Financing of small and medium sized enterprises in Nigeria

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DEDICATIONS:

To

My Loving parents:

Ardo (Alhaji) Haruna Dabo Boro

And

Hajiya Hauwa Adamu

&

My beloved wife:

Hajiya Aishatu Adamu Dabo
ACKNOWLEDGEMENTS

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May Allah abundantly bless all of you and grant ease to your efforts and endeavours as you helped ease mine.

Danjuma Adamu Dabo
ABSTRACT

The objective of this study is to assess factors which affect the performance of SMEs in Nigeria. The literature shows that economic development, growth and poverty alleviation are vitally linked with reliable and sustainable operations of SMEs. This is particularly relevant to Nigeria which seeks to diversify its real sector by reducing over-dependence on the volatile oil sector. In recognition of these problems the Nigerian government set up the Small and Medium Industries Equity Investment Scheme (SMIEIS) for SMEs. Nonetheless, as it is the case in many developing countries, SMEs are faced with poor access to financial resources, and little research seems to have focused on factors affecting the performance of SMEs in Sub-Saharan African economies including Nigeria.

The study is primarily based on an extensive mail survey of 502 SMEs in Nigeria’s two regions and three main sectors (manufacturing, business services, and trade sectors). Accordingly, a broad range of testable hypotheses have been formulated which tend to capture peculiarities in the Nigerian economy using correlation and logistic regression analysis. Access to finance, difficulties encountered, financing decisions and desire for Islamic finance turned out to be the major factors affecting regional and sectoral performance of SMEs.

The study reveals some significant differences in the regional performance of SMEs. Most important amongst these differences are: ease of 'access to finance', 'difficulties encountered' in the process, decisions about 'accepting or rejecting' bank financing, and the regional appeal of 'Islamic finance' with its different financing modes. It also reveals significant difficulties in obtaining external finance by the entire survey respondents. The study concludes that characteristics internal to the SMEs (like Firm age and size, location and legal form) and their owner-managers characteristics (like education, experience and age) seem to determine the demand for and use of external financing. It recommends policy makers and SME stakeholders to review the existing SMIEIS policies which unduly exclude most SMEs from having access to such finance.
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GLOSSARY OF ARABIC TERMS

**Amana**
(Demand deposits) Deposits held at the bank for safekeeping purpose. They are guaranteed in capital value, and earn no return.

**Bai Salam**
(Pre-payment, deferred delivery) where the buyer pays the seller the full negotiated price of a product that the seller promises to deliver at a future date.

**Bai Mu‘ajjal**
(Pre-delivery, deferred payment) where the seller sells a product on the basis of a deferred payment, in installments or in a lump sum. The price of the product is agreed upon between the buyer and the seller at the time of the sale, and cannot include any charges for deferring payment.

**Gharar**
In broad terms, it connotes risk and uncertainty. It involves the creation of excessive uncertainty or undue risk taking.

**Halal**
Permissible according to Shari‘ah.

**Ijara**
(Lease, lease purchase) A party leases a particular product for a specific sum and a specific time period. In the case of a lease purchase, each payment includes a portion that goes toward the final purchase and transfer of ownership of the product.

**Istisna**
(Deferred payment, deferred delivery) A manufacturer (contractor) agrees to produce (build) and to deliver a certain good (or premise) at a given price on a given date in the future. The price does not have to be paid in advance (in contrast to bay salam). It may be paid in instalments or part may be paid in advance while the balance to be paid later on, based on the preferences of the parties.

**Ju‘ala**
(Service charge) A party pays another a specified amount of money as a fee for rendering a specific service in accordance to the terms of the contract stipulated between the two parties. This mode usually applies to transactions such as consultations & professional services, fund placements and trust services.

**Kifala**
It is a pledge given to a creditor that the debtor will pay the debt, fine or liability. A third party becomes surety for the payment of the debt if unpaid by the person originally liable.

**Mudarabah**
(Trustee finance contract) *Rabb-ul-mal* (capital’s owner) provides the entire capital needed to finance a project while the entrepreneur offers his labour and expertise. Profits are shared between them at a certain fixed ratio, whereas financial losses are exclusively borne by *rabb-ul-mal*. The liability of the entrepreneur is limited only to his time and effort.
**Mudarib**
An agent working on behalf of the owner in a trustworthy fashion.

**Murabahah**
(Mark-up financing) The seller informs the buyer of his cost of acquiring or producing a specified product. The profit margin is then negotiated between them. The total cost is usually paid in installments.

**Musharakah**
(Equity participation) The bank enters into an equity partnership agreement with one or more partners to jointly finance an investment project. Profits (and losses) are shared strictly in relation to the respective capital contributions.

**Qard Hassana**
(Beneficence loans) These are zero-return loans that the Qur'an encourages Muslims to make to the needy. Banks are allowed to charge borrowers a service fee to cover the administrative expenses of handling the loan. The fee should not be related to the loan amount or maturity.

**Rabb-ul-mal**
This is the provider and owner of the capital in a partnership financing.

**Riba**
(usury) is translated strictly as usury; however Islamic scholars equate it as being equivalent to interest. That is payment over and above what has been lent – which causes the payment of interest or usury to be a wrong.

**Shari'ah**
(Islamic Law) The Islamic Law extracted from the Qur'an and Sunna (sayings & deeds of the Prophet)

**Takaful**
Arabic name for insurance based on Shariah rules. An Islamic Insurance is a collective protection scheme. It literally means solidarity. Takaful reflects solidarity and is akin to mutual insurance

**Ummah**
Islamic population or Muslims the world over.

**Wikala**
An Agency contract which may include in its terms a fee for the agent. Same contract can also be used to give a power of attorney to someone to represent another’s interests.

**Zakat**
Religious tax to be deducted from wealth to be paid to the needy.
### LIST OF ABBREVIATIONS

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<th>Full Name</th>
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<tr>
<td>ADB</td>
<td>African Development Bank</td>
</tr>
<tr>
<td>AMSCO</td>
<td>African Management Services Company</td>
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<td>ANOVA</td>
<td>Analysis of Variance</td>
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<td>APDF</td>
<td>African Project Development Facility</td>
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<td>Economic Intelligence Unit</td>
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<tr>
<td>FEAP</td>
<td>Family Economic Advancement Programme</td>
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<td>FOS</td>
<td>Federal Office of Statistics</td>
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<td>FGN</td>
<td>Federal Government of Nigeria</td>
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<td>FMI</td>
<td>Federal Ministry of Industries</td>
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<td>GBF</td>
<td>Growing Businesses Foundation</td>
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<td>GEM</td>
<td>Global Entrepreneurship Monitor</td>
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<td>ICA</td>
<td>Institute of Credit Administration</td>
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<td>IDA</td>
<td>International Development Association</td>
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<td>IDB</td>
<td>Islamic Development Bank</td>
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<td>IDC</td>
<td>Industrial Development Centre</td>
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<td>IFIs</td>
<td>Islamic Financial Institutions</td>
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<td>IVs</td>
<td>Independent Variables</td>
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<td>LDCs</td>
<td>Less Developed Countries</td>
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<td>LSE</td>
<td>Large Scale Enterprises</td>
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<tr>
<td>MAN</td>
<td>Manufacturers Association of Nigeria</td>
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<td>MDGS</td>
<td>Millennium Development Goals</td>
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<td>ME</td>
<td>Micro Enterprise</td>
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<td>MNCs</td>
<td>Multi-National Corporations</td>
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<td>MSE</td>
<td>Medium Scale Enterprise</td>
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<tr>
<td>MSMEs</td>
<td>Micro, Small and Medium Enterprises</td>
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<tr>
<td>NACRDB</td>
<td>Nigeria Agricultural, Cooperative and Rural Development Bank</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>NAICOM</td>
<td>National Insurance Commission</td>
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<td>NASME</td>
<td>National Association of Small and Medium Enterprises</td>
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<td>NASSI</td>
<td>National Association of Small Scale Industries</td>
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<td>NBCB</td>
<td>National Board for Community Banks</td>
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<td>NBCI</td>
<td>Nigerian Bank for Commerce and Industry</td>
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<td>NBFIs</td>
<td>Non Bank Financial Institutions</td>
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<td>NCEMA</td>
<td>National Centre for Economic Management and Administration</td>
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<td>NCGS</td>
<td>National Credit Guarantee Scheme</td>
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<tr>
<td>NEEDS</td>
<td>New Economic Empowerment and Development Strategy</td>
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<td>NERFUND</td>
<td>National Economic Reconstruction Fund</td>
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<td>NIDB</td>
<td>Nigeria Industrial Development Bank</td>
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<td>NIPC</td>
<td>Nigerian Investment Promotions Council</td>
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<td>NLNG</td>
<td>Nigerian Liquefied Natural Gas Limited</td>
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<td>NNPC</td>
<td>Nigerian National Petroleum Corporation</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>PAP</td>
<td>Poverty Alleviation Programme</td>
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<td>Profit Before Tax</td>
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<td>PLS</td>
<td>Profit and Loss Sharing</td>
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<td>Primary Mortgage Institutions</td>
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<td>PPCM</td>
<td>Pipelines and Products Marketing Company</td>
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<td>SAP</td>
<td>Structural Adjustment Programme</td>
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<td>SBA</td>
<td>Small Business Administration</td>
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<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<td>Small and Medium Enterprise Development Agency of Nigeria</td>
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<td>Small and Medium Enterprises</td>
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<td>SMIEIS</td>
<td>Small and Medium Industries Equity Investments Scheme</td>
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<td>SSE</td>
<td>Small Scale Enterprise</td>
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<tr>
<td>SSM</td>
<td>Second-tier Securities Market</td>
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<tr>
<td>STB</td>
<td>Standard Trust Bank Plc</td>
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<tr>
<td>STEP</td>
<td>Support and Training Entrepreneurship Program</td>
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<tr>
<td>TVEs</td>
<td>Township and Village Enterprises</td>
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CHAPTER ONE

INTRODUCTION
1 INTRODUCTION

1.1 Background of the Research

Nigeria, like most developing countries, faces a number of socio-economic problems, which have assumed disturbing proportions. These manifest in the enduring existence of phenomena such as mass poverty, fiscal deficits and large stacks of external debt, income inequalities, lack of or obsolete structural and physical infrastructure. These are among the many unpleasant and harsh realities that reflect on the Nigerian nation despite its abundance in resource endowments, such as human, material, mineral and vast agricultural potential. The level such inherent problems have attained is so acute, that most attempts made to resolve them have so far failed to yield the desired positive results.

The extent of poverty and the degree of inequalities, which manifest in income distribution to the different categories of persons in an economy, have been volatile issues and generally pose serious cause for concern in the developing world and particularly in Nigeria. The glaring manifestations of such inequalities in Nigeria are apparent as the desolate economic realities cannot be possibly disguised from even a disinterested observer.

Since the 1970s, global economic conditions have assumed much more difficult and volatile dimensions with slow economic growth in developed countries while most of the less developed countries recorded negative growth. Industries have shrunk in size, or worse still, some have closed down due to deep global recessions that have made it difficult to plan and commit large-scale capital investment effectively and efficiently.

Consequently, it is in these less promising conditions that small enterprises have become endearing to investors. This is due largely to their flexibility and ability to occupy and develop niche markets, which give them enhanced capacity to survive in conditions of fluctuating demand. Though difficult economic circumstances result in the closure of many SMEs, many more are always ready to replace them. These new SMEs bring with them new products, ideas, people and energy to fill the gap created by the closures.

Thus seen from this perspective the SME sector is believed to play the significant role of providing some relief from the problems that impede
development while equally providing the much-needed balance in social and economic inequalities. They are therefore essential for development as they contribute substantially to two fundamental areas of poverty reduction, that is, employment creation and economic growth, which, results in the greater economic inclusion of those in the lower income brackets.

1.2 Statement of Problem

The emergence of virile and healthy private sectors, have been recognised as the necessary agents for effective economic growth and development, and are vitally linked with the existence of reliable and sustainable operations of SMEs. This is especially so in countries with high levels of poverty most especially developing economies. More so, in most of Sub-Saharan Africa (SSA), Central Asia, lower income parts of Latin America and a host of other economies, the private sectors are almost entirely comprised of SMEs. For instance, the World Bank (2000), reports that in Ecuador 99% of all private companies have less than 50 employees. Consequently, SMEs are considered as having the only realistic employment opportunity for millions of poor people the world over.

Many small firms are launched with inadequate financial resources. To compound this problem, small firms, unlike larger, publicly-held firms, are unable to raise capital in the public debt and equity markets (Ang, 1991). Alternatively, they are restricted to sources of capital that include the owner’s savings, loans from family and friends, trade credit, and loans from banks and other financial service providers (Berger & Udell, 1998; Bitler, Robb, & Wolken, 2001). Even in the case of bank loans, however, small firms are more likely to be denied than larger, more established firms. Thus, the inability to secure external sources of capital raises the risk of firm failure. On a slightly less dire note, inadequate capital may also restrict the firm’s ability to grow, to hire employees, or to introduce new products and services thus impairing profitability and growth in the long term.

Here the conceptual emphasis on credit-worthiness is important, as it is expected that the determinants of loan safety vary systematically with size. Evidence of positive relationship between size and profitability, negative relationship between size and the variability of profit rates, greater volatility in small firm’s sales and higher failure rates in recession is such that lenders may
reasonably be expected to entertain relatively greater caution when investing in small firms (Gupta, 1972).

The SMEs therefore face many obstacles, as they often face difficult local environments that favour larger enterprises. Too often local financial intermediaries, such as banks, leasing companies, equity investors, etc., discriminate against SMEs, preferring instead to work with larger businesses, which are considered easier to deal with, less costly and less risky to serve.

Puglielli (1996) argues that small businesses take on markedly more risk than larger enterprises and usually have little collateral, thus standard credit sources (funds from commercial or development banks) are customarily inaccessible to these firms in a form conducive to efficient productive investment, or worse, credit is unavailable altogether. He concludes that the capital starvation of small industries is an economic development tragedy.

Most policy documents and SME associations indicate that SME owners consider access to finance as one of their major obstacles. Yet all efforts undertaken at different levels of economic participation in the past have done little to overcome this obstacle in a comprehensive, decisive and sustainable way. Consequently, unemployment and the rate of decline in economic development become worsened as the Nigerian economy continues to witness a build up of SMEs that are failing or performing merely at the brink of collapse. This is in spite of all the so-called policy initiatives and all manners of support and programmes successive governments have pursued to ensure the SMEs perform. Policy discontinuities worsen the situation as a result of fluidity or frequent changes to policies, programmes and implementation frameworks.

1.3 Objectives and Significance of the Study
This study aims to conduct an in-depth analysis of SME financing requirements and the types and forms of financing available in Nigeria. This is done so as to ascertain the ease or otherwise of access to both debt and equity financing by SMEs from conventional financial institutions. In other words, the research seeks to assess the performance of financial institutions in the improvement of investments by way of access to finance by SMEs in Nigeria. Other objectives to be served by this research include:
1 To demonstrate that lack of access to the desired type and form of finance from the conventional financial institutions is an impediment to the performance and survival of SMEs in Nigeria.

2 To contribute to the search for more readily accessible and viable financing sources for SMEs which provide better business funding terms and meet the needs their needs as to desired financing type and form.

3 To undertake a comparative and exploratory study of the type, nature and form of Islamic finance with those of conventional finance in a bid to ascertain their differences in acceptability or otherwise to SMEs and their owner-managers in Nigeria.

The study seeks to contribute to the search for viable and sustainable sources of finance for SMEs in Nigeria, while undertaking an exploratory search for prospective Islamic finance in Nigeria. It further attempts to enrich the dialogue on the search by both the Nigerian government and the private sector for strategies that would increase the outreach and sustainability of institutions that provide access to finance for SMEs.

This study also aims to contribute to our understanding of the development and growth of SMEs and the role of the financial sector towards providing SMEs with financing in Nigeria. It further aims to explore the role of Islamic finance as an alternative in serving the needs of the Nigerian SME market, if available.

Upon completion the research will recommend some useful suggestions to assist those involved in or interested in providing Islamic financial services in Nigeria on the type of Islamic finance required by SMEs in particular. Furthermore, it may serve as a material reference in the area of policy formulation and administration for the different tiers of government, entrepreneurs and SME financing and financial service providers.

1.4 Scope of the Study
The major focus of this study is on the SME sector of the Nigerian economy. This is predicated on the belief that it is the sector that is of most crucial importance to the achievement of long-term sustainable economic growth at both the regional and national levels.
The study is based on a detailed questionnaire survey of 502 SMEs and follow-up face-to-face interviews with some of the owner-managers, where the need for further questions and need for clarification arise.

Furthermore, given the geographical variations in SME growth and survival in Nigeria, the study is interested in the extent to which there were regional differences in the explanation of SME performance between the north and the south of the country and the factors responsible for such differences.

Thus the survey concentrates more on gathering information under the following three broad headings:

1. The nature, adequacy and desire for available external financing.
2. The characteristics of the SMEs and their owner-managers.
3. Demand for and acceptability of alternative forms of financing where such financing is or can be made available.

1.5 Research Hypotheses

The study presents in detail the hypotheses that are to be tested in chapter 5 (the analytical framework). The general directions of the hypotheses are however highlighted here in three main sections as follows:

1. Testing if any significant relationship exists between the application for debt and equity finance, difficulties encountered in seeking such financing, the decision to accept any approved finance and the use of Islamic finance (as the main dependent variables) on the one hand and the characteristics of the firm and entrepreneurs (as the independent variables) on the other hand.

2. Testing some of the variables to ascertain if any significant differences exist between the different sectors and regions in the economy that could be associated to differences in access to external financing.

3. Using an appropriate econometric (logistic regression) model the study will test for the possibility of explaining the main dependent variable given some independent variables that have relationships with the DVs.
1.6 Research Questions

The study acknowledges that problems exist both on the supply and demand sides of SME financing in Nigeria. However, it focuses more on the demand side problems. To attempt attaining the stated objectives and goals of the study some questions will be posed so as to present a direction of inquiry. These are:

1. How and to what extent do firm and owner-manager characteristics (such as, size, age, location, industry, education, training, experience, etc.) influence the investor/lender-borrower, partnership and other financial business relationships in Nigeria?

2. How accessible are SMEs to the suppliers of financing and the financing itself? Are the finance sources readily available and finances readily accessible to needy entrepreneurs?

3. What level or type of difficulties do SMEs encounter in accessing external finance?

4. Are such types of financing sufficiently attractive and readily acceptable to the entrepreneurs? Do such financing have terms and/or conditions that are unattainable to the entrepreneurs?

5. What alternative sources and types of finance other than the conventional sources and types of finance exist for SMEs in the Nigerian economy?

6. Would SMEs utilise other alternative sources of financing, such as Islamic Finance, that essentially differ in form and structure with the conventional sources of finance?

1.7 Research Methodology Overview

The study has adopted both theoretical and empirical approaches in an attempt to attain the set research objectives. The theoretical approach was undertaken through the review of different finance and economic theories that are deemed relevant and topical to issues of SME financing. This was aimed at coming up with a most appropriate model from the literature review. An in-depth review of literature on the past and current status of the role and accessibility of financing to SMEs in national economies, in general and in Nigeria, in particular was used
to achieve this. While the empirical approach entailed collecting primary data from SMEs through a cross-sectional field survey that gathers information at one point in time.

It was also significant to identify a sample size from the available total SME population. This is because it is unlikely to send out questionnaires to or interview the whole SME population. Furthermore, the main reason for sampling the population of SMEs in Nigeria is necessitated by the lack of a comprehensive census of SMEs. Thus the SME associations (the NASSI and NASME) and the Manufacturers Association of Nigeria (MAN) were approached and they provided the researcher with lists of their members in some states of the country. A sample size of 980 SMEs was obtained and utilised in undertaking the survey. The samples comprised of 490 SMEs each from the northern and the southern regions and were made up of a total of 350 SMEs in the manufacturing sector, 280 SMEs in the services sector and another 350 in the trade sector. Also some follow up interviews were conducted where it was deemed necessary to obtain further clarifications.

Of the 980 questionnaires distributed to the SME sample in the manufacturing, services and trade sectors in the geographical distribution earlier detailed, 79 were returned uncompleted because the firms had closed down, 17 were also returned unanswered as undeliverable at the addresses obtained for them and 25 were returned unfilled as the entrepreneurs declined participation in the study. Various reasons, ranging from lack of interest and time to apathy with surveys, were advanced for their refusal to participate. However 502 usable questionnaires were duly returned.

The data collected was analysed using the Statistical Package for the Social Sciences (SPSS) commencing with a descriptive analysis to reduce the raw data into a summary format in form of simple tabulation of frequency distributions and calculation of averages. Subsequently, because the data obtained are not interval data nonparametric testing is employed. This was done using tests such as one-way ANOVA (to examine the means of two or more groups of sectors), the chi square tests (to explore the possible sources of external finance available to SMEs) and Spearman's correlation coefficient (to determine the relationship between the variables in the study). Finally logistic
regression was considered relevant to this study due to its applicability in predicting group membership. This method of data analysis is therefore used to explain or predict a dependent variable on the basis of continuous and/or categorical independents and to determine the percent of variance in the dependent variable explained by the independents.

1.8 **Major Research Obstacles**

In the course of undertaking this research work some inherent impediments were encountered which created some setbacks that impacted by slowing down the pace of work and the attainment of set targets. These included but were not limited to:

1. The existence of scanty literature, prior research works, and data on the Nigerian SMEs resulted in some level of hardships and agitated concerns for the researcher. Another major impediment is obtaining a population of the SMEs in Nigeria as an SME census was only being organised by the newly created SME coordinating agency (SMEDAN).

2. Poor business and financial record keeping by SMEs. This resulted in the data collected being more qualitative than quantitative as there was a dearth of formal statistics and channels that could be used to verify such data. Consequently, this hampered the ability of the study to utilise more sophisticated methods of data analysis.

