CHAPTER ONE

GENERAL INTRODUCTION

1. General Introduction

Small and Medium Enterprises (SMEs) in Liberia have not performed credibly well and therefore have not played the expected vital and vibrant role in the economic growth and development of the country. The situation has been a great concern of stakeholder including government, citizenry, entrepreneurs and the entire private sector in the country. Government has stated it would help support the SMEs subsector through budget and policies, and other financial aid pronouncement. This raises the interest and concern about the crucial role small and medium enterprises play in the economy. There have been some major efforts from other financial and none-financial organization geared towards creating an enabling environment where small and medium enterprises will gain its status as the core of economic growth and development.

Just as it has been a great concern of all to promote the welfare of small and medium enterprises, it is a great concern to the researcher as to the problems facing small and medium enterprises in Liberia. The reality is that small and medium enterprises in Liberia fall short of performance and thus does not provide the basic opportunities such as jobs. The poor performance of small and medium enterprise in Liberia is more alarming and disturbing when compared with what other developed and developing countries have done to achieve with their small and medium enterprises. If Liberia were is to achieve an appropriate success towards development, one way is to vigorously engage in the development of small and medium enterprises (SME) by tackling the problem of access to finance.

The argument of promoting development through a robust small and medium enterprise is in line with recent studies of Beck et al., (2005a). In his publication, Beck et al.(2005), indicates that small and medium enterprise development is closely linked with growth. Beck et al. (2005), finds out a robust, positive relationship between the relative size of the SMEs sector and economic growth, even when controlling for other growth determinants. According to Ayyagari et al. (2007), in high-income countries formal SMEs contribute to 50 percent of Gross Domestic Product (GDP) on average. In the OECD countries for example, small and medium enterprises with less than 250 employees employ two-third of the formal work force (Beck et al., 2008b).

In spite of the fact that small and medium enterprises have been regarded as the core for employment generation and technological development, SMEs in Liberia have limited capacity to finance their operation and thus has fallen short of expectation. In a working paper 260, July 2001 title “constraints to Domestic Enterprise Financing in Post-conflict Liberia” Gorlorwulu, the author points out that limited access to finance is the major problem facing small and medium enterprises.

Access to finance had been singled out as one of the major challenge impeding the survival and growth of start-up SMEs in Liberia. Significantly low figures of start-up SMEs who apply for financing succeed in getting financing. According to Maas and Herrington (2006), quite a significant number of entrepreneurs are of the opinion that, although there seems to be sufficient funds available it remains difficult to access these funds, especially for start-up SMEs.

The ability of SMEs to grow depends highly on their potential to invest in restructuring and innovation. All these investments require capital and therefore access to finance remain a key issue. Against this background, the consistently repeated conception of SMEs about their problems regarding access to finance is a priority area of concern, which if not properly addressed, can endanger the survival and growth of the SMEs sector in Liberia. Ganbold (2008) argued that Investment Climate Survey conducted by the World Bank (2008) showed that one of the major impediments of nurturing firms is lack of access to financial services which would expand economic growth and employment generation as well as reducing poverty in many developing countries.

In Liberia it is evident that SMEs have constrains accessing finance which they need to flourish (Gorlorwulu., 2011). Limited access to finance facing SMEs points to limited opportunities to diversify and contribute to development. As such, access to finance is a priority issue for developing and supporting the SME sector as an engine for employment creation, poverty alleviation and socio-economic stability at large. The objective of this study is to explore access to financing problem faced by SMEs in Liberia. This include analysis of institutions involved with the development of small and medium enterprises, financial institutions providing credit facilitates in Liberia, theoretical review of financing options for SMEs, financing gaps in the SME sector and exploring various approaches to close the gaps in SME financing.

