Research Journal of Finance and Accounting
ISSN 2222-1697 (Paper) ISSN 2222-2847 (Online)
Vol.8, No.4, 2017
www.iiste.org

The Influence of Religion on Capital Structure Decision among Small and Medium Enterprises in Ghana

Prince Kusi-Mensah* Christopher Bright Daboug Richard Opoku
Department Accounting & Finance, Christian Service University College, P.O.Box 3110 Kumasi, Ghana

Abstract
This paper examines the influence of religion on capital structure decisions of small and medium enterprises (SMEs) in Ghana. The issue is very relevant considering the meritorious contributions SMEs offer to growth of the Ghanaian economy. Exploratory- descriptive of its kind, this study adopts quantitative and quota sampling approaches to select 200 SMEs owned and manage being Christians and Moslems. Statistically, the results of the study suggest that religion has a significantly weak influence as far as decisions on capital structure are concern. The direction of the study revealed that relative to Muslims, SME operators being Christians greatly accounted to the significant influence religion had on total capital structure of SME businesses. Since most SMEs owners value full ownership of their business, any capital structure that risk their full control may not be entertain.
Keywords: Capital Structure, Religion, Small and medium enterprise (SME)

1. Introduction

An aspect of corporate finance many scholars research and made several publications is capital structure and its determinants. Since Modigliani and Miller (1958) gave birth to capital structure model, researchers from different countries have had numerous studies to assess various elements in the arena of the model. Among such studies include; Modigliani and Miller 1995, 1963; Miller, 1977; Myers (1977), Myers (1984) and Myers and Majluf (1984), Titman and Wessels (1988), Singh and Hamid (1992) and Singh (1995), Rajan and Zingales (1995), Wald (1999), Bevan and Danbolt (2000 and 2002), Antoniou et al., (2002), and Hall et al (2004). Those relating to Ghana are Abor and Biekpe, 2005a, 2005b; Abor 2007, 2008 and Oppong-Boakye et al...(2013).

In financial management, capital structure theory refers to a systematic approach to financing business activities through a combination of equities and liabilities. Competing capital structure theories explore the relationship between debt financing, equity financing and the market value of the firm. Brealey and Myers (1991) defined capital structure as comprising of debt, equity or hybrid securities issued by the firm. VanHorn (1989) defined capital structure as the proportion of debt to the total capital of the firms. Pandey (2005) said capital structure is a choice of firms between internal and external financial instruments. Capital structure is defined as the specific mix of debt and equity a firm uses to finance its operations (Abor 2008). Fisseha (2010) argued capital structure of a firm describes the way in which a firm raises capital needed to establish and expand its business activities, in generic. It is a mixture of various types of equity and debt capital a firm maintains resulting from the firm's financing decisions. In synopsis capital structure is the combination of debt and equity in the operations of an entity. Literature shows three main important factors why companies employ certain mixes of debt and equity. These are: control through ownership, financial flexibility and the tax advantage of debt interest deductibility. The true determinants of corporate capital structure have been identified by different scholars stating different factors to be waggling the "structure" from different perspectives': (Cassar and Holmes (2003), Esperança et al. (2003), and Hall et al. (2004) Abor and Biekpe, 2005a, 2005b; Abor 2007, 2008 and Oppong-Boakye et al(2013). Quoted firms capital structure varies from unquoted ones including SMEs. Requite financial structure of SMEs is defined by many explicable and implicit factors for which literature reveals. Scholars identify many influential variables on the SMEs capital structure model from different countries. Gender of owner, export status, industry, location and business form are some common variables affecting SMEs finance decisions. However, Renneboog and Spaenjers (2009) found in their study that religious households are more concerned about savings and are more risk-averse. They concluded that Protestants and Evangelicals (but not Catholics) have a relatively great sense of individual financial responsibility. Lok et al. (2010) found that Christians often have more wealth than non-Christians. They also found that Catholics and Protestants do save more than others in the society. Ghoul et al. (2012) observed a sample of 36105 U.S. firm-year observations from 1985 to 2008 in order to answer the question "if religion does matter to cost of equity". They found that firms located in more religious countries enjoy cheaper equity financing costs. Baxamusa and Jalal (2014) compared the leverage of firms located in Protestant- and Catholic-majority countries within the U.S.; they also used a sample of international firms to see if the differences in leverage in the U.S. are similar to the behaviour of firms in Catholic and Protestant countries outside of the United States. Their study revealed that firms located in 'Catholic-majority' countries have more leverage whiles firms in Protestant countries do not want to use too much debt. Adding up Deten (2014) found in Holland that capital structures of SMEs in protestant areas differ from capital structures of SMEs in less- or non-protestant areas. He concluded that capital structure of SMEs is influenced by religious belief to a moderate extent. SMEs in protestant areas are using less leverage than SMEs in non-protestant areas in Holland. There is not much known about the role religious believes play on influencing capital structure decisions of SMEs in Ghana. The goal of this paper is to investigate the influence of religiosity on capital structure decision of Ghanaian SMEs, given operators' diverse religious orientations.

