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The Effect of Interest Rates on Construction and Manufacturing SMES in Ghana – A Case Study of Accra

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Abstract
The study investigates the effects of interest rates on Construction and Manufacturing SMEs in Ghana – a case study of Accra. A mixed research method was adopted to permit the researcher to use both qualitative and quantitative data collection and analysis techniques. This was due to the need to closer get a fair representation of the construction and manufacturing SMEs in Accra using the sample selected. In all, 25 SMEs were used for the research. Responses from the SMEs revealed that majority of them have shied away from acquiring loans from banks due to the high interest rates charged. To support the SMEs in these sectors, the interest rates should be reduced at least for SMEs to enable them acquire the loans and also pay on time. The Government of Ghana should also do well to increase the awareness of the government interventions set up to support SMEs in Ghana
Keywords: Interest Rate, SMEs, Financial Literacy, Effects

Introduction

This paper investigates the effects of interest rates on construction and manufacturing SMEs in Ghana, using Accra as the case study. Interest rates play a crucial role in shaping the economic landscape of any country such as Ghana. They are a key determinant of the cost of borrowing and investment decisions made by SMEs across the globe. In the context of Accra, the capital city of Ghana, interest rates have a significant impact on the operations and growth of SMEs in the construction and manufacturing sectors.

It is worth noting that like the other SMEs, the construction and manufacturing SMEs are vital components of Ghana's economy. They do this by contributing significantly to job creation, infrastructure development and Ghana's overall economic growth. Irrespective of this, SMEs in these sectors face unique challenges with interest rates being one of the critical factors that influence their ability to access financing, expand operations and meet the demands of clients.

This paper aims to explore the effect of interest rates on these construction and manufacturing SMEs in Accra shedding light on the challenges they face and the strategies they employ to navigate the complex financial environment after the 2019 financial crisis of Ghana. By delving into this topic, we seek to enhance an understanding of how interest rates impact the growth and performance of SMEs in these key sectors. In the context of Accra and by extension Ghana, where interest rates have been relatively high in recent years, SMEs in the construction and manufacturing sectors have faced significant challenges in accessing affordable financing. In this paper the researcher briefly discusses the effect of interest rates on them using the data collated from persons in key positions in some construction and manufacturing SMEs in Accra.

Literature Review

Small and Medium Scale Enterprises

The definition of SMEs is not universal. The standards used in different countries to classify businesses as small, medium-sized, or large depending on another depending on whether the nation is either developed or in development. In order to classify businesses as SMEs, the Ghanaian government has established precise guidelines that take into account the size and functional attributes of the organization. Ghana's economy, according to the Ministry of Trade and Industry Report (2014), is made up of a big number of medium-sized enterprises, a huge number of small and micro firms, and a small number of large companies.

In Ghana, SMEs are defined based on three main parameters: the number of employees, annual turnover, and fixed assets. According to the Ghanaian Statistical Service (2016), SMEs are classified as follows:

Micro Enterprises: These are the smallest businesses, often “family-owned, and typically operated with a small number of employees, usually less than 10”.

Small Enterprises: Small enterprises in Ghana are characterized by a larger workforce compared to micro enterprises, usually between 10 and 29 employees.

Medium-sized Enterprises: Medium-sized enterprises in Ghana have a larger scale of operations, typically employing between 30 and 99 employees.

Mardi (2019) from a research asserted that SMEs serve as a major driver of economic growth by reducing unemployment in both developed and developing countries. SMEs also serve as an income generating tool for the government through taxes and for the public through profits. McCann et al (2016) supports this assertion by stating that SMEs are seen as the engines for economic growth in many countries.

In Ghana, SMEs have contribute about 80% of the nation’s Gross Domestic Product (GDP) and a little over 60% of Ghana’s labour force have been employed by SMEs. Ghana benefits extensively from SMEs through employment creation, economic growth, innovation, export earnings and poverty reduction. Donkor et all (2018) agreed to this in a research where it was asserted that SMEs promote growth, job creation and poverty reduction in Ghana.

Despite their significant contributions, SMEs in Ghana face various challenges that hinder their growth and sustainability. These challenges include limited access to finance, high interest rates, inadequate infrastructure, lack of skilled labor, regulatory constraints, and competition from large enterprises. High-interest rates on loans and credit facilities have been identified as a major obstacle for SMEs in Ghana, affecting their profitability and ability to expand operations.

