

Factors Influencing Risk Management Decisions of Small and Medium Scale Enterprises in Ghana

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EXECUTIVE SUMMARY

Despite the dynamic role of small and medium-sized enterprises (SMEs) in Ghana's development, managers of these enterprises face several risks in their businesses. The occurrence of these risks may have a disastrous effect on the entrepreneurs' toiled effort for business success, if not managed.

This research therefore seeks to study the factors that stimulate or prevent owners of SMEs in Ghana in taking risk management decisions. The study was conducted in four regions in Ghana. The researchers adopted a quantitative approach and employed SATA 10 and SPSS version 20 in the analysis. Stratified and simple random sampling techniques were used to select the sample units. The probit model was used in the analysis of data. In all, 447 SMEs were sampled for the study and at least 111 from each selected region.

The probit results show that the demographic factors indicate positive influence on the likelihood of the managers to take risk management decisions. All the business-related demographic factors are significant at various levels and positive, apart from the obvious risk aversion. The estimated amount at risk, estimated cost of risk management and estimated total monthly income after tax are economic factors that all have a positive influence on risk management. The cost of risk management has a positive influence on managerial decisions with regard to risk management at a five percent level of significance. Results on government policies and tax indicate that these factors are perceived to negatively influence risk management by managers.

Risk management should be an integral part of SMEs, since firms using risk management generally outperform firms that do not, when other aspects of the portfolio were controlled. Therefore, an in-depth knowledge concerning the factors that influence the management of SMEs in Ghana (entrepreneurs), with respect to taking risk, should be of much concern to all stakeholders.

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INTRODUCTION

Risk management can be described as the process of determining the maximum acceptable level of overall risk while engaging in a proposed activity. It involves using risk assessment techniques to determine the initial level of risk and, if it is excessive, developing a strategy to ameliorate appropriate individual risks until the overall level is reduced to an acceptable level. According to Saeidi, Sofian, Abdul Rasid, Saeidi, Saeidi (2013), a paradigm change has occurred in how organizations view risk management towards a holistic view instead of looking at risk management from a silo-based perspective. Saeidi et al. (2013) acknowledged that the frequently used definition of Enterprise Risk Management (ERM) is:

“Enterprise risk management is a process, effected by an entity’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives” (COSO, 2004, p. 2).

The ability of SME managers to address the dynamics of a global economy is largely influenced by their ability to carefully identify and analyze the type of risk their businesses face, and subsequently examine the factors that need to be taken into account for control. Managing an SME, including risks that it is exposed to, is perceived to be cost prohibitive and non-value adding (Mambula, 2002). Also, there is the lack of institutional and legal structures that facilitate the management of SMEs lending risk (Mensah, 2004). It is based on this notion that this research seeks to study the factors that stimulate or prevent owners of SMEs in Ghana in taking risk management decisions. This study is of particular relevance as it provides policymakers and owners of SMEs with critical information pertaining to factors that influence the extent of managers’ decisions to undertake risk management practices.

METHODOLOGY

This study was conducted in four regions in Ghana including Greater Accra region, Ashanti region, the western region and the northern region. The researchers adopted a quantitative approach and employed SATA 10 and SPSS version 20 in the analysis. Stratified and simple random sampling techniques were used to select the sample units. The probit model was used in the analysis of data. Overall, 447 SMEs were sampled for the study with at least 111 from each selected region. The strata included agriculture, service, and the industrial sectors of the economy.

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RESULTS AND CONCLUSIONS

The risk of reduced demand for products and services (285) was the highest risk that businesses are exposed to, followed by risks posed by competitors (188), risk of weather failure (153), risk of escalating operating costs (147), occupational health and safety risks (144), fire risk (134), and risk of lack of accessible credit (120). The probit results show that the demographic factors indicate a positive influence on the likelihood of the managers to take risk management decision. Apart from years of education and gender, the rest are not significant. All the business-related demographic factors are significant at various levels and positive apart from the obvious risk aversion. Economic related factors, such as the estimated amount at risk, estimated cost of risk management, and estimated total monthly income after tax all have a positive influence on risk management decision taking. The cost of risk management has a positive influence on managerial decisions with regards to risk management at a five percent level of significance. Capital sourced from the government is positive and significantly more likely to influence risk management decision

taking. Results on government policies and taxes indicate that these factors are perceived to negatively influence risk management decision taking of managers. Apart from the total number of employees, all the business characteristics factors

negatively influence risk management decision by managers. At five percent level of significance, businesses in the urban areas are less likely to take risk management decision than those in the rural areas.

RECOMMENDATIONS

Based on the findings, the following recommendations are made to all stakeholders;

1. The managers of SMEs should recognize that a holistic approach toward managing business risk has generally been recommended to ensure effective risk management. Research has identified seven factors that can increase the effectiveness of risk management procedures. These factors are commitment and support from top management, communication, culture, information technology (IT), organization structure, training and trust. These factors must serve as a guide to all managers in taking risk management decisions.
2. The Government of Ghana's (GoG) microfinance programmes, which aim to reduce poverty, create jobs and wealth, should be enhanced through capacity building, provision of logistics and making enough funds available to cater for as many SMEs as possible.
3. The banks, credit unions and other financial intermediaries should add business advisory services, training and capacity building to their loan packages for SMEs, emphasizing risk management practices in particular.
4. Managers of SMEs should receive training through periodic workshops and conferences on risk management practices, including those experts from the Ministry of Trade and Industries (MoTI), National Board for Small Scale Industries (NBSSI), Association of Small Scale Industries (ASSI), Chamber of Commerce (CoC), Association of Ghana Industries (AGI), banks and other support institutions. It must be stated that women are more vulnerable in terms of risk management and so need more attention.
5. Insurance companies should make provision for SMEs in all sectors (agriculture, industry and service), in terms of policies, and ensure such packages are very appealing to managers of SMEs. Insurance companies should increase the creation of awareness of the existence of such policies provided.
6. The Revenue Authority is encouraged to adopt a broad based, low-rate approach to taxation. This would not distort tax revenues inflows, ensure high tax elasticities or prevent distortions to economic decisions on saving, investment, consumption and other business-related variables. This approach will help managers of SMEs to manage business risk, which will culminate in the growth of SMEs in Ghana.
7. Government policies that bother SMEs should be carefully evaluated, and these policies should be well articulated and explained to stakeholders so that it is not seen as deterrent to business development in Ghana.
8. The Bank of Ghana, through the Monetary Policy Committee, should collaborate with the financial institutions to reduce interest rates in order to ameliorate the negative effect of high interest rates on business investment and growth.
9. Information on interest rates should be made available to prospective business people by the various financial institutions. This should help them make more informed decisions on when and where to borrow.

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