SMEs produce about 25% of OECD exports and 35% of Asia's exports, according to OECD report (OECD, 1997). European Union saw the vast majority (99.8%) of its enterprises to be SMEs in 2008 and accounted for more than two thirds (67.4%) of total employment (European Commission, 2010). They represent over 90% of private business and contribute to more than 50% of employment and of GDP in most African countries (UNIDO, 1999). It is approximated that SMEs employ 22% of the adult population in developing countries (Daniels and Ngwira, 1993; Fisseha, 1991). SMEs represent about 92% of Ghanaian businesses and contribute about 70% to Ghana's GDP and over 80% to employment (Abor and Biekpe, 2006). The sector is said to be a characteristic feature of the production landscape and have been noted to provide about 85% of manufacturing employment in Ghana (Aryeetey, 2001). It is a major contributor to technical innovation and new product developments (Ou, 2006; Ergas & Orr, 2007). SMEs development is seen as accelerating the achievement of wider economic and socio-economic objectives, including poverty alleviation (Cook and Nixson, 2000). It therefore worth probing to their financing decisions, to know how it's been affected by religious believe of their owners. This study adds to existing literature on transitional economies SMEs capital structure decisions particularly in Ghana; since very few studies has been considered on the sector.

2.0 Theories and Conceptual Framework

The question of what determines the best financing mix remains debatable in corporate finance. On twenty-two listed companies in Ghana, Abor and Biekpe (2005) reveals that size, tangibility, profitability, risk, and taxation are statistically significant while growth is statistically insignificant in determining capital structure of the firms. By stereotype Oppong-Boakye et al (2013) stated profitability, asset tangibility, company size, and business risk as the determinants of entities capital structure. Abor (2008) compared capital structures of publicly quoted firms, large unquoted firms, and small and medium enterprises (SMEs) in Ghana. His results indicate that age, size, asset structure, profitability, risk and managerial ownership of the firm are important in influencing the capital structure decisions of Ghanaian firms. For the SME sample, it was found that factors such as gender of entrepreneur, export status, industry, location of the firm and form of business are also important in explaining the capital structure choice. Akin to Abor (2008), many researchers fail to consider religion as an important variable in explaining capital structure decisions among SMEs. In a study to examine the influence of two major religions (i.e., Buddhism and Taoism) in China on owner-manager agency costs, Du (2012) found that religion is significantly negatively associated with owner-manager agency costs. The reason according to Du (2012) is that, religion has a positive effect on how individual thoughts and behaviour and can restrain managers from unethical behaviours. The findings suggest that religion does matter and reduce owner-manager agency costs via restraining managers from unethical activities (Du, 2012). Whilst the influence of religion in the corporate sector may be somewhat diluted because of a well structure corporate governance, international aspects of ownership and financial markets, the influence of religion are much more powerful in the SME sector due to the closely held ownership structure of firms in the sector, and because SMEs generally access local sources of financing (Kearney et al, 2012). To identify proxies for religiosity of the firms, this paper follows the empirical corporate finance literature. A number of studies, including Hilary and Hui (2009), Kuhnen and Niessen (2009), and Kumar et al. (2011), operationalize religiosity of the firm's location to study the capital decisions of the firm. Similar to Kumar et al. (2011), this study disaggregates the variable and uses denominational approach to identify Christians and Islam religiosity. Present Ghana sees Christianity and Islam as two most prevailing religions with distinctive culture and set believes. SMEs are the backbone of the Ghanaian economy with most of its movers arousing from the two religious denominations. Two roaring theories underpinning the study of capital structure decision is the pecking order and the static order theories. Pecking order theory focuses on asymmetrical information costs. This approach assumes that companies prioritize their financing strategy based on the path of least resistance. The theory states internal financing is the first preferred method, followed by debt and external equity financing as a last resort. This study conceptualizes interest bearing debt finance (as a component of pecking theory) to scrutinize its usage among the Ghanaian SMEs, given the operators religiosity.

