

# The Demand for Landed Property as Collateral for Loan Facilities and its Impact on Small Enterprises' Investment Drive

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## Abstract

One of the biggest constraints in developing countries, as far as investment by small and medium enterprises (SMEs) is concerned, is finance. They (SMEs) often cite difficult access to finance as an important constraint on their operations. For starters the problem is often seed capital whilst that of established enterprises is working capital as well as finance for expansion. The last resort, in most cases, for most of these needy investors and prospective investors is often to borrow from financial institutions. Financial institutions, however in granting the credit required, would normally demand some form of security for the repayment of the money loaned. One of such securities often demanded by financial institutions (especially in developing countries such as Ghana) is landed property.

This study "The Demand for Landed Property as Collateral for Loan Facilities and its Impact on Small Enterprises' Investment Drive" examines the issues associated with the demand for and the use of landed property as collateral by financial institutions and SMEs respectively and the impact of this requirement on investment drive in Wa Municipality of Ghana. The study revealed that small enterprises' ability (ownership of landed property) to meet the requirement of landed property as collateral varies significantly from their willingness to mortgage their property. Fewer SMEs are able to meet the requirement than those who

cannot. There was however, massive support for the requirement. The requirement was found to impact negatively on the investment drive of SMEs. The findings are based on a sample of 302 respondents made up of all (7) financial institutions in the Municipality that accept landed property as collateral and 205 SMEs identified as legal and successful and therefore potential candidates for bank financing.

**Key Words:** Landed Property, Collateral, SMEs, Investment Drive

## **1. Introduction**

There is a global recognition of the vital role the private sector (of which SMEs are a part) play in economic development. SMEs constitute about 90% of total business units in Ghana and employs about 60% of Ghana's labour force (KDI, 2008). They serve as efficient and prolific job creators, the seed stock for large-scale enterprises and the fuel for national economic engines (Ackah and Vuvor, 2011). For instance, U.S. SMEs employed about half of the private sector work force and also contributed half of the nation's private sector output in 2006 (Ou, 2006). In Ghana, SMEs have been found to provide 85% of manufacturing employment (Steel and Webster, 1991; Aryeetey, 2001). They (SMEs) are further believed to contribute about 70% of Ghana's GDP whilst accounting for about 92% of businesses in the country. In view of the enormous contribution of SMEs in particular and the private sector as a whole, it is not surprising that the government of Ghana has taken the commendable interest in the promotion of the private sector through its Public-Private Partnership Policy. However, for the enormous contributions of SMEs to be fully realized they need access to finance for their establishment, operation and expansion. Unfortunately, SMEs in developing countries typically cite difficult access to finance as an important constraint on their operations. This difficult access is often attributable to financial policies and bank practices that make it hard for banks to cover the high costs and risks involved in lending to small firms. Conscious of the challenges faced by SMEs in having easy access to finance and in its commitment to promoting the private sector (through its PPP policy) many interventions have been made by the government of Ghana through its recent monetary policy and financial sector reforms. Although these reforms have largely increased banks' lending to the private sector, high interest rates and prohibitive collateral requirements still pose significant constraints to the operations of SMEs. Consequently, the situation of SMEs has shifted from "lack of access to credit" as it used to be in the past (as a result of macroeconomic conditions) to "difficult access to credit". This is because though SMEs now have fairly easy access to credit, access to medium to long-term financing necessary for capital investment is still an issue for SMEs to contend with (USAID, 2009).

From an economic perspective, financial institutions (both banks and non-banks) are not just suppliers (lenders) of credit, but also consumers. Supply of credit to businesses will aid the operations of their consumers (businesses) just as their (financial institutions) activity is stimulated by the demand of their clients (businesses). By lending, financial institutions are into investment. As expected of every investment there is only not a concern about the return on the investment but also the security of the amount invested. To secure the credit advanced, financial institutions will normally demand some form of collateral security from the borrower. Though the collateral can be either movable or immovable property, most financial institutions in developing countries prefer landed property. They prefer landed property because of its unique characteristics which tend to place it in a better position to be used as collateral security than movable property, at least in developing countries like Ghana. Firstly, landed property appreciates in value to offset the loss in value of the amount loaned

due to inflation. This ensures the security of the loan facility in real terms. A second good quality of landed property that makes it suitable to be accepted as collateral security is its durability. Its durable nature ensures that it is available to be used in repaying the loan in the event of default by a borrower. Although the use of movable property is yet to gain prominence in Ghana, due to the undeveloped nature of the financial sector, it is worthy to note that several financial sector reforms by government are hoped to change the situation in the near future. For instance in 2008, the Borrowers and Lenders Act came into effect introducing modern secured transaction systems and laying the groundwork for the creation of a web-based collateral registry at the Bank of Ghana. As a result more than 36,000 loans were registered by 2002 by banks and non-bank financial institutions in the collateral registry since its establishment in March 2000. These loans accounted for almost US\$2 billion in financing secured with movable property (World Bank Group, 2012).