This paper will be exploring how interest rates affects the performance of SMEs in the construction and manufacturing sector.

Theoretical Perspectives on the Impact of Interest Rates on SMEs Performance

Interest rates play a crucial role in shaping the financial environment for Small and Medium-sized Enterprises (SMEs), influencing their access to credit, cost of borrowing, and overall performance. In this literature review, we will explore theoretical perspectives on how interest rates impact SMEs' performance, focusing on key theories and frameworks that explain this relationship.

1. Financial Constraints Theory

Financial Constraints Theory posits that SMEs face limitations in accessing external financing due to asymmetric information, collateral requirements, and high transaction costs. High-interest rates exacerbate these constraints by increasing the cost of borrowing for SMEs, making it more challenging for them to invest in growth opportunities, expand operations, and innovate. As a result, SMEs with limited access to affordable credit may experience lower productivity, reduced competitiveness, and slower growth compared to larger firms.

2. Pecking Order Theory

Pecking Order Theory suggests that firms, including SMEs, prefer internal financing sources such as retained earnings over external debt due to information asymmetry and adverse selection issues. When SMEs do resort to external financing, they tend to prioritize lower-cost sources of capital before turning to higher-cost debt, such as bank loans. High-interest rates can disrupt this pecking order by making external debt less attractive and increasing the financial burden on SMEs. As a result, SMEs may face difficulties in managing their debt obligations and maintaining financial stability.

3. Investment-Cash Flow Sensitivity Theory

Investment-Cash Flow Sensitivity Theory argues that SMEs' investment decisions are influenced by their internal cash flows and external financing conditions, including interest rates. High-interest rates can lead to a mismatch between SMEs' investment opportunities and available funds, as borrowing becomes more expensive and cash flow constraints limit their ability to undertake profitable projects. This sensitivity to interest rates can affect SMEs' investment behavior, capital allocation decisions, and overall performance.

4. Agency Theory

Agency Theory examines the relationship between principals (SME owners) and agents (lenders) in the context of borrowing and lending relationships. High-interest rates can create agency conflicts between SMEs and lenders, as owners may be incentivized to take excessive risks or underinvest in projects to mitigate the cost of debt. Lenders, on the other hand, may impose stricter monitoring and control mechanisms to protect their interests, potentially constraining SMEs' autonomy and flexibility in decision-making.

Relationship Between Interest Rates and SMEs Profitability

1. Impact of Interest Rates on SMEs Profitability

Several studies have examined the impact of interest rates on SMEs profitability, with mixed results. Higher interest rates can increase the cost of borrowing for SMEs, leading to higher debt servicing costs and reduced profitability. In contrast, lower interest rates can stimulate investment, boost consumer spending, and improve cash flow for SMEs, thereby enhancing their profitability. The relationship between interest rates and SMEs profitability is complex and influenced by various factors, including macroeconomic conditions, market dynamics, and financial sector policies.

2. Access to Finance and Interest Rates
Access to finance is a key determinant of SMEs profitability, as it enables businesses to fund their operations, invest in new technologies, and expand their market reach. Interest rates play a crucial role in determining the cost of borrowing for SMEs, affecting their ability to access affordable credit and manage their debt obligations. High-interest rates can constrain SMEs' growth prospects, limit their investment opportunities, and reduce their profitability, particularly for businesses operating in sectors with thin profit margins or high capital requirements.

3. Financial Inclusion and Interest Rates
Financial inclusion initiatives aimed at expanding access to finance for underserved populations, including SMEs, can help mitigate the impact of high-interest rates on profitability. Microfinance institutions, fintech platforms, and government interventions can provide alternative sources of funding for SMEs at lower interest rates, enabling them to overcome financial constraints and improve their business performance. Promoting financial literacy, enhancing credit information systems, and fostering competition in the financial sector can also contribute to reducing interest rates for SMEs and enhancing their profitability.