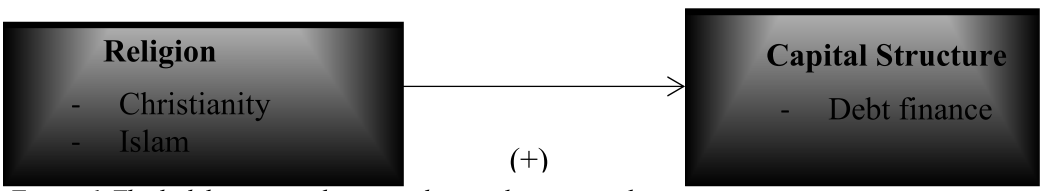

Figure 1:The link between religion and capital structure decisions

The above figure showcase a linkage between religion and capital structure decisions. Religious books such as the Bible and Quran address the issue of debt and interest in different ways. In Islam, interest (which is known in Islam as riba) is a taboo and thus prohibited in Islam. In effect, Islam condemns interest on loans akin to interest on investment and requires her followers to adhere strictly (Koran Chapter 2 verses 275-281). The Bible does not explicitly oppose all forms of debt. In the Old Testament, God commanded the Israelites not to charge interest on loans given out to the poor (Exodus 22:25, Leviticus 25:35-37, Deuteronomy 23:19). Jesus illustrated in the parable of the talents that fair interest rate is expected to be received on an invested money (Matthew 25:27) but does not necessarily forbid. This rich and deep connection between debt and religion also suggests that religion may have a significant impact on a firm's capital structure through its corporate culture given the operator's religious affinity (Baxamusa & Jalal, 2010). Prior studies support the underlining association between religiosity and the capital structure of firms. Sampling protestants and non-protestant in Holland, Deten (2014 ibid) saw that religion moderately influence capital structure of SMEs especially those in protestant areas. From the analogy, the authors postulate a significant difference between the capital structure decisions taken by people within Christianity and Islam religions. **$H_{0:}$** There is no statistical difference between capital structures decisions taken by SME operators holding Christianity and Islam believe.

3.0 Methodology

Quantitative and a quota sampling method were used to select 200 SMEs which are owned and manage by individuals with Christians or Moslems orientation in Ghana. The study took a paradigm of both exploratory and descriptive survey. It is generally recognized under Central Limit Theorem that a sample of 30 distributions is approximately normal and the results statistical tests performed are meaningful (Grinstead and Snell, 2000). The Central Limit Theorem then over buttresses the sample size of 200 SMEs chosen for this study. A Three sectioned structured questionnaire was used to collect primary data regarding the depend, independent and other relevant variables. The instrument was pre-test to check validity and its reliability to collecting the needed data for the survey. An independent sample t-test was performed in justification to the stated hypothesis.

4.0 Result Analysis

The section discusses aspects of SMEs and their owners' gender, present educational level and most importantly their religious orientations. Proctor (2000) explains that demographic data are essential to acquire fundamental information about respondents. 33% of the respondents were male (N=66) compared to 67% (N=134) female counterparts. 76% (N=152) have primary education and 20% (N=40) schooled to the secondary level. Only 4% (N=8) have tertiary education. This is an indication that most tertiary graduates fear taking the mantle of entrepreneurship in Ghana so far as the SME base is concern.

The adoption of quota sampling technique guaranteed 50% responses vis-à-vis both religions under consideration (Islam, Christianity). The result shows that Ghanaian SME movers prefer going for sole proprietary businesses (N=194, 97%) than any other, because they want full control of the business (N=139, 69.5%). However, in cases of finance the operators mostly embrace external source with internal funding (N=162, 81%). Sixty-one percent of the respondents representing majority stated clearly that they mostly rely on self finance or at worse borrow from friends and other relatives than going for bank loans etc (N=122, 61%) for fear of living under prohibitive interest burdens at the pressurizing arrow of financial institutions. Whereas this was the case, the descriptive section of the study does not capture the religious sect being so much addicted to the latter thought.

4.1 Testing Hypothesis

Table 1. Group Statistics

	Religious orientation	N	Mean	Std. Deviation	Std. Error Mean
Interest bearing debt Acceptance	Christian	100	3.01	1.030	.103
	Islam	100	3.29	.957	.096

Table 2. Independent Samples Test

H_0: there is no statistical difference between capital structures decisions taken by SME operators holding Christian and Islam believes

		Levene's Test for Equality of Variances		t-test for Equality of Means						
									95% Confidence Interval of the Difference	
		F	Sig.	t	df	Sig. (2-tailed)	MD	SED	Lower	Upper
Interest bearing debt Acceptance	Equal variances assumed	.387	.534	-1.992	198	.048	-.280	.141	-.557	-.003
	Equal variances not assumed			-1.992	196.932	.048	-.280	.141	-.557	-.003

