



## Research Article

# OPERATIONS OF RURAL BANKS AND CREDIT SUPPLY IN GHANA; A STUDY OF SOME SELECTED RURAL BANKS IN THE BRONG AHAFO REGION OF GHANA

\*Kodom Amponsah Michael

Department of Development Studies, Valley View University, Ghana

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### ABSTRACT

The rural communities of Ghana have little access to credit facilities due to the rigid and stringent criteria for accessing loans from the commercial banks. An attempt by the government to improve the credit facilities of the rural entrepreneurs resulted in the introduction of Rural Banking scheme in 1976. Data from the banks were obtained through self-administered questionnaire at the project department of the banks. Three selected rural banks in the Brong Ahafo region were used for the study. The study revealed that, the Rural Banks (RBs) did not operate according to Bank of Ghana's credit policy guidelines. Other findings need mentioning were that, access to credit was very high (84%) and average loan size has been increased almost 85% between 2008 and 2012. Delinquency rate was found to be very high for the Rural Banks' loan beneficiaries especially among the farmers and cottage industrialists. It is therefore recommended that loans to farmers should be approved at the beginning of the farming season and also part of the loan should be used to purchase inputs for the farmers and cottage industrialists to reduce diversion of loans and defaulting rate.

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## INTRODUCTION

The role of the financial sector in every economy is to mobilize financial resource within the economy and channel them into productive economic activities. Commercial banks are mostly found in urban centers and usually tend to fund urban economic activities such as manufacturing, imports and exports and among others to the neglect of the rural industries (British Council, 1996). It is against this background that the introduction of rural banks was seen as a step in the right direction to bring banking services to the doorsteps of the rural people. This step was seen as very important in the sense that, lack of affordable credit facilities is among the factors that have prevented the integration of small scale producers into the competitive market economy (Owusu-Acheampong, 1986). According to bank of Ghana, rural banks are required to allocate a specific proportion of loans for the various sectors of the economy in any particular lending period with agricultural, cottage industry and commerce taking 50, 30, and 20 percent respectively. This is to give priority to agricultural sector since it is the main economic activity in the rural communities (Bank of Ghana, 2004). However, in most cases anecdotal evidence shows that rural banks do not conform to these mandatory guidelines in their quest to maximize profit. The degree of deviation is left to the rest of the research to establish.

In Ghana about 49% of the population lives in the rural areas and therefore one of the parameters that could be used to judge the level of development of the country would be the standard of living of its rural populace (GSS, 2013). Therefore there is the need to develop mechanisms for enhancing economic viability of the rural entrepreneurs through acquisition of institutional credit facilities to increase output levels. The provisions of adequate and timely credit to the rural producers will not only increase national output but also the income levels and standard of living of the rural populace will be raised. (Anim, 2000)

### The concept and background of Rural Banking in Ghana

The term "rural bank" was introduced into the banking vocabulary of Ghana in the 1970s when the first rural bank was opened at Agona Nyarkrom in the Central Region of Ghana. No law in Ghana has provided a definition for the term "rural bank", even though section 47 of the Banking Act 1970 defines such term as "bank and banking enterprise". According to the Act; "bank means any banking enterprise (whether foreign or Ghanaian) which is issued with a license; Banking enterprise means any enterprise not yet issued with license which carries on or proposes to carry on the business of banking." According to BoG's Operational Manual for Rural Banks, a rural bank is a unit bank which is a limited liability company under the

Companies Code which is to mobilize savings and provide lending to the people within its radius of operation (Asiedu-Mante, 1991).

A 'Rural Bank' is a body incorporated under Ghana's Companies Code whose name includes the word 'bank' and which is licensed by the Bank of Ghana to carry on specified banking business which principally includes:

- The acceptance of money from the public on either deposit account or current account;
- Repayment of such monies on demand by cheque or otherwise;
- Collection of customers' cheques;
- Lending of money;
- Financing commerce, industry and agriculture through short, medium and long-term loans and advances;
- Provision of safe custody for customers' valuables;
- Investing part of customers' deposits in economic activities that promote local socio-economic development; and
- Any other service authorized by the bank's regulations (Addeah, 1989),

Rural Banking started in Ghana in 1976 in response to the need and the demand to make institutional credit and banking services accessible to small scale farmers and rural entrepreneurs for the improvement of their productivity, production, and incomes and the promotion of growth on the rural sector generally. Deposits mobilized by Commercial Banks in rural areas were being disposed-off by centralized urban-based banks to cater for the needs of urban-based large scale entrepreneurs. It was thought too risky and too expensive to lend to farmers and small scale entrepreneurs in rural areas, scattered as they are in remote areas and whose activities are, among other things, subject to natural hazard such as drought, floods, bush fires and pests (Obeng, 1991).

