Land Registration and Access to Small Enterprise Credit: Preliminary Findings

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Abstract

Land registration has assumed popularity around the developing countries for quiet sometime; the argument that it is capable of enhancing access to credit is often the underlying factor for implementing land registration programs. Several studies in the developing world have not found any significant relationship between land registration and access to credit. The aim of this paper is to establish whether or not the absence of registered land titles is a barrier to credit access amongst small enterprises in Ghana. The study involved credit officers and the results amongst other things show that as far as the main stream commercial banks are concerned, landed property is not eligible for use as collateral unless it is formally registered. Unregistered property is however accepted as collateral by the microfinance institutions. Therefore the exact impact of land registration on credit access may vary depending on the type of lender.

Keywords: Credit, Land registration, Small Enterprises

Introduction

One cannot discount the role that SME's play across the developing world. In Ghana, they make up 92% of all businesses, 80% of the private sector and 85% of manufacturing employment (Abor and Biekpe, 2006); that said, SME's encounter a number of challenges critical amongst which is the problem of credit access. About 90% of SMEs consider access to credit as the main barrier to new investments and most African businesses fail in their first year due to lack of financial support (Abor and Biekpe, 2006). Furthermore, the success rate for firms applying for bank loans is almost 70% for large firms as against 45% for small-scale enterprises (Aryeetey, 1998). Though credit constraint could be cause by a wide range of factors, there is often a strong attribution to the lack of collateral. An estimated 51% of all firms refused credit in Africa is as a result of insufficient collateral; in East Asia, Eastern Europe and Central Asia, Latin America and the Caribbean as well as South Asia, the estimates stand at 70%, 72%, 39% and 72% respectively; In addition, 19% of people who don't apply for credit in Africa do so because of the high collateral requirements (Fleisig, 2006).

The lack of assets to be used as collateral is not seen as the direct cause of the problem but rather an indirect one; as noted by de Soto (2000) the collateral problem is not one of lack of assets but rather the lack of registered land titles which renders otherwise valuable property unacceptable for collateral purposes. According to de Soto, many households in the developing world possess landed property which could be used as collateral for credit. This is also echoed by Besley (1994) that the collateral problem is due to the absence of secure property rights on land which remains the most valuable asset of most households and small businesses in the developing world. Whilst Llanto, (2007) argues that secure property rights are a basic requirement for a collateral based banking system, Deininger (2003) observes that the possession of registered land titles a precondition for access to formal credit. Land registration is most often recommended as the way forward in securing property rights to land, reducing the collateral shortage and enhancing access to credit (de Soto, 2000 and World Bank, 1975). De Soto argues that even though the poor possess valuable landed property that could enhance their access to credit, such properties are defective due to the absence of formal property titles over them. He argues that property ownership in developing countries cannot be traced or validated and that no legal protection or enforcement of property rights exists; as a result such property cannot be easily converted into money (either through sale or mortgage). over 50%, 45% and 25% of the total housing stock in Sub-Saharan Africa, East Asia and Latin America respectively are believed to be unregistered (Deininger, 2003).

The critical role that land plays in the economies of countries all over the world is well recognised. Land provides the space for every human and economic activity. It is, thus, not surprising that land accounts for 50% to 75% of the national wealth in many developing countries (Bell, 2006). A large percentage of the average household's asset portfolio especially in the developing countries is said to be made up of land (Davies and Shorrocks, 2005). Given its importance it is believed that providing secure or registered property titles to land provide the break through that will permit most SMEs to easily access credit for enhanced economic growth. However, despite the many years of implementing land registration programmes in the developing world and the strong argument often put up in support of the credit effects of land registration, Deininger and Goyal (2009) report that related empirical studies are few, outdated or non-existent in some instances. Furthermore the available empirical research carried out across countries often emerges with mixed findings or conclusions. While Feder et al (1988) Boucher (2005) establish a significant positive relation between land registration and credit access, several other studies found that either no relation at all exist between the two or the established impact on credit access was found to be insignificant (Angel et al., 2006' Carter and Olinto, 2003; Galeana, 2004; Gilbert, 2000; Place and Migot-Adholla, 1998; Mighot-Adholla et al., 1991; Broegaard et al., 2002; Pender and Kerr, 1999; Petracco and Pender, 2009).

The problem with the existing empirical research is that they all often tend to be demand side studies (involving borrowers) to the unfortunate neglect of the supply side of the credit market. The exact nature of the credit constraint is not well known in Ghana. Related studies have also focused on the developing countries of Africa, Asia and Latin America. Furthermore, studies that have systematically investigated the link between land registration and access to formal credit on a comparative basis between the developing and developed countries are notably non-existent. Despite the above, landed property registration continue to be heralded around the developing world the aim of the aim of this paper is therefore to determine what influence property registration has on credit access in Ghana.

