

# **Impact of Banks on the Small and Medium Enterprises Equity Investment Scheme on Strategic Market Performance of Smes in Lagos, Nigeria**

**Olusegun Adekunle W**

*Dept. of Business Administration*

*Babcock University, Ilishan Remo, Ogun State, Nigeria*

**Makinde, Abiola, O**

*Director Human Resources*

*Babcock University, Ilishan Remo, Ogun State, Nigeria*

## **Abstract**

Past research has proven the importance of small and medium Enterprises to economic development in Nigeria. However, there has been limited study which specifically evaluates impact of the roles of the Central Bank of Nigeria (CBN) and banks on the strategic performance of SMEs under the Small and Medium Enterprises Equity Investment Scheme (SMEEIS). This study assessed the roles of CBN, banks, and factors that influence the strategic performance of SMEs under SMEEIS.

Using Survey Research Design, this ex-post facto research adopted the post-positivist view. The population of the study consisted of funded SMEs, funding bank officials, and officials of the CBN. Using stratified sampling technique, samples were selected from various banking categories and SME sector. Questionnaires were administered to the officials of 20 banks, and Managing Directors of 160 funded projects with accurate physical addresses in Lagos. The response rate for CBN was 100%, 65% for banks, and 50% for SMEs. To test for the reliability and validity of the primary research instrument, questionnaires were pre-tested among similar subjects, peers and supervisors for this research and adjustments were made to remove perceived ambiguities.

Primary data were collected using structured questionnaires, while secondary data were gathered through content analysis of The SMEEIS Revised Guidelines. Data were analyzed using both descriptive and inferential statistics. Results showed significant improvement with t-value (1.865) and 0.066 P-value before and t-value (5.054) with 0.000 P-value after SMEEIS at 7% and 1% level of significance respectively. Another t-test showed that SMEEIS significantly impacted contributions of SMEs to economic growth with P-value of 0.00 at 1% level of significance. The Chi-square statistic was used to determine whether the SMEs perceived banks as being supportive. Results showed that banks were supportive since the  $X^2_{cal}$  (76.375) was greater than  $X^2_{tab}$  (15.507) while logistic regression depicted no significant difference in the role of CBN on building the capacity of SMEs through entrepreneurial orientation.

Banks encountered problems of inadequate openness and partial disclosure of genuine record books by SMEs; and SMEs needed essential infrastructure for better performance. This study therefore recommends clear documentation of roles of stakeholders in measurable terms as well as the provision of clear framework for

collaboration through avenues such as workshops and training to build capacity and trust. There is the need for thorough review of the Scheme by CBN and the Bankers' Committee with representatives from SMEs using findings from this study to make necessary amends; future Scheme must include detailed and measurable roles for all stakeholders.

## **Introduction**

The perspectives on entrepreneurship include those associated with the Schumpeterian tradition (Schumpeter, 1911, 1934 cited in Abimbola & Kocak, 2007), and resource based view (Alvarez and Barney, 2001; Penrose, 1995), that emphasizes the role of innovation, market process and firm resources. Morris, Kuratco & Covin, (2008) defined the innovation perspective of entrepreneurship as "concern with unique combinations of resources that make existing methods or products obsolete". Morris, Kuratco and Covin (2008) also defined value creation of entrepreneurship as "a process of creating value for customers by exploiting untapped opportunities". In the same vein, Shane and Venkataraman, (2000) also defined entrepreneurship as "the discovery and exploitation of profitable opportunities".

In defining the small enterprise, Storey, (1994) underscored the lack of uniformly acceptable definition of a small firm. This he adduces to the difference in firms' levels of capitalization, sales and employment. Consequently, definitions which utilize measures of size (number of employees, turnover, profitability, net worth, etc.) when applied to one sector could lead to all firms being ranked as small, while the same size definition when applied to a different sector could yield a different result (Storey, 1994). In Nigeria, the capital base as well as the number of employees that constitute the firm was used to come up with the definition of SMEs. The Small and Medium Enterprises Equity Investment Scheme (SMEEIS) categorizes SMEs as an enterprise which has a maximum asset base of N500 million (\$4.2 million), minus its land and working capital and the number of employees are between 10 and 300 employees (Storey, 2002).