4. Policy Implications
Policymakers play a crucial role in shaping the relationship between interest rates and SMEs profitability through monetary policy decisions, regulatory reforms, and targeted interventions. Implementing measures to reduce interest rate volatility, enhance transparency in lending practices, and promote competition among financial institutions can create a more favorable environment for SMEs to access affordable credit and improve their profitability. Additionally, supporting SMEs through capacity-building programs, business development services, and access to markets can help strengthen their resilience to interest rate fluctuations and enhance their long-term sustainability.
In conclusion, the relationship between interest rates and SMEs profitability is complex and multifaceted, influenced by factors such as access to finance, financial inclusion initiatives, and policy interventions. Understanding the impact of interest rates on SMEs profitability is essential for policymakers, financial institutions, and other stakeholders to design targeted strategies that support the growth and sustainability of SMEs in Ghana. Further research is needed to explore the specific mechanisms through which interest rates affect SMEs profitability and identify best practices for promoting a conducive financing environment for SMEs in the country.

Government Interventions
Government initiatives to support Small and Medium-sized Enterprises (SMEs) in Ghana play a crucial role in fostering entrepreneurship, job creation, and economic development. The government of Ghana has implemented various programs and policies to promote SME growth, enhance access to finance, and create a conducive business environment for small businesses. Some of the key initiatives to support SMEs in Ghana include:

1. **National Entrepreneurship and Innovation Plan (NEIP):** The NEIP is a flagship program launched by the government of Ghana to provide financial and technical support to young entrepreneurs and SMEs. The program offers training, mentorship, funding, and market linkages to help SMEs grow and scale their businesses.
2. **Microfinance and Small Loans Centre (MASLOC):** MASLOC is a government agency that provides microfinance services and loans to SMEs, especially those in rural areas and underserved communities. The agency offers affordable credit facilities, business advisory services, and capacity-building programs to support SMEs in Ghana.
3. Ghana Enterprise Agency (GEA): The GEA, formerly known as the National Board for Small Scale Industries (NBSSI), is a government agency that promotes the growth of SMEs in Ghana through business development services, access to finance, and market support. The agency offers training, coaching, and financial assistance to help SMEs improve their competitiveness and sustainability.
4. National Board for Small Scale Industries (NBSSI): The NBSSI is another government agency that supports SMEs in Ghana through capacity-building programs, business advisory services, and access to finance. The agency works closely with SMEs to address their specific needs and challenges, helping them navigate the business environment and access opportunities for growth.
5. Export Development and Agricultural Investment Fund (EDAIF): EDAIF is a government fund that provides financial support to SMEs engaged in export-oriented activities and agricultural investments. The fund offers grants, loans, and technical assistance to help SMEs expand their market reach, improve product quality, and enhance their competitiveness in local and international markets.
6. One District, One Factory (1D1F) Initiative: The 1D1F initiative is a flagship industrialization program launched by the government of Ghana to promote the establishment of manufacturing enterprises in every district of the country. The initiative aims to create jobs, stimulate economic growth, and enhance the competitiveness of SMEs in various sectors.

Research Methodology, Population and Sampling

In Ghana, Greater Accra region is the smallest administrative region in terms of the total land surface it occupies with a population of over 4 million. Though many SMEs in Ghana are not properly registered and licensed to operate, those that have been duly registered form about 90% of the companies in Ghana.

SMEs in Ghana have their operations in the various sectors of the economy, however for the purpose of this study, twenty-five SMEs licensed to operate in Ghana in the construction and manufacturing sectors were understudied. The study which is qualitative research was designed to investigate the effects of interest rates on SMEs performance in Ghana using Accra as a case study. A descriptive survey was adopted for this study. This was due to the need to portray an exact info of persons, SMEs and factors that are peculiar to them.

The population for this study was SMEs in Accra that are into construction and manufacturing. Since the actual population for this is large, the convenience and random sampling technique was adopted for sampling the respondents. According to Bawuah et al (2014), convenience sampling is selecting respondents to a research based on their accessibility and fair representation of the population understudy. For the purpose of this study, twenty-five (25) respondents were interviewed.