1.1. Liberia Financial System profile

Liberia’s financial system is shallow and remains vulnerable to political and economic stability. Banks and other financial institutions performance are slow in term of expanding their activities across the country. Financial intermediation is low while the high cost of credit (cost of micro-loan) and scarce access to financing (few banks and financial institutions that provide micro-loan), particularly in the case of small and medium enterprises (SMEs), continues to impede SMEs entrepreneurial activities and private sector development. Poor infrastructure still represents a major impediment to the expansion of financial services across the country. The Liberian financial system is dominant by the bank sector. Eight commercial banks with more than 20 branches across the country currently operate in Liberia. The banking system remains capitalized and liquid but risks are elevated stemming from high non-performance loan and low profitability.

Financial sector across has however gradually increasing in recent years, supported by substantial improvements in legal and regular frameworks. The banking system has continued to expand, with access to small and medium enterprise lending, microfinance mobile banking on the rise in Liberia. The Central bank of Liberia has progressed with new initiatives to expand financial intermediation, including the unbanked, through a USD 5 million credit-stimulus initiative to small and medium enterprises launched in 2010 and another USD 5 million facility target to the agriculture sector (IMF Financial Access Survey).

Substantial progress has been achieved in strengthening the banking sector, including the adoption of a national corporate governance framework and increasing the regulatory capital adequacy ratio and the minimum capital requirements of USD10 million for operating banks in 2010 (IMF Financial

Access Survey). According to the IMF Financial Access Survey (2010) on Liberia regulation limits investment of banks assets abroad to 50 percent for foreign currency deposits in bank receiving an “A” credit rating. Measures have also been implemented to improve supervision of the banking system including a requirement for semiannual on-site examinations of all operating banks.

The Liberian capital market, which has been wiped out by years of conflict, is new in the early stages of reemergence. However, there is not yet stock exchange or effective fixed income market in the country.

1.2 The SMEs in Liberia

Thousands of small and medium enterprises exist in Liberia providing variety of products and services in different industrial segments. Manufacturing, provision of goods, fishery, service oriented industry are the general economic activities in the SMEs sub-sector in Liberia. The countless numbers of SMEs both in the formal and informal sectors help to contribute to employment opportunity in the country in some ways. The capacity in term of employees in these small and medium enterprises depends on the size of the SME and level of capital investment as defend by Liberian government and other international bodies in agreement with developed countries.

According to the Bureau for Private Enterprise, U.S. Agency for International Development, the Liberian Government defined Small Medium Enterprises SMEs as enterprises with an investment of less than $25,000 and medium enterprises as enterprises with investment of less than $50,000. Given this definition, all forms of business in Liberia except for publicly traded company are part of the SMEs sector.

Based on the above definition, it is glaring that the capital required to start and operate SMEs in Liberia is very less and provides entrepreneurs with the opportunity to get easily engaged with SMEs as a means to bust their income and contribute to employment. In Liberia, the main sources of SMEs finance are through personal saving, donations from family members, and SUSU clubs (Liberian Marketing and Marketing survey, 2007). However, finances from these sources are very limited and thus requires external financing from banks and other financial institutions that provide micro-credit service to alleviate the access to financing problem.

The need to identify SMEs limited access to finance problems and the means of closing the gaps are the center of concern in the Liberian society. The problem of limited access to finance is being recognized not only by the researcher but also by policy makers. In an effort to address the access to finance problem, the government through it functionaries have formulated SME policy, spear headed by Ministry of Commerce and Industry, Republic of Liberia, entitle Liberia Poverty Alleviation and Wealth Creation through Small Enterprise Development. These policies include SMEs registration, use of collateral as guarantor to access finance from financial institutions and a minimum loan scheme for SMEs with low credit capacity in the country.