NB: MD = Mean Difference, SED= Standard Error Difference

An independent t-test was performed to determine if any difference exists between the capital structure decision taken among SME movers holding Christian and Islam faiths. Statistically there is a significant [t (198) =-1.99, p=.05=α level .05] difference between capital structures decisions taken by SME operators holding Christian faith (M= 3.01, SD=1.03, n=100) and those with Islam values (M=3.29, SD=.96, n=100). However, the effect size n^2>0.02 is very small. In effect, only 2% of the interest bearing debt capital decision can be explained by the business operators' religiosity. The 95% confidence interval for the difference between the mean responses was -.557 to -.003. Hence the researchers base for rejecting the null hypothesis.

Result of Levene's test, F (198) =.39, p=.53, indicates that the variance of the two populations (Christian and Islams) were deemed fit to be assumed approximately equal. This signifies a real usage of the standard t-test results.

➔ Justifying the extent of influence under t-statistic;
t (squared)/ t (squared) + (N1+N2-2)
n^2> 0.02 or 2% (approximately)

4.2 Result Discussion and practical implication

The findings show that a person's religion has a considerable impact on the decision for debt capital as a component of the pecking order theory, essentially if the debt goes with interest. That notwithstanding, a variation exists among interest bearing debt financing decision taken by Christian follower who are into SME businesses and those owners having Islam values. Dramatically, the study exposes that unlike Muslims, Christian's followers operating the SME sector mostly avoid the risk of borrowing in support of their business, so far as the borrowing goes with interest. The claim is effectively capture with critical observation from Table 1 mean response and Standard deviation calculated on both religions. In consequence, Christian follower are more risk averse than their counterpart Muslims. This suggests that even though Islam foresees interest taking as a taboo, in the context of business, her followers may not compromise *"going"* for loans even with interest, given the urgency of their financial need. This view is slightly relative to Christian business Owners. An SME operator being Christian may show reluctance in going for interest bearing debt capital, under cetris paribus. Whereas the assertion seems very contemplating, the researchers opine that Christian operators perhaps desperately anticipate full ownership and control of their businesses hence their decision (see 4.0). Indeed, it is prohibited to take interest in Islam neither is a Christian advised to take prohibitive interest, as stated in the review. It must be noted that this result does not capture the issue of whether SME operator being Christian or Muslim follower will "*offer*" assistance to another fellow for interest or not.

5. Conclusion

The study agrees statistically that religion has a significantly weak (2%) influence on Ghanaian SMEs capital structure. This assertion is in line with the study of Baxamusa & Jalal, (2010) when they suggested that religion may have a significant impact on a firm's capital structure through its corporate culture given the operator's religious affinity. In compliance to the pecking order theory adherence among the SME operators, the research highlights that relative to Muslims, those SME operators holding Christian values scarcely borrow for their businesses especially when the borrowing goes with interest. The direction of the study suggests that SME operators being Christians greatly accounts to the significant influence religion had on total capital structure of SME businesses. Deten (2014) said religion moderately influence capital structure of SMEs especially those in protestant areas in comparison to non-protestants in Holland. Finding from this study slightly varies from Deten

(2014) in terms of the strength of correlation between the dependent and the independent variable.

References

Abor, J. (2008), "Determinants of Capital Structure of Ghanaian Firms", African Economic Research Consortium Paper 176, Africa Economic Research Consortium, Nairobi

Abor, J. (2007), "Industry Classification and the Capital Structure of Ghanaian SMEs", Studies in Economics and Finance, 24 (3), 207-219

Abor J. (2005), "The Effect of Capital Structure on Profitability: Empirical Analysis of Listed Firms in Ghana", Journal of Risk Finance, 6 (5), 438–445.

Abor, J. & Biekpe N. (2005), "What Determines the Capital Structure of Listed Firms in Ghana"? African Finance Journal, 7, Part 1.

Antoniou, A., Guney, Y., and Paudyal, K.(2002). Determinants of Corporate Capital Structure: Evidence from European Countries, Working paper, University of Durham.

Aryeetey, E. 2001. "Priority Research Issues Relating to Regulation and Competition in Ghana", Centre on Regulation and Competition Working Paper Series, University of Manchester, Manchester.

Bevan, A. and Danbolt, J.(2002). Capital structure and its determinants in the UK- a decompositional analysis, Applied Financial Economics 12, 159-170.

Baxamusa, M.. & Jalal A. (2010). Does Religion Affect Capital Structure? (Working paper 2010,8-10). University of St. Thomas and University of Suffolk.

