Performance of Small and Medium Enterprises in Lagos State: The Implications of Finance

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Abstract: The main aim of this study is to examine the impact of finance on the performance of small and medium enterprises in Lagos State. The research design adopted for this study is survey research design. Data analysis and hypotheses test from 250 SME owners and operators using Pearson correlation and regression analysis indicate that, there is a relationship between SME finance and business performance. Limited information on loan qualification criteria and high interest rate mostly pose challenge to SMEs in their quest to access finance. Results also show there is significant relationship between financial management practices and the performance of SMEs. Sequel to findings of the study, it is recommended that government Flexible arrangements should be put in place for SMEs in Lagos State to enable them access fund. Government should find way to encourage financial institution to lend to SMEs by providing guarantees, interest rate subsidies and other incentives

Keywords: SMEs; Finance; Financial management; Performance

JEL Classification: L32

1. Introduction

SMEs are generally regarded as the engine of economic growth in developing economies (Agwu & Emeti, 2013) and developed nations (Alese, 2017). Specifically, Alese (2017) argues that this argument stems from the realization that almost all countries that have focused on SMEs sector have ended up in the significant reduction in poverty level and its attendant enhancement in the quality and standard of living, reduction in crime rate, increase in per capita income as well as rapid growth in national output among other salutary effects.

Similarly, small and medium enterprises (SMEs) have been largely acknowledged as the oil required for lubricating the engine of socio-economic transformation of

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any nation (Odah, 2005). Small enterprises are vital for economic development because they encourage entrepreneurship, generate employment, reduce poverty and provide suitable livelihood (Rogers, 2002) The SME sector is strategically positioned to absorb up to 80% of jobs, improve per capita income, increase value addition to raw materials supply, improve export earnings and step up capacity utilization in key industries.

However, despite the deluge of studies on the SME sector in Nigeria and Lagos specifically, few studies have critically investigated effect of how finance when acquired are used on the performance of SME since the skills needed to set up a business is not same as those needed to run a business (Edward, 2012). Most of the existing studies often focus on Commercial Banks' Credit and SMEs Development (Dada, 2014), impact of micro-finance on small scale business (Ashamu, 2014); effect of SMe financing on economic development (Taiwo, Falohun & Agwu, 2016) among others. hence the need desire to understudy the impact of finance on business performance of small and medium scale businesses in Lagos state as case study. Specifically, the study examines the relationship between entrepreneur's level of access to credit facilities and business performance, relationship between financial management ability of an entrepreneur and business performance and ascertain if there is a correlation between entrepreneur's limited sources of finance and degree of business success.

2. Literature Review

Nigerian businessmen and women are innovative in assessing opportunities and in the ability to nearly as effective in product innovation. They tend to concentrate on the rapid adoption and imitation of foreign innovation and know-how. For example most manufacturers usually make products based on foreign brand label under license. As to technology, most of the machinery used in production are imported from developed economy and developing countries like United State, and Hong Kong respectively. This may explain the difficulty of Nigerian SMEs in the manufacturing to diversify from the traditional methods of production

In the past, Nigeria concentrated producing a limited range of highly labor-intensive goods such as textiles plastic etc. It is quite true that Research and development (R & D) is not common with small size firms. They prefer rapid imitation of new imported technology as a more viable and economic alternative. Thus, many manufacturers prefer to stay in industries where R & D are not important.

Moreover, the skills and processes needed to grow a business are different from those needed to start a business. In fact, Edward (2012) asserts that many entrepreneurs had poor hiring processes, poor financial management; problems

having difficult conversations with employees; underestimated the power of culture; and made many hiring mistakes when trying to build a growth-management team.

To create an enabling environment for growth, the Federal Government of Nigeria over the decades has put in place different kind of institutional frame work to promote small scale enterprises in the country. These include the establishment of industrial development centers (IDCS), the small scale industries credit scheme, credit guidelines to financial institution, working for yourself/entrepreneurship development programme (WFYP/EDP) National Economic Reconstruction Fund and others.

Financial assistance to small business sector is also available in the form of credit scheme i.e. Small Scale and Medium Industries Credit Scheme (SSIC), Small Scale Enterprises loan Scheme (SMES). In 1999 Banker's committee came up with the Small and Medium Industries Equity Investment Scheme (SMIEIS). Through this, banks were mandated to set aside 10 percent of their profit before tax for the purpose of equity financing of small and medium enterprises.