Both entrepreneurship and SMEs have been widely described and proven to be instruments of achieving economic growth and development in addition to creating employment. The contribution of SMEs in Nigeria has been positively reported as visible in the economic transformation of the country and every successive government has emphasized its importance (Rebecca & Benjamin, 2009; Arowomole, 2000). Contextually therefore, Udechukwu, (2003) asserts that the development of SME is an essential element in the growth strategy of most economies and holds particular significance for developing countries like Nigeria. SMEs are a vital part of any market economy because they are represented in all sectors of the economy. They play important roles in job creation, provision of goods and services within and across national boundaries. Mazzarol (2000) further observed that at the commencement of the new millennium, small businesses were heralded as the engine of economic growth, the incubator of innovation, and the solution to decades of persistent unemployment. The fulfilment of the enormous potential of the sector has been a consistent theme since the commencement of the Industrial revolution. According to him, most Governments especially in Less Developed Countries (LDCs) now recognize the need to formulate policies that create conducive atmosphere for the establishment and operation of SMEs (Mazzarol, 2000).

To this effect, the World Bank has numerous SME activities. For example, in year 2003, about 1.3 billion U.S. dollars was set aside for SME support programs with a distribution of 80% as direct finance for SMEs and 20% used in indirect support such as technical assistance and institution building (World Bank 2002, 2004). The developing world has also not been left out. In Nigeria, the Federal office of statistics has shown that 97% of all businesses in the country employ less than 100 people. It is therefore assumed that almost all businesses fall into the category of SMEs (Ariyo, 2000), while in South Africa, about 60% of the economic output come from SMEs (Kesper, 2000).

Many factors have been known to play pivotal roles in the effectiveness or otherwise of entrepreneurial ventures. These determinants could be at varying levels ranging from the government, institution, social as well as cultural. At the level of government, impediments to entrepreneurial

growth include licenses, permits, laid down protocols and administrative costs (Thurik, 2003). Other inhibitory issues include dearth of information on investment opportunities, inappropriate government policies which disfavour SMEs in the areas of need for specialized management and employment legislation (Bank of England 2001; Bygrave et al 2001). A Swedish study on SME owners further revealed that the failure or stagnancy in ventures was attributed to the government in the areas of bureaucracy, tax requirements and insensitive policies (Good and Graves, 1993). It is in view of these challenges posed by the SME that the research is being undertaken. For these reasons, the following hypotheses are tested

HO1: There is no significant difference in the designated and actual role of banks to SMEs under SMEEIS.

HO2: There is no significant difference in the designated and actual role of CBN in building SMEs capacity through entrepreneurial orientation under SMEEIS.

## **Methodology**

### **Research Design**

This research is an ex-post facto research which is research carried out after the fact has occurred without any interference from the researcher.

The study also adopts the research philosophy of the post-positivist view of science that knowledge is not based on irrefutable observable grounds, that it is always somewhat speculative, but that science can provide relatively solid grounds for that speculation.

### **Population**

There are over 160 projects funded in the Lagos State area by 24 banks. These banks were later consolidated into 20 banks which represent the consortium of banks from which participants were selected for this study. Questionnaires were sent to all 20 banks (24 banks were consolidated) and 13 banks responded to the survey questionnaires representing 65% of banks. One questionnaire was sent to CBN on its role on SMEEIS and the questionnaire was completed by CBN and returned for analysis. SME projects were selected based on criteria such as; active funding, the funding bank, amount of funding, complete address, and type of business.

### **Sampling Technique**

For this study, both purposive sampling and stratified random sampling were used. Purposive sampling was used based on the researcher's knowledge of the study and the population of study.

### **Research Instrument**

There were three different survey questionnaires developed for this study. The questionnaires designed for SMEs had a total of six questions. The 5 questions addressed the financial status of the SMEs before SMEEIS.

The questions were targeted to asking questions about the roles of the banks and their perceptions of SMEs productivity under SMEEIS.

### **Validity and Reliability of Research Instrument**

This study therefore compared observations from one respondent to another during a pre-test of the questionnaires to students with the same background and level of education. Questionnaires were initially administered for pre-test and the results from the pre-test caused the researcher to make amends to the questions where ambiguous or not clear, and for content validity purposes.