### Types of credit facilities provided by Rural Banks

Rural Banks are to provide the following two types of credit facilities:

#### 1. Loans:

A loan is meant to provide financing for purposes known in advance by amount and subject. There are two types of loan, thus; Individual loans - these are loans where the borrower is one person, an association or a company, and Group loans - these are also granted individually, however, the applicant is a member of an informal group and each individual loan is guaranteed jointly and severally by all other group members.

#### 2. Overdrafts

An overdraft is meant to provide financing for purposes which are known in general only. The amount needed is an estimate proposed by the applicant and approved by the sanctioning authorities of the rural bank. Rural banks' credit facilities are also classified according to their lifetime for which they are approved. These are; Short term credits- these are loans and overdrafts approved for a period up to 18 months, Medium term credits- these are loans and overdrafts approved for a period

between 18 months and 5 years, and Long term credits- these are loans and overdrafts approved for a period of more than 5 years. Long term credits are only granted where long term investment could be justified (Hartmut *et al.*, 1985)

### Conditions for securing rural bank's loan

An eligible applicant for a rural bank's loan must submit an application form signed or thumb printed by the applicant. Applications are accepted from individuals, informal groups, associations and companies. The application must contain; the description of the purpose for which credit facility is applied for, specification of the amount required, the period for which credit facility is needed, and explanation of the sources from where repayments could be expected (Bhartt, 1993). Additionally, an applicant eligible for any credit facility from a rural bank must fulfill the following conditions; he must have been a customer of the bank for at least six months and must maintain either a savings account or a current account, his honesty, integrity and reputation must be well known in the community, his professional competence must be demonstrated through a good record about previous or actual successful management of a farm, a fishing venture, a small industry or a trading business, his history of debt repayments must be without blame and he must not have any actual overdue on his accounts, and he must explain an actual need of funds for starting, continuing or rehabilitating a promising and economical undertaking (Hartmut *et al.*, 1985)

### The financing proposal of Rural Banks

The financing proposal of rural banks must correspond to the rural bank's general lending policy as shown below; a minimum of 50% of the lending of the rural banks should go to agriculture, approximately 30% of the lending should go to cottage industries, and a maximum of 20% of the lending should go to trade and transport (Bank of Ghana, 2004).

## MATERIALS AND METHODS

The research was carried out using case study of some selected Rural Banks in the Brong Ahafo Region (Baduman and Kintampo rural banks and Bomaa Area rural bank). Bomaa Area and Baduman rural banks were selected from the cocoa and cashew (cash grown zones of the region) grown areas respectively while Kintampo rural bank was selected from the commercial zone of the region (non-cash crop areas). The data for the research were derived from both primary and secondary sources.

The primary data was mainly centered on the management of the Rural Banks. Questionnaire was the main data collection instrument that was used to collect the primary data. Self-administered questionnaire was used to interview the management of the selected banks. The analysis was presented in the form of statistical tables and graph but more of narrative procedure. Contextually; the study examined the credit policy guidelines for rural banks by BoG, operations of rural banks with regards to credit supply, the delinquency rate, and the constraints of rural banks in terms of credit supply. Time series data covered from 2008 to 2012.

## RESULTS

### Access to Credit and Average Loan Size

Access to credit is measured by loan applicants as against loan recipients. The relationships between loan applicants and recipients as well as average loan size are shown on Table 1.

Table 1. Loans granted by the banks

Year	Total Applicants	Total Recipients	Percentage of applicants who Received	Total loan Granted (GH¢)	Average loan Size (GH¢)
2008	10972	8869	80.8	3586132	404.3
2009	11782	9294	78.9	5116176	550.5
2010	14527	12302	84.7	8146476	662.2
2011	11917	10595	88.9	5993900	565.7
2012	13606	12074	88.7	9026624	747.6
Average			84.0		

Source: Field survey, 2013

From Table 1, it could be realized that access to credit in general was very high. On the average, 84% of the total applicants did receive loan from their banks. This means that customers could rely more on the banks for credit facilities in times of difficulties.

