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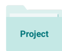
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Do lenders value firm reputation? Evidence from SMEs in Ghana

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Abstract: Our paper examined the effects of firm reputation on access to external funding among small and medium-sized enterprises (SMEs) in Ghana by controlling for firm specific variables such as firm size, firm performance, leverage and managerial competence. It contributes to our knowledge on how firm reputation, especially organisation identity, assists firms in accessing external funding. We analyzed primary data of 423 SMEs registered in the Accra Metropolis of Ghana using regression analysis. Even though, we documented positive relationship between firm reputation and access to finance, only firm image was significant. This denotes that firm reputation could assist SMEs in accessing external financing if SME managers develop and improve their information and communication practices to highlight tangible evidences of firm success. This could be achieved by keeping proper books of accounts on firm operations, which could reduce lenders' perception of risk and thus, facilitate easier access to external funding.

Keywords: access to finance; firm reputation; organisational identity; small and medium-sized enterprises; SMEs; emerging economy.

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1 Introduction

Small and medium-sized enterprises (SMEs) have been acknowledged as important drivers of economic growth and development. In many developing countries, the SMEs sector constitutes a vast majority of businesses and account for a large share of overall employment in the private sector. Given the significant contributions of this sector, it is imperative for researchers to investigate the myriad of factors that could influence their success (Fischer and Reuber, 2000). Access to and cost of finance has been identified as one of the most constraining features of the business environment of SMEs (Beck, 2007). Biekpe (2004) advanced that the lack of support from traditional banks and other lenders explains why most small businesses fail in their first year in the sub-Saharan African region.

Prior theoretical research has noted that firms with good reputations access external funding more easily because investors trust these firms to make decisions consistent with their interests. Meeting the expectations of these investors by firms with good reputation is a mechanism for ensuring they consistently reap the returns of good reputation (Bulow and Rogoff, 1989; Gomes, 2000; Siegel, 2005). However, the relation between firm reputation and access to external funding has not been documented empirically in the context of SMEs. In view of the costs associated with achieving and maintaining good reputation, it is assumed that managers would only embark on initiatives to improve firm reputation only when they are certain of potential rewards.

Lending based on firm reputation was a fairly typical practice of bankers in banking history. Cao et al. (2010) assert that early bankers often did not ask for collateral but based their loans on their assessment of how reputable customers were. A deeper knowledge of a borrower's business and personal character served as the basis for loan application approval in the absence of reliable financial statements. Information asymmetry that emanated from the dearth of accounting principles and standards in those early days were compensated for by bankers close personal ties and acquaintance with the reputation of businesses. It was only in the 1890s when financial accounting emerged

that banks began to use financial statements for evaluating borrowers. In spite of popularity of solid accounting standards and practices, the phenomenon of relying on firm reputation to grant loans is still prevalent in many developing countries, especially within the SMEs sector where these firms fail to keep good financial records and also lack the requisite resources to serve as collateral security to support their loan applications.

We examine the relationship between firm reputation and access to finance within the context of a particular component of firm reputation: organisational identity. While firm image focuses on the way an organisation presents itself to its publics (especially visually), organisational identity is known to be internally focused and connected to executives' sense making and self-perception of the firm (Bromley, 2000; Fombrun and van Riel, 1997). Drawing on signalling and identity theories, corporate reputation is increasingly being viewed as the outcome of identity-consistent initiatives and communications that business organisations direct at stakeholders (Whetton, 1997; Barnett et al., 2006; Ansong and Agyemang, 2016). Hence, the perception held by outside stakeholders about the reputational status of an organisation is positively correlated with those within. Identity theory is concerned with the interlocking attributes of the organisation that give it certainty, stability and coherence and thus makes it identifiable. The thrust of the theory bothers on raising self-referential questions such as 'who am I?' and 'who are we?' and assisting organisations to discover and define themselves (Albert and Whetten, 1985). For identity theorists, the prevailing definitions of corporate reputation represent only a distorted interpretation stakeholders hold about the main features of a company's identity (Whetten and Godfrey, 1998). As a result, an accurate representation of what constitutes firm reputation must emanate from within the organisation.

