africa's financial systems are small, shallow and costly, with limited outreach. This bring to the fore the need to research into finding more effective ways of financing SMEs in developing countries, particularly Ghana, outside the formal financial system, looking at the traditional setup and practices of the people of Ghana.

A critical look at the challenges of SMEs in developing countries face in relation to accessing finance from the formal financial institutions, the high cost involve [22] inadequacy leading to the existence of financing gap [9]. This clearly shows that the SMEs have financial need which are not being satisfied by the traditional banks resulting in a situation of large amounts of funds which would have otherwise been used by these firms to develop their businesses and the nation not getting to them [23]. There is therefore the need to develop an alternative, but effective and cheaper ways for financing the SMEs. This calls for an empirical assessment of the effectiveness of assets leasing as the best alternative and/or complement in SMEs financing in Ghana [19][12].

According to the above-elaborated significances that SMEs play in the development of national economics despite the number of challenges that it faces, the central theme of this paper is to examine leasing as an alternative source of funding for the sustainable development of SME's in Ghana. The paper is arranged in five sections, section 2 focuses on the theoretical background of this study. Section 3 focus methodologies for this paper,

section 4 focus and the statistical analysis of the study. And lastly section 5 focuses on the conclusion and contributions of this study.

Theoretical Background

Access to external finance has been recognized as an effective tool for rapid growth and development of SMEs in both developed and developing countries [11]. As a result, any limit on SMEs access to external finance may impede its growth and development. Research by [11] on the SMEs access to external finance in sub-Saharan Africa, which Ghana is included, established that access to external finance remains the topmost problem facing the SMEs, this confirms an earlier findings of similar research by [18][10]. The trend has been attributed to several factors among others, as poor and shallow financial system [11], information asymmetry [21], leading high cost of credit [16].

Due to this fact several reforms in the formal financial system have been initiated by the Government of Ghana in easing SMEs access to bank finance [24]. Yet the problem of accessing external funding still persists. This can be attributed to the less capable of most public institutions in Ghana coupled with corruption. And this has promoted the need for an alternative source and which Leasing has proven to be viable.

Although leasing in the formal sector is only a recent development on the Ghanaian financing market, informal type of leasing have existed in the country from time immemorial until Merchant Bank (GH) Limited formalised it. This informal leasing was mainly limited to land ownership and acquisition in the country. Through efforts of the World Bank, the International Monetary Fund (IMF) and the Government of Ghana, under a policy of the Economic Recovery Programme (ERP) and the Structural Adjustment Programme (SAP), the practice of leasing, as a business enterprise has now become an observable feature of the Ghanaian economy [25]. Prominent among the policy initiatives for improving performance of the financial system was the Financial Sector Adjustment Programme (FINSAP), whose main purpose was to reform and strengthen the financial sector [26] [27].

Research conducted by [28] a member of the World Bank Group, on the leasing market in Ghana shows an increase in the number of firms using leasing in financing businesses. “The results show that the number of new leases issued in the country grew from 311 in 2005 to 536 at the end of 2006 – an increase of 72%. The total lease portfolio represented by gross lease receivables by the sector also increased by over 73% from \$29.8 million in 2005 to \$51.3 million in 2006. The report notes a significant increase in the number of leasing providers, from seven in 2005 to 12 in 2007, with many banking institutions entering the sector” [28]. These findings present a hope for the leasing business in Ghana, therefore with support from the stakeholders in the field, assets leasing in Ghana will count among the best practices around the globe. The hypothesis below was formulated in according with the above-elaborated literature;

H1: the increase in institutional initiative, policy and support coupled with an increase number of leasing firm has presented leasing as an alternative financial source for SME’s in Ghana.

Considering the difficulties SMEs face in accessing bank finance, [22], it is no surprise to see an upsurge in the use of lease as an alternative source of finance by these SMEs. Research by Oxford Economics on the level of use of lease by the SMEs in Europe shows, the relative importance of leasing was highest for relatively young enterprises aged between two and five years [29]. Similar research by [12] and [30] separately also supported the notion that, access to lease is much easier and cheaper for SMEs as compared to access and cost in bank loans. According the survey result by [29], on why SMEs choses lease, it reveals that, such decisions vary from country by country, rather than sector by sector. Some of the factors in consideration among others were, tax benefits and collateral considerations.

Enough evidence suggest that the transactional cost of lease is lower than contracting loans, since the cost of creating and enforcing security for loans are avoided. Repossession of leased equipment is easier and cheaper as compared with that of loan [31]. Furthermore, the simple regulation in leasing makes is easy in contracting, especially in the SMEs sector that is characterised with high rate of illiteracy. This allows leasing companies to reach out to a large number of clients. Also the typical tax-treatment

of leasing, lessors benefit from being able to take capital allowances on the leased equipment. However, the availability of tax benefits depends on whether the typical tax treatment of leases is available to all leases or is restricted to some leases [31].