However, the major challenge facing small and medium enterprises operators is lack of finance (Owualah, 1999). Lack of capital, has been identified as the most serious problems of establishing and running small and medium enterprises. Many operators face this challenge and are often constrained to rely on personal and family funds to carry out their business. Where there is need to expand and huge sums of money is required, these SMEs lack the collateral security with which they can approach commercial or microfinance banks for assistance.

According to Onyeiwu (2012), empirical evidence shows that in Nigeria, the level of external finance for the SMEs i.e. bank loan and equity is very low. Drawing from a Survey of SMEs conducted by World Bank between 2006 and 2007 and using four developing countries, namely Nigeria, Brazil, India and South Africa as example, it is evident that Nigerian SMEs are starved of necessary funds which can propel them into better performance. To this end, micro-finance banks are set up to alleviate poverty and also to serve as a platform for promoting entrepreneurial development (Akinbola, Ogunnaike & Tijani, 2013).

In Nigeria, funds for financing small businesses can be sourced from personal savings, loans and grants from relatives, friends and business associates. These sources entail little or no legal formalities. Nigerian banking industry (commercial, agricultural and investment banks) muster funds from government and international financing agencies, like World Bank, using Central Bank of Nigeria (CBN) as the arrow head Okafor & Onebunne (2012). Such funds are normally geared towards development and establishment of small firms. Most often the funds are available to SMEs through equity participation and venture capital activities. Banks also lend money to businesses ranging from short-term overdraft

facilities to medium and long-term loans and advances. According to Okafor & Onebunne (2012), the terms and conditions for accessing funds of this nature are spelt out against each credit type. There is an allegation that large firms dominate bank`s loan portfolio, because they often provide adequate and qualitative financial information about their past and current operations and can better articulate future plans of their business to support loan demands (Mumbula, 2002). Moreover, they provide better collateral than small firms (Okafor, 2008). Since small businesses are perceived as risky borrowers, fund providers attempt to minimize credit risk exposure when dealing with them by offering small amount of loans rather than full financing, at very high cost.

The assumption made by discovery theory concerning the nature of entrepreneurs follows directly from its assumption about the nature of opportunities. Since opportunities are created by exogenous events in an industry or market and since these opportunities are objective and thus, in principle, observable, then everyone associated with that industry or market should be aware of the opportunities.

The theory is premised on three important assumptions: (1) Opportunities exist independent of the entrepreneurs, (2) that the nature of entrepreneurs differs in some important ways from non-entrepreneurs and (3) the nature of the decision making context is very risky. The general assumption of the discovery theory is that the goal of entrepreneurs is to form and exploit opportunities (Shane & Venkataraman, 2000).

Shane (2003) noted that technological changes, political and regulatory changes, and social and demographic changes are the examples of the kinds of events that can disrupt the competitive equilibrium that exists in a market or industry, thereby forming opportunities.

The discovery theory is based on realist assumptions in the philosophy of science which assumed that opportunities, like mountains, exist as real and objective phenomena, independent of the actions or perceptions of entrepreneurs, just waiting to be discovered and exploited (McKelvey, 1999). Thus, to explain why entrepreneurs associated with an industry or market are willing and able to exploit opportunities while non-entrepreneurs are not, discovery theory must necessarily assume that entrepreneurs who discover opportunities are significantly different from others in their ability to either see opportunities or, once they are seen, to exploit these opportunities (Kirzner, 1997; Shane, 2003).

However, unlike discovery theory, creation theory believes that the nature of opportunities do not exist independent of entrepreneurs. It depends on the level of the individual's evolutionary level of thinking. More so, the nature of entrepreneurs may or may not differ from non-entrepreneurs and that the decision making context is highly uncertain. Thus, it holds that opportunities do not necessarily evolve out of pre-existing industries or markets (Dosi, 1988). The term "search" has little or

no meaning in creation theory since that implies entrepreneurs attempting to discover opportunities that already exist. In creation theory, entrepreneurs do not search; they act, and observe how consumers and markets respond to their actions and in fact, entrepreneur's actions are the essential source of these opportunities but rather, they build the mountains

Kayode & Afred (2014) investigated the determinants of capacity of SMEs in employment creation in Lagos State, Nigeria. Using population of registered small and medium scale businesses in Lagos, State and a sample 260 SMEs, it was found that sources of capital among other factors is significant in determining both income generation and employment generation potential of the SMEs in Lagos.