Thus, organisational identity is defined as 'the members' consensual understanding of 'who we are as an organisation' [Nag et al., (2007), p.824] that emerges from that which is 'central, distinctive and enduring' to the organisation as a whole [Albert and Whetten, (1985), p.265]. Organisational identity has been recognised as the cognitive, affective and psychological antecedent to managerial action and reaction (Livengood and Reger, 2010). Corollary to this, we argue that the ability of business executives to seek and succeed at securing external funding is influenced by their self-evaluation of the reputation of their firms. It is assumed that executives of highly reputable firms are more empowered to access external funding than those with poor reputation.

Our study contributes to the extant literature on firm reputation in several aspects. First, we studied the relationship between firm reputation and access to finance within the context of organisational identity, which to the best of our knowledge is the first article that explores this relationship. Second, our analysis was undertaken in the context of SMEs in a developing country, Ghana. Prior studies in this field were primarily conducted in the context of developed markets, where the pressure for firms to rely on their reputation to secure funding is potentially less stronger than emerging markets.

The remainder of this article proceeds as follows: The second section provides literature review and hypotheses development. Third section describes research methodology employed. Fourth section reports the empirical results and the final section presents the conclusions and recommendations of the study.

2 Literature review and hypotheses development

The signalling theory draws attention to the initiatives companies pursue to influence their stakeholders and harness support for their preferred actions and pursuits. Corporate communications and other social interactions are designed to send strategic signals to relevant resource providers about the key characteristics of their firms (Weigelt Weigelt, K. and Camerer, 1988). For identity theorists, the ability to send accurate signals and attract the necessary resources from strategic partners is dependent on the knowledge of internal stakeholders about their own strengths and weaknesses (Albert and Whetten, 1985). Hence, we reasoned that the perception of both external and internal stakeholders on firm reputation is important in securing external funding.

While there have not been specific studies on organisational identity, several empirical studies have been conducted on the relationship between firm reputation (largely tilted towards firm image) and corporate financing. Siegel (2005) provides empirical evidence that good reputation assists firms in emerging economies to gain access to capital from outside markets because reputation compels them to comply with capital market regulations. Agarwal et al. (2011) studied the impact of 'management quality', a proxy for firm reputation and provide evidence to the effect that firms with higher quality management do enjoy easier access and lower cost of capital.

Firm reputation does not only influence access to finance but also the cost of finance. In the case of the debt markets, Diamond (1991) posited that reputation can enable firms to access financial resources in a much easier and cheaper way. Also, Cao et al. (2010) relying on large samples from 1987 through 2006, documented that firm reputation is negatively related to the cost of equity but not with the cost of debt. Finally, Abor and Biekpe (2007) examined the determinants of bank financing among Ghanaian SMEs. Employing firm age as a proxy for firm reputation, they also provide evidence that firms with good reputation turn to gain access to bank loans but our study differs from Abor and Biekpe (2007) in several important ways. Abor and Biekpe (2007) restricted their analyses to only bank financing. In contrast, we study the broad construct of the sources of financing to include financial institutions and individual lenders. Individual lenders are key sources of financing for SMEs in developing countries and cannot be ignored when addressing the financing challenges of this sector (Beck, 2007). Additionally, we study a specific dimension of firm reputation that has not yet been investigated, organisational identity, in addition to firm image. Based on the above discussions, we anticipate that firm reputation (i.e., organisational identity and firm image) on a whole will assist SMEs gain easier access to external funding. Hence, we examine the following hypotheses:

H1 Organisational identity is positively related to access to external funding.

H2 Firm image is positively related to access to external funding.

2.1 Control variables and access to finance

Firm size (measured by number of employees) represents either the largeness or smallness of the firm. The larger the firm, the lower the risk of default. This is the position held by most lenders because large firms tend to be more commercially successful; more diversified; and have tangible assets to pledge as collateral. It is

anticipated that firm size will have a positive effect on obtaining credit. On the other hand, smaller firms may find it extremely difficult to resolve information asymmetries with lenders, and thus may not be successful at accessing external funding. Aryeetey et al. (1994) studied the supply and demand for finance of small scale enterprises in Ghana and found that the success rate for large firms applying for bank loans is higher than that of smaller firms. Similarly, Abor and Biekpe (2007) established a significantly positive relationship between firm size and bank debts. Thus, firm size is predicted to be related positively to the bank-debt ratio of SMEs.