This study used both face and content validity. Copies of proposal and questionnaires were sent to experts in methodology and students to review and provide comments on the validity of the questionnaires and methods chosen. Feedback provided was considered and questionnaires have been adjusted accordingly.

## Data Collection

This study collected primary data using both purposive and the stratified random sampling techniques. There were different categories of contributors and these different categories were used as the strata to randomly choose participants. Questionnaires were designed and used in this study to gather data from participants in the SMEEIS and both open-ended and closed-ended questions were used for the questionnaire.

## Results

**Table 1:** Showing what prompted banks to formulate SMEEIS?

	Frequency	Percent
It is CBN mandatory request to deposit money and Banks to fund investment in SMEs	4	30.8
To increase the flow of investment and establish linkages in raw materials/ products value chains	4	30.8
To support government initiative to promote SMEs as vehicles for rapid industrialization and economic development	5	38.5
<b>Total</b>	<b>13</b>	<b>100.0</b>

Source: Researcher's Field Survey (2013)

Table 1 above show that 4 (30.8%) banks out of the 13 banks in Nigeria indicated that CBN's mandatory request to banks to deposit money to SMEEIS funds to service SMEs prompted them to formulate SMEEIS, 4 (30.8%) other banks agreed that increasing the flow of investment and establishing linkages in raw materials and products value chains prompted them to participate in SMEEIS, and the remaining 5 (38.5%) banks indicated that supporting government initiative to promote SMEs as vehicles for rapid industrialization.

**Table 2:** What was the maximum amount funded?

	Frequency	Percent
1.75 billions	2	15.4
150 millions	2	15.4
193 millions	1	7.7
230 millions	2	15.4
398 millions	2	15.4
450 millions	1	7.7
50 millions	1	7.7
80 millions	2	15.4
<b>Total</b>	<b>13</b>	<b>100.0</b>

Source: Researcher's Field Survey (2013)

Table 2 above show the maximum amount of fund that banks provided to SMEs under SMEEIS programme varies from one bank to another. This amount ranges from N50 million to N80 million and N450 million, up to N1.75 billion.

**Table 3:** What were the selection criteria for funded SMEs?

	Frequency	Percent
Perceived risks involved	3	23.1
Financial ability and developmental impact	4	30.8
Review of application and data submitted	3	23.1
Real sector was given priority	2	15.4
Viability, integrity and social impact	1	7.7
<b>Total</b>	<b>13</b>	<b>100.0</b>

Source: Researcher's Field Survey (2013)

Table 3 above below show the selection criteria used by banks to select the SMEs they funded under SMEEIS. 3 (23.1%) banks used perceived risks involved in SMEs as selection criteria, 4 (30.8%) banks used financial ability and developmental impact of the SMEs, 3 (23.15%) banks based their selection criteria on SMEs submitted data, 2 (15.4%) banks indicated giving priority to the real sector of the economy as their criteria, and 1 (7.7%) bank gave consideration to validity, integrity and social impact of SMEs for selection.

**Table 4:** Supportive

	Observed N	Expected N	Residual
4.00	27	8.9	18.1
5.00	20	8.9	11.1
6.00	7	8.9	-1.9
7.00	13	8.9	4.1
8.00	5	8.9	-3.9
9.00	3	8.9	-5.9
10.00	2	8.9	-6.9
11.00	2	8.9	-6.9
12.00	1	8.9	-7.9
<b>Total</b>	<b>80</b>		

Source: Researcher's Field Survey (2013)

**Table 5:** Test Statistics

	Supportive
Chi-Square	76.375 <sup>a</sup>
df	8
Asymp. Sig.	.000

Source: Researcher's Field Survey (2013)

The decision rule states that If  $X^2_{cal} > X^2_{tab}$ , reject  $H_0$ , null hypothesis. Since the  $X^2_{cal}$  (76.375) is greater than  $X^2_{tab}$  (15.507),  $H_0$ , the null hypothesis is rejected. Therefore, it can be safely concluded that, SMEs do perceive banks as being supportive in Nigeria, though this may vary across countries of the world.