The study sought to find out;

- The knowledge and perception of SMEs in Wa about the requirement of landed property as collateral and their ability to meet it
- The challenges of using landed property as collateral in the area
- The impact of this requirement on SMEs access to finance and their investment drive.

It is an undeniable fact that the requirement of collateral security (in this case landed property) by financial institutions in granting loans is indispensable because it is one of the safest ways of guaranteeing the repayment of the loan. It is, however, equally undisputable that SMEs will always require credit from financial institutions. The significance of this research lies on the fact that there is the need to investigate the challenges of using landed property as collateral security and its attendant impact on SMEs access to finance and to recommend measures through which the system (the demand for landed property as collateral) can be improved for the benefit of both financial institutions on one hand and SMEs on the other hand.

## **2. Literature Review**

The issue regarding the exact meaning of SMEs has long been debated upon and researchers have yet to reach a consensus. SMEs have as many definitions as there are many disciplines in the social sciences. For instance, the World Bank Group defines SMEs as enterprises with up to 300 employees and total annual sales of up to US\$15 million (Gibson, 2008) whilst the European Commission defines SMEs as having not more than 250 employees (Lucács, 2005). UNIDO, on the other hand, defines SMEs in two ways: for developing countries; Large firms (with 100+ workers), Medium firms (with 20 - 99 workers), Small firms (with 5 - 19 workers), and Micro firms (with < 5 workers) and for industrialized countries: Large firms (with 500+ workers), Medium firms (with 100 – 499 workers), and Small firms (with ≤ 99 workers) (Peter, 2008). The definition of SMEs, therefore, depends on who is defining it and where it is being defined (Ward, 2005). Whatever forms the definition of SMEs may take, however, two salient items are certain: number of employees in an enterprise and/or an enterprise's balance sheet or turnover. For instance, UNIDO defines SMEs in developing countries based on number of employees in an enterprise and ranges them (SMEs) from small enterprise (5 – 9 workers) to medium-sized (20 – 29). The World Bank basis its definition on both number of employees and enterprises' turnovers. The National Board for Small Scale Industries (NBSSI) of Ghana, on the other hand, defines SMEs based on number of employees (which should not be more

than 29 workers), and enterprise's balance sheet (which should not exceed the equivalent of US\$100,000 excluding land and buildings). The Venture Capital Trust Fund (VCTF) Act 2004 (Act 680 section 28) defines SMEs as "an industry, project, undertaking or economic activity which employs not more than 100 persons and whose total asset base, excluding land and building, does not exceed the cedi equivalent of US\$1 million in value".

In general, a distinguishing feature of SMEs is that they have no direct access to both local and international capital markets (Ackah and Vuvor, 2011) because of the high intermediation costs of smaller projects. However, they face the same fixed costs as large scale enterprises in complying with regulations but have limited capacity to market their products abroad (Kayanula and Quartey, 2000). In Ghana, the SME sector is characterised by low levels of education and training of the self-employed. A vast majority are family-owned businesses (FOB) and there is often little separation of the business' finance from that the owner even to the point that the owner's or operator's personal accounts are used for the businesses (Ackah and Vuvor, 2011). SMEs in Ghana can be categorized into two: urban and rural enterprises. The former can be sub- divided into 'organized' and 'unorganized' enterprises. Organized ones tend to have employees with a registered office and are mostly solely owned by an individual whereas the unorganized ones are mainly made up of artisans who work in open spaces, temporary wooden structures or at home and employ little or in some case no salaried workers. They rely mostly on family members or apprentices. Rural enterprises are largely made up of family groups, individual artisans, women engaged in food production from local crops. The major activities within this sector include: soap and detergents, fabrics, clothing and tailoring, textile and leather, village blacksmiths, timber and mining, bricks and cement, beverages, food processing, wood furniture, electronic assembly, agro processing, chemical based products and mechanics (Liedholm & Mead, 1987; Osei et al., 1993) as cited by (Kayanula & Quartey, 2000).