Results and Discussions

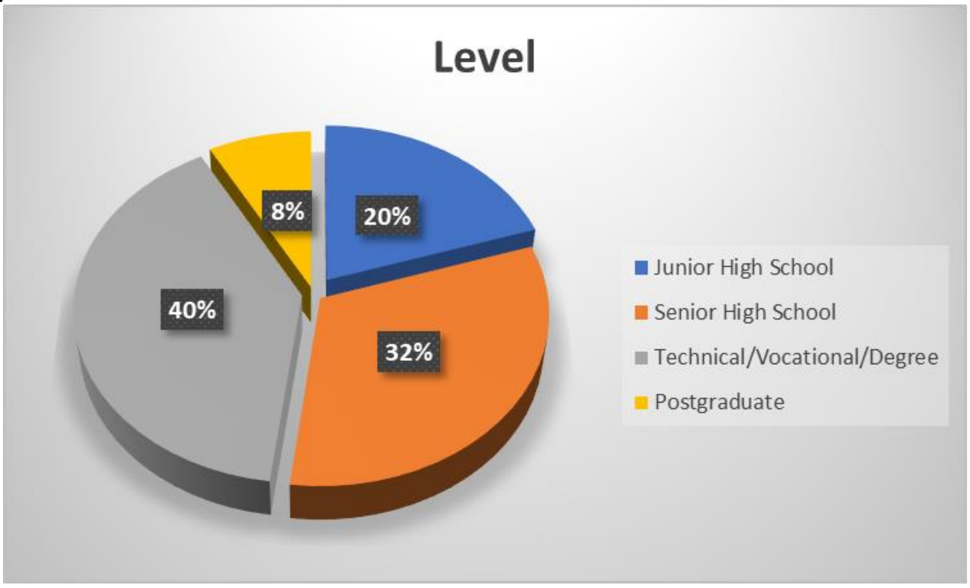
This session of the article focuses on the analysis of the data collected from the respondents in the survey conducted. A total of 25 respondents were used for the research as stated earlier. Out of the 25 respondents, 14 represented small scale enterprises while the remaining 11 represented medium scale enterprises. This is represented in the table below.

Type	Frequency	Percentage (%)
Small Scale	14	56
Medium Scale	11	44
Total	**25**	**100**

Source: Field Survey (2024)

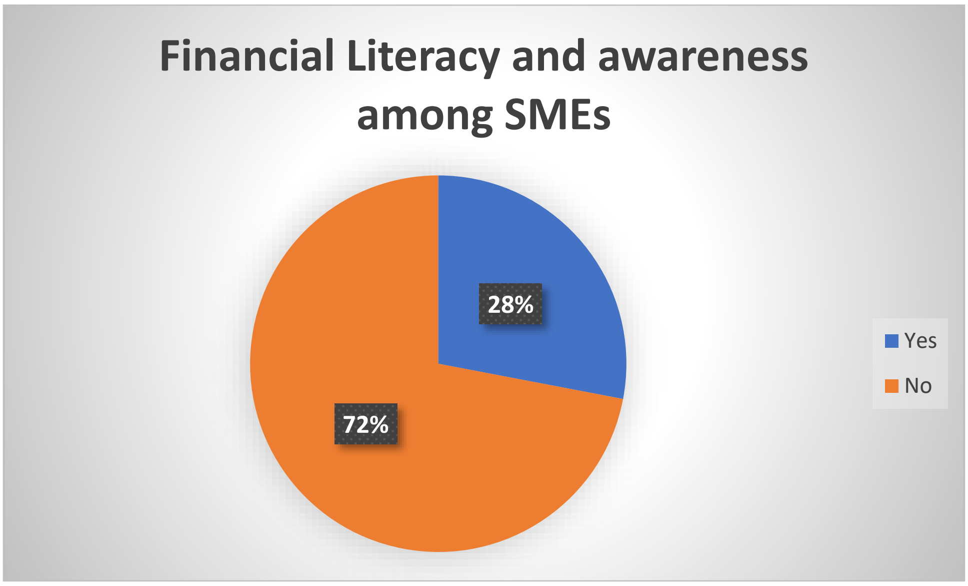
The researcher observed that in Accra, the predominant SMEs in operation are small scale enterprises. This is quiet opposite to many researches about SMEs in Accra which presupposed that medium scale enterprises are more than small scale enterprises. Out of the 25 SMEs interviewed for this study, 12 were in the manufacturing sector, 10 were in the construction sector and the remaining 3 were in the other sectors.

Another question posed to the respondents was about their level of education. The figure below shows the educational level of the top officials in the SMEs that were interviewed for this study.