## Discussion

The results of this finding are consistent with past research on the role of banks in promoting SMEs productivity. For example, (OECD, 2006) found that while SMEs are vital for economic growth and development in both industrialized and developing countries, by playing a key role in creating new jobs, financing is necessary to help them set up and expand their operations, develop new products, and invest in new staff or production facilities. Many small businesses start out as an idea from one or

two people, who invest their own money and probably turn to family and friends for financial help in return for a share in the business. But if they are successful, there comes a time for all developing SMEs when they need new investment to expand or innovate further. That is where they often run into problems, because they find it much harder than larger businesses to obtain financing from banks, capital markets or other suppliers of credit(OECD, 2006).

The difficulties that SMEs encounter when trying to access financing can be due to an incomplete range of financial products and services, regulatory rigidities or gaps in the legal framework, lack of information on both the bank's and the SME's side. Banks may avoid providing financing to newly founded SMEs because they do not have the requisite collateral and to those SMEs with high risk of loss (OECD, 2006). SMEs are at a particularly severe disadvantage when trying to obtain financing relative to larger and more established firms. It can also be difficult for potential creditors or investors to distinguish the financial situation of the company from that of its owners.

If entrepreneurs cannot gain access to finance through the regular system, they may not start up a business or simply go out of business, a potential loss to the economy. But the other danger is that they will abandon the formal system altogether and operate in the informal economy, sidestepping taxes and regulations, and thus not making a full contribution to economic growth and job creation. In most countries, commercial banks are the main source of finance for SMEs, so if the SME sector is to flourish it must have access to bank credit (OECD, 2006).

When banks have ceilings on amount they can charge as interest rates, they are unable to extend credit without adequately pricing credit to reflect the risk of lending to SMEs. In other cases, when banks own businesses, they tend to extend credits that favour businesses affiliated with them. In a market where banks can earn acceptable returns on other lending, it will not develop the skills needed to deal with SMEs (OECD, 2006). This is the case with the Nigerian banks.

As SMEs begin to grow, but have yet to establish the track record or size and collateral that would give them access to bank financing, they tend to turn to other types of risk capital offered by venture capitalists, who favour larger projects at later stages of the business cycle. Although there are many countries where the venture capital industry is still under-developed, the global venture capital industry is now a relatively mature industry that has succeeded in mobilizing hundreds of billions of dollars from institutional investors and deploying these funds to attractive business opportunities throughout the world. In contrast to the formal venture capital sector, the role played by early stage risk capital, although not well known, is more relevant for innovative SMEs, and thus presents an opportunity for government policy intervention (OECD, 2006).

To assess the role of banks in promoting SMEs strategic performance under SMEEIS, the banks were asked whether they provided training to SMEs after funding. Most of the banks, 8 (57.14%) indicated that they did not provide training for the SMEs after funding. The banks are not required by the Scheme to provide training however for their capacity building and relationship building with the SMEs, training before and after funding could have established the trust and rapport needed to boost equity participation and the profit-sharing thereof. The banks with the exception of one bank all indicated in Figure 117 that they have a follow up plan. The only bank that did not have a follow-up indicated it does not have adequate skill in the area of follow-up with SMEs. This is interesting and should not be ignored. For banks to be effective, it should not be assumed that banks have all the skills necessary to effectively implement such a scheme as SMEEIS. It should be mandatory for management and staff of banks who would be involved in SMEEIS to attend several related trainings.

As part of the assessment of the role of banks, the banks were asked if they provided guidance in investment to SMEs. With the exception of 2 (14.28%) banks, the remaining 12 (approximately 86%) banks claimed they provided guidance on investment to SMEs. While one bank did not provide guidance on investment because SMEs have their own business plans, another did not give a reason for not providing guidance. The banks are asked to provide reasons for why provided guidance on investment to SMEs and why not if applicable. The idea behind this question was because SMEEIS did

not stipulate specifically what the roles of banks are regarding assistance to SMEs. Some of the banks responded with the type of assistance other than what the question is trying to measure. The banks' responses could be considered as been adequate as a starting point for a new scheme. These procedures could be improved on in the future especially if they work on this knowing where the SMEs really.