SMEs have various sources of finance. But according to most authors of the subject matter (Boom et al., 1998; Longenecker, 1994; Mullen, 2012) there are basically two types of financing namely, debt and equity. Debt refers to funds borrowed to be paid at a future date with interest (Hisrich and Peters, 1995; Anderson and Dunkelberg, 1993) agreed upon by both the lender and the borrower. Equity, on the other hand, refers to funds contributed by investors who become owners or part-owners of the firm and whose returns are normally based on the firm's profits. Survey results reveal an overwhelming importance of equity finance in the start-up of small enterprises in Ghana, the more so the smaller the firm (Aryeetey et al., 1994). Besides these two main sources (which this paper will term as formal/major sources) there are non-major or non-formal sources too. Hisrich and Peters (1995) classify them into internal and external. Internal sources include, but not limited to, operational and investment profits, sales of assets, extended payment terms and accounts receivable. External sources include personal savings (their own, relatives' or friends'), suppliers credit, customer advances (in the case of established enterprises) and government and non-government agencies.

Findings from various research works have resoundly and repeatedly shown that SMEs face serious challenges in accessing bank credit (Cuevas et al., 1993; Aryeetey et al., 1993) The question today is therefore no longer about "whether SMEs face financial constraints" but rather "how to make their access to bank credit better or easier". The common reason for the difficult access to bank credit by SMEs is their inability to pledge acceptable collateral. The

system of land ownership in Ghana and the regulatory framework for land title registration have a negative impact on firms' access to formal credit using landed property as collateral. For instance, most people lack clear title to their property whilst much of real property is communally owned under the customary land ownership system. Since there cannot be legal ownership without a clear title this tends to limit the supply of real property as collateral. The land title registration component of the Ghana Land Administration Project (LAP) is expected to address this issue of lack of clear titles, it is hoped. Even with a clear title and as the sole owner of a property, the process of title transfer (assignment) affects the time and money involved in the finalization of a mortgage and consequently access to borrowed capital. Collateral provides an incentive to repay and offset losses in case of default. It is therefore not surprising that Aryeetey et al (1993) found that the availability of collateral plays a significant role in the readiness of banks to meet the demands of the private sector. According to them, under a study which they conducted on the supply and demand for finance for small enterprises in Ghana, collateral was required of nearly 75% of sample firms that needed loans. According to the study, among firms that had their applications rejected, lack of adequate collateral (landed property) was the main reason given by banks.

Apart from collateral, loan transaction costs have also been noted to also contribute to the inability of SMEs to access credit like large firms (Cuevas et al., 1993). They (Cuevas et al) argue that high transaction costs of lending do not make the net margin banks expect compare favorably against safe investment represented by treasury bonds. Thus though SMEs have a strong interest in credit commercial banks' quest for profits often deter them from supplying credit to SMEs because of the high transaction costs and risks involved. Due to the small nature of the amount often required by SMEs, cost of processing the loans tend to be higher relative to the loan amounts. Apart from that, banks do not normally risk lending to SMEs (especially new investors – large or small) who do not have a track record because of the difficulty in obtaining the information necessary to assess the risks of new unproven ventures. Lastly, the probability of failure for new SMEs is considered to be high (ibid).

In view of the various challenges faced by SMEs in accessing loan facilities, SMEs as Schiffer and Weder (1991) assert, face more challenges in doing business than large enterprises because of the difficulties in financing start-ups and expansion peculiar to them (SMEs). According to them (Schiffer and Weder) small firms tend to experience more difficulties than medium-size firms that also experience more difficulties than large firms. In most developing countries, lending to small businesses and entrepreneurs remain limited because financial intermediaries are apprehensive about supplying credit to businesses due to their high risks, small portfolios, and high transaction costs (Ackah and Vuvor, 2011). According to Dr. Kwadwo Ansah Ofei (JEL: G21, I30, N27) small and medium enterprises are unable to assess loans because of the conditions attached to the banking methodologies (cited in Ackah and Vuvor, 2011). This he grouped into two:

**Formal bank methodologies:** These consist of several techniques to pre-screen clients and concentrate on relatively few large transactions. They include; feasibility studies, collateral, track record and minimum deposits.