Cassar, G., and Holmes, S., (2003). Capital structure and financing of SMEs: Australian evidence", Journal of Accounting and Finance 43, 123-147. 24

Cook, P. and F. Nixson, 2000. "Finance and Small and Medium-Sized Enterprise Development", IDPM, University of Manchester, Finance and Development Research Programme Working Paper Series, Paper No 14

Daniels, L and Ngwira A.(1993), `Results of a Nation-wide Survey on Micro, Small and edium Enterprises in Malawi', GEMINI Technical Report No 53. PACT Publications , New York.

Deten M(2014) Does Religion Matter To Capital Structure in SMEs? Evidence from the Netherlands 3rd IBA Bachelor Thesis Conference, July 3rd, 2014, Enschede, The Netherlands.

Du, X. (2012). Does Religion Matter to Owner-Manager Agency Costs? Evidence from China. J Bus Ethics 118:319–347.

Ergas, H. And Orr, J., 2007, *SME Trends and Achievements.* Sydney: CRA international.

Organization For Economic Co-operation and Development, 2005. *OECD SME and entrepreneurship outlook 2005.* OECD Publishing.

Esperança, J.P. P.M.G. Ana and A.G. Mohamed.(2003). "Corporate debt policy of small firms: An empirical (re)examination". Journal of Small Business and Enterprise Development, 10(1): 62–80.

Fisseha Y (1991), `Small Scale Enterprises in Lesotho: Summary of a Country-wide Survey', Gemini Technical Report No. 14, Washington D.C, Development Alternatives Inc.

Fisseha M. K (2010), the determinants of capital structure, Evidence from commercial banks in Ethiopia; Research Project Submitted to the Department of Accounting and Finance, College of Business and Economics, Mekelle University, for the partial fulfillment of the degree of Master of Finance and Investment; Reg.No.-CBE/PR0025/01,Mekelle, Ethiopia

Ghoul, S.E., Guedhami, O., Ni, Y., Pittman, J., Saadi, S. (2012). Does Religion Matter to Equity Pricing? J Bus Ethics 111:491–518

Hall, G., Hutchinson, P., and Michaelas, N.(2004). Determinants of the Capital Structures of European SMEs, Journal of Business Finance & Accounting 31,711-728.

Kearney, C., Mac an Bhaird, C., & Lucey, B. (2012). Culture and Capital Structure in Small and Medium Sized Firms. Access on December 15, 2014 from Social Science Research Network: http://ssrn.com/abstract=2185284

Lok, R., Wingen, M., Otten, F. (2010). Religie en verschillen in vermogen en inkomen Bevolkingstrends, 1e kwartaal 2010, 53-58.

Miller M. (1977). Debt and Taxes. Journal of finance 32, 261-275.

Modigliani, F., & Miller, M. H. (1958). The cost of capital, corporation finance and the theory of investment. The American economic review, 48(3), 261-297.

Modigliani F. and Miller M. (1963). Corporate Income Taxes and Cost of Capital: A Correction. American Economic Review53, 433-443.

Myers, S.C., (1977). Determinants of corporate borrowing. J. Finance. Econ. 5, 147–175.

Myers S.C., (1984). The capital structure puzzle. Journal of Finance 34 (3), 575-592.

Myers, S. C. and Majluf N. S. (1984), Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have. Journal of Financial Economics, 13, 187-222.

Oppong-Boakye P.,Opoku A.K and Konadu A.J(2013) Determinants of Capital Structure: Evidence from Ghanaian Firms Research Journal of Finance and Accounting Vol.4, No.4

OECD, (1997). Globalisation and Small and Medium Enterprises, Synthesis Report, Organisation for Economic Cooperation and Development.

Ou, C., 2006. Banking and SME Financin in the United State. *Small business research summary,227.*

Rajan R.G. and Zingales L. (1995). What do we know about Capital Structure? Some evidence from international data. Journal of Finance 50 (5), 1421-1460.

Renneboog, L., Spaenjers, C. (2009). Where Angels Fear to Trade: The role of religion in household finance. Center discussion paper. Universiteit van Tilburg, Tilburg.

Titman S. and Wessels R., (1988). The determinants of Capital Structure Choice. The Journal of Finance 43 (1), 1-19.

Wald, J.K. (1999). "How firm characteristics affect capital structure: An international comparison". Journal of Financial Research, 22: 161–87.

Pandy, I. M. (2005). Financial Management. 9th Edition, Vikas Publishing House Pvt. Ltd.,India.

Van-Horne, J. (1989). Financial Management and Policy. 12th Edition, Upper Saddle River,Prentice-Hall, New Jersey, U.S.A.