3. There is a relative scarcity of time series studies on the SME sector (Cook & Nixon, 2000) thus trends cannot be obtained that can be meaningfully compared. In addition, studies on SMEs in different countries tend to present a difficulty of comparison of the findings due to differences in cultural, environmental and economic conditions. Thus surveys conducted are more often on an ad hoc basis thereby making it difficult if not impossible to generalise findings from such studies as personal, firm and business culture characteristics manifest in different ways everywhere.

4. The dearth of literature or limited reference to Islamic finance being applied in the sector. Invariably, the required linkages between utility of Islamic finance models rather than their form and the financing of SMEs were very limited if not unavailable in most of the sources searched.
1.9 **Structure of the Study**

The study consists of nine chapters commencing with an introduction of the study in *chapter 1*. It highlights the aims and motivations of the study, the research problem, scope, questions, gives an overview of the research methodology and hypotheses and concludes with the obstacles and significance of the study.

*Chapter 2* demonstrates the theories that have been used to set the framework upon which the concepts and hypothesis expounded will be tested. While *chapter 3* proceeds to outline the methodology applied in the research by giving a detailed description of the research design and techniques used.

*Chapter 4* presents a review of the Nigerian economy by highlighting its historical evolution and the impact of reform programmes on the economy. It further discusses the financial system in the economy and the challenges of globalisation to the economy.

*Chapter 5* reviews the focal area of this study (i.e. the SME sector) by discussing its role in economic growth and development of national economies. It proceeds to review the Nigerian SME sector before highlighting the sources of finance and the financing constraints that are relevant to the sector. In *Chapter 6* literature on Islamic finance is reviewed in relation to intermediation and SME financing then its relevance in the global market.

*Chapter 7* commences the data analysis with a detailed descriptive analysis of the collected survey data, while *chapter 8* proceeds to detail the statistical results of testing the hypotheses using the spearman's correlation coefficients and the predictions of the dependent variables using logistic regression.

Finally, *chapter 9* provides a summary of the study, then draws conclusions and offers recommendations based on the findings of the study to academics, policy makers, the financial institutions and the entrepreneurs.
CHAPTER TWO

THE ANALYTICAL FRAMEWORK
2 THE ANALYTICAL FRAMEWORK

2.1 Introduction

An analytical framework is described as a lens through which the researcher perceives the entire course and question of his study. It also facilitates the systematic development and organization of the research plan and strategy. Furthermore, it presents a distinctive process by which the researcher is able to portray and evaluate data in order to arrive at the outcome of the research (Alam, 2002). Likewise, Burkart, (1968 p.14) and Alam (2002) observe that frames of reference influence our perception, but even more they influence our interpretation of what we see and the formulation of plans of action while dealing in depth with case studies. In addition, a frame of reference directs our attention to a particular range of possible experiences and equips us with methods of relating what we find to other knowledge.

The literature already reviewed on the financing of the SME sector in Nigeria reveals a dearth of research in the field, which could be sufficient to impact positively and contribute meaningfully to policy making and thereby to the country's much desired economic growth. Nonetheless, it has highlighted the vital importance of making efforts to surmount the impediments SMEs face in financing their ventures. This is with a view to ensure the maximisation of their commitment and positive input towards the economic growth and development of Nigeria. Therefore, the need to identify ways that would encourage an increased and effective participation of the SME sector in stimulating and sustaining the economic development and growth of the Nigerian economy, through improved access to alternative external finance sources, serves as the main thrust and motivation for this study.

Accordingly, this research attempts to understand and attain a clear perception of the influences of different owner-manager and firm characteristics on the exchange activities and interactions between lenders and borrowers in the SME sector in Nigeria. Thus the analytical framework is intended to present an outline for analysing the empirical data obtained by the study within the area of conventional and Islamic banking and finance systems with particularly reference to the question of financing the SME sector in Nigeria. The framework will assist in the analysis and suggestion of certain relationships with a view to
achieving a better understanding of their significance. This will enable a projection of how these relationships can be better employed in ensuring better access to external finance in the form desired by the SMEs so as to achieve sustainable growth in the sector and the economy at large.

To facilitate the foregoing, the chapter is arranged into four sections with section 2.2 highlighting the theoretical framework of the research in relation to the financing of SMEs. Section 2.3 gives the conceptual framework upon which the research is based. Then section 2.4 provides an identification and definition of both the dependent and independent variables that determine and therefore point us to the hypotheses of the study which are covered in section 2.5.

2.2 Theoretical Framework

For any academic research to add value to the existing literature it has to be based on some theoretical foundation. Therefore, as this is an empirical study it intends to briefly review the relevant theoretical literature that exists on the focus of this study. This will serve to identify the areas in which this study will augment and enhance the knowledge base that already exists.

Udell (2004) identifies the reasons that researchers and policymakers are interested in SME lending as follows. First, there is considerable concern that SME lending may be characterized by a funding gap even in developing economies. Second, because growth in the SME sector may be vital to the growth of developing economies, it may be particularly important to understand the special features of SME lending in these economies. Third, an understanding of SME lending may be essential to our understanding of how the credit channel of monetary policy works and of credit crunches.

Over the past ten years there has been a surge of interest in the academic literature over SME financing compelled in great part by these policy issues and the overall importance of the SME segment of the economy, and SME lending in both developed and developing economies (Udell, 2004). Researchers have examined a variety of issues related to SME lending including the role and nature of relationship lending (Boot, 2000), the importance of small bank lending to economic growth (Berger, Hassan and Klapper 2004), the impact of
technology on small business lending (Petersen and Rajan 2002), and the nature of non-bank commercial lending (Carey, Post and Sharpe 1998).

A concise review of the theory of the small firm as it relates to firm size structure in SMEs initiates the theoretical framework, followed by a review of principal-agent theory. Then the theories of information asymmetry, moral hazard and adverse selection, which are critical concepts to the key focus of this research on the financing needs of SMEs in Nigeria, are reviewed. The theories of financial intermediation, transactions costs and rate of return and credit markets and credit rationing are also reviewed and considered relevant to this research.

2.2.1 Theory of the Small Firm

Alam (2002) contends that the determination of the size of a firm may be based either on the value of capital investment or the number of employees which are input measures of firm size as they are internal to the firm. Then again, the volume of sales or turnover is also a determinant of firm size that is an output measure because it relates to the exchange partners outside the organisation. He further argues that in financing organisations the volume of exchange transactions or sales is an important size characteristic, being determined in financial exchange by different number of customers.

Di Tommaso & Dubbini (2000) identify four main methods that explain firm size.

- The technical efficiency approach founded on the concepts of technical and allocative efficiency.
- The institutional efficiency approach where the crucial aspect is the relationship between efficiency and transaction costs.
- The imperfect competition approach which is based on market power.
- The dynamic approach consisting of dynamic models of firm life-cycle.

The technical efficiency approach refers to the traditional analysis of firm size which is conducted in the context of a competitive equilibrium. In this approach economies of scale, which are predominantly of a technical nature, determine the optimal size of the firm (Baumol, Panzar, & Willig, 1982; Viner, 1932). However the organisation of the firm also has an influence on its size. Actually, these organisational factors, such as entrepreneurial and managerial factors intervene, creating diseconomies of scale and thereby changing the optimal size of the firm (Knight, 1965; Lucas, 1978). Sources of organisational diseconomy
are, for example, control and communication. Once a firm starts to increase in size, both the degree of control and the immediacy of communication will decrease, which makes the function of coordination necessary. Thus, it is argued that the optimal size of a firm results from a trade-off between the reward of coordination and communication costs (Geanakopolus & Milgrom, 1985).

According to the institutional efficiency approach, the efficient size of the firm rises in the presence of organisational innovations which reduce bureaucratic costs. Thus, the basic explanation for the size and distribution of firms offered by this approach is the minimization of transaction costs. This transactional approach also works for cases of cooperation between big firms and SMEs if cooperation is seen as an alternative to integration. Particularly, independent firms which choose to cooperate, rather than merge, will benefit from the advantages of integration while avoiding running into the relative costs dictated by the structure's rigidity and bureaucratization. Such conditions are the growth in specificity of assets and the frequency of transactions (Williamson, 1985).

The imperfect competition approach is based on the market power of firms. In other words, size distribution is derived from conditions of imperfect competition in which all participants in the economic system must act. Unlike the previous approaches, it is neither labelled as an efficiency hypothesis nor as one of adjustment versus equilibrium. Instead, size distribution reflects market power and its competitive structure. By introducing differentiation of costs, tastes and product, a firm's market quota no longer depends on price strategies but on the segment of the market which it serves. These cost differentials between big and small firms explain the number of small firms on the market while noting that the costs differ both for technical reasons (based on firms size, different techniques can be used) and for the advantage of small firms' flexibility.

The dynamic approach consists of the theories that analyze processes of dynamic competition like the firm's life-cycle (Marshall, 1948) and Schumpeter school of thought like evolutionary theory (Nelson & Winter, 1978; 1982). According to this, the primary source of innovation is the activity of research and development: in pursuing this activity the larger and more established firms have an advantage over those which are smaller and newer.
These models of the firm's life-cycle put the size of the firm down to its age and growth (Di Tommaso & Dubbini, 2000). They suggest that firms generally enter the market as small firms and only begin to grow through learning. The fact that a small and young firm must face greater risks than a big firm means that it will face greater turbulence. The existence of SMEs would thus be explained by a predominance of organisation diseconomies. They also note that among regularities observed on the financial side the small firm usually has difficulty in obtaining credit (Evans & Jovanovic, 1989) and is more sensitive to recession from a liquidity point of view. Undercapitalisation is also typical of the small firm.

2.2.2 Theory of the Principal-Agent
In studying the financing of SMEs the theory of agency assumes some relevance in both debt and equity financing. Jensen & Meckling, (1976 p.306) define agency relationship as a contract under which a person(s) (the principal) engage another person(s) (the agent) to perform some service on their behalf, which involves delegating some decision making authority to the agent. Thus from the SME perspective, the owner-manager assumes the role of the agent for the lender &/or investor (the principal). However, as noted by Binks & Ennew, (1996), the main source of external finance provided for small firms is bank finance. Therefore, in discussing information asymmetry in the principal-agent relationship, it is useful to consider the bank as the principal. Similarly, McMahon et al., (1993 p.69) examine agency theory from the position of the financial interests of stakeholders by exploring how stakeholders benefit from each other. This they base on modern finance theory which examines the way in which the capital market enables the allocation of scarce financial resources between individuals and business enterprises over time.

Similarly, Binks & Ennew (1996) discuss the small business finance market within a principal-agent framework. Here, the small firm is the agent of the finance provider, and thus undertakes to generate returns from its investment projects on behalf of that provider. In a 'perfect markets' setting, with full information available to both parties in the contract, a finance gap would not occur. However, finance markets are characterised by a number of market imperfections, not least of which is the problem of information asymmetry.
Figure 2.1 presents a model of principal (provider) and agent (small firm) interaction. The problems detailed under the principal, in this case, depict those problems encountered where financing is sourced from banks. Information asymmetry and related problems such as adverse selection and moral hazard are central to the problems encountered by providers and, sequentially, by small firms. The problems encountered by the SMEs in accessing finance are compounded by the trends in the finance industry. Trends such as centralisation of lending decisions, greater reliance on computer credit scoring, and preference for short-term financing options by banks are representative of what happens in the industry. Consequently banks only accept to grant approval for loan applications where the interest rates are higher and the collateral requirements are also more stringent to compensate for the increased risks occasioned by information asymmetry. Alternatively, the banks reject the firm’s application for financing as a last resort (Lean and Tucker, 2001).

**Figure 2-1: Information Asymmetry in Small Firm Lending**

The agency problem arises because savers that invest in a business venture typically do not intend to play an active role in its management thereby delegating that responsibility to the entrepreneur.
Healy & Palepu, (2001) suggests some solutions to the agency problem. They argue that the first approach is to ensure that optimal contracts (such as compensation agreements and debt contracts) between entrepreneurs and investors, which seek to align the interests of the entrepreneur with those of external equity and debt claimants, are entered into. These contracts frequently require entrepreneurs to disclose relevant information that enables investors to monitor compliance with contractual agreements and to evaluate whether entrepreneurs have managed the firm's resources in the best interests of external owners. A second mechanism for reducing agency problems is the board of directors, whose role is to monitor and discipline management on behalf of external owners. Finally, information intermediaries, such as financial analysts and rating agencies, engage in private information production to uncover any manager misuse of firm resources.

2.2.3 Information Asymmetry Theory

Information asymmetry refers to a situation where owner-managers know more about the prospects for, and risks facing their business, than do lenders. It is a situation where shareholders of a firm have less information than the managers about how the firm is doing even though the shareholders put a considerable amount of funds in the firm (Taylor, 1998). In the last two decades, much progress has been made in advancing the theoretical knowledge on how asymmetric information affects optimal loan contracts (see Bester, 1985; Broecker, 1990; Jaffee & Russell, 1976; Stiglitz & Weiss, 1981).

In a perfect markets setting, with perfect and costless information available to both parties, and no uncertainties regarding present and future trading conditions, the principal-agent relationship does not suffer from the market failure of information asymmetry. However, information in the real world is neither perfect nor costless, and in addition the small business finance market is characterised by risk and uncertainty regarding future conditions. It is therefore acknowledged that Information is distributed asymmetrically between the bank and the firm (Lean & Tucker, 2001).

If the relatively small size of SMEs means that it is uneconomic for banks to invest time and resources in developing an in-depth understanding of each enterprise, then banks may lack the information to accurately gauge the level of
risk involved in lending to SMEs. Consequently, information asymmetry may, therefore, be more acute in the case of SMEs.

The information asymmetry problem may not only result in good lending prospects being rejected but also poor prospects being accepted by the providers (Altman, 1968). Furthermore, where information asymmetries exist, theory predicts that lenders may respond by increasing lending margins to levels in excess of that which the inherent risks would require. Theory also suggests that banks may also curtail the extent of lending - credit rationing - even when the SME would have been willing to pay a fair risk-adjusted cost of capital. The implication of raising interest rates and/or curtailing lending is that firms will not be able to finance as many projects as otherwise would have been the case. In a nutshell, investment will be below the level that would have occurred had there not been information asymmetry.

Consequently, Altman (1968) identified one of the errors that are most concern to the small business sector, which occurs in bank and entrepreneur exchange activities, as a consequence of information asymmetry. This error occurs where a good investment project is incorrectly rejected by the lender. Common occurrence of this type of lending error would contribute significantly to a finance gap. He points out that in theory, the provider of finance can reduce the risk of errors and risks of lender payment default by carefully screening firms at the outset and monitoring projects during the life of the loan. However, screening and monitoring are high cost activities associated with the lending proposition. If the lender is to recoup these costs then borrower interest rates may be increased, additional risk may be covered by demanding collateral or avoided altogether by rejecting the loan application.

Similarly, Lehmann & Neuberger (2001) explain that the more information that banks obtain about borrowers, the less they have to improve borrower incentives by setting loan contract terms (including, in particular, interest rates and collateral requirements). Nonetheless, investing in information is costly hence investments in gathering and analysing information will only be made up to the point where benefits just offset the costs involved. Thus, the general problem of information asymmetry manifests in one of three ways in relation to banks appraising loan applications from firms. These are; acceptance of the
loan application but at a higher than risk-adjusted interest rate; acceptance but with strict collateral requirements; or outright rejection of the loan application.

In contrast, the nature of the information asymmetry problem on the firm's side is that it cannot prove the quality of its investment projects to the provider of finance (usually the bank). Small firm managers often suffer from a lack of financial sophistication as they are often product or service specialists, not specialists in the area of finance. Thus, the information asymmetry problem is partly one relating to difficulties in the spheres of communication and credibility. This is compounded by the fact that new or recent start-up businesses may be unable to provide evidence of a good financial performance track record.

Banks often rely on past financial performance as an indicator of the future profitability of projects. A closer relationship between the bank and the firm therefore reduces information asymmetry regarding the firm's understanding of the lending constraints faced by bank managers (Watson, 1986). Hoshi, Kashyap, & Scharfstein, (1991) present evidence from Japan to support the concept that banks help alleviate the information/incentive problems that firms face in raising external capital. They find that investment by firms that have an established banking relationship (i.e., those firms that are expected to be able to avoid external financing) appears to be less sensitive to liquidity considerations than investment by firms without such banking contracts.

2.2.4 Adverse Selection Theory

Adverse selection is a situation in which information asymmetry creates a problem where the entrepreneurs who have more risky business projects would more actively seek equity financing (where dividend payments to shareholders would be optional) rather than debt financing which require interest payments (Taylor, 1998). Likewise, Stiglitz & Weiss, (1981) explain that the problem of adverse selection arises where the bank has incomplete information regarding the underlying quality of the project and the management of the small firm.

Leland & Pyle (1977) argue that adverse selection problems affect borrowing decisions because of information asymmetry between borrowers and lenders. They represent the adverse selection model as one in which the entrepreneur's readiness to invest equity in his own project serves as an indicator of the good
quality of the project. Hence, in models of borrower adverse selection, it is argued that, borrowers sort themselves by pledging different amounts of collateral (Besanko & Thakor, 1987; Bester, 1985; Stiglitz & Weiss, 1986).

Thus banks resolve or reduce the negative impact of the information asymmetry problem by way of accepting applications for finance by small firms with higher than risk-adjusted interest rates. This becomes necessary and results specifically from the adverse selection problem or as a result of greater concentration in the market for finance (Lean & Tucker, 2001).

2.2.5 Moral Hazard Theory

Once loans are made to businesses, the owners of the business may have incentives to take higher risks than they otherwise would. This is because the owner of the firm benefits fully from any additional returns but does not suffer disproportionately if the firm is liquidated. This is referred to as the moral hazard problem. Stiglitz & Weiss (1981) maintain that moral hazard relates to a single borrower facing multiple investment opportunities where an increase in the loan interest rate affects his rents from safe versus risky ventures differently. The borrower's preference for risk increases with the loan interest rate, so that the rate increase skews his project choice towards greater risk.

Similarly, Taylor (1998) explains that moral hazard manifests as one of the problems associated with information asymmetry where the entrepreneur-manager (agent) acts in a way that is anything but in the best interest of the stakeholders (the principal). Thus the manager becomes less careful about the firm after the shareholders or investors have put in the desired funding. Where this occurs and the management of small firms fail to perform to their full capabilities, the problem of moral hazard manifests. This is compounded by the fact that it is too costly for banks to effectively monitor small firm projects, thereby resulting in equilibrium credit rationing and a shortfall in debt provision (Bester, 1987; Bester & Hellwig, 1989; Binks & Ennew, 1996).

Invariably it is assumed that to maximize their expected earnings, owner-managers of SMEs take on as much risk as possible. Even when this consideration is balanced with an aversion to risk in their revenues, entrepreneurs will still have a strong incentive to take on risky positions. What is
more, this incentive will become progressively stronger as their trading position deteriorates below the level required to earn a profit. Thus Lean & Tucker (2001) conclude that an entrepreneur who has performed badly has an incentive to take increasingly risky positions ("gambling for resurrection"), as well, of course, as to manipulate his accounts to hide the losses.

Inderst & Müller (2003) signify that studies in this area have centred on theories based on borrower moral hazard (for example, Chan & Thakor, 1987; Kiyotaki & Moore, 1997). While Cornell & Shapiro (1988 p.16) argue that the costs of financial distress are likely to be particularly severe for small growing firms because moral hazard problems increase with leverage. Another variant of moral hazard promoted by Jensen (1986) is the idea in what he termed "free cash-flow theory," which gives rise to a situation where firm managers increase the firm's size even when this is not in the best interest of equity-holders.

The moral hazard problem can be viewed as creating a situation of over-investment. However, from a theoretical standpoint, the extent to which moral hazard gives rise to over-investment is not clearly established. For example, incentives for over-investment might be influenced by the legal form of the entity. Where the entity is a proprietorship or partnership and the liability of the owner(s) is unlimited, it can be argued that the owner(s) may be less prone to moral hazard because the owner(s) may suffer loss in event of liquidation.

Where banks accept loan applications from SMEs upon the condition that the borrower meets stricter and higher collateral requirements it is likely to be as a consequence of moral hazard problems, compounded by the trend towards longer-term debt. Also, outright rejection of a loan application can result from moral hazard, market concentration, centralisation of lending decisions, and the increasing use of computer credit-scoring (Lean & Tucker, 2001). However, it is argued that the use of collateral can resolve private information and moral hazard problems (Chan & Thakor, 1987) and it can also resolve under-investment moral hazard (Stulz & Johnson, 1985). It is further argued that when banks lend to a firm, their monitoring of the firm helps to impose discipline in the firm and, in so doing, reduces the tendency within the firm to over-invest. Conversely, Bester (1987) concludes that the entrepreneur's equity investment in his own firm's project serves to mitigate the moral hazard problem.
2.2.6 Theory of Financial Intermediation

Banks always perform the function of taking deposits from savers/households and making loans to economic agents requiring capital. The understanding of the roles played by these intermediaries in the financial sector is found in the many and varied models in intermediation theory. Claus & Grimes (2003) indicate that current theories of the economic role of financial intermediaries built on the economics of imperfect information began to emerge during the 1970s with the seminal contributions of Akerlof, (1970); Rothschild & Stiglitz, (1976) and Spence, (1973) They further state that financial intermediaries exist because they can reduce information and transaction costs that arise from an information asymmetry between borrowers and lenders. Financial intermediaries thus assist the efficient functioning of finance markets; therefore any factors that affect the amount of credit channelled through financial intermediaries can have significant macroeconomic effects. Similarly, Allen & Santomero (1996) indicate that theories of financial intermediation have been built on the models of resource allocation based on perfect and complete markets by suggesting that it is frictions such as transaction costs and asymmetric information that are important in understanding intermediation. While Bhattacharya & Thakor, (1993) see financial intermediation as a response to the inability of market-mediated mechanisms to efficiently resolve informational problems.