**Informal banking methodologies include:** personal relations, family connections and knowledge of business relations.

Despite the enormous challenges SMEs face in accessing credit, their economic importance is undebateable (O'Neill, 1993; Storey, 1994; Beck et al., 2004; Snodgrass & Winkler, 2004; Gebremariam et al., 2004). It is their significant contribution to economic growth and development that has necessitated a plethora of research works on ways of improving SMEs access to credit. As Anyima – Ackah (2006) puts it, “the private sector is the engine of growth therefore they must be given the necessary tools to increase their growth”. Research has shown that the SME sector is a very important part of the economic machinery of most nations. SMEs are important because they create jobs, pay taxes, provide innovations, and are very instrumental in countries' participation in global markets. On a global scale, SMEs make up over 90% of business units in the world and account for between 50% - 60% of total employment (Katto, 2008). In the European Union (EU) SMEs employed 90 million people in 2008 alone (EC, 2009). Beck and Kunt (2004) state that SME activity and economic growth are important. According to them, this importance is due to the relatively large share of the SME sector in most developing countries and the substantial international resources from sources like the World Bank Group, that have been channeled into the SME sector of these nations. Kayanula and Quartey (2000), on their part, recognize them (SMEs) as the engines through which the growth objectives of developing countries can be achieved and are potential sources of employment and income in many developing countries. In Ghana SMEs account for nearly 93% of the registered businesses (Ackah and Vuvor, 2011) and therefore play an important role in economic development by providing employment opportunities, opening up new business opportunities, enhancing entrepreneurship, and fostering creativity among many other things. Mensah (2005) makes the analogy that SMEs act like sponges by soaking up surplus labour to provide a large share of employment and income in Ghana. In 2006, SMEs employed about half of the private sector work force and also contributed half of the Ghana's private sector output (Ou, 2006). There is empirical evidence that SMEs enhance competition and entrepreneurship and that direct government support can boost economic growth and development. Also SMEs growth boosts employment more than large firms because they are labour intensive and make better use of scarce resources with very small amounts of capital. Hellberg (2000) also states that developing countries should be interested in SMEs because they account for a large share of firms and development in these countries. SMEs are not only important because they are a source of employment but also because they are a source of efficiency, growth and economic decentralization (Love and Roper, 2013; Ardic, et al., 2011). Finally, they are very important in the fight against poverty as they help in the poverty reduction strategy for most governments especially those in the developing countries where poverty is most severe. Since they employ poor and low-income workers and are sometimes the only source of employment in the rural areas, their contribution cannot be overlooked.

### **The Legal Framework of Mortgages in Ghana**

Section 1(3) of the Mortgages Decree states that “a mortgage may be created in any interest in immovable property which is alienable”. This means that before an interest in immovable property can be mortgaged, the prospective mortgagor must have the right of alienation. In other words he must have the capacity to assign or transfer a portion or all of his interest in the property to some one else. An individual cannot therefore mortgage property that belongs to an entire family or community on his own. He must have the consent of the entire family or community to do so. Any mortgage transaction that is not done with the consent of the group owning the property is considered null and void. This provision of the Decree is good because it will preclude unscrupulous members of the family or community from

mortgaging family property without other members' consent. This will help curb litigation. On the other hand, it does not only limit the supply of landed property for collateral but also prolongs the period of time and money required to finalize a title transfer. This actually results in more time involved in accessing a credit.

For a mortgage to be enforceable it must be evidenced in writing signed by the mortgagor or his agent authorized in writing to sign on their behalf. Otherwise, it should be excused from the necessity of writing by the operation of the rules of equity, excused from the necessity of writing by any enactment (in the case of customary law transaction). The writing should state the name and address of each mortgagee and each mortgagor; state the nature of the mortgagor's interest in the property mortgaged; identify the mortgaged property by reference to its location and boundaries; where the mortgage secures the payment of money, state on which date payment is due and state the principal sum lent or to be lent (Mortgages Decree, 1972 (NCRCD 96)). For such writing to receive legal recognition it must be registered. "Every writing evidencing a mortgage shall be deemed to be an instrument which may be registered in accordance with the land registry act, 1962 (Act 122)" (NCRCD 96 Section 3(2)).

A mortgage will be unenforceable in two ways;

- Where the performance of an act or acts secured by the mortgage derives from a contract that is illegal, say a contract to commit murder. In such a case a court may order the return of title documents or the removal of any clog on the title to the mortgaged property. (NCRCD 96, Section 14(1)).
- Where the performance of an act or acts secured by the mortgage derives from a contract, which is void or voidable at the mortgagor's option. An example of a void contract is a contract to repay money lent or to be lent to a minor.

The effect of a mortgage is that it is a security for the performance of the act or acts provided in the mortgage and not for any performance promised in any past or future contract. The mortgagor is personally liable, as well as liable on the mortgage security, for the performance of the act or acts secured by the mortgage.