Since the enactment of said policy, the establishment of SMEs has increased in number but with no promising growth. Hundreds of SMEs have found their way on the market offering products and services but at a lower scale. These micro and small businesses are founded primarily by Liberian with the desire and potential to establish and grow their own businesses. Given the countless number of Small and medium enterprises (SMEs) which signer a potential for growth, it is believed that SMEs are the emerging core of the domestic corporate private sector. If an enabling environment is provided for them, they will contribute substantially to national growth, job creation and exports. (MOCI, 2010)

Unlike SMEs in the developed countries, SMEs in Liberia are informal. They are mainly owned and operated by private individuals, family members, and few key persons in the case of manufacturing. In Liberia, there is not a single financial program drew out to compensate SMEs as they strive to access fund. Accessing funding and bearing the entire interest rate is the sole responsibility of individual SMEs. Policies makers have failed over the time to create and adapt policies where government could prioritize subsidizing financial institutions as a way to reduce the burden of credit requirement place on loan by banks and financial institutions. Additionally, SMEs in Liberia are not funded by capital market. The reason is that there is no capital market where SMEs could attract investors in order to expand their operations. The total absence of capital market in Liberia and government failure to create programs that will ease the problem of access to finance facing SMEs are the basic factors that differentiate Liberian SMEs from others.

Given these factors, the SMEs in Liberia do contribute less to the economic development of Liberia as compare to other countries as a result of limited access to finance. To compete with other developing and developed countries, the Liberian government should prioritize the development of SMEs through financial policies that will close the gap of limited access to finance problem. The role of

Liberian government is cardinal in terms of financial policies and it has the propensity to enable SMEs to contribute to the country.

Research shows that SMEs contribute immensely to the general economic viability of most developed and developing countries. The reason is that many of these countries give priority to SMEs where the problem of access to finance is no longer a key problem to them. See table below.

Table 1
Contribution of SMEs in Selected Asian Economies (In Percentages)

Industrial characteristics	Malaysia (1985)	Singapore (1990)	Republic of Korea (1991)	India (1994)
Contribution to total number of industrial establishment	92.1	88	97	94
Contribution to total industrial employment	49.4	40	63.5	31
Contribution to total industrial production	46.7	26	44.5	40
Contribution to total industrial value addition	30	23	45.8	35

Source: Confederation of Asia Pacific Chamber of Commerce and Industry-Journal of Commerce and Industry, Vol. 11, 1994; page 6-18

1.3 Prospect of SMEs in Liberia

As per its prospect, Small Medium Enterprises (SMEs) play a crucial role by creating jobs for many Liberians. A vast majority of the Country inhabitants live on self-employment form where income is generated. For example, SMEs in rural Liberia are the sources of employment and production of food in addition to other products. These business activates are funded by private individuals who strive to improve their income generation. Owners of these SMEs are private individuals many of whom lack the standings set by financial institutions to meet credit criteria to expand their business operation. However, eighty percent of household income in the country is generated from SMEs

The International Financial Corporation (IFC), Liberian’s government, and a number of other financial and development organizations are helping Liberia’s small and medium size enterprises (SMEs) in winning the backing they need to grow. These efforts are met to boost SMEs performance to contribute to the growth and development in Liberia.

As a means to boost the performance of SMEs, the Liberian government, international and national financial organizations have underscored the need to promote SMEs activities throughout the country. During the 2013 conference held in Liberia’s capital, Monrovia, and co-hosted by IFC, the Monrovian president, Ellen Johnson Sirleaf, established $1 million Liberian innovation fund for Entrepreneurship that will boost access to finance for smaller businesses as a means to help them grow (Driving SME growth in Monrovia).

Additionally, the international finance Corporation (IFC) has established a collateral registry system in Liberia, which allows SMEs to obtain loans using movable assets, such as equipment for collateral. CHF international, a humanitarian aid organization has helped to establish the Liberian Enterprise Development Finance Company (LEDFC), a Liberian-registered non-bank financial institution. Currently, the Liberian Enterprise Development Finance Company (LEDFC) is ensuring that SMEs in Liberia have access to finance to support the growth and development of the country.

These efforts are geared towards creating an enabling environment where SMEs operator can best serve the demand for their products and contribute to the overall growth of the Liberian economy. An improved SMEs operation in Liberia will lead to jobs creation, poverty alleviation, self-sustainability and the eradication of hunger. It thus requires a robust effort, training and massive awareness for all stakeholder to identify SMEs access to finance problem, find amicable solution to this problem and institutionalize programs that will help improve SMEs.