Besanko & Kanatas (1993) note that theories of financial intermediation suggest two alternative roles for banks, the more traditional view (Fama, 1980; Niehans, 1978) describes banks as being "special" in that their demand deposit liabilities provide transactions services. Subsequently, the focus shifted to the lending function of banks. Hence Fama (1985) notes that bank reserve requirements impose costs that appear to be borne by the bank’s borrowers, implying that there must be something "special" about bank loans relative to other credit contracts. James (1987 p.234) provides empirical support that banks provide some special service not available from other lenders.

More recent views of the role of banks emphasize informational imperfections and suggest that it is the provision of monitoring services in conjunction with lending that is "special." Monitoring is important because of the well-known
agency problem that exists between a firm's insiders and its outside investors (Barnea, Haugen, & Senbet, 1985; Jensen & Meckling, 1976).

Besanko & Kanatas, (1993) suggest that an alternative mechanism for controlling insider moral hazard is reliance on bank loans coupled with bank monitoring of borrower activities. The information that a bank acquires on its borrowers (for example, through the bank’s supervision of a borrower’s collateral assets such as its accounts receivable) enables the bank to monitor borrower actions as well as more directly control relevant borrower decisions. Consequently, bank loans can be viewed as “inside” debt that is, debt financing provided by a party with inside information about the borrower, in contrast to bonds or equity issued to an anonymous capital market.

The role of information asymmetry as an alternative rationalisation for the importance of financial intermediaries has been stressed as frictions that relate more to investors’ information sets. On their part, Leland & Pyle (1977) suggest that an intermediary’s informed status is signalled by investing its wealth in assets about which it has special knowledge. While Diamond (1984) also argues that by acting as “delegated monitors” for their numerous clients, intermediaries overcome the major problems of information asymmetries.

2.2.7 Transactions Cost and Rate of Return

One major problem that SMEs encounter in their quest for external finance is the perception that they have high failure rates which initiates reluctance on the part of the finance providers towards either lending or investing in them (Scarborough & Zimmerer, 1984; Smallbone, 1990). Similarly, Storey & Johnson, (1987 p.3) maintain that small firms are distinguished from large firms by their fairly high probability of failure, which is a basic feature of small firms.

On their part McMahon et al., (1993) argue that agency problems in SMEs are likely to be more severe as a result of information asymmetries, moral hazard and adverse selection. Therefore, information asymmetry contributes to the increase in costs of obtaining external finance (Keasey & Watson, 1993; Myers & Majluf, 1984). In contrast to internal finance, obtaining external finance is more expensive for small firms as they are noted to pay more for external finance and equity (Beedles, 1991) and also for debt finance (Confederation of British
Pettit & Singer (1985) also argue that where providers of finance entertain fears of wealth exploitation by the owner-managers and/or incurring additional costs in monitoring SME financing, they may demand higher interest rates as a compensation mechanism. While Mckillop & Hutchinson, (1992; 1994) also note that the higher the levels of collateral that the small firms have to put up for external finance, the higher the cost of finance.

On rate of return, Whittington (1972) argues that better use of existing capital attracts additional profits than use of new capital. Birley & Westhead (1990) find that there exists an inverse relationship between the profitability of small firms and the use of external finance. Whereas Keasey & Watson (1994) found that bank finance for SMEs tends to generate a higher rate of return.

2.2.8 Credit Market and Credit Rationing

Ma & Smith (1996) indicate that while credit markets imperfections exist in all economies, these imperfections seem to have particularly important implications for developing countries. For example, Goldsmith (1969 p.47) is quoted to have said that "the cost of financing ... is distinctly lower in financially developed than in less developed economies", and other authors (see McKinnon, 1973; Shaw, 1973) have argued that the credit markets of developing countries are 'fragmented', causing investment funds to be allocated inefficiently. They further argue that the limited development of their financial markets, and the high cost of transacting in them, accounts for the poor real performance of a variety of less developed economies. In particular, it appears that credit market imperfections have serious consequences for economic growth. An important source of financial market imperfections is the presence of informational asymmetries, and a consequence of such imperfections is the existence of credit rationing. Indeed, the importance of credit rationing, in all economies, is evidenced by the extensive government interventions in financial markets that are rationalized by its existence (Ma & Smith, 1996).

A large variety of government interventions in credit markets are motivated by the perceived presence of informational frictions and rationing of credit. In developing countries there is an even greater array of policy interventions that are similarly motivated. These include interest rate controls, and a large number of directed credit programs (Bhatt, 1988; Jaramillo, Schiantarelli, & Weiss, 1992;
Tybout, 1983) which highlight several kinds of government credit market interventions in LDCs. While (Bhatt, 1988; Diaz-Alejandro, 1985; Jappelli, 1990; McKinnon, 1973; Shaw, 1973) underscore the importance of informational frictions in developing country credit markets.

Credit rationing means the denial of credit at any price (Bhattacharya & Thakor, 1993). In an analysis of a credit market with adverse selection and moral hazard, Stiglitz & Weiss (1981) conclude that credit rationing can spring from adverse selection, moral hazard or both. Theoretical literature exists exploring how informational frictions can lead to credit rationing (Bernanke & Gertler, 1989; Gale & Hellwig, 1985; Stiglitz & Weiss, 1981; Williamson, 1986; 1987).

Conversely, Besanko & Kanatas (1993) argue that an entrepreneur with a limited endowment must seek external financing in order to undertake a project. Limited liability induces the entrepreneur to make decisions that differ from those outside investors’ desire and that the entrepreneur himself would choose if he were able to self-finance. Various features of credit markets have been interpreted as being designed to address this agency problem. For example, Grossman & Hart (1982) describe the issuing of risky debt by the entrepreneur/manager as a means of “bonding” his behaviour, which is made credible by a personal bankruptcy cost borne by the manager in the event of default. Easterbrook (1984) and Jensen (1986) view corporate cash disbursement as a mechanism that mitigates this agency problem by removing from insiders’ control “excess” cash that could be used inefficiently or converted to perquisite consumption, and by forcing the firm to the capital market for funding where it must supply information on its activities.

Also, Bester (1985) introduces collateral as an additional instrument indicating how it can sort privately informed borrowers in a separating equilibrium thereby obviating rationing even if the collateral is insufficient to make loan risk less (Chan & Kanatas, 1985). Also Bhattacharya & Thakor (1993) argue that collateral reduces rationing even if it cannot eliminate it altogether.

2.3 Conceptual Framework

The growth of a firm is motivated by external opportunities, such as promising demand prospects for the firm’s product and internal inducements, such as
under-utilisation of the existing resources of the firm (Penrose, 1959). These internal growth factors include the features of the firm itself, such as the size and age of the firm; the characteristics of the firm's resources, such as those of the employees and the manager(s) of the firm; as well as the firm's strategic choices. Penrose (1959) argues that firm and entrepreneur characteristics determine the level of difficulty or ease which SMEs encounter in accessing and obtaining both debt and equity financing from lenders and investors.

Similarly, Lean & Tucker, (2001) explain that small firm financing problems relate to the characteristics of the firm itself and the attitude and objectives of the owner-manager. Such characteristics include their diversity, higher risk, inability to provide strong collateral, and stage of development effects. Consequently, the influences of these characteristics on the problems of access to financing by the SMEs in Nigeria will be investigated and analysed to afford the study an insight into their impact. These factors as identified by Storey (1994) are split as follows to enhance their effective investigation:

- The characteristics of the firm (SME).
- The characteristics of the owner-manager.
- Business strategies.

Further to the above, this study intends to expand the scope of the investigation into the influences of the following relevant areas;

- The characteristics of the SMIEIS fund: that is, the fund's origin, size, age, management, investment size, sectors served and investor size.
- Some relevant Islamic banking and finance methods: the applicability and role of Musharakah and Mudarabah in financing of SMEs.

2.3.1 SME Characteristics

Barkham et al., (1996) suggest that theory and research point to three potentially important influences on firm growth, these are firm size (Evans, 1987a; Evans, 1987b; Jovanovic, 1982), geographical location of the firm (Hitchens & O'Farrell, 1988; Storey, 1994) and its industrial sector (Storey 1994). Confirming and expanding on this, Storey (1994) identifies six characteristics of the firm which empirical studies consistently investigated with respect to their impact on small firm growth. These include firm age, size, sector/market, legal form, ownership and location.
**Firm Size and Age:** There is no general agreement on how firm size should be measured and therefore there is a wide variation in the growth variables used by researchers (Hitchens & O'Farrell, 1988). A firm's size may be measured by its total assets and capital employed in the business, its revenue or profits or by the amount of human and physical capital it employs. Jensen & McGuckin, (1997) suggest that though the relationship between size and age of the firm is by no means linear, in aggregate the more a firm grows (the bigger it is) the more likely it is to survive another period (the older it is).

Earlier studies indicate that certain types and sources of finance impact on SMEs at different stages of a firm's life cycle (Carey et al., 1993; Cressy, 1993; Moore, 1994; Smallbone, Piasecki, & Rogut, 2001). In relation to the age and size of a firm, the financing of new start-up SMEs depends heavily on owner's personal funds and loans from family and friends. Also young growth SMEs, at the early growth stages, tend to additionally rely on the firm's retained earnings. For firm start-up financing, Storey & Strange (1992) find that founder's personal savings are the most important source of initial capital investments, with loans and overdrafts from banks constituting the next most important source of finance. Also, a study by Binks & Vale, (1984) find that in Nottingham, 76% of start-up firms used personal savings for part or all of their initial capital, a figure paralleled by the 71% for business service new firms found by Keeble, Bryson, & Wood, (1992). Similarly, Evans & Leighton (1989) indicate that the probability of starting a new business is highest if the entrepreneur has accumulated certain personal assets in terms of wealth or home ownership.

The size and age of SMEs influence their access to finance as lenders and investors are more comfortable with firms that have accumulated sufficient amount of tangible assets that would be of collateral value. Mugler (2000) confirms this by arguing that banks prefer to offer loans based on tangible assets in an attempt to mitigate problems associated with increased risk ensuing from information asymmetry, moral hazard and adverse selection.

Previous studies analysed by Storey (1994) indicate that there is an almost unanimous finding in both the United Kingdom and United States that younger firms grow more rapidly than older firms. This growth factor increases the need for additional funding which is unlikely to be met from internal sources but more
certainly from external funding sources. At this point the firm's age and size, in tangible assets terms, act as an impediment to obtaining the required external financing. Thus Sahlman (1990) and Wetzel (1994) argue that because start-up firms are arguably the most informationally opaque, this results in their encountering much more difficulty in obtaining intermediated external finance.

Davis & Yeomans (1975) attribute the problem of access to external financing by SMEs due to firm size to the perception of greater risk(s) investments in small firms contend with. It is a well-known fact that the likelihood of failure among smaller firms is clearly higher than among their larger counterparts (Agarwal & Audretsch, 1999; Sutton, 1997; Wagner, 1997). Several studies of small firm survival and failure have repeatedly identified difficulties with financial management and an inability to secure adequate sources of capital as major contributors to business failure and dissolution (Gaskill, Van Auken, & Manning, 1993; Lussier, 1996; Watson, Hogarth-Scott, & Wilson, 1998).

**Firm Ownership:** On the ownership structure of the firm, it is argued that the type of ownership influences the sources of finance available to a firm and the degree of difficulty it will encounter in accessing such financing (Charlesworth, 1998). Berle & Means (1932) argue that the separation of ownership from control produces a condition where the interest of the owner and of the ultimate manager may, and often do, diverge and where many of the checks that formerly operated, to limit the use of power, disappear. This was further highlighted by Demsetz (1983) who maintains that the separation of ownership and control in the modern business structure retains a central position in writings about the economic theory of the firm.

One of the primary motives of entrepreneurs for starting a small business is to exert greater control over the work environment and to internalise the benefits of personal effort and risk-taking through higher expected earnings. Hence, it is understandable that many small business managers would resist any dilution of this control by way of outside equity from venture capitalists or business angels (Lean & Tucker, 2001). Levicki & Acton Society Trust, (1984) indicate that the findings of studies reveal a consensus that owner-managers and entrepreneurs place emphasis on autonomy and independence as major personal goals and they use the enterprise as the major arena for their expression.
**Firm Legal Form:** Hakim (1989) finds that firms with the capacity for faster growth were much more likely to be limited liability companies while the typical no-growth firms were home-based unincorporated firms which employed only one or two people including the owner-manager. Hence, Storey (1994) concludes that the firm's legal form influences the firm's growth. While, Deakins & Freel (2003) argue that the key benefit of incorporation is credibility with customers, suppliers and financial institutions. Thus, incorporated firms are more likely to have easy access to external finance in comparison to unincorporated firms, considering the difficulty often faced in ascertaining the entrepreneur's personal funds and assets from those of the firm.

**Firm Location:** the influence of location on access to finance is also a factor that this research intends to investigate since banks would look at the availability of a market for the products of the firm so as to ensure full recovery of any financing made out to such firms. Gudgin, (1978) emphasizes that local knowledge of the markets and premises, family ties, limited capital and the cost of moving must all be taken into account in the decision about location. Conversely, studies on firm location suggest that neo-classical theories of the firm location have little applicability to the start-up firm, because most new firms are established where the founders happen to be living at the time of going into business (Fothergill & Gudgin, 1982; Keeble & Wever, 1986).

**Firm Industry Sector:** Earlier research indicate that most SME founders set up business in the industry or sector in which they had worked and are familiar with. The finding of Binks & Vale (1984), that the majority of new firm founders in the Nottingham area set up in the same sector even if the industry had suffered from recession, supports this contention. Similarly, Keeble, Walker, & Robson, (1993) explain that the industry with which an individual is familiar has certain advantages such as lower levels of risk and better business contacts which render it most attractive for that individual, even when its profitability levels and prospects are relatively poor (see Oxenfeldt, 1943). Thus investigating the impact of a firm's industry or market sector on the ease or otherwise with which it can access finance is also a subject of enquiry in this research.
2.3.2 Owner-Manager Characteristics

Several empirical studies show that personal characteristics of the leaders of business firms influence the amount of success of those firms (Friedlander & Pickle, 1968). Though, in the context of leadership of firms a distinction is sometimes made between entrepreneurs and managers (Hartmann, 1959).

The reason that entrepreneurial characteristics are so important to the study of small firms is related to their structure (Holliday, 1995). The entrepreneur is the central personality in the firm thus the owner-manager's characteristics significantly govern the culture of the firm and thus affect operations and the firm's access to external finance. Thus Barreto, (1989 p.143) states that entrepreneurship in any or all of its different roles is essential if we are to understand how the market system generates change and growth.

The attitude and objectives of the owner-managers can exert important influences on the firm's ability to secure external finance, such as unwillingness to provide personal assets as collateral. These attitudes and objectives may sometimes constitute an important constraint upon the range of external financing sources available to the firm (Lean & Tucker, 2001). However, Binks & Ennew, (1996) argue that many small firms are forced to provide earnings expansion to protect their limited liability status (which would otherwise be eroded by the provision of personal assets as loan collateral).

Storey (1994) identifies entrepreneur characteristics that empirical studies repeatedly investigated as significantly influencing the success of firms. These include the entrepreneur's age, educational attainment, management skills, training, previous sector experience and prior firm size experience.

**Entrepreneur's Age:** Some studies conclude that the age of the owner-manager is an important characteristic and factor in the consideration of firms for external finance by lenders and investors (Peters, Cressy, & Storey, 1999). In a survey of Scottish manufacturing firm founders, Cross, (1981) reveals that a vast majority of entrepreneurs were between twenty-six and forty-five years old when they set up a new firm. This age range is considerably younger than that of the typical chief executive running a small manufacturing firm.
Also, in his study, Cressy, (1993) finds that both younger and older owner-managers are more likely to encounter difficulties in sourcing for external finance than middle-aged owner-managers. It is therefore argued that though younger entrepreneurs may have more energy for the success of an enterprise, they lack the credibility and business experience in the market place and are more likely to be financially constrained (Storey, 1994). While, Judd, Taylor, & Powell, (1985) in their examination of the personal characteristics of the small retailer find that the age of the entrepreneur is inversely related to success. They conclude that as the retailers increase in age and retail experience, their profitability ratios decrease and they tend to be less successful. They also add that age is not a variable that can be influenced. Consequently, they express the fear that their findings may in some cases encourage lenders to discriminate against older people for new-venture loan applications in an unjustifiable manner. This is because they are of the opinion that the relationship between age and success allows for many exceptions (such as the possibility of the existence of older successful entrepreneurs).

**Entrepreneur's Education & Training:** The evidence on educational attainment levels appears to be somewhat divergent. Literature on education, entrepreneurial psychology, motivation and strategy has produced a mass of contradictory findings which have resulted in a wide range of theoretical interpretations of data supplied in studies (Barkham et al., 1996). However, one useful typology to consider when relating entrepreneurial characteristics to firm growth is the distinction between craftsmen and opportunist entrepreneurs. First put forward by Smith, (1967) this categorisation is supported in a number of subsequent studies (Boswell, 1973; Cooper & Dunkelberg, 1986; Smith & Miner, 1983). The craftsman entrepreneur is characterised by low levels of formal education, high technical ability, lack of managerial orientation, limited business goals and a reluctance to plan ahead. The opportunist entrepreneur has a degree-level education, a long-held ambition to start a firm and make it grow large, diverse business experience and a high level of managerial capacity.

Storey (1994) argues that education provides a basis for intellectual development which the entrepreneur requires to be in business successfully, and that higher levels of education provide the individual with greater confidence.
in dealing with customers and bankers. He underscores the assertion that education is a key constituent of the human capital required for business success, thus educated entrepreneurs are more likely to establish faster-growing firms. More so, that this will enhance their ability to meet information and business plan requirements of lenders.

Storey & Strange (1992) found that the educational level of firm founders in northern England tends to be rather low with the likelihood of a founder having some formal qualification being universally related to age. Pickles & O'Farrell, (1987) also show that most entrepreneurial males in Ireland are generally those with partial or complete secondary education, while entrepreneurship in manufacturing, distribution and miscellaneous services is more strongly associated with higher levels of education than transport and construction. In Belgium the educational level of the new entrepreneur is shown to be lowest in manufacturing and higher in services (Donckels, Dupon, & Michel, 1987).

Bolton, (1971 p.22-25) concludes that on the whole small firm owner-managers tend to be relatively poorly educated and few of them make financial gain their key goal. Without exception later studies of entrepreneurs and owner-managers all underline this point (Bannock, 1981; Boswell, 1973; Scase & Goffee, 1980; 1982; Stanworth & Curran, 1973; Storey, 1982).

The problem of management training in SMEs is vast considering that lack of education and training hinders development. For example, growth requires considerable financial investment, but obtaining finance is often contingent upon the skills of the entrepreneur. In their study of rural entrepreneurs in UK, Townroe & Mallalieu, (1993) found that one quarter of business owners had attended some sort of training course in connection with the setting up of their business. Also, Macpherson, Jayawarna, Wilson, & Elsammani, (2003) indicate that a study by Homan, Hicks-Clarke, & Wilson, (2000), responded to research focused on SMEs within the manufacturing sector that had identified the lack of management skills of owner-managers as a contributory factor in either impeding growth or indeed causing failure of small businesses. Thus, Macpherson et al., (2003) are of the view that the development of appropriate skills will be of paramount importance in arresting any further decline.
**Prior Management Experience:** Another characteristic of the entrepreneur that is relevant and important as an influence on the exchange activities with external financing sources is management experience. In particular previous managerial and professional expertise in the successful formation and/or running of new firms is important as demonstrated in many studies (Keeble et al., 1993). Storey (1994) argues that the entrepreneur plays a key role of organising the work of others hence prior experience of this task is likely to supplement the expertise of the entrepreneur and enable business objectives to be more easily achieved. He therefore concludes that prior management experience is positively associated with new firm growth. While Lean & Tucker, (2001) argue that due to the lack of business experience of many small firm owner-managers in the early years, business risk may be more significant than for larger firms. This perception of higher business risk in small firms affects their ability to access external finance.

In his study Cross, (1981) demonstrates that most Scottish firm founders had held managerial jobs immediately before setting up their own firms, while 58% of Barkham's (1987) south east sample were found to have been previously employed in managerial, professional, scientific or technical occupations.

### 2.3.3 Business Strategy

Burns & Grey (1988) note the tendency of SMEs not to invest in training and signify that the link between strategy, tactics and results is not always explicit and often confused. Many studies have demonstrated the heavy reliance of SMEs on internally generated funds but, once established, they tend to operate gearing ratios similar to or higher than large firms and a proportion of short-term debt that is higher than large firms (Burns, 1987).

Considering that the sources of finance accessed by a firm and their corresponding financial structures influence the propensity of SMEs to grow, their relative reliance on short-term debt finance is therefore far from ideal. Hence, it is suggested that the constraint imposed on firms that utilise short-term debt funding can be avoided by the adoption of the capital for equity exchange (Deakins & Hussain, 1994). Consequently, Storey (1994) suggests that those firms which have either shared external equity or have been willing to allow an external holding in their company are more likely to grow than those which decline to share or disallow external equity participation.
The use of business plans and budgets plays a key role in the process of raising external financing as it affords the investors and lenders a detailed understanding of the venture being financed and the possibility of full recovery of any financing involved. Reid (1998) points out that banks use business plans to assess the ability of SMEs to repay loans and also gives the owner-managers the opportunity to demonstrate their expertise and experience. Thus firms that do not utilise such business plans in running their businesses are more likely to encounter difficulties in raising loans (Advisory Council on Science and Technology, 1990; Boocock & Presley, 1993; Reid, 1998).

2.3.4 Characteristics of Financial Institutions
Deteriorating credit market conditions may aggravate financial constraints stemming from asymmetric information, incentive problems and limited collateral. During such periods financial intermediaries may restrict the supply of loans to some businesses, thus precluding the financing of valuable investment and production opportunities (Atanasova, 2003).

Lean & Tucker (2001) state that small firms generally have smaller financial reserves to draw upon in times of crisis and are also relatively highly geared compared to larger firms due to the difficulty and expense of attracting new equity finance. Thus, they are characterised not only by higher business risk but also higher financial distress risk. Thus, rather than focusing their attention on evaluating the income streams flowing from an investment project, banks may focus more upon the value of collateral available in the event of financial distress. This creates a problem for small firms in that they often do not have significant fixed assets to rely upon and use as collateral in their early years of establishment. The stage of development, then, may be an important determinant of, and constraint upon, the type and amount of external finance raised. Small firm financing will then typically be heavily secured debt with few occurrence of external risk capital contribution (Cruickshank, 2000).