### **3. Methodology**

Just like any other research work, data had to be collected, analyzed, interpreted and findings made in order to achieve the objectives of the study. In order to achieve the objectives of the study the quantitative research method was adopted. Though the study was conducted in Wa, it is worthy to note that findings should not be deemed to be limited to Wa. The reasons for this inference are a) all financial institutions covered for this study and their sister-branches in other regions have a centralized administration. It was therefore assumed that the conditions that exist in banks in Wa with regard to the use of landed property as collateral are the same in other sister-branches located in other regions, and b) the forms of ownership of landed property are the same across the country. In view of these, SMEs, no matter where they are located in Ghana, are expected to face the same conditions in accessing credit using landed property as collateral. Consequently, the case study design was adopted using SMEs in Wa.

Data was gathered from both primary and secondary sources. Primary data was collected using both self-completion questionnaires and an interview schedule. An interview schedule was used to collect data from SMEs. This data collection tool was chosen taking into account the low levels of education of most of business owners in the town. This technique was used

to enable the researcher explain issues that would need further clarification. Questionnaires were administered to financial institutions.

From a targeted population of 440 enterprises a sample of 205 SMEs was drawn using the systematic random sampling technique. Based on a chosen sample size of 205 and a population of 440, a sample fraction of 2.15 was realized and rounded up to 3. The first sample unit was then randomly selected between 1 and 3 and from there every 3rd unit in the frame was selected to obtain the desired sample. The 205 enterprises were based on Aryeetey et al (1994) classification of SMEs, which range from micro (1-9 workers) to small-scale (10-29 workers) to medium-scale (30-140 workers). Questionnaires were also served on all the financial institutions in the town.

#### 4. Results and Discussions

##### 4.1 Characteristics of Respondents

All the respondents were SMEs located in Wa. Variables that were considered under this section included type/nature of business, size of firm, and number of employees. The respondent SMEs had a working force of between 3 and 40 employees. Out of the 205 respondents, 24.4% of the businesses were registered as Limited Liability Companies. The rest were registered as Sole Proprietorships, Partnerships or Family-Owned Businesses.

**Table I: Forms of Participant SMEs**

Form of SME	Frequency	Percentage
Private Limited Company	50	24.4
Partnership	15	7.3
FOB	61	29.8
Sole Proprietorship	79	38.5
Total	205	100

##### Source: Author's Construct

As can be observed from the table above, the majority of sample firms were registered as Sole Proprietorships. They accounted for 79 out of the 205 responses received, representing 38.5%. 50 respondents (24.4%) were Private Limited Liability companies. 29.8% were FOBs whilst the rest (7.3%) were registered as Partnerships.

On type/nature of business, it was revealed that the 205 respondents were fairly spread across a wide range of the Ghanaian economy. For instance, 47.3% were into retail trading, perhaps an indication of how attractive people find the sector as a result of the establishment of both the University of Development Studies (UDS) and Wa Polytechnic. Retail trading was followed by the artisanal sector with 40.5%. This was not surprising because about 69.8 per cent of the region's (Upper West Region) population, aged 6 years and older, have never attended school (UNICEF, 2012). Most of the boys and girls who dropout out of school end up learning one trade or another and this has accounted for a high number of dressmaking, hairdressing, electrical repair and plumbing shops. The services sector accounted for 23, representing 11.2% whilst the construction sector accounted for 1%.

**Table II: Type/Nature of Business Engaged in by Participant SMEs**

Type/Nature of Business	Frequency	Percentage
<b>Retail Trading</b>	97	47.3
<b>Services</b>	23	11.2
<b>Artisans</b>	83	40.5
<b>Construction</b>	1	1

**Source: Author's Construct**

In terms of firm sizes it was revealed that majority (110 representing 53.6%) of sample firms were microenterprises. This was followed by small-sized enterprises (79 representing 38.5%) and then by medium-sized enterprises (16 representing 7.8%). The first possible reason for this trend (micro enterprises being dominant followed by small-sized enterprises and then medium-sized firms) is due to the slow expansion rates or lack of it of SMEs due to incompetence, lack of expansion finance, etc. The second explanation per haps is the ages (when each enterprise was established) of the businesses. Most of the businesses in the area were established not quite long ago. Though a new business can start from any point (micro, small, or medium) or can expand quickly from one level to another, it is undeniable that most businesses start very small (micro) and then grow into large firms. As most of the businesses were started either a few years before, during, or after the establishment of UDS and Wa Polytechnic, it makes a lot of sense to suggest that that is the reason why few enterprises are small-sized whilst even fewer are medium-sized. Nevertheless, firms in the sample recorded high growth rates – firms had tripled their assets in just a period of between 8 – 15 years. Micro enterprises recorded the highest growth of about 9 percent per annum whilst small – and medium – scaled enterprises recorded a 2.5 percent growth. Growth in employment was 4 – 7 percent per annum across size categories. The high growth rate was due to the high demand for goods and services from students and staff of UDS and Wa Polytechnic as well as the numerous visitors to the town.