## **Conclusion and Recommendations**

While the Nigerian government and all stakeholders of SMEEIS recognize the importance of SMEs in contributing to the Nigerian economy, there is great deal of work yet to be done to change the orientation of all involved. The observation in this study is that of finger pointing. The CBN had several roles assigned by the SMEEIS guidelines but all of these roles have to be reassessed and rewritten to reflect performance measures. Some of these roles are very vague leaving the premier bank to interpret its roles as it wishes. The roles have to be more specific in measurable terms.

The CBN and the Federal Government need to provide rigorous training to entrepreneurs and there has to be incentives provided for banks to participate. Most of the banks that participated in SMEEIS see their roles as fulfilling the mandate of CBN. While mandates would prompt banks to participate, they have to have the support of the CBN and the Federal Government in making sure they do not lose money on investment.

## **References**

- [1] Alvarez, S. A. & Brarney, J. B. 2001, How entrepreneurial firms can benefit from alliances with large partners. *Academy of Management Executive*. 15(1), 139-148
- [2] Ariyo, D. 2001, Small firms are the backbone of the Nigerian economy. In *African Economic Analysis*. Retrieved September 24, 2011, from <http://www.afbis.com/analysis/small.htm>
- [3] Arowomole, K. A. 2000, Modern business management (Theory and Practice). 1st Edition. Sango-Ota, Ogun State: Ade-Oluyinka Commercial Press.
- [4] Bank of England, 2001, Finance for small firms, An eight report. Domestic Finance Division, [www.bankofengland.co.uk](http://www.bankofengland.co.uk).
- [5] Good, W.S. & Graves, J.R. 1993, Small business support programs: The views of failed versus surviving firms. *Journal of Small Business and Entrepreneurship*, 10, 66-76.
- [6] Kesper, A. 2000, Failing or not aiming to grow? Manufacturing SMMEs and their contribution to employment growth in South Africa, TIPS Working Paper, No 15.
- [7] Mazzarol, T. 2000, Do formal business plan really matter? A survey of small business owners in Australia, Paper presented at the ICSB World conference 2000, Brisbane, Australia, June.
- [8] Morris, M. H., Kuratko, D. F., & Covin, J. G. 2008, Corporate Entrepreneurship and Innovation, 2<sup>nd</sup> edition, Thompson South-Western, Mason, OH.
- [9] OECD (*Organization for Economic Cooperation and Development*) 2006, The SME financing gap (Vol. I): Theory and evidence.
- [10] OECD (*Organization for Economic Cooperation and Development*) 2006a, The SME financing gap (Vol. II): Proceedings of the Brasilia Conference, 27-30 March 2006.
- [11] OECD (*Organization for Economic Cooperation and Development*) 2006b, The OECD Brasilia action statement for SME and entrepreneurship financing.
- [12] Penrose, E.T. 1959, Theory of the Growth of the Firm, 3<sup>rd</sup> ed., Basil Blackwell, Oxford
- [13] Rebecca, E. O., & Benjamin, J. I. 2009, Entrepreneurial competencies: The missing links to successful entrepreneurship in Nigeria. *International Business Research*, 2(2), pp.62-71.
- [14] Schumpeter, J. A. 1911, Theorie der wirtschaftlichen Entwicklung. Leipzig: Duncker & Humblot
- [15] Shane, S. & Venkataraman, S. 2000, The promise of entrepreneurship as a field of research, *Academy of Management Review*, 25, 217-226.
- [16] Storey, D. J. 1994, Understanding the small business sector. Routledge, London.

- [17] Storey, D. J. 2002, Education, training and development policies and practices in medium-sized companies in the UK: do they really influence firm performance? *Omega, International Journal of Management Science*, 30, 249-264.
- [18] Thurik, R. 2003, Entrepreneurship and unemployment in the UK. *Scottish Journal of Political Economy* 50(3), 264-290.
- [19] Udechukwu, F. N. 2003, Survey of small and medium scale industries and their potentials in Nigeria, Central Bank of Nigeria Seminar on small and medium industries equity investment scheme (SMIEIS) CBN training Centre, Lagos 6-18