With regard to firm performance, some scholars profess that firms with increasing sales and profits have great influence on ease of access to credit because profitable firms tend to have low bankruptcy risk (Storey, 1994; Abor and Biekpe, 2007; Kira and He, 2012). According to Ooi (1999), profitable firms turn to be more attractive to financial institutions as lending prospects and are, therefore, more likely to access external funding. Hence, it is predicted that firms with stronger financial performance would have lower probability of default and thus higher probability of success at accessing external funds. This suggests that highly profitable SMEs can easily access more external funds. It is expected that there would be a positive relationship between firm performance and access to finance.

Leverage mirrors the riskiness of a firm and its credit history. It is anticipated that lenders would be less enthusiastic about lending to risky firms or firms with the history of credit repayment challenges. Conversely, however, highly geared firms are the most likely to seek for external funding (Coleman, 2004). Given the likelihood of bankruptcy risk leverage poses, it is expected to have a negative influence on access to external debt capital.

Agarwal et al. (2011) examined the relationship between managerial competence and access to finance. The authors suggest that well-managed firms will be better insulated from industry- and economy-wide factors, and hence should have low risks profile, leading to easier access to external funding. They also provide evidence that firms with competent managers do enjoy a lower cost of capital. Mensah (2004) reviewed SME financing schemes in Ghana and recommended the need for training programs in accounting, business management, preparation of business plans, financial statement analysis, personnel management, marketing and other subjects as well as one-on-one counselling of business owners. He contends that the absence of competent business managers is adversely affecting the ability of SMEs to acquire financing and raises the risk being taken by SMEs and lenders by entering business. Hence, it assumed that managerial competence will be positively related to access to finance.

3 Research methodology

The empirical analysis of this study is based on a sample of 423 SMEs, drawn from the response of firms registered with the National Board for Small-Scale Industries (NBSSI) and the Association of Ghana Industries (AGI) in the Accra Metropolis as at September, 2013. The sample selection was based on the criteria set by the Regional Project on Enterprise Development for SMEs in Ghana, meaning that firms with less than 100 employees were included in the study sample. Following Krejcie and Morgan (1970), to ensure a 5% margin error, 254 medium sized and 302 small-sized firms were randomly

selected from 750 medium-sized and 1,400 small-sized firms, respectively. The research instrument was pre-tested through a pilot study covering 50 respondents. The pre-testing assisted the researchers to modify some test items to suit the understanding of the respondents. Statistical analysis includes descriptive statistics and regression analysis. Validity and reliability were ensured by using a panel of experts to evaluate the research instrument for conceptual clarity, pre-testing the research instrument in a pilot study and comprehensively reviewing the literature for theoretical constructs and empirical conclusions.

3.1 Model

This study adapts the model of Zarook et al. (2013). The new model considers the relationship between access to finance and firm reputation, firm age, firm size, firm performance, leverage and managerial competence. The model for the empirical study takes the following form:

$$ATF_i = \alpha_i + \beta_1 FR_i + \beta_2 \ FI_i + \beta_3 FS_i + \beta_4 LE_i + \beta_5 FP_i + \beta_6 MC_i + \varepsilon_i \quad (1)$$

where *ATF* represents access to finance; *FR* represents firm reputation; *FI* represents firm image; *FS* represents firm size; *LE* represents leverage; *FP* represents firm performance; *MC* represents managerial competence.

3.2 Measurement of variables

The classical approaches to measuring corporate reputation such as the use of Fortune's America's Most Admired Companies or Britain's Most Admired Companies data are neither available nor applicable to the SME sector, hence, organisational identity was measured based on the items employed by Sweeney (2009). Respondents were asked to indicate the ratings they believe other firms in the same sector would award the firm on the basis of quality of products and services, quality of staff, environmental responsibility, community responsibility and quality of management. Firm age is included in our model as a proxy for firm image (i.e., external stakeholders' evaluation of a firm's reputation). Young firms find it difficult to access funds due to information asymmetry.

It is believed that firms that have operated for a long period of time have proven that they can survive the critical start-up period and have generated the capacity to take on more debts (Diamond, 1991). Overtime, older firms also tend to develop a credible image as they honour their debt obligations to lenders. This 'visible' reputation reduces the risk of lending to older firms and thus, positively influences the extent to which these firms can access debt capital from lenders. Klapper et al. (2010) discovered that firms that have operated for less than five years are less likely to succeed at accessing debt financing from lenders. Thus, lenders should be more willing to extend credit to older firms. Following Man (2011), the questionnaire sought for information with respect to how easy respondents could access funds from banks, lending institutions and investors. The variables controlled for include firm performance, firm size, leverage and managerial competence (see Table 1 for a detailed description of how variables were measured).