2 Research Methodology

Surveys involving credit officers were conducted in the five month period from February and June 2011. Empirical data collection was preceded by review of the relevant literature. A total of 200 questionnaires were distributed;108 questionnaires were successfully completed and returned (representing an overall response rate of 54%) and were made up of 57 respondents from Commercial banks (CBs) and 51 from Microfinance institutions (MFIs). The questionnaire were either posted or emailed to respondents and involved only closed ended questions. The data was descriptively analysed using the statistical package for social scientist (SPSS 17). To determine the influence property registration has on credit access this study's approach was to investigate whether: small enterprises are always required to provide collateral to qualify for credit; lenders require or prefer landed property to other forms of collateral; whether the possession of a registered property title is a necessary requirement; the provision of collateral or registered property title is sufficient to trigger credit supply and finally whether borrowers possessing registered property titles enjoy better loan terms. The preliminary result presented below provides a general overview on all these questions except the last one.

3 Results

The median age of the survey respondents was 30-45years. A majority (42.6%) of these respondents have 5-10years experience. As argued earlier for land registration to have any influence on credit access a number of conditions must be met: (a) collateral must be a necessary requirement when dealing with SMEs; (b) landed property must be the required or most preferred to other forms of collateral and (c) lenders must not accept unregistered property. The results relating to these three conditions are presented below.

The relationship between land registration and credit access is premised on the use of landed property to secure credit; the strength of this relationship will therefore depend on whether or not borrowers are required to provide collateral. If lenders are willing to grant the credit without taking collateral (unsecure credit) then all the arguments made so far will not hold. The results show that about 52% of respondents in most instances will not approve a small enterprise credit proposal if collateral is not provided. Elsewhere, Inderst and Mueller (2007) also estimated in their study that about 70% to 80% of firms applying for loans in the low and middle income economies are required to provide collateral. Given the acute nature of information asymmetry in the developing world, the role of collateral in credit contracts is more pivotal in helping lenders overcome the problems of adverse selection and moral hazard.

Even though lenders are unlikely to provide credit without taking collateral, the form of collateral required in any given situation will determine what influence property registration could have on access; therefore respondents were asked to indicate their level of preference for various forms of collateral. As far as this study is concerned lenders revealed that they usually go for landed property; indeed about 64% ranked landed property as the most preferred collateral. The preference for landed property could be explained by the fact that collateral is more valuable the more immobile and immune to damage it is (Feder and Feeny, 1991) and only landed property possesses this quality. Having said that the provision of collateral per se is not sufficient to have a credit proposal approved (69%). There are other more critical variables that have to be taken into consideration before credit is granted; for instance the lenders may be more interested in the borrower's credit history and how he intends to repay the facility. Failure to meet these two criteria would almost certainly cause the credit request to be declined even if the borrower were able to provide the preferred collateral.

Finally, Field and Torero (2004) observe that for land registration to have any influence on credit access the possession of registered titles must be a requirement; hence an attempt was made to determine if lenders require registered property titles by finding out the kind of property documents accepted. All the respondents indicated that when taking landed property as security, they require borrowers to provide documentary proof of ownership; this is an indication that without documentary proof of ownership, land will fail to qualify as an acceptable collateral asset. Since about 70% of land ownership in Ghana is under customary system and as such undocumented, most land owners especially in the rural areas may not have documentary evidence of their land rights and such lands are not eligible for collateral purposes. The kinds of documentary evidence required vary but were broadly classified into three groups: registered documents, unregistered documents and a combination of registered and unregistered documents. None of the respondents accept only unregistered documents; whilst 53% accept both registered and unregistered documents as proof of ownership, 47% accept only registered documents such as title certificates or registered deeds/lease. The above results thus confirm the findings by Dower and Potamites (2005) that the possession of registered land titles is not an important determinant of credit supply mainly because informal documents serve as sufficient evidence of ownership to permit the use of such lands as collateral. About 82% of all 51 respondents who accept only registered documents are from UBs; whilst 74% of those who accept both registered and unregistered documents are from MFIs.

4 Conclusion

The results indicate that collateral is mostly necessary in granting credit to SMEs; and that SMEs with no collateral to offer are most likely to be denied credit in Ghana. On the issue of whether or not registration is required to make land an acceptable collateral asset as argued by some in the literature, majority of loan officers accept both registered and unregistered land as collateral. In terms of availability, credit is made available to both registered and unregistered land owners all things being equal. As long as there is documentary proof of ownership, unregistered land is eligible to be used as collateral. The lack of documentary evidence of ownership however, will make unregistered land unacceptable since it is a requirement that must be met. The bottom-line of the argument is that it is the lack of documentary evidence of land ownership that will make landed property ineligible for collateral purposes and not the absence of registered titles. Even though land registration is one way of providing this documentary evidence, documentation could be achieved without embarking on the costly process of land registration. Therefore since registration programs may be a huge burden on the limited government budget, other means of providing documentation should be explored and encouraged. The preliminary findings however, appear to be pointing to a significant difference between the commercial banks and microfinance institutions which is yet to be examined; the above results should therefore not be generalised for all categories of financial institutions in Ghana.

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