H2: Due to the ease of accessing lease and its flexibility in terms of contractual arrangement presents leasing as an alternative source of funding for SME's development.

Methodology

Research Design and Method

The research method adopted was a mixed method approach as both qualitative and quantitative methods were used. Using a cross section data collected on randomly selected SMEs from the small-scale mining, building construction and manufacturing sectors. Also the research explored issues of leasing in general and understands the phenomenon of the effect of other sources of capital in building sustainable enterprises in Ghana. The sectors selected were found to be appropriate for this research work, since they use the lease as means of financing their businesses.

Data acquired for this study was analysed using SPSS Statistical Package version 20. In order to examine the extent and influence of leasing as an alternative choice, the study conducted a Spearman's correlation and linear regression analysis to test it hypothesis.

Data collection

A purposive sampling technique was used in selecting the entrepreneurs located in various parts of the Ashanti Region of Ghana. Purposive method was used because these entrepreneurs are scattered all over the vast landmark of the region and only small fraction uses asset leasing. A sample size of 500 SMEs were selected, but only 244 were found to be using assets leasing, hence concentration was geared toward that group. Due to this factor only 244 that had access or used any form of leasing was included in the analysis. These firms was only included because they serve as key informant to this study. And this in consistent with [32] approach which suggests that to ascertain relevant information for a particular study there is the critical need to identify and collect data from relevant key informants.

180 **Data Analyses**

181 Table 1 presents the Spearman's correlation output of all independent and dependent
 182 variables tested. The table 2 presents the findings from the linear regression analysis
 183 conducted to examine the influence of the independent variables on the dependent
 184 variable. That is how the various factors influences firms to turn to lease financing as the
 185 alternative source.

186 **Table 1: The Correlation Matrix of variables Relationships**

187 **Spearman's rho Correlations**

		Frequency of use	Difficulty in use	Reasons for use	Information	Satisfaction	After Sales Service	How you rate after sales Service
Frequency of use	Correlation Coefficient	1.000	.786**	.897**	.892**	.935**	.847**	.931**
	Sig. (2-tailed)	.	.000	.000	.000	.000	.000	.000
	N	244	244	244	244	244	244	244
Difficulty in use	Correlation Coefficient	.786**	1.000	.864**	.826**	.840**	.660**	.853**
	Sig. (2-tailed)	.000	.	.000	.000	.000	.000	.000
	N	244	244	244	244	244	244	244
Reasons for use	Correlation Coefficient	.897**	.864**	1.000	.915**	.840**	.755**	.916**
	Sig. (2-tailed)	.000	.000	.	.000	.000	.000	.000
	N	244	244	244	244	244	244	244
Information	Correlation Coefficient	.892**	.826**	.915**	1.000	.830**	.878**	.924**
	Sig. (2-tailed)	.000	.000	.000	.	.000	.000	.000
	N	244	244	244	244	244	244	244
Satisfaction	Correlation Coefficient	.935**	.840**	.840**	.830**	1.000	.785**	.894**
	Sig. (2-tailed)	.000	.000	.000	.000	.	.000	.000
	N	244	244	244	244	244	244	244
After Sales Service	Correlation Coefficient	.847**	.660**	.755**	.878**	.785**	1.000	.809**
	Sig. (2-tailed)	.000	.000	.000	.000	.000	.	.000
	N	244	244	244	244	244	244	244
How you rate after sales Service	Correlation Coefficient	.931**	.853**	.916**	.924**	.894**	.809**	1.000
	Sig. (2-tailed)	.000	.000	.000	.000	.000	.000	.
	N	244	244	244	244	244	244	244

** . Correlation is significant at the 0.01 level (2-tailed).

Difficulty in use has about 0.786 correlations with the frequency of use. This indicates that there is a strong relationship between persons who have encountered difficult using leasing and the frequency at which they use leasing. Thus peoples difficulty to use lease correlates positively with how often they use lease. This correlation is significant at $p\text{-value} < 0.01$. It can also be observed that 0.897 Spearman's rho correlation coefficient shows a very strong positive relationship between reasons for using leasing and the frequency of using leasing. There is sufficient evidence to therefore conclude that the correlation presence between peoples reason for using leasing and how often leasing is been used is significant, since $p=0.00$ is less than the significance level of 0.01.

Furthermore, difficulty in using leasing recorded about 0.864 correlation with the reason for using leasing. This means that there is a very strong positive relationship between person's difficulty in using leasing and their reasons for using leasing. This relationship is significant at $p\text{-value} < 0.01$. Also, the mode of which people hear about leasing services has about 0.912 correlation with the reasons which they use leasing. This indicates a very strong positive relationship between the information about leasing services and the people's reason for using leasing. Since the $p=0.00$ is less than the significance level (0.001), there is enough reason to conclude that the correlation between this variables is significant.