**Loan contracts:** Banks worldwide suffer from problems associated with the effects of adverse selection and moral hazard. Because a bank cannot be certain about a borrower’s ability ex-ante and it cannot perfectly monitor a borrower’s effort ex-post, the bank must design contracts to try to achieve the first-best full information outcome. Loan contracts generally require that
borrowers post assets that can be taken over by lenders should the borrowers default on the promised payments. An explanation for such contractual arrangements is that borrowers and lenders have asymmetric information about the project that the loan is financing. Thus because borrowers appear to know more about the project than the lender, the borrowers' evaluation of the project tends to be higher than that of the lenders.

Lean & Tucker (2001) identify the problem of information asymmetry and the resulting adverse selection and moral hazard as being further compounded by certain trends in the banking sector. Firstly, competition in the banking sector is leading to greater market concentration. This has an important impact on the market for small firm finance as there is evidence that larger/universal banks are less well placed to build close relationships with small business customers than smaller/regionally-based banks (Bannock & Doran, 1991; Binks, Ennew, & Reed, 1991). Secondly, a broad trend is that banks are further centralising business lending decisions and/or limiting branch manager discretion to lend outside of very strict policy guidelines. The ultimate lending decision maker has thus become even more remote to the small business borrower. Thirdly, although authors such as Binks & Ennew, (1996) argue that the introduction of expert systems and other knowledge-based decision support systems to bank lending should reduce information costs whilst raising quality and consistency in lending decisions, such developments may actually lead to a greater unwillingness to lend to firms with non-standard projects, particularly in highly innovative or high-technology sectors. Fourthly, recent evidence reveals a decline in the use of bank overdraft facilities and a move towards term-loan lending among businesses (Binks & Ennew, 1996). The result might be more cautious lending by banks; as such loans are not repayable on demand. Furthermore, there is likely to be a greater demand for collateral (business or private) to support loans with a longer maturity.

**Collateral:** In situations where collateral is scarce and contract enforcement weak, banks are never quite able to achieve the optimal allocation of loans where low-risk entrepreneurs pay a low interest rate and high-risk entrepreneurs pay a high interest rate resulting in the rationing of credit (Gupta, 2003). In addition, Swift & Riding, (1990) indicate that in the event of bankruptcy there is
the increased risk of non-recovery of debts in the service industry as firms in the sector are characterised by few tangible assets. Thus such firms obtain less favourable credit terms than firms in the manufacturing sector who have tangible assets that can be disposed of if they default.

In many LDCs, banks require collateral that is many times higher than the value of the loan because the costs of foreclosing a property can exceed the value of the property itself. In parts of Mexico and Thailand, for example, collateral valued at three to nine times the loan size is required by banks (La Porta, Lopez-de-Silanes, & Zamarripa, 2001).

Atta-Mensah (2003) signifies that collateral in loan agreements acts as a disincentive for borrowers to default while also playing an important role in loan negotiations even when borrowers and lenders have the same information but differ in opinion. It also serves to signal information to the lender about the riskiness and prospects of the project the loan is needed for. Borrowers provide collateral as a way of sorting themselves out by risk class if lenders believe that the level of secured loan indicates the project's profitability. Lenders may have such beliefs because secured debt is costly for borrowers whose projects are of low quality (Atta-Mensah, 2003). Examining the data in the United Kingdom, Black, de Meza, and Jeffreys (1996) find that the value of collateral posted by small businesses exceeds the value of loans. Leeth and Scott (1989) and Berger and Udell (1990) find that most commercial loan agreements require collateral as security. Consequently, Black, de Meza, and Jeffreys (1996) find that the size of collateral impedes the creation and growth of small firms.

**Relationship Lending:** This is an important characteristic describing a typical bank based financial system, as it implies that there exist a long term, information intensive contractual relationship between a single bank and a particular borrower (Elsas & Krahnen, 2002). Welch, (1997) argues that relationship lending and loan collateralization are complementary institutions potentially designed (and ex-ante agreed upon) to minimize ex ante costs of coordination failure. Collateral is based on particular assets coming from outside the firm (outside collateral, like a portfolio of securities, or a personal guarantee by a third party), or based on particular assets from inside the firm (inside collateral, like machinery, equipment, buildings). For outside assets, collateral
increases payments to the bank in borrower default, may resolve adverse selection problems, affects incentives for strategic default by the borrower, and can substitute for information about project quality (see Besanko & Thakor, 1987; Bester, 1994; Bolton & Scharfstein, 1996; Manove, Padilla, & Pagano, 2001). For inside assets, however, collateral serves different functions; it defines priority over the firm’s future cash flows among lenders, and also provides incentives and/or valuable information for monitoring (Rajan & Winton, 1995).

Credit rationing: theory has linked the financing motive to credit market imperfections, which may cause financial institutions to restrict credit to their customers (Atanasova, 2003). Inderst & Muller, (2003) argue that collateral improves the bank's expected payoff from financing low-signal projects, thus extending the range of signals at which the bank is willing to provide credit.

The empirical results of the study by Petersen & Rajan (1995) show that firms which do not suffer from credit rationing do not use trade credit, while firms for which asymmetric information generates credit rationing react by using trade credit. Also the empirical evidence in Nilsen, (1994) finds that when the interest rates increase (because the monetary policy is tightened); small firms react by using trade credit to avoid credit rationing (Blais & Gollier, 1997).

2.3.5 SMIEIS Fund Characteristics
To put together an outline of the SMIEIS fund it is significant to gather information on the demographic features of the fund in the Nigerian economy. This will facilitate the analysis of the entire data set collected in our survey on the fund. It is therefore aimed that the results obtained from the analysis would afford a thorough understanding of the fund's general characteristics. It is also aimed to determine the influence, if any, of such characteristics on the results of the study to be presented after the data analysis. These are;

- The fund size
- Investment size/amount
- Investment by sector
- Investment by regions/states

2.3.6 Islamic Banking and Finance
Research in Islamic economics creates a better understanding of fundamental principles governing the economic system and how different economic agents
interact according to Islamic rules. It is therefore argued that adherence to these rules will lead to effective compliance with Islamic shari'ah thereby reducing informational asymmetry, adverse selection and moral hazard. This will ensure equitable property rights and well supervised fair and efficient markets. In addition the Islamic economic system is based on rules of conduct specified for both the individual and the society which if adhered to assure an Islamic society of economic growth and development (Iqbal & Mirakhor, 1999).

The freedom to enter into contracts and the obligation to remain faithful to their stipulations has been so emphasised in Islam that faithfulness to the terms of the contract is seen as the characteristic that is supposed to distinguish a Muslim. Thus Iqbal & Mirakhor, (1999) conclude that the strength of the religious commitment determines the degree of rule-compliance, and therefore, the effectiveness of the institutions which govern an economic system. This will ensure less divergence between the choices individuals make and those expected of them by the institutions thereby reducing the cost of enforcing contracts and rules of conduct. Thus information asymmetry and moral hazard will be minimised since a large part of uncertainty arising from asymmetries of information will be eliminated through rule-compliance.

Both Musharakah and Mudarabah are variants of equity finance modes of Islamic finance. The study attempts to investigate if any relationship exists between the availability of Islamic finance and the desire of the entrepreneur to apply for and/or even to accept external finance that is currently available in the Nigerian financial market. This is ensured by, attempting in the survey conducted, to discover the awareness and desire for Islamic finance as an option to available interest-based conventional finance. The entrepreneurs were further requested, in the survey, to indicate their preference or otherwise for Islamic finance and to specify if they would be willing to move their banking business to an Islamic bank (if and when available).

2.4 Defining Research Variables
2.4.1 Dependent Variables
2.4.1.1 Applied for Debt Finance
This is defined as the explicit desire that exists in a firm for new or additional funds from outside sources of debt finance with which to finance starting up a
new business venture or expansion. Thus the manifestation of this need for financing is ascertained where a firm has identified and applied for finance from the finance provider(s), irrespective of whether or not the application is successful. Basically the consideration here is the need for external debt finance expressed through applying for the finance by the SMEs.

2.4.1.2 Applied for Equity Finance
Here the interest of this study is the need for external equity finance being signified and followed through by the SMEs applying for the finance from their bank's SMIEIS equity investment fund.

2.4.1.3 Difficulties in raising external finance
In seeking external finance, firms encounter difficulties that range from even the availability of such financing, the type and form of financing to the acceptability or severity of the terms of the available financing.

Investors and lenders often decline or turn down such funding requests by borrowers (SMEs). In research works undertaken by both Aston Business School, (1991) and the University of Cambridge, (1992) the following reasons were advanced to support this application turn-down, these are:

- Lack of collateral or security
- Lack of personal financial contribution
- Lack of success in previous business venture(s)
- Lack of track record
- The project may be too risky or the proposed project's lack of viability
- Business expansion deemed to be too rapid
- Borrower (the firm) exceeded approved borrowing limits.

2.4.1.4 Acceptability of external finance offered
Where a firm succeeds in securing an approval for external finance application, it may still encounter further difficulties in the processing of such loans which may impede its plans for expansion (University of Cambridge, 1992). This translates to the offer for the approved external finance being made on terms that may be unfavourable or practically unattainable by the firm. Some examples of such terms are;

- The request for higher level of collateral than the firm can afford.
• Higher than normal interest rates
• Tenor mismatch, that is, where shorter duration of the approved finance may not match the tenor needs of the firms.
• The funds offered are below the amount or level of finance required.

2.4.1.5 Use of Islamic Equity finance
This refers to the willingness of the surveyed SMEs to utilise Islamic finance equity financing modes where available in financing future needs of the firms.

2.4.2 Independent Variables
2.4.2.1 SME Characteristics
• Size of the firm: From the preceding review it is apparent that SMEs are variously defined by different institutions and government agencies in Nigeria. This study is primarily focussed on SME financing and the literature review has highlighted the relevance of tangible assets in sourcing of external finance. Thus in this study the number of people in the firm’s current employment is employed in defining our firm size or the asset value where the staff size is not obtainable or available. For small enterprises the total number of employees is up to 50 and an asset value of less than N50 million. While for medium enterprises the total number of employees is up to 300 and an asset value of less than N200 million.

• Firm’ age: refers to the number of years the enterprise has been in active business as at the time the survey for this study was conducted.

• Ownership structure and type: The type of ownership of the firm in this study refers to the classifications as applied by the Corporate Affairs Commission (CAC) in Nigeria (that is sole proprietorships, partnerships and incorporated firms). The CAC is the body responsible for registration of businesses from where they derive their legal form.

• Location and industry sector: This refers to the location of the enterprise within the country in relation to regional location (i.e. South or North) and the type of industry or industrial sector the enterprise is in.

2.4.2.2 Owner-Manager Characteristics
• Entrepreneur's age: The age bracket within which an owner-manager falls as given in the survey is used here.
• **Education and training**: This is the level of educational attainment of the entrepreneur and any training in business or SME management skills.

• **Managerial skills and experience**: These are measured by the experience of owner-managers in previous employment or at management level.

### 2.4.2.3 Business Strategy

• **External equity participation**: This is measured in the survey by the application for SMIEIS venture capital fund by respondents from their banks.

• **Business plan**: Knight & Knight (1993 p.33) explain that a business plan is a written document of the firm that charts its future course and targets in specific terms. This study views a business plan as a document that presents a detailed analysis of the firm's current position and future targets.

### 2.4.2.4 Financial Institutions

• **Collateral**: This refers to the level of collateral that will be required by financiers with a view to justifying the risks associated with financing the SME and serves to cushion the effects of default or bankruptcy. Thus the criteria here is whether or not SMEs gave collateral for financing received.

• **Interest**: This refers to the interest charges banks apply on financing advanced to SMEs which in some cases are above market rates for SMEs due to the perceived high risks involved in lending to such firms.

### 2.4.2.5 SMIEIS Fund

This is defined as the equity investment fund that banks in Nigeria set up for investment in SMEs. It has the features of venture capital funds.

### 2.4.2.6 Islamic Finance

• **Musharakah**: This is an Islamic financing mode that entails both investors and entrepreneurs share in the project finance and management. It is based on sharing of profits and losses on a pro-rated basis.

• **Mudarabah**: This mode of Islamic finance is based on a principal-agent relationship where the investors on the one hand only supply capital while the entrepreneurs provide their entrepreneurial skills. This mode is based on pre-arranged profit sharing ratios while in case of losses the investors bear
such losses totally if it is established that the entrepreneur was not negligent or dishonest in the business venture.

2.5 Statement of Hypothesis

The study hypotheses are extensively derived from the literature review and the focus of previous studies where the characteristics of the small and medium sized enterprises, their owner managers and business strategies adopted by such SMEs have been used before. Here the research hypotheses are propounded under seven broad areas with the first five areas representing each of the five dependent variables discussed above. The other two areas represent the study’s investigation of differences in the sectors or regions on access to conventional and desire for Islamic finance. The hypotheses are each studied by looking at the dependent variables on the one hand and the independent variables that are assumed to have relationships with them on the other. Thus each main hypothesis is further broken down based on the independent variable of interest. Also instead of representing the null and alternative hypotheses with \( H_0 \) and \( H_1 \) respectively, the study hypotheses have been labelled with figures signifying first the dependent or main test variable and a sub-number for the independent variable in each hypothesis.

All these hypotheses will be tested within the null hypothesis (which is usually represented by \( H_0 \)) that no relationship (in the case of the five dependent variables) and no difference exists (in the case of the regions and the sectors) in the variables being tested in each case.

2.5.1 Applied for Debt Finance

The type of finance (debt finance) and the firm, owner-manager of financing characteristics identified from the literature review are used here to set the following hypotheses:

**Hypothesis 1:** There is a relationship between the decision to apply for debt finance and Firm, Entrepreneur or Financing Characteristics.

**Hypothesis 1.1:** There is a relationship between the decision to apply for debt finance and the size of the SMEs.

**Hypothesis 1.2:** There is a relationship between the decision to apply for debt finance and the age of the SMEs.
Hypothesis 1.3: There is a relationship between the decision to apply for debt finance and the legal form of an SME.

Hypothesis 1.4: There is a relationship between the decision to apply for debt finance and using a written business plan.

Hypothesis 1.5: There is a relationship between the decision to apply for debt finance and education and training.

2.5.2 Applied for Equity Finance

The literature review highlighted the type of finance (equity finance) and firm, owner-manager or financing characteristics used to set the hypotheses here.

Hypothesis 2: There is a relationship between the decisions to apply for equity finance and Firm, Entrepreneur or Financing Characteristics.

Hypothesis 2.1: There is a relationship between the decision to apply for equity finance and the age of the SMEs.

Hypothesis 2.2: There is a relationship between the decision to apply for equity finance and the legal form of the SMEs.

Hypothesis 2.3: There is a relationship between the decision to apply for equity finance and the use of business plan.

Hypothesis 2.4: There is a relationship between the decision to apply for equity finance and the owner-manager's status.

Hypothesis 2.5: There is a relationship between the decision to apply for equity finance and the age of the entrepreneurs.

Hypothesis 2.6: There is a relationship between the decision to apply for equity finance and the entrepreneur's education and training.

Hypothesis 2.7: There is a relationship between the decision to apply for equity finance and the entrepreneur's previous experience.

Hypothesis 2.8: There is a relationship between the decision to apply for equity finance and debt financing applied for.

Hypothesis 2.9: There is a relationship between the decision to apply for equity finance and the entrepreneur's awareness of other sources of equity finance.

2.5.3 Difficulties in Raising External Finance

Hypothesis 3: There is a relationship between difficulty in obtaining external finance and the Firm or Entrepreneur Characteristics.

Hypothesis 3.1: There is a relationship between difficulty in obtaining external finance and the size of the SMEs.

Hypothesis 3.2: There is a relationship between difficulty in obtaining external finance and the age of the SMEs.
Hypothesis 3.3: There is a relationship between difficulty in obtaining external finance and SME legal form.

Hypothesis 3.4: There is a relationship between difficulty in obtaining external finance and the use of business plan.

Hypothesis 3.5: There is a relationship between the difficulty in obtaining external finance and the entrepreneur's age.

Hypothesis 3.6: There is a relationship between the difficulty in obtaining external finance and entrepreneur's education and training.

Hypothesis 3.7: There is a relationship between the difficulty in obtaining external finance and the entrepreneur's experience.

2.5.4 Decision to Accept Approved External Finance

Hypothesis 4: There is a relationship between the decision to accept approved external finance and some financing terms.

Hypothesis 4.1: There is a relationship between the decision to accept approved external finance and collateral requirement.

Hypothesis 4.2: There is a relationship between the decision to accept approved external finance and interest charges.

2.5.5 Use of Islamic Finance

Hypothesis 5: There is a relationship between the desire to use Islamic finance and the decision to apply for or accept external finance.

Hypothesis 5.1: There is a relationship between the desire to use Islamic finance and the decision to apply for external finance.

Hypothesis 5.2: There is a relationship between the desire to use Islamic finance and the decision to accept external finance.

2.5.6 Conventional Finance differences by Region

Hypothesis 6: There is a difference between the Northern and Southern region SMEs in some dependent variables.

Hypothesis 6.1: There is a difference between the Northern and Southern region SMEs in applying for external finance.

Hypothesis 6.2: There is a difference between the Northern and Southern region SMEs in the difficulty in obtaining external finance.

Hypothesis 6.3: There is a difference between the Northern and Southern region SMEs in the decision to accept external finance.

2.5.7 Islamic Finance Differences by region and Sector

Hypothesis 7: There is a difference between the region and industry sector of SMEs in the decision to use Islamic finance.

Hypothesis 7.1: There is a difference between the Northern and Southern region SMEs in the desire to use Islamic finance.

Hypothesis 7.2: There is a difference between the industry sectors of SMEs in the desire to use Islamic finance.
2.6 Summary

Some theories and concepts that have some bearing on the area of study and that are applied in testing the relationships between the study's variables are analysed in this chapter.

The size theory of the firm, which indicates that access to finance is determined by the size of a firm, is examined. It is discussed that large firms have easier access to external finance sources than SMEs by virtue of their being seen to have more assets and track record therefore are less informationally opaque. The principal-agent theory states that the relationship of the SME and investors is that of principal (investors) and agents (SMEs) where due to information discrepancies (information asymmetry theory) the agent may act in a manner that is not in the best interest of the investors. This action is a consequence of information asymmetry, which manifest as the theories propounded as moral hazard and adverse selection. In these theories it is said the agent after having obtained the investors funds may take decisions to maximise his gain to the detriment of the investors. These actions could range from taking on riskier but more profitable ventures which the agent might otherwise not take with his own funds or the agent may engage in expenses that are more to maximise personal benefit than for the firm.

It also examines in more detail the consequences of these information asymmetries that manifests in adverse selection and moral hazard and the cumulative effect of all these problems on the credit market especially for SMEs. These affect the perception of the risk profile of small firms which then results in finance providers, most especially lenders, taking stronger or more strict positions on collateral, interest rates and profitability which explain the discussion on the theory of transaction costs and rates of return. The impact on the SMEs of all the problems associated with and caused by agency problems is the increased difficulty in accessing finance external to the firm and its owners which result in credit rationing by banks and denial of funds by investors.

This leads to a discussion of the conceptual framework by examining the characteristics that influence the exchange activities between the small firm and external finance sources. In the case of the owner-managers the impact of their ages, level of education, managerial experience, training and skills were
adopted as the characteristics that would form the structure upon which the
enquiry will be based. Likewise for the firm characteristics such as the firm's
age, size, ownership type, location and industry have been discussed and
structured into the study variables.

For business strategy it is considered that the decision to allow external equity
participation determines to a large extend the types and sources of finance
available to the SMEs. Equally the use of business plans has also been shown
to be relevant and useful in the process of seeking external financing especially
for banks as they need to carefully appraise the projects and their viability.
Financial institutions on their part make it a point to adequately secure their
lending to customers, thus for SMEs that presents a difficulty as most are small
and new therefore have little or no tangible assets to pledge as security.
Furthermore where the SMEs are unable to pledge substantial security or due to
the perception of their business and financial risk profile, lenders increase the
cost of funds to compensate for the deficiencies. The Nigerian equity fund
scheme (SMIEIS) and the Islamic finance modes of Musharakah and
Mudarabah are variants of equity financing that have been considered in this
study as they present alternatives to the available debt finance. Thus they too
are seen as variables that form part of the conceptual framework of this study.

The main study variables are detailed in this chapter as need for external
finance which reflects as the decision to apply for debt and equity finance by
SMEs, the difficulties associated with raising finance and also the acceptability
of such financing by the owner-managers of SMEs. Thus the study links these
main variables to the independent variables which are identified as the
characteristics of the firm, owner-managers, financial institutions, SMIEIS and
Islamic finance modes to facilitate a rationalization of the interrelationships and
their influences on SME financing in Nigeria. Having defined the variables, the
chapter proceeds to state the research hypotheses that would be tested in order
to establish whether or not the relationships do exist as assumed.
CHAPTER THREE

RESEARCH METHODOLOGY
3 RESEARCH METHODOLOGY

3.1 Introduction
Wagner (1997) defines methodology as the process, principle and procedure by which researchers approach problems and seek answers. While Creswell (1994) sees it as being the entire process of the study; that is the procedural framework within which the research is conducted. Remenyi & Williams (1995) also explain that methodology only describes an approach to problems that may be operationalised into a research programme. They therefore argue that though methodologies are important, it is pertinent to note that they serve to provide generic guidelines rather than definite directions as to how research should be conducted. However Bryman (1984) notes that researchers confuse methodology and methods with each other. Thus while methodology, whether described as qualitative or quantitative, refers to an epistemological stance, research methods refer simply to the way and means of gathering data.