**Table III: Size Categorization of Participant SMEs**

Size Category	Frequency	Percentage
Microenterprise	110	53.6
Small-Sized Enterprise	79	38.5
Medium-Sized Enterprise	16	7.8
Total	205	100

**Source: Author's Construct****4.2 Knowledge and Perception about the use of Landed Property as Collateral**

In finding out the extent to which firms were aware of the requirement of landed property as collateral, the results revealed that a great majority of respondent firms were fully aware of the requirement. 112 sample firms (representing 54.6%) said they were aware of the requirement whilst 45.4% answered “no” to the question. The results showed further that the larger the firm size, the more it was likely to be aware of the requirement. For instance, out the 110 microenterprises interviewed, only 35% were aware of the requirement of landed property as collateral. This is much lower than 73% (58 out of 79) of small-scale enterprises

that were aware of the requirement. 15 or 93% medium-sized firms were aware of the requirement.

As to whether they supported the requirement of landed property as collateral by financial institutions, the difference between those who were in support of it and those who did not was much wider than those who had knowledge about the requirement and those who did not. 74% of sample firms were in support of the requirement whilst the rest did not agree with financial institutions demanding landed property as collateral. In terms of support by size category of sample firms, microenterprises supported it more (84%) than medium-sized enterprises (75%) that also supported it more than small-sized enterprises (59%). The figures suggest that there is more support for the requirement than there is not, which is an indication that businesses now appreciate formal bank methodologies better.

**Table IV: Knowledge and Perception of SMEs about the requirement of landed property as collateral**

	Knowledge		Perception	
	Yes	No	In Support	Not in Support
Microenterprise	39	71	93	17
Small-sized Enterprise	58	21	47	32
Medium-sized Enterprise	15	1	12	4
Total	112	93	152	53

**Source: Author's Construct**

#### **4.3 Willingness of Firms to use Landed Property as Collateral**

In order to assess the level of effective supply of landed property by small enterprises for collateral purposes, the study examined the level of ownership of landed property by sample firms and their willingness/readiness to use it as collateral for bank credit. It was found that almost three-quarters (74.6%) of sample firms did not own landed property. Furthermore, it was revealed that bigger firms were more likely to own landed property than smaller firms. This means that the smaller the firm the more likely it is to be screened out, as they are least likely to provide acceptable collateral (an affirmation of the findings of Aryeetey, et al, 1994).

On how willing sample firms were to mortgage their property, it was found out that majority (74.6%) were willing to use their landed property as collateral whenever the need arose. This figure is sharply higher than the low number (25.4%) of sample firms that owned landed property. This means that small enterprises are more willing to mortgage their property than they have it. While demand for working capital was widespread across the sample, demand for credit for expansion/investment purposes was dependent on firms' performance. 83.6% of sample microenterprises were willing to mortgage their property for a loan whilst 75% of sample medium-sized firms were willing to do same. 49.4% of small-sized firms were however willing to put up their landed property as collateral for a loan. Comparing these figures with the figures of those who were in support of the requirement, one will realize that more sample firms supported the requirement (85.5% of microenterprises and 59.5% of small-sized firms) than are actually willing to mortgage their property (83% of micro enterprises and 49.4% of small-sized firms). The same number of medium-sized firms who supported the requirement was willing to use landed property as collateral. The common reason cited by

those not ready to use their landed property as collateral was ‘fear of losing one’s property in the event of default’.

**Table V: Ownership and Willingness to use Landed Property as Collateral**

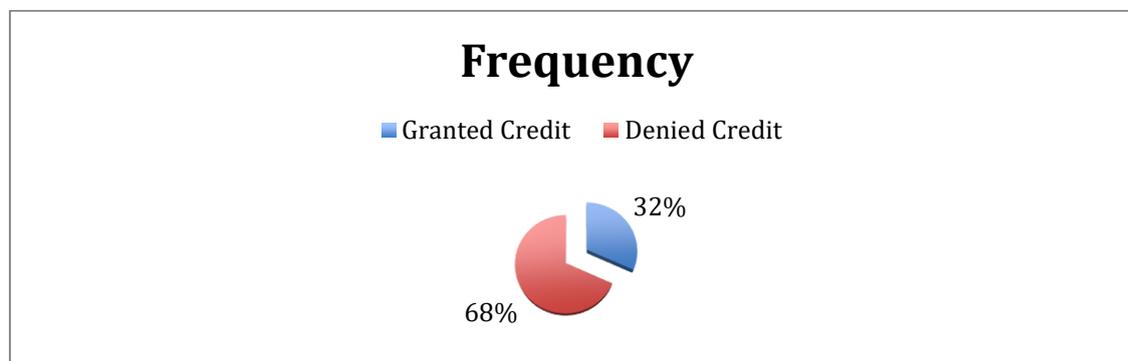
	Own Property	Don't Property	Own Willing	Not Willing
<b>Micro</b>	19	91	92	18
<b>Small</b>	23	56	39	40
<b>Medium</b>	10	6	12	4
<b>Total</b>	52	153	153	52