Table 1 Measurement of constructs

Construct		*ITEMS (continuous scale 1–5)*	*Sources*
Access to finance	1	Ease of accessing funds from banks	Man (2011)
	2	Ease of accessing funds from other lending institutions	
	3	Ease of accessing funds from individual investors	
Organisational identity	1	Quality of products and services	Sweeney (2009)
	2	Quality of staff	
	3	Environmental responsibility	
	4	Community responsibility	
	5	Quality of management	
Firm performance	1	Profit growth	Man (2011) and Burton and Goldsby (2009)
	2	Sales growth	
Managerial competence	1	Delegation of assignment	Nakiyinga (2012)
	2	Coordination of tasks	
	3	Risk management	
	4	Compliance with industry-related regulations	
	5	Interconnectedness of issues, problems and opportunities	
	6	Relationship with stakeholders	
	7	Planning of business operations	
	8	Supervision of subordinates	
	9	Leading of subordinates	
	10	Maintaining of personal network of contacts	
	11	Possession skills and experience to perform highly	
	12	Training of employees	
	13	Smooth running of organisation	
	14	Motivate subordinates	
Leverage		Total assets/total debts	Barton (2001)
Firm image		Years business has been in operation (ratio variable)	Abor and Biekpe (2007)
Firm size		Number of employees (ratio variable)	Barton (2001) and Orser et al. (2000)

Source: Survey data (2014)

4 Empirical results

4.1 Descriptive statistics

Table 2 summarises the descriptives of the dependent and independent variables, reporting the mean, standard deviation, minimum and maximum statistics for the attributes of the firms included in the sample. Access to finance records a mean of 0.9026, implying that, on the average about 90% of loan requests were successful. Firm image (firm age) has a mean of 14, meaning that, on average, the SMEs in our sample have been in business for fourteen years. Organisational identity indicates a mean of 3.9707. This implies that the respondents considered their firms to be of very good reputation. Size in terms of number of employees has a mean of 14.1915. The mean value of financial performance is 1.17 having a maximum value of 3 and minimum value of 1 with a standard deviation of 0.35. On the whole, the financial performance of the firms in our sample was not impressive. Managerial competence recorded a mean of 4.0478. Leverage (measured as total assets/total debts) indicates a mean value of 3.4161, suggesting that most of the SMEs do not employ a lot of debts in their operations.

Table 2 Descriptive summary statistics

Variable	*Mean*	*Std. deviation*	*Minimum*	*Maximum*
Access to finance	0.9026	0.5025	1.0000	3.0000
Organisational identity	3.9707	0.5923	1.0000	5.0000
Firm image	14.0000	13.3499	1.0000	70.0000
Managerial competence	4.0478	0.5234	1.0000	5.0000
Firm size	14.1915	12.1520	1.0000	65.0000
Firm performance	1.1700	0.3537	1.0000	3.0000
Leverage	3.4161	0.9039	1.0000	5.0000

Source: Survey data (2014)

4.2 Multicollinearity tests

The multicollinearity tests results for the independent variables employed in the study are reported in Table 3. The calculated VIF (Variance inflation factor) in all cases is less than 2 indicating that there is no multicollinearity problem for the current regression analysis (Fox, 1991).

Table 3 Multicollinearity tests

Variables	*Tolerance*	*VIF*
Organisational identity	0.556	1.800
Firm image	0.725	1.379
Managerial competence	0.573	1.746
Firm size	0.718	1.393
Firm performance	0.691	1.448
Leverage (Assets/debts)	0.611	1.637

5 Results and discussion

Regression analysis was used to estimate the effect of firm reputation on access to finance. The results are presented in Table 4. The empirical results of this study showed that both firm image and organisational identity had a positive relationship with access to finance. However, the relationship between organisational identity and access to finance was not significant. This implies that lenders tend to rely more on how long firms have been in business to decide whether to grant credits or not. The result supports the notion that firms with good track records tend to have fewer problems acquiring external funds. The findings is also in line with those of Abor and Biekpe (2007) who argue that a long-term lending relationship reduces the severity of informational asymmetries for lenders by informing them about the borrower's credit history as well as the personal behaviour of the firm's manager. However, the findings also reveal that the ratings of SME managers' about the reputation of their firms will do little at influencing lenders to extend credit to these firms. Tangible and visible indicators of firm reputation, such as firm age, are those that can positively influence the ability of SMEs to access external funding.