The preceding chapter detailed the analytical framework of this research. Accordingly, this chapter discusses the research methodology used in this research. Section 3.2 gives an overview of the two research paradigms; section 3.3 then describes the methodologies employed in undertaking some previous research works. Sections 3.4, and 3.5 proceed to lay out the research design, and research strategies adopted for this study respectively. The process of data collection, data preparation and that of data analysis and presentation are covered in sections 3.6, 3.7 and 3.8 respectively.

3.2 Overview of Research Paradigms
The two main approaches to empirical research, qualitative and quantitative research, can be taken to form two distinctive clusters of research strategy (Bryman, 2004) or can be seen to represent two paradigms, each historically assuming different ontologies and epistemologies (Hathaway, 1995; Merriam, 1988; Rennie, 1995). Assumptions, values, and philosophy underlying methods and techniques, and their use are inherent in these paradigms (Fielddeldey-Van Dijk & Ucamp, 1998). A paradigm in this sense refers to our working assumptions of the world; how we know and respond to it (Cornbleth, 1991). International debate has suggested that the 'qualitative - quantitative' terms represent what Kuhn referred to as a paradigm clash (Rennie, 1995).
However, between qualitative and quantitative approaches there is evidence of some harmony (Bryman & Burgess, 1999). If we separate the levels relating to paradigms, methods and techniques, then methods and techniques are compatible (Mouton, 1996) regardless of paradigms they originated from or are associated with. For example, methods can be triangulated (Durrheim & Wassernaar, 1999). One approach can facilitate use of the other approach or the different approaches can complement each other (Bryman & Burgess, 1999). Similarly, Strauss & Corbin (1998 p.31) explain that 'data collection and analysis can be done in both modes, and in various combinations, during all phases of the research process'.

3.2.1 Quantitative Approach

Gage (1994 p.372) defines quantitative research as:

"The ideals of quantitative research call for procedures that are public, that use precise definitions, that use objectivity-seeking methods for data collection and analysis, that are replicable so that findings can be confirmed or disconfirmed, and that are systematic and cumulative—all resulting in knowledge useful for explaining, predicting, and controlling the effects of teaching on student outcomes."

According to Huysamen (1997), "descriptions of quantitative research typically recognize a cycle of successive phases of hypothesis formulation, data collection, analysis and interpretation". Quantitative research focuses on the statistical and attempts to quantify the extent to which a “group” or the target subject are aware of, think this, believe that or are inclined to behave in a certain way; otherwise, it focuses on finding how many. However Bryman 1984) also explains that quantitative approach places more emphasis on fixed measurement and hypotheses testing of causal relationships, whereas Bell (1991) argues that the approach provides a wide but shallow emphasis.

Consequently, using a deductive approach, quantitative research seeks to establish facts, make predictions, and test hypotheses that are already stated. A large part of the data analysis of quantitative research is statistical. It strives to show that the world can be looked at in terms of one reality; which, when isolated in context, can be measured and understood, a perspective known as
positivism (Gay & Airasian, 1999). The approach uses surveys, experiments, histories and analysis of archival information techniques (Wagner, 1997).

3.2.2 Qualitative Approach

Qualitative research has been described as 'the interpretative study of a specified issue or problem in which the researcher is central to the sense that is made' (Parker, 1995 p.2). Basically, qualitative research involves methods of data collection and analysis that are not quantitative (Lofland & Lofland, 1984). It uses unreconstructed logic to get at what is actually real. That is the quality, meaning, context or image of reality in what people actually do, not what they say they do (as on questionnaires). Unreconstructed logic means there are no step-by-step rules, that researchers ought not to use prefabricated methods or reconstructed rules, terms and procedures that try to make their research look clean and neat (as in journal publications).

Most often qualitative research is grounded theory which means it is built from the ground up. Palmerino (1999) referred to it as ‘focus group research’ where samples are often very small and which can be used to determine the characteristics of a particular group. These groups may range in size but they are smaller than the samples used in quantitative research. This enables the researcher to spend more time making an in-depth analysis of the topic being researched. Wagner (1997) indicates that this approach utilises techniques such as case studies, participant observation and interviews. In the opinion of Bryman (1984) the qualitative approach seeks to understand the social world.

Qualitative research may be used for exploratory work before a large scale or more complex study is mounted (Hakim, 2000). Bell (1991) therefore argues that this approach gives a narrow but more detailed focus. It therefore tends to be used most heavily in disciplines where the emphasis is on description and explanation rather than on prediction.

3.2.3 Contrasting the Two Paradigms

Bryman (2004) argues that on the face of it, there would seem to be little to the distinction between the two research approaches other than the fact that quantitative researchers employ measurement and qualitative researchers do not. Layder (1993) opines that the status of the distinction between the two
research paradigms is ambiguous, because it is almost simultaneously regarded by some writers as a fundamental contrast and by others as no longer useful or even simply ‘false’. Hoepfl (1997 p.14) further explains the basic differences between the two forms of research by saying that "phenomenological inquiry, or qualitative research, uses a naturalistic approach that seeks to understand phenomena in context-specific settings. Logical positivism, or quantitative research, uses experimental methods and quantitative measures to test hypothetical generalizations''. Similarly, Liebscher (1998 p.669) states that a quantitative research methodology is appropriate where quantifiable measures of variables of interest are possible, where hypotheses can be formulated and tested, and inferences drawn from samples to populations. While, qualitative methods, on the other hand, are appropriate when the phenomena under study are complex, are social in nature, and do not lend themselves to quantification.

On his part, March (1988) argues that qualitative methods are accurate and provide more fact, but are slower to emerge, as the method is more expensive and more complicated. In contrast he further argues that quantitative methods are quicker, cheaper, simpler and provide wide ranging overviews but they are also more subjective and are prone to bias.

Wagner (1997) argues that the two different approaches offer different trade-offs with regard to external validity, reliability and precision. He notes that quantitative measurements are qualitatively accurate, while qualitative evaluations are always subject to human judgement hence, can be faulty. Also Gill & Johnson (1993) indicate that because the quantitative approach is highly structured, it is higher in terms of internal validity and reliability but low in ecological validity. While, in the case of the qualitative approach, it is conversely low in internal validity and reliability due to the weakness of its structure.

Furthermore, whereas quantitative researchers work mostly with numerical data, qualitative researchers use mainly "non-numerical data such as observations, interviews, and other more discursive sources of information" (Gay & Airasian, 1999). Another difference between the two types of research is that where quantitative research seeks to find evidence which supports or does not support an existing hypothesis, "qualitative designs allow the hypotheses to emerge from patterns of recurring events" (Huysamen, 1997).
Arguments are made supporting the view that social research is based on 'qualitative knowing' and that quantification extends, refines, and cross-checks qualitative knowledge. That is, current thought holds that the two paradigms are not mutually exclusive and could very well support each other in most social science inquiry. Thus to criticize qualitative data as being subjective is to accuse it of having high unreliability; to extol the objectivity of quantitative data is to interpret it as having low shortcoming (Howe, 1985 p.10-13).

Thus Hoepfl (1997 p.3) concludes that each approach represents a fundamentally different inquiry paradigm and researcher actions are based on the underlying assumptions of each paradigm. In recognition of this therefore, many researchers today advocate a paradigm of choices that seeks methodological appropriateness as the primary criterion for judging methodological quality. This will allow for situational responsiveness that strict adherence to one paradigm or another will not (Patton, 1990 p.30).

### 3.3 Methodologies of Previous Studies

A review of the different methodologies that have been employed by researchers in the past informs the focus of this research in this section. This is done with the intention to evaluate the relevance of these methodologies in shaping the methodology and research design applied in this research.

Some recent research works on SMEs have tended to be exploratory in nature (Burns & Walker, 1991; Oakey, 1984; Peel & Wilson, 1996; Van Auken & Carter, 1989). Oakey (1984) explored the different patterns of capital investment funding and investigated the effect these have on innovation within SMEs by utilising chi-square and measures of correlation to analyse the results obtained.

On the other hand, the dominance of research that is descriptive in nature manifests at the early stages of developing a paradigm for the study (Abakhail, 1999; Calof, 1985; Dunkelberg & Cooper, 1983; Hajjar, 1989; Hutchinson & Gray, 1986; Jones, McEvoy, & Barrett, 1994; Keasey & Watson, 1993; McKillop & Hutchinson, 1994; Osaze, 1981; Tamari, 1980). In this regard, Hajjar (1989) in his research on small business finance undertook his investigation using mail questionnaires and personal interviews and used descriptive research (charts, frequency tables, percentages & ratios).
The examination of some relationships within SMEs, the differences among groups or the independence of various factors, formed the focus of other studies (Bracker, Keats, & Pearson, 1988; Bracker & Pearson, 1986; Carter & Van Aukcn, 1991; Hassan, 1990; Keasey & McGuinness, 1990). These studies involved in-depth examinations of a small number of SMEs in their own context and adopted methods that ranged from the application of the field study approach (Oakey, 1984; Osaze, 1981) to the use of case-study approach (Austin et al., 1993; Binks, Jenning, & Vale, 1986).

Past studies had largely relied on the most common methods of collecting primary data, which are, by the use of questionnaires and interviews, while some relied on the use of published data entirely. Consequently, in spite of the general agreement by researchers that participant observation is the most effective way of studying the life of an SME, there appear to be no research works that have utilised such methods in their studies (Curran & Burrows, 1987; Holiday, 1995; Stockport & Kakabadse, 1992). Thus Stockport & Kakabadse (1992 p.188) opine that ethnography "provides a means of generating better quality information and knowledge of entrepreneurship". It also provides detailed insight into the day-to-day activities and operations of small firms.

Most of the studies undertaken on SMEs employed quantitative techniques in their data collation and analysis. Gibb (1990) and Wortman (1987) agree with this position by noting that there exists a shift from undertaking research using relatively unsophisticated tools (such as percentages and ratios) to the application of more sophisticated statistical methods of analysis. These research works have employed statistical methods like the chi-square test (McKiernan & Morris, 1994; Peel & Wilson, 1996) the T-test and F-test (Bracker & Pearson, 1986) and correlation (Keasey & McGuinness, 1990).

3.4 Research Design

A research design provides a framework for the collection and analysis of data. A choice of research design reflects decision about the priority being given to a range of dimensions of the research process (Bryman, 2004). It therefore represents a structure that guides the execution of a research method and the analysis of the subsequent data. A more detailed definition of research design is given by Oppenheim (1992) as being:
"A basic plan or strategy of research, and the logic behind it, which will make it possible and valid to draw more general conclusions from it. Thus the research design should tell us how our sample will be drawn, what sub-groups it must contain, what comparisons need to be measured (when and what intervals) and how these measures will be related to external events, for example, social, medical or other interventions. Research design is concerned with making our problem researchable by setting up our study in a way that will produce specific answers to specific questions."

Parker (1997) explains that the interpretation of aspects of research design such as reliability and validity differ in relation to qualitative and quantitative research. For example, a mistaken assumption that a phenomenon remains the same even different ways are used to study it informs the concept of validity in ‘quantitative’ research. The traditional ‘quantitative’ concept of reliability also rests on the assumption of stability, rather than change in subject matter. When conducting qualitative research, we focus on, and articulate the process of change (Parker, 1997). Similarly, Wolcott (1994) explains that it seeks to understand a world which is continuously being constructed, not a ready-made one. Kvale (1996) discusses his understanding of validity which relates to the credibility of the researcher, the communal dialogue engaged in, and pragmatic criteria which needs to be considered continually throughout the research.

Hakim (1987 p.171) highlights the importance of research design thus:

"Research is in the nature of sailing off to chart unexplored seas, or more correctly, trudging off to mark unexplored territories. Research design is about aiming in the right direction, getting your bearings right (from previous studies) and making sure you are adequately equipped to get there and back. ... Research designs, which fail in their original intentions, are not always quite so lucky, but it helps if one is clear that their original plan made sense, can offer some reasons on why it went awry, and describes what was discovered instead."

Sekaran & Sekaran (1992 p.92) explain that the design decisions become more rigorous as the research proceeds from the exploratory stage (where an attempt
is made to describe certain characteristics of the phenomena that is of interest to the study) to the hypothesis testing stage (where the study examines whether or not the conjectured relationships have been substantiated and an answer to the research questions obtained. An effective research design links abstract and stylized concepts and questions with the empirical world's complexities and challenges. A research design must at once be specific and highly flexible. It must be expansive enough to adapt these very complexities while still pointing you towards relevant data (King, Keohane, & Verba, 1994).

There are basically three types of research: the exploratory, descriptive and causal (Aaker & Day, 1990; Zikmund, 1994) which are discussed as follows:

3.4.1 Exploratory Research
Research is done to gain an understanding or to gain new insights into a particular phenomenon. Exploratory research is used to derive precise research questions or to develop hypotheses. It requires a flexible and wide far-reaching strategy, open-ended techniques, and the use of atypical samples. It is undertaken for heuristic purposes (a particular technique of directing one's attention in learning, discovery, or problem-solving), to get closer to an explanation (Palys, 1997; Selltiz, Wrightsman, Cook, & Society for the Psychological Study of Social Issues, 1976).

Selltiz et al. (1976) explain that the primary objective of this type of research is to provide insights into and an understanding of the problem confronting the researcher. This type of research attempts to "determine whether, and to what degree, a relationship exists between two or more variables" (Gay & Airasian, 1999). Generally it is meaningful in a situation where the researcher does not have enough understanding of the phenomena being investigated so as to proceed with the research project. Malhotra (1996) further points that exploratory research is characterised by flexibility and versatility with respect to the methods of enquiry as formal research protocols are not employed.

By becoming familiar with the phenomenon being investigated, through exploratory research, the researcher can begin to identify important variables and questions of interest. In the process, the researcher must avoid foreclosing what may prove to be worthwhile avenues of investigation and remain open to
various perspectives. Exploratory research is a good source of ideas and helps ensure that when more systematic research questions and designs are formulated they will be meaningful. It is important to acknowledge that the results of exploratory research may be little more than subjective (Palys, 1997) and may also be wrong. At a minimum, users of information gathered through exploratory research must seek out subsequent work to find out whether preliminary results have been overturned or not.

3.4.2 Descriptive Research
This type of research attempts to answer questions about the current status of the subject of study. Descriptive research attempts to accurately portray the characteristics of whatever entity is being studied, be it an individual or a population (Palys, 1997; Selltiz et al., 1976). Usually, this type of research involves studying the preferences, attitudes, practices, concerns, or interests of some group of people (Gay & Airasian, 1999). Two critical issues in descriptive design, both necessary for validity, are the ability to generalize from the sample (which must be large) and the reliability and validity of the observations or measurements (Fong, 1992). Descriptive studies deal with questions of “what are things like?” or “what is going on?” while exploratory studies deal with the question “why is it going on?” (De Vaus, 1993). A descriptive study is therefore undertaken so as to establish and illustrate the characteristics of variables in a situation. Its main goal is to describe relevant aspects of the phenomena of interest to the researcher from an individual, organisational, industrial or other perspective (Sekaran & Sekaran, 1992).

3.4.3 Causal Research
Explanatory research attempts to study causal relationships (Palys, 1997). The purpose of such research is to test a hypothesis about a causal relationship between variables (Selltiz et al., 1976). Also called ex-post facto research, causal research seeks to discover a cause-effect relationship between two or more different programs, methods, or groups. It is concerned with determining cause-and-effect relationships that typically take the form of experiments which are best suited to determine cause and effect (Unnava, Burnkrant, & Erevelles, 1994; Churchill, 1995). Here the researcher does not usually have control over the causal factor or independent variable because it is studied after the fact. The
effect is called the dependent variable (Gay & Airasian, 1999). In undertaking causal research the design adopted is the use of both the exploratory and the descriptive types of research.

3.5 Research Strategies
Research strategy simply means a general orientation to the conduct of social research (Bryman 2004). In adopting a research strategy, this research considered the trend revealed through review of similar past studies. The literature revealed that most mainstream research works undertaken used data obtained from primary sources. These primary sources, which are discussed hereunder, include observations, case studies, interviews and questionnaires.

3.5.1 Observational Research
Generally scientific enquiries begin with observation and in the course of the study, where the need to verify the accuracy of what has been achieved arises, the research periodically reverts to the technique. Nisbet (1997 p.15) explains that observation is not a 'natural' gift rather it is a highly skilled activity for which an extensive background knowledge and understanding is required and also a capacity for original thinking and the ability to spot significant events. Thus where a research relates to the study of human behaviour, the direct observation mode of research has been found to be a most favoured means of data collection (Al-Kharusi, 2003).

The direct observation approach is applied in research within the respondent’s natural work environment, either through participant or non-participant observation. The former entails the researcher getting involved in the natural work environment while the latter entails the researcher watching the happenings without being personally involved (Sekaran & Sekaran, 1992). In addition observational research can either be structured or unstructured observations which are affected by the researcher’s knowledge about the particular aspects under study.

One advantage of observational research is that it can lead to the elimination of respondent’s bias which results from his involvement in answering questions in surveys (Abakhail, 1999). This then eliminates the need for dependence on
"second-hand" accounts of phenomena from respondents who offer their own interpretations of events (Saunders, Thornhill, & Lewis, 1997 p.199).

Conversely, it also has some drawbacks that impede its effectiveness such as in a situation where due to inadequate training, the researcher becomes overwhelmed and thus exhibit bias in the collection of data. Sekaran & Sekaran (1992) note that observation itself may largely influence or determine the behaviour exhibited by the respondents where the observation is for a short duration. This implies in effect that the respondents may not act or behave naturally because of their awareness of being observed. Furthermore, the researcher may fail to foresee or contemplate the influence attributable to factors external to the research and the researched. Another major drawback that relates to time and financial resources is the fact that this technique is expensive. Additionally, in the case of being a participant observer in group studies, the researcher is faced with the risk of becoming over-socialised or "going-native" (that is, giving up the research and joining the group for life) which invariably affects the neutrality of the researcher. Thus, this technique is adjudged unsuitable for use as this study is focused on a sector-wide and country-wide coverage and it's utility could not be established.

3.5.2 Case-Study Based Research

Yin (1994) defines case study as "an empirical inquiry that investigates a contemporary phenomenon within its real life context; when the boundaries between phenomenon and context are not clearly evident, and in which multiple sources of evidence are used. Bryman (2004) explains that the basic case study entails the detailed and intensive analysis of a single case, while Stake (1995) observes that case-study research is concerned with the complexity and particular nature of the case in question. Adelman, Jenkins, & Kemmis (1977) also describe case study as 'an umbrella term for a family of research methods having in common the decision to focus on inquiry around an instance. Thus it is principally concerned with the interaction of factors and events and it is only by sometimes taking a practical instance that a full picture of this interaction can be obtained (Nisbet & Watt, 1980 p.5).

Lang & Heiss (1984) are of the view that this approach involves an in-depth analysis of the subject being studied, including the use of archives, interviews,
questions and observations thereby facilitating the collection of meaningful information. It is particularly appropriate for individual researchers because it gives an opportunity for one aspect of a problem to be studied in some depth within a limited time scale (Bell, 1999). Jankowicks (1995 p.180) explains that case study research is also used in comparative case studies where organisations are chosen to represent different possible positions, regardless of the relative frequency of these perspectives in a population.

Bryman (1984) also explains that case study research technique is relevant in work that focuses on trying to understand areas of an organisation's functions that are not well documented but that can best be investigated through contact with the organisation. In addition case studies are of most utility in researching issues that required a deep understanding of how things happen rather than in testing out relationships between the events that occur. When the primary task is to understand how action is taken to manage specific situations, a qualitative case study approach is helpful. A case study approach provides for a complete understanding of the complexity of a situation by examining the phenomenon within the context that it occurs (Yin, 1984).

The great strength of the technique is that it allows the researcher to concentrate on a specific instance or situation and to identify or attempt to identify the various interactive processes at work. These processes may remain hidden in a large-scale survey but may be crucial to the success or failure of systems or organisations (Bell, 1999 p.10-11). In case study research it is deemed more appropriate to treat the representative sample in terms of qualitative logic for the selection of cases for study, other than the quantitative logic of sampling from a population. This clearly differentiates it from the survey approach in which organisations are chosen to be representative of some population. Thus Eisenhardt (1989) concludes that in order to generalise results in a case study research, the findings need to be obtained from multiple studies which combine theory building and theory testing empirical studies. While Denscombe (1998 p.36-37) maintains that the extent to which findings from this research type can be generalised to other examples in the class depends on how far the case study example is similar to others of its type.
Therefore in view of the focus of this research, being to investigate the financing problems of and viability of financing options available to SMEs in Nigeria, this technique is applied. The case study for this research is therefore limited to the SMEs in Nigeria within the manufacturing, trade and services sectors only.

3.5.3 Interviews

Interview is a direct verbal contact between the researcher and the sampling population and may be conducted through either face-to-face or telephone conversation. Interviews are classified according to the structural nature of the questions being used. These are structured interviews, semi-structured interviews and unstructured interviews (Saunders et al., 1997) and are each used to address specific research problems. Thus the decision to choose between the different types of interviews depends largely on the researcher's understanding of the research problem and variables (Babbie, 1973).

Nisbet & Watt (1980 p.13) point out that interviews provide important data, but they reveal only how people perceive what happens not what actually did or does happen. Conversely, Sellitz, et al. (1962 p.583) point out that interviewers are human beings and not machines which therefore increases the danger of bias creeping into interviews, and of their manners having an effect on the respondents. To remedy the bias problem, Gavron (1966 p.159) suggests that though it is difficult to see how bias can be completely avoided, awareness of the problem plus constant self-control can assist in resolving the problem.