In a similar study, Bello, Robert and Iliyasu, (2015) assessed the effect of entrepreneurial skills management and funding on small and medium enterprises in Northern Nigeria. 300 SMEs were drawn from three states (Kaduna, Bauchi, and Niger) from the manufacturing sector of Northern Nigeria. The result of the study indicated that funding has significant influence on the performances of SMEs in northern Nigeria and accounts for 42.8% of the variations in the performances of SMEs. This result is in agreement with the works of Evbuomwan, Ikpi, Okoruwa, & Akinyosoye (2013) and Onakoya, Onakoya, Jimi-Salami, & Odedairo, (2013).

Hypothesis One: There is no significant relationship between entrepreneur's level of access to credit facilities and business performance.

Hypothesis Two: There is no relationship between financial management ability of an entrepreneur and the success of business performance, in Lagos State, Nigeria.

Hypothesis Three: There is no correlation between entrepreneur's limited sources of finance and degree of business success.

3. Methods

The research design adopted for this study was survey research design. The study is focused on 11,663 SMEs in Lagos according to NBS (2013). Using Yamane's sample determination method as given below, a total of 387 SMEs were selected as sample for the study. Sample Size (n) $= \dfrac{N}{1 + N(e^2)}$

Where N =Total Population, e = significant (error Margin) and

1 = Constant. Significant error of 5% (0.05) was applied.

Consequently, questionnaire was adopted as research instrument to elicit data from the operators of the SMEs.

4. Data Analysis and Hypotheses Test

Test of Hypotheses

In the course of this research work, three hypotheses were tested. Findings and conclusion from the analyzed data, hypotheses are tested at 0.05 level of significance.

Hypothesis One

H_0: There is no significant relationship between SMEs level of access to credit facilities and business performance

The summary of the Pearson Correlation analysis of hypotheses one is presented below.

Table 1. Pearson's Correlation Showing relationship between entrepreneur's Level of Access to Credit Facilities and Business Performance

		Entrepreneur's Level of Access to Credit Facilities	Entrepreneurs Business Performance
Entrepreneur's Level of Access to Credit Facilties	Pearson Correlation Sig. (2-tailed) N	1 250	518** 000 250
Entrepreneurs Business Performance	Pearson Correlation Sig. (2-tailed) N	.518** .000 250	1 250

* Correlation is significant at the 0.05 level

As evident from the above table, result revealed that the calculated correlation coefficient r =0.518 at 0.05 significant level. Since the calculated r value is greater than the tabulated r value, the null hypothesis is rejected while the alternative hypothesis is accepted with the conclusion to the effect that there is a significant relationship between enterpreneur's level of access to credit facilities and business performance. The interpretation of this finding is that an improvement in the enterpreneur's level of access to credit facilities would likely lead to about 51.8% proportional increase in business performance.

Hypothesis Two

Table 2. Pearson's Correlation Showing relationship between financial management ability and Business Performance

		Financial Management Ability	Entrepreneurs Business Performance
Financial Management Ability	Pearson Correlation Sig. (2-tailed) N	1 250	429** 000 250
Entrepreneurs Business Performance	Pearson Correlation Sig. (2-tailed) N	429** 000 250	1 250

* Correlation is significant at the 0.05 level

Source: SPSS Version 20

From the summary of the Pearson correlation of financial management and SME performance above, result revealed that the calculated correlation coefficient r =0.429 at 0.05 significant level is positive and significant. Since the calculated r value is greater than the tabulated r value, again the null hypothesis is rejected while the alternative hypothesis is accepted with the conclusion that "there is a significant relationship between financial management ability and business performance. The interpretation of this finding is that an improvement in the financial management ability would likely lead to about 42.9% proportional increase in business performance.

Hypothesis three

H_o: There is no correlation between entrepreneurs' limited sources of finance and degree of business success.

In testing the third hypothesis, regression analysis was employed to estimate the predicting power of access to fiancé on business performance of SMEs in Lagos state as well as the significance of the influence.