### Sectoral Loan Allocation

Loans granted by the banks for the various sectors are shown on Figure 1 and the extent of deviations from the BoG's credit policy for Rural Banks in Ghana.

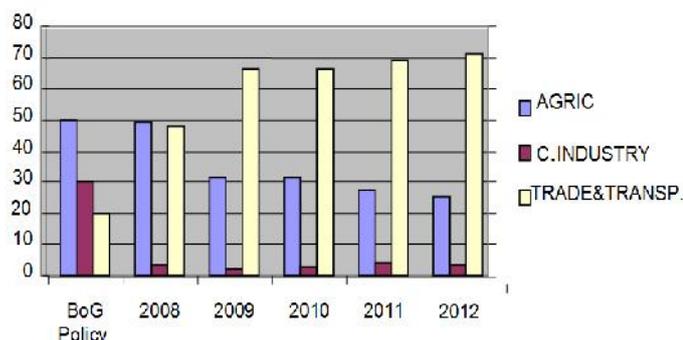


Fig. 1. Sectoral Loan Allocation of the three Banks and Extent of Deviations from the BoG's Credit Policy

From Figure 1 on the average, cottage industry received 3.0% of the total loans granted to the three major sectors of the rural economy (cottage industry, trade and agriculture) instead of the 30% specified by the BoG. The sectoral allocation of the rural banks' loan was highly skewed towards the trade and transport sector (Figure 1). On the average, trade and transport sector took 64.1% of the total loans granted by the banks, this was far above the 20% mandated by the BoG. Agricultural sector which is the major economic activity in the rural economy on the average received 32.9%.

### Delinquency Situation of the Banks

Delinquency measures the default rate of the loans collected from banks by their customers. Even though delinquency is a problem with any financial institution that lends money to the public, the situation with the Rural Banks was alarming since the defaulting rate was high. The Table 2 elaborates on the delinquency rates for the three Banks.

From Table 2, Kintampo Rural Bank (KRB), Bomaa Area Rural Bank (BARB) and Baduman Rural Bank (BRB) have delinquency rates of 36.2%, 27.1% and 28.9% respectively. The average delinquency rate of the three banks was 31.9%. This means that, the banks' on the average were able to recover 68.1% of the total loans granted to customers.

Table 2. Delinquency rate for the three banks

Bank	Total loan granted From 2008 to 2012 (GH¢)	Loan recovered		Loan defaulted	
		Absolute(GH¢)	%	Absolute(GH¢)	%
KRB	13568892	8656953.0	63.8	4911939.0	36.2
BARB	2346368	1710502.3	72.9	635866.7	27.1
BRB	15954056	11343333.8	71.1	4610722.2	28.9
Total	31869316	21710789.1	68.1	10158527.9	31.9

Source: Field survey, 2013

## DISCUSSION

Access to credit of the Rural Banks' customers was found to be high. On the average 84% of the total customers who apply for loans did receive (Table 1). It was however found that, salary workers and businessmen with relatively bigger capitals have almost 100% access to credit as compared with the farmers and cottage manufacturers. Delinquency rate was found to be high for Rural Banks' loan beneficiaries. The delinquency rate for rural bank customers is supposed to be between 10% to 15% (Addo, 1987). On the average, the delinquency rate was 31.9% (Table 2). This was very high among farmers and cottage industrialists loan beneficiaries. The implications of this high defaulting rate were that, it could affect the banks' loan sizes to potential customers and their ability to grant loans to the deserving customers. The causes of these high defaulting rates include the fact that most customers who went for loans did not use the loans for the intended purposes and the project department of the banks did not visit customers after granting them loans to find out how their projects were doing.

It was found from the results that, the Rural Banks did not operate according to the BoG's regulations (Fig. 1) with regard to credit supply. There has been much emphasis on profit maximization of the banks where the distributing sector (trade) was a force to reckon with as compared with the other sectors like cottage industry and agriculture. The implications of this practice of the banks were that; the two main productive sectors of the rural economy of Ghana (agriculture and cottage industry) will not be attractive to the youth in the rural communities. Most of the youth will therefore prefer to join the distribution sector (trading) where they can easily get credit facilities from the banks. This will finally lead to a situation where farming and cottage industry will be left for only the old people in the rural communities who can at most only produce

to feed their families without surplus for sale. Again, as the rural economy becomes less attractive to the youth in the rural areas due to inadequate credit facilities from the Rural Banks, the youth will be attracted to migrate into the urban centers in search of jobs which are non-existent. When the rural-urban migration of the youth keeps on increasing, there is going to be shortage of food items and other simple manufactured goods in the country. This will finally lead to increase in the prices of food items which can spark off inflation in the country since food items form one of the major variables of the Consumer Price Index which is used to determine the level of inflation in the country. Finally, as the prices of food items keep on increasing in the country due to shortage of food supply from the rural areas as a result of inadequate credit facilities to the farmers, importation of food as well as other manufactured goods will be at high ascendancy. This will gradually kill the local initiatives in the area of manufacturing and also worsened the Balance of Payment problems of the country.