3.5.3.1 Personal or Face-to-Face Interviews

This is where the researcher has the consent and willingness of the respondents to conduct personal interviews at acceptable places (for example the office or home of the respondents). The respondents to be interviewed in this study will mostly be owner-managers of SMEs, senior bank and government officials that would otherwise be too busy to answer the questionnaires. Also owner-managers from whom further clarifications are necessary upon return of the questionnaires are interviewed. The advantage of this method is that it guarantees an immediate response from the respondents and allows for further explanation of any ambiguous questions or answers to questions. Response rate is appreciably higher than in most other methods.
Oftentimes conducting oral surveys requires a staff of interviewers; to control this variable as much as possible, the presentation and preparation of the interviewer is an important consideration. Thus, the interviewer should take care to dress and act in such a way that would not offend the general sample population. Equally, the interviewer should be well acquainted with the questions, and have ample practice administering the survey with mock interviews. If several interviewers will be used, they should be trained as a group to ensure standardization and control. Interviewers also need to carry a letter of identification/authentication to present at in-person surveys.

When actually conducting the interviews, a decision has to be made about how much of the participants' responses need to be recorded and how much the interviewer will need to "probe" for responses. Also, how much the interviewer will need to account for context (what is the respondent's age, race, gender, reaction to the study, etc.) except where a close-ended question survey is being administered. However, when recording more open-ended responses, the researcher needs to decide beforehand, (depending on the purpose of the study) whether the interview should be recorded word for word, or whether the interviewer should record general impressions and opinions. However, for the sake of precision, the former approach is preferred. More information is always better than less when it comes to analyzing the results.

Sometimes respondents respond to a question with an inappropriate answer; this can happen with both open and close-ended question surveys. Even if you give the participant structured choices the response might still require the interviewer to probe for an appropriate answer. In an open-question survey, this probing becomes more challenging. The interviewer might come with a set of potential questions if the respondent does not elaborate enough or strays from the subject. The nature of these probes, however, need to be constructed by the researcher rather than being improvised by the interviewers, and should be carefully controlled so that they do not lead the respondent to change answers.

Badr (1982) argues that face-to-face interviews are amongst the most significant and effective tools of collecting information, especially given that most people like to talk directly more than they like to write. However, Easterly-Smith, Thorpe, & Lowe (1997) indicate that oftentimes its complexity is underestimated.
This technique has the following advantages as identified by (Babbie, 1973; Lang & Heiss, 1984; Rubin & Babbie, 1989):

- The response rate is expected to be high.
- It can eliminate the confusion respondents have over certain questions that may result in “don’t know” answers as the interviewer is present to offer clarifications and elaborations.
- The researcher has the added opportunity of being able to observe and assess the non-verbal language of the respondent.

Nonetheless, the technique has some disadvantages, such as,

- It is expensive and time consuming where the sample covers a large geographical area.
- Getting appointments with highly placed respondents is almost always difficult (Shaughnessy & Zechmeister, 1994).

3.5.3.2 Telephone Interviews
This method is one of the fastest means of collecting data from a specific respondent who has the ability to communicate through the telephone without bias. It is also used as a means to follow up with respondents on issues arising from earlier mail, telephone or interview methods used. The advantages attributable to this method include the relatively significant response rate, the wider coverage of respondents and the ease with which the sequence and questions can be reviewed and adjusted.

Phone surveys certainly involve all of the preparedness of the face-to-face surveys, but are known to encounter new problems because of their reputation. It is much easier to hang-up on a phone surveyor than it is to slam the door in the face of an interviewer, and so the sheer number of calls needed to complete a survey can be very sizeable. Computer innovation has tempered this problem a bit by allowing more for quick and random number dialling and the ability for interviewers to type answers into programs that automatically set up the data for analysis. Systems like CATI (Computer-assisted survey interview) have made phone surveys a more cost and time effective method. Even though that makes them popular respondents are getting increasingly more reluctant to answer phone surveys because of the rise in telemarketing.

Therefore to ensure a basic understanding of the significant issues at the beginning of this research and subsequently of the variables applied the interview method was used. The technique, along side the literature review,
assisted in the development of the instrument used for the subsequent large scale study. It also was prominent in gaining clarifications from the respondents on some aspects of the responses that the researcher felt needed elaboration after the survey questionnaires were returned.

3.5.4 Survey or Questionnaire Based Research

This is an efficient mechanism for data collection for the researcher who knows what is required and who is aware of ways to measure the variables of interest. Stone (1978) explains that this approach is the most popular means of data collection and the most frequently used method in the social sciences. While Remenyi & Williams (1995) opine that it is a highly structured means of collecting specific information as a response to highly directed questions.

Thus, Bell (1999) suggests that the aim of a survey is to obtain information which can be analysed and patterns extracted and comparisons made. In most cases this approach will aim to obtain information from a representative selection of the population and there from be able to present the findings as being representative of the population as a whole. However, great care has to be taken to ensure that the sample population is truly representative.

A questionnaire is a printed list of questions designed to elicit information or opinions from respondents who are chosen in some designated manner (Miller, 1991; Oppenheim, 1992). It is often used to describe a set of questions administered face-to-face or by telephone in the form of a structured interview (Oppenheim, 1992). Malhotra (1999) and Zikmund (1994 p.350) describe a questionnaire as a pre-formatted set of written questions to which respondents record their answers, usually within rather closely defined parameters. They can be responded to away from the researcher as self-administered, group-administered, postal or email questionnaires.

Questionnaires are one of the most popular methods of conducting scholarly research. They provide a convenient way of gathering information from a target population. Questionnaires are easy to analyze, and most statistical analysis software can easily process them. They are cost effective when compared to face-to-face interviews, mostly because of the costs associated with travel time (Bachrack & Scoble, 1967; Hochstim & Athanasopoulos, 1970; Moser & Kalton,
This is especially true for studies involving large sample sizes and large geographic areas (Clausen & Ford, 1947; Goode & Hatt, 1962; Ruckmick, 1930). Written questionnaires become even more cost effective as the number of research questions increases.

Written questionnaires reduce interviewer bias because there is uniform question presentation (Jahoda, Deutsch, & Cook, 1962). Unlike in-person interviewing, there are no verbal or visual clues to influence a respondent to answer in a particular way. Many investigators have reported that interviewer voice inflections and mannerisms can bias responses (Barath & Cannell, 1976; Benson, 1946; Boyd & Westfall, 1965; Cahalan, 1951; Collins, 1970; Dohrenwend, Colombotos, & Dohrenwend, 1968; Franzen & Lazarsfield, 1945). Written surveys are not subject to this bias because there is no interviewer. Conversely, the lack of an interviewer limits the ability to probe responses. Structured questionnaires often lose the "flavour of the response", because respondents often want to qualify their answers (Walonick, 1993). By allowing space for comments, the researcher can partially overcome this disadvantage.

However, Schwarz (1999) states that it is well accepted, in the behavioural sciences, that surveys are not perfect vehicles for collecting data because they require subjects to recall past behaviour. Some social scientists contend that observation captures behaviour more accurately (Andrews, Nonnecke, & Preece, 2003) with ample data to support their position. Others suggest that the survey questions bias subject judgements and answers (Schwarz, 1999).

One alternative, many contend, is to collect behavioural data using multiple approaches (Rogers, 1987; Sudweeks & Simoff, 1999). Observations, focus groups, individual interviews, email, Web-based, postal, and random digital dial telephone surveys can be used in combination to improve results quality (Smith, 1997) and sample representativeness (Swoboda, Muehlberger, Weitkunat, & Schneeweiss, 1997; Yun & Trumbo, 2000).

Although high response rates are more difficult to achieve with self-completion questionnaires than by individual interviews (Cartwright, 1983) questionnaires were the choice data collection instrument in this study. The sample size required for reliable estimates and viable statistical analysis was such that it
could be achieved only by postal questionnaire given the resources available to
the researcher and the need for national representation.

The survey based research method can be conducted through either personally
delivered, postal-mail or e-mail questionnaires.

3.5.4.1 Postal Surveys
Postal surveys involve sending already prepared questionnaires to selected
respondents through the post. Postal questionnaires can be a cheap and is
considered most appropriate for a wider coverage of the target respondents
across the country or the population of a study (Jordan, 1998; Oppenheim, 1992).
It also serves best for raising personal and sensitive questions that
respondents' would be shy or unwilling to answer in the presence of any person.
In addition, because the researcher is not present while the respondents write
their answers, data collected is free of any investigator effects (Jordan, 1998;
Oppenheim, 1992). That is, the respondents cannot be influenced by the
researcher and will not, consciously or unconsciously, try to answer in the way
that they think the researcher wants them to.

The drawback with this method is that though it is considerably cheap to
administer, it is time consuming, as it may require continuous follow-up.
Furthermore it needs to be despatched with some form of introductory or
reference letter and a duly-stamped return envelop otherwise there is every
tendency that the response will be below expectation. The weaknesses of postal
questionnaires are related to the fact that they may be filled in away from the
researcher. This means that the respondents do not have the chance to ask the
researcher about anything that is unclear, as they do in interviews or focus
groups (Jordan, 1998). Hence, careful design of the questions is needed
incorporating the gathering of preliminary information from a sample of the target
population, for example using focus groups, and pilot testing of the
questionnaire. Therefore, survey piloting is crucial to achieving research goals
and ensuring that subjects complete the survey. Survey piloting is the process of
conceptualizing and re-conceptualizing the key aims of the study and making
preparations for the fieldwork and analysis so that not too much will go wrong
and nothing will have been left out (Oppenheim, 1992 p.64).
In addition, the researcher has no control over how the questionnaire is answered: the respondent may answer the questions in the wrong order; answer questions incompletely; miss out questions or whole sections; or pass the questionnaire onto others (Oppenheim, 1992).

A common criticism of mail surveys is that often there are low response rates (Benson, 1946; Phillips, 1941; Robinson, 1952) which can dramatically lower confidence in the results. Although a large number of questionnaires can be sent out by post, because they are answered away from the researcher, only small proportions tend to be completed and returned. When returned questionnaires arrive in the mail, it's natural to assume that the respondent is the same person you sent the questionnaire to. A number of researchers have reported that this may not actually be the case (Clausen & Ford, 1947; Franzen & Lazarsfield, 1945; Moser & Kalton, 1971). Many times business questionnaires get handed to other employees for completion.

Furthermore, Jordan (1998) quotes a return rate of around 25%. This is because the people who actually take the time and effort to complete the questionnaire and return it may not be representative of the population in whom the researcher is interested (Jordan, 1998). Thus return rates are likely to be lower the more time and effort it takes to complete a questionnaire. Therefore, there is an advantage to keeping questionnaires as short and concise as possible (Jordan, 1998). Obtaining significant response rates with conventional postal surveys has always been a challenge. Consequently, Krosnick, (1999) argues that the motivation of respondents to complete a survey decreases as question difficulty increases (e.g., question interpretation, data entry volume, number of choices), as respondent's ability to answer decreases (e.g., perform complex mental tasks, make judgements), and as respondent's motivation decreases (e.g., topic salience, belief in usefulness of questionnaire).

Although high response rates are more difficult to achieve with self-completion questionnaires than by individual interviews (Cartwright, 1983) questionnaires were the choice data collection instrument in this study. The sample size required for reliable estimates and viable statistical analysis was such that it could be achieved only by postal questionnaire given the resources available to the researcher and the need for national representation.
3.5.4.2 E-mail Survey

This simply involves sending the questionnaire to identified respondents through their e-mail addresses and response is in through the same medium. The format of email survey can accommodate the principles of paper questionnaire design (Dillman, 2000; Oppenheim, 1992; Preece, Rogers, & Sharp, 2002). These principles include the development of question scales and multiple choice answers from qualitative exploratory interview data, elimination of question bias through proper wording, and the use of clear, unambiguous and concise wording. Like postal surveys, successful email surveys have been shown to include: informed consent information, rating definitions and examples, rating scale formats such as Likert type, semantic differential and nominal scales, and a set of demographic items (Preece et al., 2002; Witmer, et al., 1999).

The strength of this method is that it is the cheapest form of data collection. Incidentally the process of follow-up is also quite cheap and easy as a single e-mail can be addressed to all respondents identified not to have responded by the desired time. In addition, respondents were found to write lengthier and more self-disclosing comments than they do on mail surveys (Bachmann, Elfrink, & Vazzana, 1996; Kiesler & Sproull, 1986; Loke & Gilbert, 1995; Schaefer & Dillman, 1998). Email also affords the technical ability to track whether the delivered email survey was opened, responded to or deleted as well as if the survey was undeliverable (Paolo, et al., 2000).

However, email surveys have significant technical drawbacks. They can be altered by the survey takers themselves (Witmer et al., 1999). There is no way to prevent someone from changing, eliminating or adding questions to the survey. Respondents have also found them to be confusing to complete (Sheehan & Hoy, 1999). This may be caused by the fact that email survey completion is dependent upon the email software (if the survey is included as part of the email), or on the word processing software (if the survey is attached as a document). How respondents enter the answers to the survey question may vary because of this. Some respondents may not know how to manipulate the survey text to enter the responses correctly. In other words, the researcher does not have control over how the questions are displayed by software and how responses are entered into the email survey text.
3.6 Data Collection

It was decided that questionnaires be the primary instrument used in this research for data collection in view of their utility in comparison to other methods. To achieve maximum collection of data through the use of questionnaires, the following processes were therefore employed; instrument development, pre-testing, instrument review and structure completion, sampling, and instrument distribution. These are discussed as follows.

3.6.1 Instrument development

In developing the survey instrument, that is the questionnaire, the researcher must ensure the research objectives, research questions and data requirements are considered and used to articulate the questionnaire framework and structure. Thus, Malhotra (1996 p.350) sees questionnaire design as more of an art rather than a science. He describes the process as starting with an indication of the information needed and the type of survey method to be applied. It subsequently decides on the contents of individual questionnaires. The questions are structured to ultimately provide quick, inexpensive, efficient and accurate means of assessing information about the organisation (Remenyi & Williams, 1995; Sheatsley, 1974).

The function of a questionnaire is measurement (Oppenheim, 1992) thus the measurement and scaling procedures must also be decided upon and carefully chosen. What a questionnaire measures depends on the issues under investigation, the aims of the study, and the research design (Oppenheim, 1992). These measures afford the researcher the means of assigning numbers or other symbols to characteristics of objects in accordance to certain pre-specified rules (Gofton, 1997). Scaling on the other hand involves creating a continuum on which measured objects are located (Malhotra, 1999). Thus scaling is considered an extension of measurement.

Malhotra (1999 p.255) indicates that generally scaling techniques are classified as either comparative or non-comparative. Srinivasan & Park (1997) also indicate that there are four primary scales of measurement; the nominal, ordinal, interval and ratio. While Malhotra (1999) opines that it is desirable to use more than one scaling technique in many situations. Scaling techniques comprise of
continuous and itemised rating, namely the Likert semantic differential and staple scales. Of these rating scales, the Likert scale is the most widely used in questionnaires of previous research works. The Likert scale requires the respondents to indicate a degree of agreement or disagreement with each of a series of statements (Albaum, 1997). Thus a questionnaire based on the Likert scale is easy to design, construct, administer and analyse. Malhotra (1999) indicates further that respondents find the Likert scale easy to comprehend and use making it suitable for mail survey, and telephone or personal interviews.

Likewise, questionnaires that utilise the close-ended questions are relatively easier to process and analyse thereby affording the researcher the advantage of a standard format of responses to conduct statistical tests. Questionnaires can provide quantitative data using closed (or fixed-response) questions, where the respondent is presented with a number of alternative responses to a question and asked to mark the one that they feel is most appropriate (Jordan, 1998; Oppenheim, 1992). On the other hand qualitative data can be gathered using open (or free-response) questions to which respondents are asked to write their own answer (Jordan, 1998; Oppenheim, 1992).

Closed questions have been criticised for forcing people to choose their answer from the alternatives provided rather than answering in their own words (Converse & Presser, 1986). Nonetheless, closed questions are more specific than open ones, communicate the same frame of reference to all respondents and well designed response categories can more accurately detect differences among respondents (Converse & Presser, 1986). One argument against closed questions is that they may fail to provide an appropriate set of meaningful responses in substance or wording to respondents (Schuman & Presser, 1996).

Conversely, open-ended questions can be time-consuming especially when applied to a large sample as their responses may vary significantly. Consequently, this may result in the researcher misinterpreting some answers and misquoting the responses. Thus because the Likert scale uses multiple-choice close-ended questions, standard answers are selected enabling the coding of the responses with greater accuracy, faster and more easily.
However, questionnaire design should begin with open questions in pilot or pre-test work (Schuman & Presser, 1996). The results of which can then be used to create appropriate sets of responses for closed questions. Using open follow-up questions as probes of key closed questions can combine the advantages of both open and closed questions (Converse & Presser, 1986). While response rates vary widely from one questionnaire to another, well-designed studies consistently produce high response rates.

It is important to design questions very carefully as a poorly designed questionnaire renders results meaningless (Rubin & Babbie, 1989) as designing good questions is much more difficult than it seems. To effectively ensure that questions measure what they are supposed to measure test them out first, using small focus groups (Busha & Harter (1980)

The researcher aimed to use the questionnaire in this research to obtain two different types of information; firstly, the descriptive data that will avail the characteristics of the owner-manager and those of the firm (SMEs). Secondly, the data that is of a subjective nature such as the respondent’s beliefs and opinions. These two types of data when obtained and analysed can be used to generalise the views of the sample to the whole research population.

The process of developing the questionnaire entailed the review and examination of several questionnaires previously applied in SME research. This was with a view to comprehending the correlational synthesis between their research objectives and the information they eventually collected. Therefore having reviewed questionnaires from the works and PhD theses (Boswell, 1973; Hajjar, 1989; Pratten, 1991; Abakhail, 1999; Al-Kharusi, 2004) journal articles, exploratory surveys and some dissertations on the Nigerian economy were also sought and reviewed.

Drawing substantially from the suggestions of Dillman (1978) and McKiernan & Morris (1994) initially, the research focused on planning and constructing the questions in order to strengthen validity. This includes determining the questionnaire structure (whether open-ended or close-ended) so as to generate the most valid data. Malhotra (1996) suggests that in wording the questionnaire language that is clear, accurate and not subject to bias should be used.
Considerable attention is given to the physical design of the questionnaire (Abakhail, 1999). The format, spacing, and positioning of questions can have a significant effect on the response rate (Mayer & Piper, 1982). It is recommended that the development of structured questionnaires includes preliminary qualitative work, as the best way of ensuring that questionnaire content is meaningful to participants (Hoinville, Jowell, & Associates., 1978; Morton-Williams, 1985). Dillman, (1978) also stresses the need to present an attractive and well-organised questionnaire that looks easy to complete with questions related to one subject grouped together. Consequently the survey instrument adopted in this research was a close-ended questionnaire structured in a mixed format of nominal and ordinal responses.

Oppenheim (1992) notes that a fundamental principle of questionnaire design is ensuring that the content is of direct relevance to the experiences and concerns of the intended study group. While essential for purposes of validity, relevance also enhances the likelihood of a high response rate. Most surveys aim to make the sample design as straightforward as possible; a common starting point, therefore, is to consider the viability of taking a simple random sample from a single sampling frame (Cochran, 1977; Sarndal, Swensson, & Wretman, 1992). Therefore attention was devoted throughout to key tenets of questionnaire design: simplicity of wording; optimum length of questions; avoiding leading questions and double barrelled questions; ordering of items within questions and clarity of routeing instructions (Czaja & Blair, 1996; Oppenheim, 1992).

3.6.2 Pilot study (Pre-testing)
Designing the perfect survey questionnaire is eventually impossible nonetheless researchers still create effective surveys. Hunt, Sparkman, & Wilcox (1982) explain that pre-testing refers to testing the questionnaire on a small sample of respondents so as to identify and eliminate potential problems. It can assist determine the effectiveness, strengths and weaknesses of the survey instrument concerning question format, wording and order. It also tests for how long it takes recipients to complete the survey instrument, to check for question clarity and instructions and to enable the researcher remove any items which do not yield usable data (Bell, 1999). The pre-testing should ideally also test for question variation, meaning, task difficulty, and respondent interest and attention.
Malhotra (1996 p.341) advises that pre-tests should be extensive and should test all aspects of the questionnaire, including question content, wording sequence and layout, question difficulty and instructions. He then concludes that even the best questionnaire can be improved by pre-testing. Zelnio & Gagnon (1981) argue therefore that generally questionnaires should not be used in the field survey without adequate pre-testing. Thus the pilot work is used to establish if the respondent understands instructions, to ascertain how much time it takes to test each subject, to obtain practice in administering all the tasks and making all the necessary measurements (Barrett, 1995).

There are two types of survey pre-tests: participating and undeclared. While Participating pre-tests dictate that you tell respondents that the pre-test is a practice run, when conducting an undeclared pre-test, you do not tell respondents that it is a pre-test. According to Converse & Presser (1986) if researchers have the resources to do more than one pre-test, it is better to use a participatory pre-test first, then an undeclared test. Ideally, this should be tried out on part of the group, or on a group similar to the one, that will form the population of the study, especially in terms of background characteristics, familiarity with the topic and attitudes and behaviours of interest (Bell, 1999; Diamantopoulos, Schegelmilch, & Reynolds, 1994).

The purpose of the pre-test is to ascertain the validity of the survey instrument and how the survey works and what changes are necessary before the full-scale study commences. Researchers might also want to pre-test the reliability and validity of the survey questions. To be reliable, a survey question must be answered by respondents the same way each time. According to Weisberg, Krosnick, & Bowen (1989), researchers can assess reliability by comparing the answers respondents give in one pre-test with answers in another pre-test. Then, a survey question's validity is determined by how well it measures the concept(s) it is intended to measure. The respondents will therefore indicate how long it took them to complete the questionnaire and should they leave any questions unanswered the researcher will then find out why (Bell, 1999).

The process of pre-testing commenced with the first draft of the questionnaires being given to my research supervisor. Following his comments some amendments were effected and the reviewed draft was then circulated to some
research students of MIHE/Loughborough University and University of Leicester. Also two lecturers from Farnborough College of Technology and Lancaster University (who are both professionals in computer science) were approached and also provided their comments which assisted in revising the questionnaire. Also they were to advise if data to be obtained would be compatible with the statistical software (i.e. SPSS) that would be used in the research data analysis.