Moreover, persons who are satisfied recorded the highest correlation of about 0.935 with how often (frequency) people use leasing. This shows a very strong positive relationship between people who were satisfied with the leasing process and the frequency of using leasing. The presence of correlation between these variables/factors is significant at $p\text{-value} < 0.001$. Further, people ratings of after service and the means through which they receive information recorded the second highest correlation of about 0.878. This indicates a very strong positive relationship between these two factors. The relationship is significant as there is sufficient evidence that $p=0.000$ is less than the significance level (0.01).

Interestingly, the lowest correlation of about 0.660 was recorded between provision of after service and peoples difficulty in using leasing. This means that there is a strong

218 positive relationship between these two factors. The relationship between them is
219 significant at $p < 0.01$.

220 Table 2: Result of Linear Regression

Model	R-square	Unstandardized Coefficient		Standardized Coefficient	t-value
		Beta (β)	Std Error	Beta (β)	
1. AL	.483	-.479	.164	.695	-2.929
2.AL, CAL	.784	.034	.110	-.106	.311
3. AL, CAL, DCL	.845	.064	.093	-.191	.682
4.AL, CAL, DCL, LS	.887	-.153	.083	-.404	-1.846
5. AL, CAL, DCL, LS, RAE	.888	-.201	.096	-.392	-2.080
4. AL, CAL, SCL, LS, RAE, ASS, RASS	.898	.026	.104	-.420	.250

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222 According to the regression result above it can be seen that model 6 had the highest R-
223 square value of 0.898, implying that all the independent variables to some extent had a
224 significant influence as to firms decision to move towards lease financing. That is all the
225 variables have 89% influences on the dependent variable. This shows that firms are aware
226 of leasing as an alternative source. And mostly firms in the mining sector are taking
227 advantage of it to have access to relevant machinery and equipment's to improve on the
228 efficiency of their business activities and operations. Also other factors that motivate firms
229 in this sector to move towards this form of financing are the flexible nature of accessing this
230 service and the terms associated with it. Furthermore, the after sales service provided by
231 firms lower the risk that the firm bares since risk is shared between the leasing firm and the
232 other party involved. According to the above regression output supports the hypothesis
233 stated for this study. Therefore all hypotheses were supported.

234 3 CONCLUSION

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Various agencies, particularly government, have given a lot of emphasis on the development of small and medium enterprises (SMEs). Various programs and facilities are provided to increase the competitiveness of the sectors. However, it has to be recognized that depending on these alone will not guarantee the success of the SMEs. Many factors must be considered including their financial status and other factors.

From the foregoing results, it can be derived empirical conclusions with respect to financing options available to SME's and that adequate capital and credit have remained a key success factor for SME's.

There is, in general, a strong correlation among the various dynamic factors of leasing in terms of financing options available to SMEs. The leasing sources also exhibited, to a very large extent, dependence among each other.

The ranges of finance available are numerous, but there are no easy accesses to these funds. Inadequate access to financial resources and credit facilities in formal financial institutions continued to persist because there are more discerning in their choice of SME's they choose to finance. These institutions grant more short term commercial credit to SME's because of higher interest charges than disbursement from SME's fund. The conditions for accessing SME's fund are stiff and unrealistic- there is no clear standard guideline for all banks to comply.

Difficulties in accessing credit and the high cost of credit are imparting negatively on the operations of SMEs. Most SMEs are unable to provide the necessary collateral to access loans from the banks and in the process good business ideas could not be implemented.

It is in this regard that leasing as an alternative source of funding for SMEs must be critically considered by emerging markets. Unlike other forms of credit, lease finance is relatively easier to access because normally it did not require a collateral security. This can be seen from the survey conducted, where 50% of respondents indicated easy access to leasing facilities. Other advantages of leasing include the early recouping of investment and the treatment of the lease rental as full expense in a company's account books for tax purposes. This was also reflected in the high number of respondents favouring leasing. Leasing also has a high developmental impact particularly for SMEs because it deepens the financial sector and increase competition to push down interest rates. In addition, it builds access to capital and improves cash flow for SMEs because monies that would otherwise be used on equipment are retained and ploughed back into the business to enhance its operations. It is the view of this writer that leasing must be integrated into SMEs development in developing countries to catapult the economic development of these nations.

To address the financing needs of these SMEs, the following recommendations are also put forward:

1. It is important for the SMEs to consider all alternative financing options, probably through professional advice, to select an appropriate financing mix that maximizes the value of the business enterprise.
2. The SMEs should be enlightened on the advantages of using the leasing as a source of financing.
3. Private leasing – there are some specialized leasing companies, and some Banks are developing leasing services for selected clients. They should be encouraged by government to provide cost-effective services to SMEs in view of the advantages of equipment leasing.
4. Awareness creation must be made on the existence and advantages of leasing, thereby breaking the myths around leasing.

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