Table 4 Regression model results

Variable	*Coefficient*	*Standard error*	*t-value*	*Significance*
Organisational identity	0.008	0.046	0.148	0.882
Firm image	0.096	0.002	2.039	0.042
Managerial competence	-0.188	0.051	-3.549	0.000
Firm size	0.177	0.002	3.729	0.000
Firm performance	0.346	0.069	7.152	0.000
Leverage	0.235	0.029	4.569	0.000
R2	0.329			
Standard error of regression	0.4146			
F-Statistic	34.016			
F-Statistic (probability)	0.000			

With respect to managerial competence, a significantly negative relationship between managerial competence and access to finance was reported, contradicting the hypothesis of a positive association. Given that lenders are unlikely to reject properly-managed firms, such firms exhibiting low access to external funding maybe due to the fact that such firms do not readily seek for external funding in view of the prevailing high interest rates in the Ghanaian economy. Unlike other SMEs, they do not require external debt funding or may decide to let good projects pass rather than resorting to loan acquisitions that could disrupt current impressive financial performance.

In the same vein, the empirical results also show that leverage has a negatively significant (the reverse explanation of the regression sign is due to the way leverage was measured, i.e., the ratio of total assets to total debts instead of the ratio of total debts to total assets) relation with access to finance. The results of this study also indicate that

SMEs with sufficient internal funds generally seem to avoid gearing. This is in line with the reasoning of the pecking-order theory, which states that businesses adhere to a hierarchy of financing sources and prefer internal financing to external financing. In an emerging economy characterised by unfavourable macroeconomic environment such as high inflation rates, it is expected that well-managed firms would rarely seek external financing.

The significantly positive relationship between firm size and access to finance is consistent with the argument that the probability of default is lower among larger firms because they are characterised by higher diversification; the presence of assets to pledge as collateral; and commercial success. The results of this study indicate that SMEs with high number of employees have easier access to external financing. Relatively smaller firms denote higher risk, which could cause financiers to shy away from lending to them. Also, larger firms are better-positioned to deal with the challenges of information asymmetry through the development of well-structured systems that provide adequate information for lenders to grant credit. This result is consistent with Abor and Biekpe (2007) who found that the success rate of larger firms applying for bank loans is higher than that of smaller firms.

The empirical results of this study also show a significantly positive relationship between firm performance and access to finance. This is consistent with the findings of Ooi (1999) who provided evidence to the effect that profitable firms turn to be more attractive to financial institutions as lending prospects and are therefore more likely to access external funding. This is probably due to the low default risks posed by profitable firms. However, this result contradicts that of Abor and Biekpe (2007), who found a negative relationship between profitability and access to bank-debt ratio among Ghanaian SMEs.

6 Conclusions and implications

This study examined the relationship between firm reputation and SMEs' access to external funding in Ghana. The empirical results revealed that firm image, firm size and firm performance have significantly positive associations with access to finance, while managerial competence and leverage have significantly negative relation with access to finance. The results clearly indicate that older, larger and profitable SMEs find it easier to access external financing because such firms have overtime built a reputation that is tangible, visible and verifiable by lenders. Evidences such as being able to survive the challenges of the critical start-up period; possession of tangible assets and impressive financial statements are the factors most important at accessing external funding. The ratings of managers about the reputation of their firms do not matter. Therefore, it is imperative that SME entrepreneurs and managers should seek to develop and improve their information and communication practices to highlight tangible evidences of firm success. This could be achieved by keeping proper books of accounts on firm operations, which could reduce lenders' perception of risk and facilitate easier access to external financing.

7 Limitations and directions for future studies

Although, our study makes important contribution to existing knowledge on how firm reputation influence the willingness of lenders to grant credit to firms, it is not without limitations. First, extant literature argued that a comprehensive measure of firm reputation must incorporate the assessments of both internal and external stakeholders. However, the research instrument employed in this study only sought responses from SMEs' owner-managers (internal stakeholders). The use of firm age as a proxy for firm image, even though consistent with previous studies (e.g., Abor and Biekpe, 2007), did not provide the opportunity to analyze the effects of the ratings of different categories of external stakeholders on access to external funding. It would be insightful if a study could be conducted to compare how the reputation ratings of different stakeholders impact on firms access to external funding. Secondly, future studies could address how a composite measure of firm reputation influence firms access to external funding.

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