From the results, the rural banks which were in the cash crop growing areas relatively gave more loans to farmers than the one in the non-cash crop growing areas. For instance, the Bomaa Area and Baduman Rural Banks which were in the cocoa and cashew growing areas, on the average gave 44.8% and 32.9% of their total loans to farmers as compared with Kintampo Rural Bank which was in the non-cash crops growing areas that gave 3.2% to farmers within the same period. The reason was that, the farmers in the cash crop areas used their farms as collateral securities to get more loans and also the banks were relatively comfortable with the cash crop farmers than the non-cash crop farmers because cash crop farmers were relatively less defaulters of loans. This was testified from the fact that, the average defaulting rate for BARB, BRB, and KRB were 27.1%, 28.9%, and 36.2% (Table 2) respectively.

### **Factors Militating Against Rural Banks in Their Quest to Provide Credit Facilities**

Essentially Rural Banks are to galvanize local initiatives and local commitment to mobilize local resources and on-lend them to deserving customers in their catchment's areas using simplified procedures and criteria (Anim, 2000). However in their quest to provide credit facilities face some problems, some of these problems were identified and discussed: Most of the customers (especially farmers and cottage industrialist) were unable to meet loan requirements. In most cases they found it difficult to get guarantors, preferably salary workers who were supposed to be in the same bank with them. Again, the high defaulting rate especially among farmers and cottage industrialists was identified as one of the major challenges facing the banks. The project department of the banks on the other hand, found it difficult to monitor the projects of loan beneficiaries to assess the viability of their projects. This was due to the fact that, feeder roads leading to farms and small towns where farmers and cottage industrialists lived were unmotorable especially during the raining seasons.

### **Recommendations**

Based on the major findings, the following recommendations were made:

In order to reduce high delinquency rate, loans to farmers should be approved at the beginning of the farming season. This

will reduce the rate at which loans are diverted to uses other than its intended purpose which is to expand their farms. Again certain percentage of the loans given to farmers should be used to purchase farm inputs like fertilizers and insecticides for the farmers and the rest be given to them in cash to reduce diversions of the loans. Furthermore, the loans to farmers should be given in stages upon the recommendations of the project officers after visiting the farms to assess the progress of the farms. The project department of the various Rural Banks should be adequately equipped with motor bikes/four wheel drive pick-ups to enable them visit loan beneficiaries regularly. This will enable the bank officials assess the progress of their projects and where necessary give them top-up loans to complete their projects and also to know whether they are using the loans for the intended purpose. This is because under funding a project is equally as harmful as over funding it. The Rural Bank's Department of the BoG should insist on Rural Banks to operate according to BoG's directives to ensure the full benefit of the Rural Banks to the rural folk. This should be done by visiting the Rural Banks regularly and scrutinizing their activities to ensure that they are operating within the policy framework of the BOG. Bank of Ghana periodically should also reward those Rural Banks found to operate within its policy framework and vice versa.

### **Conclusion**

The introduction of Rural Banks in the country since 1976 has constituted one of the major sources of mobilizing funds from the rural folk and transferring such funds to investors; including farmers, traders, and manufacturers. The study revealed that, the philosophy behind the introduction of Rural Banks partly has been fulfilled and partly has not. Where it has been fulfilled is sending banking services to the door steps of the rural folks especially with the introduction of Susu schemes. However, with regards to the BoG's credit policy guidelines for Rural Banks, most of them were not operating within the policy framework. In this regards the two main productive sectors of the rural economy; agriculture and cottage industry were not given the due attention when it comes to the supply of credits to the rural communities by the Rural Banks. The Rural Bank Department of the BoG must therefore ensure that, the Rural Banks in the various communities do operate within the policy framework of the BoG to ensure that credit and banking services go to the farmer and the small-scale entrepreneur who but for the Rural Banks would have no access to institutional credit.

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