1.4 A **Review of Microfinance Service Providers in Liberia**

Microfinance service providers in Liberia can be divided into three main categories: (i) commercial banks, (ii) credit unions and (iii) credit-only institutions. There are also small rotating saving and credits clubs known as SUSU Club and moneylenders. Commercial banks specializing in microfinance have been established to help in the delivery of financial service to small and medium enterprise in Liberia. One of those banks is Access Bank Liberia Lit.

1.4.1 Banking Sector

Commercial banks in Liberia have only recently started to consider microfinance as a viable business line. As of the end of 2008, only two of the existing banks engaged in some sort of microfinance lending. Eco-bank had an active portfolio of about US$3.6 million in ninety eight (98) associations/unions, which provided such funds to about seven thousand clients, while the Liberian bank for Development and Investment (LBDI) provided 1.3 million US dollar to about 160 clients. In January 2009, after several years of sustained efforts by the government and development partners, such as International Finance Corporation (IFC), the European Investment Bank (EIB), and the African Development Bank (AFDB), ACCESS Bank Liberia – a commercial bank specializing in microfinance started operations with a paid-in capital of US$6 million and a projected business plan to reach a portfolio of sixty thousand clients in the next five years. Currently, Access Bank Liberia Limited is the leading Bank in terms of providing micro-loan to small and medium enterprises (SMEs) in Liberia.

1.4.2 Credit Union

Credits Union has traditionally engaged in providing financial service to low-income members of the population, and contributes to micro credit program nowadays in Liberia. As of end of 2008, a census by the World Council of Credit Union (WOCCU) identified 154 operational credit unions, with a total of almost 26 thousand clients.

1.4.3 Credit-Only

There are other microfinance provider companies' credit-only institutions that operate in the country. BRAC Microfinance Company, formally known as Building Resources Across Communities (BRAC), International, a Bangladeshi Microfinance Institution emerged as one of the popular credit institution in the country. The institution has a paid-in-capital of US$4 million and an expectation to reach ninety thousand clients in the next five years with branches throughout the country. Other credit-only institutions are Liberty Finance and LEAP. There are also NGOs involved in microfinance to some extant as part of their relief and rehabilitation programs, as well as traditional arrangements such as rotational funds, savings clubs and other traditional and marginal forms of saving or credit activities all in support of creating access to finance by small and medium enterprises. See table one.

Table Two

Indicator	Liberty Finance	LEAP	BRAC	Aggregate
Counties covered	Montserrado, margibi, Bong, Nimba	Montserrado, margibi, Bong, Bomi, Lofa and Nimba	Montserrado, margibi, Bong, Nimba	
# of branches	6	6	10	22
Active client	8,096	19,500	4,690	23,286
# of Female	6,054	16,966	4,690	27,710
% of Female	75	87	100	85.8
# of male	2,024	2,534	0	4558
% of male	25	13	0	14.1
Loan portfolio out-standing	448,191	1,072.106	898.016	2,418,313
Average Loan size	106	96	191	131
Portfolio at Risk>30 days	10.09%	4%	0	7.04

Source: The Liberian Strategy for Financial Inclusion (2008-2012)

1.5 Review of Key Agencies that are involved with the Development of SMEs in Liberia

The Liberian government has created agencies and ministries for the development of SMEs and larger businesses and to provide financial and regularity guidance in enhancing the economic development of all sectors in the country. The main government ministries and agencies involved with SMEs development in the country include the following:

1.5.1 Ministry of Commerce and Industry (MOCI)

The Ministry of Commerce and Industry is responsible for promoting, developing, and regulating all commercial and industrial activities in the country with three major bureaus: commerce, Industry and Central Administration. The Ministry is currently monitoring the activities of the countless numbers of large, small and medium size businesses in the country. As an incentive for small businesses to register, MIC has lessened the annual registration fees from $200 to $100 for the small enterprises operators/ entrepreneur. This creates the opportunity for informal Small and Medium Enterprises to formalize their businesses as a gateway to accessing external finance given the low risk feature of formal and legal business.