Source: Author’s Construct

#### 4.4 Is Adequate Collateral a Biding Constraint?

Lack of adequate/acceptable collateral dominated respondents’ perceptions of constraints on their access to credit, especially for investment. The Pie Chart below shows the number of sample firms who have ever been granted or refused credit from financial institutions in Wa. From the chart below, 68% of sample firms stated that they had been denied credit before whilst 32% had had credit before.

**Figure I: Sample SMEs Granted or Refused Loans**



Source: Author’s Construct

Among the reasons cited for refusal of credit, lack of adequate/acceptable collateral was ranked first (which proves right the opinion of Binks, et al, 1992) with 65.4%. Below are the details.

**Table VI: Reason for Refusal of Credit**

Reasons	Frequency	Percentage
<b>Inadequate/Unacceptable Collateral</b>	68	65.4
<b>Viability of Business</b>	21	20.2
<b>Default on Previous Loan(s)</b>	5	4.8

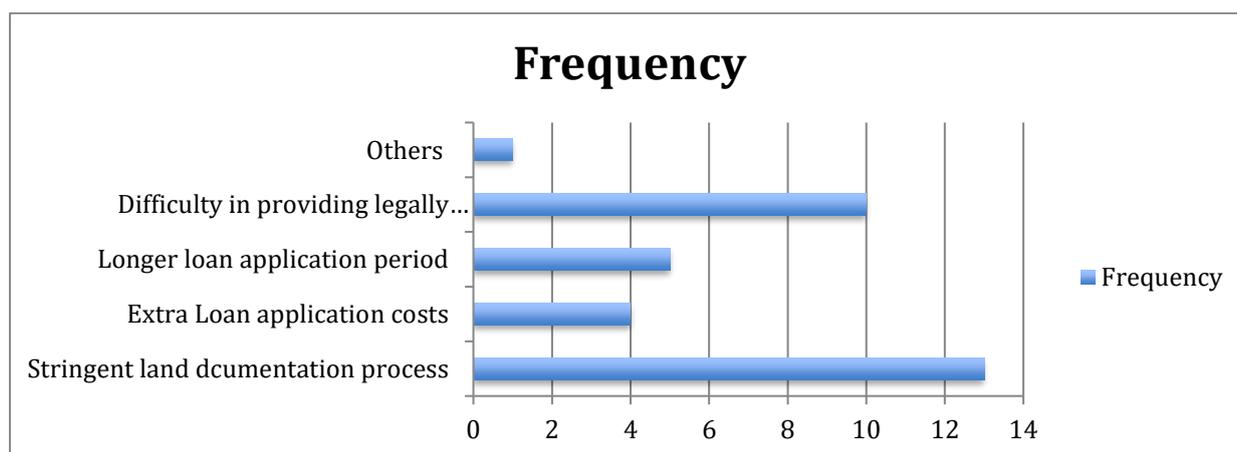
<b>Competence of Entrepreneur</b>	6	5.8
<b>Other Reasons</b>	4	3.8

#### Source: Author's Construct

Out of a total of 104 respondents who had applied for a loan and had their applications rejected, 65.4% stated lack of collateral as the reason for their refusal. 20.2% cited viability of their businesses as a reason whilst those whose applications were turned down because of perceived lack of experience of management or incompetence constituted 5.8%. Refusal due to applicants' default on previous loans represented 4.8%. 3.8% applicants were refused on other grounds such as business relations, inability to provide audited financial statements, family connections, etc. The study revealed that the smaller the firm size the more likely it was to cite inadequate or unacceptable collateral as a reason for its denial of credit.