Considering that pilot studies are better performed and more effective if personally administered, the researcher went to Nigeria to meet the randomly selected pilot study sample. The members of the private sector SME related organisations (MAN, NASME and NASSI) were the sources utilised in selecting the pilot study respondents. So also were the researcher’s personal sources in the finance sector, especially previous colleagues in the banking industry. It was decided and communicated to them that they should not at this point answer the questions but rather study them and give their comments on the contents regarding clarity, sequence, language and interpretation of the questions.

Also, while in Nigeria, the researcher approached and requested two PhD students and two lecturers in the University of Abuja to evaluate the questionnaires and furnish their comments on their structuring and ease or otherwise of understanding. Subsequently, in an attempt to achieve a wider array of comments, a senior lecturer and a PhD student in Ahmadu Bello University and two chartered accountants were each availed the questionnaires to solicit their comments. Here the intention is to focus on the evaluation of the viability of the instruments to produce meaningful results.

Having collated all the comments from the reviews mentioned above and undertaken a revision and modification of the research instruments, the actual pre-testing of the randomly selected sample was then undertaken. The pilot test questionnaires were personally distributed to the owner-managers of ten SMEs, the leaders of two SME associations and the regulatory government agency for SMEs (SMEDAN) to review and comment on the wording, sequence, irrelevant items and ambiguity which could affect clarity and validity. They were told that the researcher would return to collect the questionnaires and to ask questions to determine any problems faced in reviewing the usability of the instruments.
Subsequently, during collection of their responses, the researcher conducted face-to-face interviews with the respondents to follow-up on their comments.

Accordingly, after collating all the comments of the reviews and from the sample respondents, the instruments were revised by rephrasing some questions and editing the varied question responses. Then the final draft questionnaire was developed for the full-scale field study involving the entire sample population.

3.6.3 Questionnaire Structure
The questionnaire used in this research was designed for the SMEs and their owner-managers. Structurally, the first page of the questionnaire comprised of an introductory letter duly signed by the supervisor of this research. In essence the letter served to briefly introduce the researcher and the focus of the research. It proceeded to assure the respondents of utilising their responses with absolute confidentiality and that the responses will only be used strictly for the research purpose only. It also served to guarantee the participants a share in the results of the research.

The 8 page SME questionnaire was divided into 5 sections as follows:

1. General background information: this section has 11 questions which sought to obtain the general background information on the SMEs.
2. Owner-Manager background: here 6 questions sought for information on the entrepreneur’s characteristics.
3. Financing information: has 13 questions which attempt to ascertain the financing needs and problems the SMEs contend with.
4. SMIEIS fund: the 7 question in this section attempt to evaluate the need for and utilisation of the fund and any problems faced.
5. Islamic financing: the 10 questions here sought to find out the awareness, need and inclination for Islamic finance by SMEs.

The sequencing and structuring of questions in the survey instrument were consistent with the suggestions outlined by Dillman (1978).

3.6.4 Sampling
Before conducting a survey a relevant survey population must be chosen as unless a survey population is very small, it is usually impossible to survey the entire relevant population. Therefore, researchers usually just survey a sample of a population from an actual list of the relevant population, using a sampling frame. The sampling frame is "a list or set of directions for identifying the target
population" Malhotra, (1999 p.330). With a carefully selected sample, researchers can make estimations or generalizations regarding an entire population's opinions, attitudes or beliefs on a particular topic.

Bryman & Burgess (1999 p.87) describes a sample as that segment of the population (the sampling frame) that is selected for investigation. In undertaking a research project, it is often extremely unlikely and almost impossible for the researcher to command the resources and have the time to conduct a survey of the entire population of his study. It is unlikely that he can send out questionnaires to or interview the whole units that have been identified as the sampling frame. It is therefore almost certain that as a solution, the researcher will need to choose a significant sample from the total population of those that questionnaires will be sent to and/or those to be interviewed. Thus, Sekaran & Sekaran (1992) and Saunders, Thornhill, & Lewis (1997) argue that using sampling gives a better understanding of the phenomenon. This is so because, in their opinion, with a small and more representative sample, the researcher can devote more time and attention to designing, piloting, distributing and collecting the research instrument and to analysing the data.

One main reason for sampling the population of SMEs in Nigeria is the lack of a comprehensive census of SMEs. Thus this study aims to maximise the sample size with the goal of ensuring the ability to effectively test the hypotheses developed and to afford the ability of undertaking a comparison with the results of other earlier studies. Sampling size is described as one of the most important elements in reducing sampling errors (Durrani, 2001).

There are two different types of sampling procedures, these are probability and non-probability. Probability sampling methods ensure that there is a possibility for each person in a sample population to be selected, whereas non-probability methods target specific individuals. Clearly, there can be an inherent bias in non-probability methods. Therefore, according to Weisberg et al., (1989), it is not surprising that most survey researchers prefer probability sampling methods, which is what this study also employs.

Considering the variety in SME definitions by different institutions and government agencies in Nigeria, this research adopted a working definition
using an estimated range. The indexes of total assets value and number of employees were used as follows;

- **Small enterprise**: up to ₦50 million in total assets or 50 employees.
- **Medium enterprise**: up to ₦200 million in total assets or up to 300 employees.

The researcher approached the chairman of MAN Kano branch through a letter duly signed by the research supervisor. In response the association availed the researcher a list of its members and a duly signed covering letter introducing the research questionnaire and requesting members to give their maximum cooperation. Likewise, the NASSI and NASME leaderships were also written to and contacted personally by the researcher and thy rendered similar assistance with their members. These associations availed their lists of members which were segregated into sectors and then a random sample of 980 SMEs was selected as the sampling frame.

### 3.6.5 Instrument Distribution

In undertaking all types of surveys, some basic practicalities need to be considered before the surveying begins. These include the need to find the most convenient time to carry out the data collection, most especially in interview surveying and group-administered surveys, and also how long the data collection is likely to take. Finally, there is the need to make practical arrangements for administering the survey.

Having decided on the mail questionnaire as being the main instrument for data collection in this research, the questionnaires to SMEs were divided into three groups and distributed as follows;

1. **Group 1**: 490 questionnaires were served on sample population selected from some states (such as Kano, Kaduna, Bauchi, Plateau) in the northern part of the country.
2. **Group 2**: 300 questionnaires were served on some states (such as Lagos, Edo, Oyo, Delta) in the South-western part of the country which represents one of the main areas of business activity in the country.
3. **Group 3**: 190 questionnaires were also served on some states (such as Enugu, Anambra, Rivers, Abia) in the south-eastern part of the country.
In Kano a research worker was enlisted to deliver the questionnaires to the offices of the sample respondents and then to return after four weeks for collection of the completed questionnaires.

### 3.6.5.1 Response Rate

This is the single most important indicator of how much confidence can be placed in the results of a mail survey. A low response rate can be devastating to the reliability of a study (Benson, 1946; Phillips, 1941; Robinson, 1952). It is argued that low response rates are not an inherent shortcoming of mail surveys and that the researcher would do everything possible to facilitate and maximize response (Berdie, Anderson, & Niebuhr, 1986 p.17). Even though, Jones & Lang (1980) point out that increasing the response rate does not necessarily improve the precision of survey results.

Furthermore, the following procedures were utilised with a view to ensuring a good response rate is obtained, these are:

- A letter of introduction and explanation, duly signed by the research supervisor, was included in each questionnaire being physically distributed or despatched,

- A self-addressed, stamped envelope for returning the questionnaire was included. It is argued that mail surveys that include a self-addressed stamped reply envelope get better response (Brook, 1978; Harris & Guffey, 1978; Jones & Gerald, 1978; Kimball, 1961; McCrohan & Lowe, 1981; Peterson, 1975).

- An introductory letter from the MAN, duly signed by their executive secretary, was also included with all questionnaires that went out to the sample that was raised out of their membership.

### 3.6.5.2 Following Up On Non-respondents

One of the most powerful tools for increasing response is to use follow-ups or reminders (Duncan, 1979; Scott, 1961). Thus Follow-up mailings are an important part of administering mail surveys. Non-respondents can be sent letters of additional encouragement to participate.

Researchers can increase the response from follow-up attempts by including another copy of the questionnaire (Futrell & Lamb, 1981; Sivan, Epley, & Burns, 1980). The most successful follow-ups have been achieved by phone calls (Roscoe, Lang, & Sheth, 1975; Sheth & Roscoe, 1975; Speer & Zold, 1971). Thus here, the researcher followed-up identified slow or non-respondents with
phone calls (which helped remind and encourage some of such respondents) and personal visits by the researcher or the employed research worker.

### 3.6.5.3 Notification of Cut-Off-Date

Several researchers have examined the effect of giving subjects a deadline for responding (Duncan, 1979; Erdos, 1957; Houston & Nevin, 1977; Jones & Gerald, 1978; Jones & Lang, 1980; Nevin & Ford, 1976; Vocino, 1977). While a deadline will usually reduce the time from the mailing until the returns begin arriving, it appears that it does not increase response, and may even reduce the response. One possible explanation is that a cut-off date might dissuade procrastinators from completing the questionnaire after the deadline has past. However, the researcher deemed it necessary to intimate the non-respondents being followed-up of a cut-off date with the intention of encouraging a response.

### 3.7 Data Preparation

Having undertaken the fieldwork as a result of the research problem identification which culminated in preparing an appropriate research design for the study, the research proceeds to organize the responses preparatory to their analysis (Al-Kharusi, 2003; Durrani, 2001; Malhotra, 1999).

#### Figure 3-1: Data Preparation Process

```
CHECK
  ↓
EDIT
  ↓
CODE
  ↓
TRANSCRIB
  ↓
CLEAN DATA
  ↓
SELECT AN ANALYSIS STRATEGY
```

*Source: Malhotra, (1999 p.420)*
The data preparation process as represented in Figure 3.1 by Malhotra (1999) indicates the route involved. The process of data preparation commences with checking those questionnaires that are acceptable and usable out of the total that had been returned. Thereafter the researcher edits, codes and transcribes the data. Subsequently the data output obtained from these processes are then cleaned. Finally, the strategy that will be employed in the data analysis is selected (Malhotra, 1999).

3.8 Data Analysis Technique

The data obtained from the survey having been prepared through coding, transcribing and cleaning, are then analysed using a number of techniques. These techniques for analysing the data range from conceptual analysis (Roure, Keeley, & van der Heyden, 1990) to regression analysis (Macmillan, Zemann, & Subba Narasimha, 1987). However Allison (1999) argues that the selection of any technique in particular is dependent upon the sample size and the nature, complexity and source of data.

3.8.1 Descriptive technique

For most research projects having complex raw data structure, Zikmund (1994) recommends that analysis should begin with some form of descriptive analysis to reduce the raw data into a summary format. This is usually in form of simple tabulation of frequency distributions and calculation of averages.

For raw data to take on a form that will ensure it is understood and interpreted, it is transformed into descriptive statistics. This is achieved through the conversion of collected data into statistics through the use of frequencies. Descriptive statistics serve as a medium for presenting data in a manageable form thereby making it the first form of analysis. Thus the most common form of summarising data is through the calculation of averages, frequencies and percentages (Babbie, 1973; Sekaran & Sekaran, 1992; Zikmund, 1994). Thus descriptive statistics summarises the distribution of attributes on a single variable, while other forms of statistics summarise the association between variables called the measures of association (Babbie, 1973).
3.8.2 Characterisation and Measurement of Data

To ensure meaningful data analysis the researcher needs to understand the type of data obtained. This will facilitate the researcher's ability to select the type of statistical technique that will best apply to the study. To convert the initial data, (which are simply research observations recorded in a variety of forms including ticks, timings, question responses or ratings) into a system that enables comparisons to be made, data are coded into some categorisations.

Youngman (1979) explains that the most widely used characterisation of data distinguishes four levels of measurement for data. These are nominal, ordinal, interval and ratio. While nominal data represents observations that are differentiated only by type, ordinal data is an ordered relationship between data categories. Thus where objects are rated in order of importance or size, then the obtained data are ordinal. Interval data, on the other hand, equally spaces the categories while also being ordered. Ratio data also requires that data should satisfy some rational equivalence in addition to the conditions already demanded for interval data (Youngman, 1979).

In this study the nominal and ordinal scale of data measurement are employed. Some of the study variables (such as age and size of the firm, the owner-managers age) are regarded as interval or ratio variables due to their being identical in the differences between the categories. However, when such interval or ratio variables are grouped together they assume the characteristic of ordinal variables (Bryman & Cramer, 1990 p.65; Siegel & Castellan, 1988).

3.8.3 Parametric versus Nonparametric Testing

Nonparametric methods were developed to be specifically used in cases when the researcher knows nothing about the parameters of the variable of interest in the population. In more technical terms, nonparametric methods do not rely on the estimation of parameters (such as the mean or the standard deviation) describing the distribution of the variable of interest in the population. Therefore, these methods are also sometimes (and more appropriately) called parameter-free methods or distribution-free methods.

Parametric tests require interval data which are data that come from an interval scale and make parametric assumptions which concern the characteristics of
the underlying population that the samples come from. These assumptions are
that populations are normally distributed and that samples come from
distributions with equal variance.

Siegel & Castellan (1988) also confirm that where the study variables are being
measured on an interval scale and where the observations result from a specific
population, the parametric testing of data is the most appropriate to use.
Conversely, Conover (1980) argues that nonparametric testing do not require
specific assumptions to be made about the population thus making them more
advantageous as they involve less conceptual work resulting in their being
easier and quicker to use.

In nonparametric tests calculations cannot be performed on the raw data nor
can assumptions be made about the underlying populations. The assumption
that can however be made about the numbers produced in a rating scale is that
they allow for the data to be rank ordered. The ratings therefore place the
subjects into a specific order thereby making them ordinal data.

Non-parametric tests have several advantages over parametric tests: non-
parametric test are appropriate for small samples, make fewer assumptions
about the data and are available to analyse data which are inherently in ranks
(Siegel & Castellan, 1988). It is therefore recognised that data in this study do
not meet the assumptions of parametric test and may not properly test the
hypotheses. Thus to analyse the data in this study, the nonparametric statistical
testing is used. Similarly, the use of the logistic regression is supported by the
categorised paired opposites in the data. Siegel & Castellan (1988) indicate that
variables opposite of each other and categorised as paired opposites, also
known as dichotomous variables, are also identified as ordinal variables.

3.8.4 Analysis of Variance

Analysis of variance (ANOVA) tests are conducted to ascertain where exactly
the differences lie in terms of variables. An important technique for analyzing the
effect of categorical factors on a response is to perform an ANOVA. Depending
upon the type of analysis, it may be important to determine:

- which factors have a significant effect on the response, and/or
• How much of the variability in the response variable is attributable to each factor.

Durrani (2001) and Al-Kharusi (2003) note these assumptions in ANOVA:

• The categories of the independent variable are assumed to be fixed. Inferences are made only to the specific categories considered.
• The error term is normally distributed with a zero mean and a constant variance. Further the data can be transformed to satisfy the assumptions of normality. In ANOVA the error terms are uncorrelated, if they are however correlated, then the f value can be seriously distorted (Neter, Wasserman, & Kutner, 1985).

Martin (1978) and Norusis (1998) explain that ANOVA is applied in examining the differences among means for two or more populations. While Malhotra (1996) argues that researchers are often interested in examining the differences in the mean values of the dependent variable for several categories of a single independent variable. He points out that this can be determined by conducting one-way ANOVA. This is used when the data are divided into groups according to only one factor. The usual questions are:
  • Is there a significant difference between the groups?, and
  • If so, which groups are significantly different from which others?

Consequently, this study will use the one-way ANOVA to examine the means of two or more groups of sectors (e.g. business activity). This is because, as summed up by De Vaus (1996), “an ANOVA permits the researcher to use the data in the sample for the purpose of making a single inferential statement concerning the means of the study’s population”.

3.8.5 Chi-Square

The absence of ordering in data restricts the choice of association measure largely to chi-square or one of its derivatives. The chi-square is a measure of the amount of derivation from random expectation in a table. Where the value obtained is sufficiently higher to warrant a rejection of the null hypothesis it would therefore follow that the data exhibited tendencies for certain joint responses to predominate. Malhotra (1996) explains that chi-square assists us in determining whether a systematic association exists between two variables. However the size of chi-square can only be interpreted to mean that the relationship exists rather than as an indication of the degree of association.

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Brenson & Levine (1992) explain that the test is conducted by computing the cell frequencies that would be expected if no association were present between the variables, giving the existing row and column totals. Thus the null hypothesis (Ho) is that there is no association between the variables.

Snedecor & Cochran (1989) also explain that a chi-square test is used to test if the standard deviation of a population is equal to a specified value. This test is either a two-sided or a one-sided test. The two-sided version tests against the alternative that the true standard deviation is either less than or greater than the specified value. The one-sided version only tests in one direction.

However Malhotra (1999) indicates that there are some limitations that manifest in the use of this technique which are:

- The data should be converted from percentages to absolute counts
- An underlying assumption of the technique is that the observations are drawn independently
- The chi-square test should not be conducted when the expected frequencies in any of the cells is less than five or when the table has two rows and two columns

To further investigate the responses chi-square tests were conducted to explore the external finance sources available to SMEs. The study also employs chi-square test to show the need for finance by SMEs, the financing pattern and the difficulties faced by SMEs when seeking external finance.

3.8.6 Logistic regression

This enables the prediction of a discrete outcome, such as group membership, from a set of variables that may be continuous, discrete, dichotomous, or a mix of any of these. Logistic regression is also applied to ordered categories (ordinal data), that is, variables with more than two ordered categories which indicates that the predictor variables in logistic regression can take any form. As such, logistic regression makes no assumption about the distribution of the independent variables. They do not have to be normally distributed, linearly related or of equal variance within each group thus the relationship between the predictor and response variables is not a linear function.

Generally, the dependent or response variable is dichotomous. This type of variable is called a Bernoulli (or binary) variable. Although not as common,
applications of logistic regression have also been extended to cases where the dependent variable is of more than two cases, known as multinomial or polytomous logistic regression.

Logistic regression with a binary Dependent Variable is used in preference to ordinary linear regression because if linear regression is used, the predicted values will become greater than one and less than zero if readings far enough on the X-axis are taken.

The logit transformation is defined as the logged odds:

$$\text{odds} = \frac{\theta(x)}{1 - \theta(x)} = \frac{\text{Probability of the presence of characteristic}}{\text{Probability of the absence of characteristic}}$$

and

$$\logit[\theta(x)] = \log \left( \frac{\theta(x)}{1 - \theta(x)} \right) = \alpha + \beta_1 x_1 + \beta_2 x_2 + \ldots + \beta_i x_i$$

Where

- $\theta$ = the probability of presence of the characteristic of interest (i.e. the dependent variable can take the value 1 with a probability of success $\theta$, or the value 0 with probability of failure 1 - $\theta$)
- $\alpha$ = the constant of the equation and,
- $\beta$ = the coefficient of the predictor variables.
- $x$ = the independent variables.

Thus Logistic regression generates the coefficients (and its standard errors and significance levels) of a formula to predict a logit transformation of the probability of presence of the characteristic of interest:

$$\text{Logit} [\theta(x)] = \alpha + \beta_1 x_1 + \beta_2 x_2 + \ldots + \beta_i x_i$$

The goal of logistic regression is to correctly predict the category of outcome for individual cases using the most practical model. To accomplish this goal, a model is created that includes all predictor variables that are useful in predicting the response variable. Holmes & Nicholls (1989) have used logistic regression to develop an explanatory model from which the probability of an SME preparing or acquiring a particular level of financial information (specifically SBA) can be
estimated given the values of certain enterprise and owner-manager characteristics expressed as categorical variables.

Several different options are available during model creation. Variables can be entered into the model in the order specified by the researcher or logistic regression can test the fit of the model after each coefficient is added or deleted, called stepwise regression. Stepwise regression is used in the exploratory phase of research but it is not recommended for theory testing (Menard 1995). Theory testing is the testing of a-priori theories or hypotheses of the relationships between variables. Exploratory testing makes no a-priori assumptions regarding the relationships between the variables, thus the goal is to discover relationships. Backward stepwise regression appears to be the preferred method of exploratory analyses, where the analysis begins with a full or saturated model and variables are eliminated from the model in an iterative process. The fit of the model is tested after the elimination of each variable to ensure that the model still adequately fits the data. When no more variables can be eliminated from the model, the analysis has been completed.

One of the main uses of logistic regression relevant to this study is its applicability in the prediction of group membership. This method of data analysis is therefore used to predict a dependent variable on the basis of continuous and/or categorical independents and to determine the percent of variance in the dependent variable explained by the independents; to rank the relative importance of independents; to assess interaction effects; and to understand the impact of covariate control variables. Since logistic regression calculates the probability of success over the probability of failure, the results of the analysis are in the form of an odds ratio. Consequently, logistic regression has been selected as the most useful predictive modelling methodology appropriate to the categorical and/or irregularly distributed dependent and independent variables obtained through this survey.

The success of the logistic regression can be assessed by looking at the classification table, showing correct and incorrect classifications of the dichotomous, ordinal, or polytomous dependent variables. Also, goodness-of-fit tests such as model chi-square are available as indicators of model suitability. The Wald statistic tests the significance of individual independent variables. The
process by which coefficients are tested for significance and inclusion or elimination from the model involves the following different techniques:

**Wald Test:** This test is used to test the statistical significance of each coefficient (β) in the model. However, several authors have identified problems with the use of the Wald statistic. Menard (1995) warns that for large coefficients, standard error is inflated, lowering the Wald statistic (chi-square) value. Agresti (1996) states that the likelihood-ratio test is more reliable for small sample sizes than the Wald test.

**Likelihood-Ratio Test:** The likelihood-ratio test uses the ratio of the maximized value of the likelihood function for the full model (L₁) over the maximized value of the likelihood function for the simpler model (L₀) that is the model having only the constant (dependent variable).

**Hosmer-Lemeshow Goodness of Fit Test:** This statistic evaluates the goodness-of-fit by comparing the actual number in each group (observed) to the number predicted by the logistic regression model (predicted). This is a chi-square statistic with non-significance as the desirable outcome, indicating that the model prediction does not significantly differ from the observed.