1.5.2 Ministry of Finance (MOF)

The primary function of the ministry of finance is the fiscal operation of government including revenue collection, expenditures, and debt management. The Revenue department of the Ministry of finance consists of the internal revenue, customs and excise, and Income tax bureaus. Through the various divisions of the revenue Department, the Ministry of finance collects revenue from the private sector in the areas of real estate and realty leasing, national identification cards, motor vehicles, income tax, corporation and partnership, national reconstruction, health, development and progress revenue, customs duties, transshipment, special releases and bond, rubber sales, royalties on the gross sales of iron ore, diamond and gold, dividend and profit sharing revenue, and miscellaneous taxes. The Ministry of Finance monitors the activities of concessions in the mining, agriculture, and light industry sectors. Trends in production, prices, and export, forestry, and oil palm are studied in the mining and agriculture sectors.

1.5.3 Ministry of Planning and Economic Affairs (MPEA)

The Ministry of planning and Economic affairs is the overall monitor for the various government Ministries. The three bureaus of the Ministry of Planning and Economic affairs are sectorial planning, Rural Regional planning, and Economic Affairs. Among other things, the basic activities of the ministry of Planning and Economic Affairs is in the area of research and statistics, monitoring of agreements and specific project and overseeing budget allotments for the various ministries of Government.

1.5.4 Ministry of Agriculture

The agriculture sector has the potential to accelerate the economy of Liberia. Approximately 70% of the country's population resides in the rural areas and more than two-third of the country's population depends on agriculture and related activities for their livelihood. Given the national objective of agriculture development, the dependency upon agriculture in the rural areas, and the contribution agriculture can make to the Liberian economy, the role of the MOA is important, directly and indirectly to the development of SMEs.

1.5.5 National Investment Commission (NIC)

The national investment Commission was created by an Act of the Legislature in September, 1979 to coordinate the investment policies of Liberia and to efficiently promote a more effective conclusion of investment agreements related to all sectors of the economy. The commission receives, evaluates, and processes all investment agreements in collaboration with relevant Ministries and Agencies of Government. It is the only agency of government to guide and monitor investment proposal. The SMEs department of the National investment commission was instituted by government to help develop SMEs. Currently, the department is catering to those who have requested project assistance in the areas of woodworking, carpentry, blacksmithing, animal husbandry, and restaurants. NIC/SME activities are primarily in the areas of industrial extension service and training, and product marketing.

1.6 Characteristics of SMEs in Liberia

The characteristics of SMEs in Liberia include ownership structure, limited geographical location, flat and small, no separate business units and dependent on IT is low, if not absent at all. However, the major characteristics of SMEs in Liberia relates to ownership structure. In this regard, owners of SMEs are either sole proprietors or partners. Even those of the SMEs that have register and are publically knew, the ownership hangs on one individual, family or partnership among others in the country. Given such ownership structure, financial institutions view SMEs as risky business entity where the possibility to repay loan is rare. That fact that these SME are not subjected to any legal regulation, it is difficult to establish their performance against which the issue of creditworthiness could be established.

Other characteristics of Small Enterprises (SMEs) in Liberia include Labor intensive production, concentration of management on one key person, limited access to fund, high cost of fund as a result of high interest rate in financial institutional that offer microcredit, poor managerial skill, lack of adequate financial record keeping, poor capital structure, high production cost as a result of inadequate infrastructure, lack of access to international market and inability to distinguish between personal and business finance.

These characteristics accounts for the mass failure and under-performance of SME. And, in a broader context, these characteristics are unique to all small and medium enterprises in the country regardless of their legal form (*Liberia Business climate Survey*).Consequently, banks and other financial institutions also view SMEs as highly risky.

1.7 Statement of the Problem

The issue of limited access to finance problem in the context of small and medium enterprise has been recognized by researchers and policy makers alike. This issue is a major controversy among SMEs operator as many cry out that limitation to access finance continuously impede their business operations.