#### 4.5 Challenges of Using Landed Property as Collateral

Figure II: Challenges of using landed property as collateral



Source: Author's Construct

The above chart shows the challenges of using landed property as collateral by sample SMEs that have ever mortgaged their property. Close to half (13 representing 39.4%) of the respondents cited stringent land documentation processes as a major challenge of using landed property as collateral. They complained that the processing of documents for transfer of titles, perfection of titles and all other activities concerning interests and rights in land is very cumbersome. A check at the Lands Commission revealed that an average of three months was required to have lease prepared or an assignment completed. The Lands Officer however blamed this delay in processing on the lack of computers and other logistics. He was of the view that the complete computerization and well resourcing of the office will reduce the time remarkably. 10 respondents or 30.3% mentioned the difficulty of providing a legally enforceable title as a challenge. They explained that due to the communal land ownership (most lands are owned by the family, clan or community) it is difficult to produce a legally

enforceable title. According to them, there is often litigation between siblings (where the property is inherited), or family members (where the land belongs to the entire family). 15.2% (5) respondents were of the view that the use of landed property as collateral prolonged the loan application period and subsequently the loan-processing period. They were of the view that obtaining a valuation report on the property, acquiring a lease (where one does not have one) and registering the mortgage all delay the period involved in accessing credit. Extra loan application costs (which are not incurred in using other forms of collateral) was considered as a challenge by 4 (12.2%) of respondents whilst 3% stated other factors as challenges.

## **5. Conclusion**

It emerged from the study that SMEs appreciate the importance of the requirement of landed property by financial institutions as collateral. This was revealed in the high support given to the requirement. The study also showed a high level of readiness by SMEs to mortgage their property. It was however revealed that the ability of SMEs to meet the requirement of landed property as collateral is low as evidenced in the low level of ownership of landed property revealed. This therefore limits the amount of landed property available to SMEs to use as collateral. The inability of SMEs to provide adequate or acceptable collateral was found to be highest with smaller-sized firms. Thus the smaller a firm's size, the more likely it was to cite collateral as a major constraint on its access to finance. It is therefore concluded that landed property as collateral is a major constraint on SMEs access to bank credit.

The results of the study also established the challenges of using landed property as collateral which include stringent land documentation processes, extra loan application costs (higher cost of capital), longer loan processing periods, difficulty of producing legally enforceable titles (due to the communal land ownership practiced under the customary land tenure system), among others. These challenges of using landed property as collateral were found to further compound the already precarious condition of SMEs in terms of access to bank credit. Since most SMEs are unable to provide landed property as collateral for loans whilst those who can encounter a lot challenges in doing so, the study therefore concludes that the requirement of landed property as collateral impacts negatively on the investment drive of SMEs, as it limits further the ability of these small enterprises to access credit for investment purposes. It is worthy to note, however, that the magnitude of such impact is not necessarily the same across size categories of SMEs.

Bearing in mind the vital role SMEs play in economic growth and development and also the undeniable importance of collateral security in lending, the paper recommends the following:

- Unnecessary delays in title transfer processes should be prevented by land sector agencies. Government should resource the lands commission adequately to ensure expedition of land documentation (transfer of titles, perfection of titles and all other activities concerning interests and rights in land). This will reduce the time and the cost involved in preparing lease documents and processing assignments (title transfers).

- It was realized that most of the respondents who did not have title documents were ignorant about title registration. It is hereby recommended that government should make it a national initiative to educate the public (through the Lands Commission) on the requirements and importance of title registration. This will not only help potential mortgagors but will also help reduce the numerous land disputes confronting the nation.
- Introduction of Alternatives to landed property. One of the respondents had this to say when he was asked for the adverse effects of this requirement on investment; “it makes the rich richer since they are the people who always have property”. This can be interpreted to mean that this requirement favors large-sized firms more than small-sized ones. To expand small enterprise lending, it is therefore recommended that financial institutions should develop alternatives to landed property as collateral to secure loans, such as personal guarantors, sales contracts, liquid assets (such as Treasury bills, fixed deposits, and insurance policies), and liens on equipment financed. Although all these, may depend on the ability of the legal system to enforce commercial contracts, with the establishment of the Commercial Courts (which came into operation since January, 2005) to handle issues like investment, insurance, taxation, contracts, intellectual property rights, and solvency cases, financial institutions can feel secured. What remains to be done is the decentralisation of this court (Commercial Court) by Government to the regional levels and resourcing them adequately to enforce commercial contracts. This, it is hoped, will encourage financial institutions to develop and have confidence in alternatives to landed property as collateral.
- Disputing parties to land litigation (especially in cases of family disputes) should endeavor to resort to Alternative Dispute Resolution (ADRs) rather than the courts.
- There is the need for the decentralization of loan processing to the regional levels/branches. Government should sensitize all financial institutions to establish legal departments at their regional branches. These will handle all legal issues relating to mortgage transactions, thereby speeding up the process.

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