Table 3. Regression analysis of limited access to finance and business performance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.933[a]	.870	.870	.98503

a. Predictors: (Constant), risk_taking_ability

Source: Field Survey, 2016

Table 3 above shows the result of the regression analysis of the impact of limited access to finance on business performance of SMEs in Lagos. The linear regression estimated the coefficients of the linear equation, involving one independent variable that best predict the value of the dependent variable. The dependent variable is business performance while the independent variable is access to finance. In like manner, results of the linear regression showed that the regression coefficient (R) and the coefficient of determination (R^2) is 870. This means that, a positive and linear relationship exist between the dependent and independent variables. In addition, the totality of the access to finance can explain about 87% of the variation on the business performance while the remaining 13% is due to unexplained or the factors not measured in this model.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.358	.192		1.862	.064
	risk_taking_ability	.958	.023	.933	40.763	.000

a. Dependent Variable: Business_performance

Source: Field Survey, 2016

The coefficients of the model of the T-test revealed that, at 0.05 level of significance, relationship between limited access to finance and business performance (t = 40.763, 0.00, P < 0.05) there is statistically significant

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1612.271	1	1612.271	1661.659	.000[a]
	Residual	240.629	248	.970		
	Total	1852.900	249			

[a.] Predictors: (Constant), risk_taking_ability

[b.] Dependent Variable: Business_performance

The analysis of variance (ANOVA) performed on the regression model yielded an F-value of 1661.659 which was also significant at ($p< 0.05$). This implies that performance of Small and medium scale enterprise is a function of access to finance.

4.1. Discussion of Findings

Analyses of the responses to the research questions indicated that the surveyed SMEs have limited access to funds. For example, about 192 of the surveyed SMEs representing about 67% still fund their businesses with donations from family and friends just as about 70% of the businesses indicated that they have limited information on loan qualification criteria. More importantly, high interest rate, according to the respondents, pose challenge to their access to finance.

It was also hypothesized in this study that, there is no significant relationship between access to credit facilities and business performance. On the contrary, it was found that there is significant relationship between access to credit facilities and business performance ($r=0.518$ $p< 0.00$) of SMEs in Lagos State. Thus, the issues involved in understanding funding gaps are complex. It is not easy to disentangle whether a drop in the amount of funding results from low demand or contraction in funding supply. The explanation of the latter, which has dominated the policy discussion, is often rooted in market failure: the fixed costs of screening and monitoring smaller/younger businesses, which are more informational opaque, may be prohibitively high. The resulting information asymmetries may give rise to problems of adverse selection and/or moral hazard leading to credit rationing (Stiglitiz & Weiss, 1981). In these circumstances, funding may only be available where the entrepreneur has some track record Petersen & Rajan (1994) or can demonstrate commitment to the business, such as through providing collateral Bester (1985). Recent developments in credit scoring have helped lower the fixed costs of lending and reduce reliance on collateral, thereby improving small firms' access to finance (Allen, De Long, & Saunders, 2004). Indeed, improvements in the credit information infrastructure might be expected to help the flow of finance to SMEs and overcome some of the asymmetries.

Furthermore, by analyzing data for the second hypotheses, we found that, there is indeed a significant relationship between financial management ability and business performance of the surveyed SMEs in Lagos (r=0.429, p< 0.00). This suggests that.

5. Conclusions and Recommendations

There is a positive and significant relationship between SME's access to credit facility and business performance. Financial management practices have significant impact on the performance of SMEs in Lagos. Thus, availability of funds can help SMEs acquire appropriate technology and also expand operations and scale of their businesses. By such expansion, the gain economies of scale and learning curve thereby increasing their profit margins. Since financial management practices are aslo capable of substantially influencing their performance, access to finance, not only debt of equities giving rise to the right mixture of debt and equity as cost of finance may weigh down the business and also limit investment opportunities the business can explore. Consequently, flexible arrangements should be put in place for SMEs in Lagos State to enable them access investable funds. Even though state governments and non-governmental organisations sometimes give non-institutionalized credits to small businesses particularly those who have undergone their skill acquisition trainings, such funds are usually too meagre to fund promotional expenses of starting a business. More so, seminars and workshops which will improve SMEs entrepreneurs 'managerial capabilities be emphasized by both Government and other relevant agencies and institutions that are major stakeholders in SMEs development in Nigeria. Again, SMEs should maintain proper accounting record and not just to maintain accounting records but introduction of financial management into funding activities will go along way for judicious use of scarce fund and lay a solid ground to obtain finance either at the money or capital markets. Finally, SMEs and entrepreneurs alike should stop shying away from admission of angel investors.

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