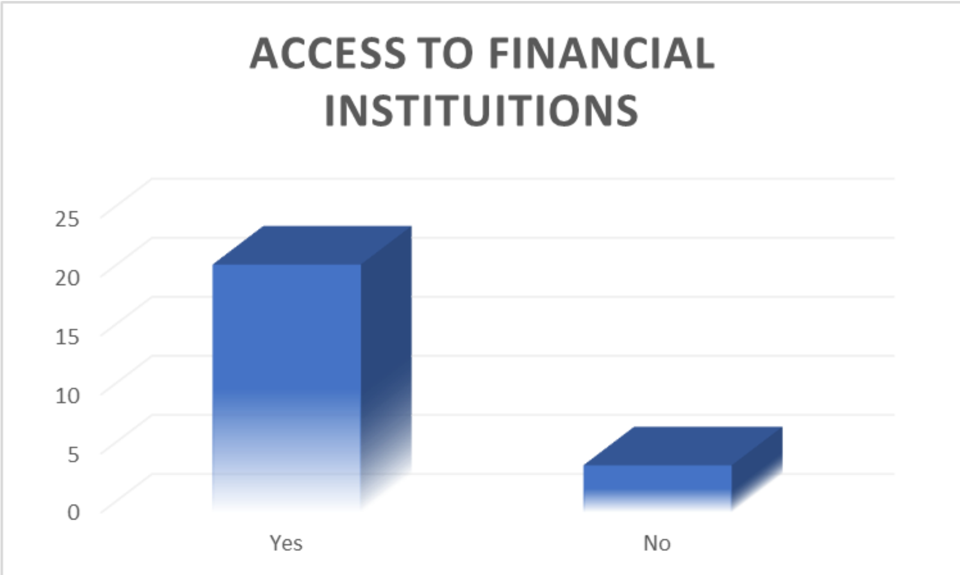


This study revealed that the view that the SME sector is being operated majorly by persons without a formal education and technical knowhow, is not entirely true. From this study, it was observed that some SMEs are being operated by persons with BECE, WASSCE, degree and postgraduate degrees. This is most likely due to the high unemployment rate in Ghana. Many graduates after completing school are somewhat compelled to start their own businesses hence the high involvement of persons with educational backgrounds in the operation of SMEs in Accra Ghana.

The figure below shows the level of financial literacy exhibited by the respondents of the various SMEs involved in this study.



Financial literacy refers to the knowledge and understanding of financial concepts, such as budgeting, saving, investing and managing debt. Majority of the respondents interviewed revealed that SMEs in Ghana are not adequately literate about finances and their level of financial awareness was also not adequate. From my study, it was observed that limited financial literacy among SMEs contributes greatly to the challenges faced when accessing financial services. This observation was also seen by Agung et al (2020) in research.



The figure above shows the responses given by respondents on their access to financial institutions for funds. From the interviews, it was observed that 84% (n = 21) of the respondents have had access to one or more financial institutions while the remaining 16% (n=4) have not accessed any financial institutions. Further questioning revealed that more than half of those that had access to the institutions have applied for loans.
All the respondents were asked the reasons why they do not apply for loans and that too frequently. Below are the responses they gave.

Reason	Number	Percentage
Inability to get collateral	7	28%
High Interest rate	15	60%
Didn't know about such loans	3	12%
Total	25	100%

From the responses, it was observed that majority of the SMEs were deterred from applying for loans from financial institutions due to the high interest rate charged. The respondents mentioned that these high interest rates cause most people to default in the loan repayment and end up paying much more than anticipated initially. They also stated that the high interest rates turns to affect their profit margins and sometimes their working capital is reduced as well.

Conclusion

From the analysis, it was observed that though many SMEs require funds for growth and sustainability, they are deterred from acquiring for loans from banks and other SMEs due to certain factors with high interest rate being the leading factor. The high interest rates hinder these SMEs and causes many of them to fold up due to financial constraints. 60% of the respondents of this study stated that their unwillingness to apply for loans is due to the high interest rate on loans. SMEs should stop being too dependent on financial institutions and take advantage of the policies the government has put in place to support SMEs. About 28% of SMEs exhibited little financial awareness and this was instrumental in their inability to create other sources of funds for the running of their firms. SMEs should also prioritize internal financing to external financing.

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