It is important to note that no business can operate efficiently and effectively when it faces the problem of limited access to finance. In Liberia, critical among the problems that affect SMEs is the issue of limited access to finance and or resource poverty which form the basis of the research. SMEs in Liberia hardly succeed obtaining loans from banks because they do not meet the standards set by these banks. More besides, these SMEs are not subject to government financial regularity to assure financing institutions that the likelihood of paying back is possible. As a result, it becomes difficult for SMEs to access finance in order to grow. Consistent with some scholarly research and popular view, limited access to finance is the key reason that leads to the failure of small and medium enterprise, especially the start-up SMEs. Given the size and structure of the Liberian SMEs, it appears riskier to attract external financing due the possibility of default and failure to meet credit requirement signaling one of the key reason why small and medium enterprise encounter difficulties to access finance. Furthermore, SMEs in Liberia are highly informal business institutions, many Lack adequate asset for credit guarantee, and several are highly risky.

Consequently, financial institutions and investors alike are critical about venturing with small and medium enterprises. The major argument is that Small and medium enterprises are in most cases not creditworthy due to high level of information asymmetry. Only SMEs providers know their operation. These SME are not subjected to high level financial regulations such as audit and business plan as such offering credit to these informal business entities entails higher risk which financial institution find difficult to accept.

To compensate against the high risk, financial institutions/banks in Liberia offer loans at a higher rate, introduce credit rationing, credit scoring and other measure that are at the disadvantage of small and medium enterprises owners in the country. These tough credit policies and credit requirements in financial institutions impede SMEs capacity to attract funds and contribute to growth and development nationwide.

And therefore, the research seek to explore the access to finance problem and to explore various means by which the gap can be filled which, if not done will continue to worsen the problem and malfunction of SMEs in Liberia. Specific question that this research addressed are as follow: What are the obstacles that affect small and medium enterprises in accessing finance in Liberia?

1.8 The Purpose of the Study

The research takes into consideration SMEs that operated in the informal sector where SMEs do not comply with government financial regulation. These SMEs are not funded by capital market neither do they benefit from any financing regularity such as subsidies from government. Consequently, they face limited access to finance problem. These problem account for their underperformance and limit their contribution to the overall growth and development of the Liberian economy and thus calls for immediate attention. Base on the aforesaid, the objective of this study is to explore the access to finance problem facing SMEs in Liberia and to explore the means by which the gap can be filled.

1.9 Significance of the Study

Small and Medium Enterprises (SMEs) play a key role in the development of every nation. SMEs serve as the core for growth and development wherein individual persons have the will power to determine their economic status based on their personal investment as entrepreneurs, if finances are available. As such, the issue of limited access to finance requires kind attention in order to explore means by which SMEs can access finance to persuade growth and expansion.That, the floor of fund from financial institutions to SMEs subsector is required in order to fill the gap of limited access to finance.

The study contribute to policies requires to fill the gap of limited financing facing SMEs in Liberia. The implementation of the recommended policies will positively address the issue of the flow of fund from financial institutions to SMEs.

Secondly, the exploration of access to finance problem has path a new way by which small and medium enterprises (SME) can acquire amicable solutions in addressing the key factor that limited their ability to access finance in banks and other financial institutions in Liberia. By this, SMEs will adopt new method, advocate for government financial policies aimed at addressing limited access to finance problem. This leads to job creation, povertyreduction, and the increase in revenue across the Liberia wherein the micro-economic activities in the country will by then improve.

Unlike other studies, this research focuses on limited access to finance facing SMEs in Liberia. There are series of research that point out the issue of limited access to finance in the developed countries. However, none exist to explain how SMEs in Liberia are faced with access to finance constraints and what possible solution can be adapted to close the limited access to financing gap. Furthermore, the studyis unique as compare to others in that it focus on SMEs that operate on the informal sector. The study also contributes to the controversy debate about limited access to finance which affect not only small and medium enterprises but also corporate business entities in Liberia. The controversy issues surround major concern about SMEs creditworthiness, repayment, default, lack of financial record, lack of collateral and financial institution tough financial policies that affect the floor of fund through short term credit to SMEs owners in Liberia and elsewhere in the world.