### 3.9 Summary

This chapter has highlighted the aspects of research methodology that describe the types and attendant methods of research applied in this study. It commenced by discussing quantitative and qualitative approaches to research which it is argued can be triangulated. One approach can facilitate use of the other approach or the different approaches can be used to complement each other. This approach has been found to have been applied in some previous research on the subject of this study. Most of the studies undertaken on SMEs employed quantitative techniques in their data collation and analysis, such as, the chi-square test, the T-test and F-test and correlation.

In adopting a research strategy the literature reviewed reveals that most mainstream research works undertaken used data obtained from primary sources, which include observations, case studies, interviews and questionnaires. This study primarily used questionnaires then interviews in case studying the SME sector in Nigeria. The survey based research method can be
conducted through either personally delivered, postal-mail or e-mail questionnaires. A questionnaire is a pre-formatted set of written questions to which respondents record their answers, usually within rather closely defined parameters. Interview, on the other hand, is a direct verbal contact between the researcher and the sampling population which may be conducted through either face-to-face or telephone conversation.

As this research selected the questionnaire as the most appropriate method of primary data collection, five stages were covered in the process of data collection. It commenced with the development of the research instrument followed by the pilot study. The results of the pilot study were then used to structure the questionnaire appropriately before determining a sampling frame and therefrom the sample population for the study. Finally the survey instruments were distributed taking into consideration the importance of response rate, follow-up on non-respondents and notification of cut-off dates and their potential impacts on responses.

The process of data analysis is also detailed starting with measuring, coding and cleaning data before entering same in the chosen statistical software to be used in the analysis. Having done that, the Statistical Package for Social Science (SPSS), which is an integrated system applied specifically to the analysis of social science data, was chosen for the data analysis. The statistical techniques most appropriate to meet the research objectives and simplify the process of data analysis were selected. These techniques included descriptive analysis, data measurement criteria, non-parametric, ANOVA, chi-square and finally logistic regression tests of data collected to ensure meaningful results.
CHAPTER FOUR

THE NIGERIAN ECONOMY
4 THE NIGERIAN ECONOMY

4.1 Introduction

The features of the Nigerian economy, upon which this study is based, are discussed in this chapter in the context of economic development considering the primary areas of financial structure and the performance of the economy since independence. The first section (4.2) presents a general background of the Nigerian economy. The second section (4.3) outlines the economic and development planning that was pursued starting with the first national plan in 1962. The third section (4.4) presents the performance of the Nigerian economy before, during and after the structural adjustment programme (SAP) while section four (4.5) looks reviews the manufacturing and trade sectors. In the fifth section (4.6) the Nigerian financial sector is considered in some detail by looking at its structure and evolution. The last section (4.7) looks at the impact of globalisation on the Nigerian economy.

4.2 General Background of the Economy

Nigeria is currently a federation of 36 states in addition to the Federal Capital Territory, Abuja. The country covers a land area of 923,768 sq. km and by July 2003 has an estimated population of 133,881,703 which constitutes about 250 ethnic groups (CIA Factbook, 2003).

Though Nigeria is mostly a traditional agrarian society, modern agriculture, industry and services were the mainstay and primary sources of growth for the Nigerian economy in the 1960s. Invariably, from colonial times until the early 1970s, the backbone of the economy was agriculture. Investment in manufacturing which became notable after independence was mainly in import-substitution, secondary processing and final assembly, all of which depended on external inputs. Then over 50% of Nigeria's GDP was recorded by agriculture, being the primary sector of the economy (CBN, 2000; CIA Factbook, 2003). Thus the agriculture sector constituted the main source of export receipts and thereby revenue of the nation. Nonetheless, the widespread hopes for a bright future with the attainment of Independence in 1960 soon crashed as the country lurched from one crisis to another, such that its first ten years of independence were described as a 'decade of troubles' (Crowther, 1978:59).
In the 1970s, the 30 months old civil war, which was a fall out of the political turmoil and ethnic rivalries that fuelled coups and counter coups, ended in January 1970. Similarly, in 1975 the nation discovered oil reserves in commercial quantities. Hence, oil emerged as the dominant sector of the nation's economy (Wright, 1986:23). Thus the perspective and expectations for prosperity and growth were further intensified due to the huge oil reserves.

With the huge revenues from crude oil exports, government assumed the role of being the economy's prime mover and leader. Successive governments placed a great deal of emphasis on the implementation of a series of ambitious development plans which were aimed at ensuring rapid economic growth and development. This was buttressed by the fact that by the mid 1970s, the country came to depend on the sale of crude oil for some 90% of its income, 95% of its foreign exchange earnings and 11% of its GDP (Abba, 1985; Olukoshi, 1995). The resultant inflow of foreign exchange earnings mainly from improved oil prices as well as high rates of domestic and foreign investments in industry, construction and services helped to sustain the GDP's growth rate at reasonably high levels. As a result the overall economic performance at this point became impressive. For instance, the nation's GDP between 1970 and 1974 recorded an average growth of about 8.8% (CBN, 2000). Similarly, Olukoshi (1995) observes that the huge revenue boom was accompanied by a significant increase in the contract and import components of public expenditure of the state. Therefore ambitious infrastructure projects were undertaken side by side with public-sector-led investments in industry, agriculture and the social sector. Nonetheless these investments failed to permeate the economy with inter-sectoral linkages.

The oil boom led Nigeria to neglect its strong agricultural and light manufacturing bases in favour of an unhealthy dependence on crude oil. Whereas the economy appeared to be a monoculture economy, in reality it operated more as a dual economy. It was therefore at this point that oil took on the feature of a dominant variable in the economy. Consequently the agriculture sector's share in total domestic output dropped from nearly 60% in the 1960s to about 35% by 1975 (CBN, 2000). Although non-oil exports became significantly low, the country enjoyed a favourable balance of payments position, on the external sector during the period, as a result of the significant boost in crude oil exports.
Furthermore, observers of the Nigerian economy note the rapid growth of the urban and industrial sectors, the relative poor performance of agriculture and the widening gap between rural and urban incomes. Thus the third national development plan emphasised not only an increase in income but a more even income distribution (Zartman et al, 1983 p89-90).

The oil boom was accompanied by persistent and ever rising price level changes, steady decline in agricultural self-sufficiency, an increasing resource outlay on imported consumer goods and skyrocketing unemployment fuelled by the near total neglect of industrialisation. The increase in consumer goods importation resulted from the changing tastes and preference for foreign goods over local goods of the populace. Furthermore the manufacturing process was seen rather slow in providing the required consumer goods in comparison to importation of finished goods which guaranteed faster profits for importers.

In effect, the country failed to make use of its oil wealth to diversify its economic base and strengthen its productive capacity in the manufacturing sector. Thus despite governments’ active involvement in economic activities oil revenues were neither sufficiently nor judiciously utilised in establishing a meaningful economic base that could ensure an enduring economic performance, sustainable growth and development of the economy. Thus the oil wealth, the concurrent decline of other economic sectors, and a lurch toward a statist economic model fuelled massive migration to the cities and increasingly led to widespread poverty, especially in rural areas. A collapse of basic infrastructure and social services since the early 1980s compounded this trend.

The oil market collapse in 1980 threw the economy into a crippling shock and served to intensify the crisis it went into and instantly exposed the weaknesses inherent in the Nigerian economy. It experienced severe debt problems and acute foreign exchange shortfalls. For instance, while total earning from oil in 1980 was $24.9bn it fell to $10.05 billion in 1983. Additionally, the figure for 1986 was a paltry $6.0bn and in 1987 it further fell to $5bn and barely improved in 1987 to about $7bn (Asiodu, 1992). Thus Obadina (1999) concludes that Nigeria’s economy is burdened by the biggest external debt in Africa, due mostly to its heavy dependence on oil revenue which left it vulnerable to the plummeting oil prices. This resulted in signs of economic distress as the nation
encountered difficulties in funding imports and meeting local and international commitments. This in turn, resulted in a fall in government spending, a reduction in industrial capacity utilisation due to shortages of raw materials and spare parts and an escalation in inflation and unemployment rates.

The resulting crisis culminated in the introduction of an economic stabilisation policy package in 1981. Further efforts made to arrest the ever-rising economic problems in the country led to the introduction of various rounds of budget tightening austerity measures between 1982 and 1985. The unfolding scenario obliged government to engage in heavy borrowing to finance budget deficits of 1981 to 1983. By 1983 an external debt figure of about $17 billion was recorded with about $11 billion being long and medium term loans. While about $6 billion was the outstanding amount for goods imported between 1981 and 1983. On the domestic front, there was equally a massive recording of substantial internal debt accruing to banks and government's local contractors (CBN 2000).

In 1984 negotiations for an International Monetary Fund (IMF) loan commenced. The loan was being arranged to assist in a planned economic adjustment programme and a foreign debt-refinancing plan. However, hitches manifested as the government indicated its unwillingness to accept the attendant IMF conditionalities, which mainly included, but were not limited to, currency devaluation, subsidy removals and trade liberalisation. The failure to reach a consensus on the negotiations left the debt situation unresolved and worsening which led the government to utilise about 44% of the nation's foreign exchange earnings to service external debts in 1985.

The failure of these measures manifested by way of political instability and economic stagnation. As a result a structural reform programme was initiated in 1986, which was characterised by constant and excessive devaluation of the nation's already weakened currency. The reform programme was aimed at stimulating domestic production, diversification of the export base of the economy, elimination of controls, removal of subsidies, rationalisation of public enterprises, and exchange rate reforms (Oyovbaire and Olagunju, n.d.; 36). This resulted in the unintended devaluation of all the nation's assets (productive resources) and outputs from a ratio of 1:4 in 1981 to a ratio of about 1:126 in 2001. In other words, the nation witnessed steady erosion of the
competitiveness of its non-oil tradable goods sector, thereby resulting in the marked decline of both food production and agricultural exports.

In spite of years of implementing the SAP policies, none of its objectives were much in evidence. Human development and economic indicators for the country as reported remained unimpressive (UNDP 1997; World Bank, 1996; FOS 1996). Indeed, it would seem, as one study has sought to demonstrate that the Nigerian economy has remained mired on a `dead end' (Nnoli, 1993).

It is apparent that former governments failed to diversify the economy away from overdependence on the capital-intensive oil sector, which provides 20% of GDP, 95% of foreign exchange earnings, and about 65% of budgetary revenues. The largely subsistence agricultural sector has failed to keep up with rapid population growth, and Nigeria, once a large net exporter of food, had to import food. Following the signing of an IMF stand-by agreement in August 2000, Nigeria received a debt-restructuring deal from the Paris Club and a $1 billion credit from the IMF, both of these contingent on economic reforms. The IMF allowed the agreement to expire by November 2001 and Nigeria apparently received much less multilateral assistance than expected in 2002. Nonetheless, foreign oil investment and production increases kept growth at 3% in 2002. The government lacked the capacity and willingness to implement the market-oriented reforms urged by the IMF, such as modernization of the banking system; curbing inflation by blocking excessive wage demands; and resolving regional disputes over oil industry earnings distribution (CIA Factbook, 2003).

Although, economic growth in Nigeria was dismal throughout much of the 1990s in the years 2000 and 2001 real GDP increased faster than at anytime since 1991. In 2000 and 2001, real GDP rose 3.83% and 4.21% respectively. Averaged over the period from 1992 to 1998, real GDP grew just 2.6%, well below the rate of population growth of nearly 2.8% (CBN, 2003).

4.3 Economic and Development Planning

Development planning is particularly popular in developing countries because it is regarded as the best strategy for transforming such economies and for narrowing the gap between them and the advanced industrial countries (Olaloku et al, 1979). The strategy of planning is therefore essentially to direct the
economy in a given direction, assign specific priorities to be followed and mobilise the resources of a nation to achieve rapid economic development.

Kirk-Greene and Rimmer (1981 p141) signify that in Nigeria the purpose of pre-independence development planning was the economic generation of mass welfare. However, after 1960 development planning assumed a broader scope encompassing government policy to achieve national economic objectives, such as, accelerated growth and higher levels of average material welfare.

The post independence plans were referred to as being comprehensive in contrast to earlier colonial plans. Olaloku et al (1979) emphasise that the plans were more comprehensive as they were formulated within the framework of an improved system of national accounts. The plans covered the operations of both the public and private sectors and had their projects related to a number of well-articulated overall economic targets. However, the national plans still did not really encompass all economic activity in the country as they continued to be very largely programmes of public capital expenditure.

4.3.1 Development Planning 1962 – 1989

CBN (2000) indicates that successive governments in Nigeria prepared and implemented four national development plans between 1960 and 1985 that fully ran out their terms. The first national development plan spanned the period 1962 to 1968, while the second, third and finally fourth covered the periods 1970 to 1974, 1975 to 1980 and 1981 to 1985 respectively. The fifth plan was to span 1988 to 1992 but got truncated part way and replaced in 1986 by SAP.

The first plan was formulated based, for the first time, on analysis of the economy and its major trends (World Bank, 1974 p23). It gave the highest priority to the development of trade, industry and agriculture (Berger, 1975). The First national development plan (1962, p60) had as one of its main objectives the stimulation of the establishment and growth of industries which would contribute both directly and materially to economic growth. Hence, the plan also introduced additional incentives for encouraging investment in industries, which included the setting up of a development bank and the extension of industrial estates to be leased to investors at subsidised rates.
A total provision of £44 million was made for expenditure on industrial investments in the first national development plan. But on expiry of the plan period in March 1968, a little below one-third of the amount had actually been spent in trade and industry (Berger, 1975; World Bank, 1974 p23). The reason adduced for this low performance was principally the civil war that engulfed the country. Other reasons are linked to the lack of a concrete list of prepared projects for the industrial development programmes and clearly defined measures for their promotion other than the very general formulation of the objectives. In addition, when the plan was issued, except for the oil refinery, there were no completed feasibility studies for any of the projects, which would have guaranteed prompt execution of the scheduled projects.

Table 4-1 gives the percentage sectoral distribution of planned and actual public expenditures under the first three national development plans.

<table>
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<tr>
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</thead>
<tbody>
<tr>
<td></td>
<td>Plan</td>
<td>Actual</td>
<td>Plan</td>
</tr>
<tr>
<td>Economic</td>
<td>67.8</td>
<td>58.3</td>
<td>53.1</td>
</tr>
<tr>
<td>Social</td>
<td>11.3</td>
<td>20.2</td>
<td>11.5</td>
</tr>
<tr>
<td>Regional Development</td>
<td>24.2</td>
<td>19.8</td>
<td>26.6</td>
</tr>
<tr>
<td>Administration</td>
<td>7.2</td>
<td>19.5</td>
<td>18.2</td>
</tr>
<tr>
<td>Financial Obligations</td>
<td>0.6</td>
<td>2.4</td>
<td>2.2</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>


The World Bank (1974) concludes that the main hindrances, within the first plan implementation period, were the lack of readiness of projects and the limited executive capacity in some sectors, although to some extent resource constraints were also noticeable. Lewis (1967) also argues that the main weaknesses of the first plan were incomplete feasibility studies and inadequate evaluation of projects, accompanied by meagre public participation, aggravated by excessive political intervention in economic decisions.

The second plan for reconstruction and development, launched immediately after the civil war in 1970, was originally meant to cover the period 1970 to 1974.
but was later extended to end in March 1975. Schatzl (1973) suggests that, the second plan attempted to lessen the conflict between the objectives of the private and public sectors by direct participation of government institutions in industrial firms and indirectly by measures of economic policy.

The government aimed to progressively substitute Nigerian for foreign interests in both the ownership/management and technical direction of economic enterprise. Berger (1975 p90) highlights the main objectives of the second plan as the high growth rate of the national economy, increased food production, greater reduction of unemployment and rapid industrialisation of the economy. Thus post-war reconstruction, restoring productive capacity, overcoming critical bottlenecks and achieving self-reliance were major goals of the second plan.

The third Plan strategy focused on the internationalisation of the rapid growth of the oil sector. So it aimed at using the public revenues from oil to create the infrastructure of "self-sustaining growth" (Third National Development Plan, 1975 p27-9). However because of misplaced priorities and the fall in oil revenues, the expected GDP of 9% crashed to 5%. Hence, the third plan also failed because it neglected the grassroots and failed to encourage private investment. The level of agricultural and industrial productivity dropped significantly due to over-dependence on government contracts and political patronage. Emphasis was not placed on increased productivity (Baje, 2003). Hence Sayre P. Schatz notes that economic reasoning gave way before economic enthusiasm and necessary co-ordination and implementation were ignored (Library of Congress, 1991).

The fourth plan stressed the promotion of 'self-reliance' which practical implications included increasing substitution of foreign factors of production, products, services, techniques and tastes. The plan's focus stressed Nigeria's efforts to convert its oil wells into a solid foundation for self-sustaining growth and development in the shortest possible time as a result of the first great oil price increase in 1973-74 (Fourth National Development Plan, 1981 p6). However, it suffered setbacks due largely to falling oil revenues and an increased need for imported food due to failure in modernisation of agriculture. Projected to rise 12.1% annually, exports actually fell 5.9% during the plan period, as a recession among the nations of the Organisation of Economic Co-operation and Development (OECD) reduced demand for third world imports.
Due to the overthrow of two Nigerian governments (1983 and 1985), the fifth plan was postponed until 1988-1992. The fifth plan's objectives were to devalue the Naira, remove import licenses, reduce tariffs, open the economy to foreign trade, promote non-oil exports through incentives, and achieve national self-sufficiency in food production. It sought to improve labour productivity through incentives, privatisation of many public enterprises and various government measures to create employment opportunities.

In a nutshell, the failure of all the aforementioned plans to meet set goals could be traced to several factors, amongst which were the frequent revisions in projected expenditure, overemphasis on public investment, distortions in plan implementation, official corruption, poor co-ordination, inconsistencies and over-dependence on oil. Besides, insufficient attention was paid to the small indigenous sector and the machinery for implementing developments in the public sector was unsatisfactory.

4.3.2 Rolling Plans From 1990

At the end of 1989 the Nigerian government abandoned the concept of fixed five-year plans for the rolling plan method. The three-year rolling plan was introduced for the period 1990 to 1992, in the context of more comprehensive fifteen to twenty-year plans. The rolling plan which was revised annually was considered more appropriate for an economy that was faced with uncertainties and rapid unpredictable changes. The objectives of the Nigerian rolling plan were to reduce inflation and exchange rate instability, maintain infrastructure, achieve agricultural self-sufficiency and reduce the burden of SAP on the most vulnerable social groups (Library of Congress, 1991). Table 4.2 shows the trend in government budgeting within the rolling plan periods.

Olojede and Lawal (2001) consider the national rolling plans to have addressed numerous socio-economic problems in the country. These are the declining standard of living of the people, high level of poverty, rising level of unemployment, high crime rate, low per capita income, weak industrial base, low level of agricultural production and low capacity utilisation in the real sector. They further opine that projects were assessed and admitted into the rolling plans based on economic viability, relevance to sectoral objectives and priorities, inter/intra-sectoral linkages and foreign exchange implications.
Table 4-2: Federal Government Budget 1986 - 1990 (₦ Millions)

<table>
<thead>
<tr>
<th></th>
<th>1986</th>
<th>1987</th>
<th>1988¹</th>
<th>1989²</th>
<th>1990²</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Petroleum profits</td>
<td>8,108</td>
<td>19,027</td>
<td>20,934</td>
<td>22,521</td>
<td>38,627</td>
</tr>
<tr>
<td>Other</td>
<td>4,194</td>
<td>6,072</td>
<td>6,377</td>
<td>6,893</td>
<td>9,138</td>
</tr>
<tr>
<td>Total revenues</td>
<td>12,302</td>
<td>25,099</td>
<td>27,311</td>
<td>29,414</td>
<td>47,765</td>
</tr>
<tr>
<td><strong>Expenditures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current</td>
<td>7,697</td>
<td>15,646</td>
<td>19,409</td>
<td>21,235</td>
<td>27,208</td>
</tr>
<tr>
<td>Capital</td>
<td>8,527</td>
<td>6,373</td>
<td>8,340</td>
<td>9,797</td>
<td>12,555</td>
</tr>
<tr>
<td>Total expenditure</td>
<td>16,224</td>
<td>22,019</td>
<td>27,749</td>
<td>31,032</td>
<td>39,763</td>
</tr>
<tr>
<td>Allocations to state and local governments</td>
<td>4,333</td>
<td>8,970</td>
<td>11,722</td>
<td>12,197</td>
<td>20,442</td>
</tr>
<tr>
<td>Adjustments</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>-1,892</td>
</tr>
<tr>
<td>Balance</td>
<td>-8,255</td>
<td>-5,890</td>
<td>-12,160</td>
<td>-13,815</td>
<td>-14,332</td>
</tr>
</tbody>
</table>

1 Provisional.
2 Projected.


However, some factors hindered the full realisation of the rolling plan objectives. These include inadequate budgetary provisions, frequent changes of personnel, weak or lack of relevant databases, poor rules and regulations enforcement and limited participation of relevant stakeholders. Other factors included inadequate capacity and political uncertainties. Consequently, Nigeria's income per capita in 1984 was over $1,000 but this plunged to below $300 by 1994. At the time (i.e. 1984) the percentage of Nigerians who lived below poverty level stood at 35%, and by 1994 the level had doubled to 70% (Baje, 2003).

4.3.3 Nigeria's Vision 2010 Project

The Vision 2010 project was inaugurated with the main goal of developing a blueprint to transform the country and place it firmly on the route to becoming a developed nation, by the year 2010. The report was comprehensive and ambitious as it proposed short, medium and long term measures seeking to stimulate economic growth and place Nigeria amongst developed economies by the year 2010. It detailed many separate actions to be taken ranging from "agreeing on a medium term macroeconomic strategy with the World Bank/IMF" to "liberalising expatriate quota, work visas and permits." The Vision Report (1997 p78) highlights Nigeria's economic aspirations as making Nigeria a major
industrialised nation and economic power continually striving for sustained economic growth and development towards improving the quality of life for all.

One of the milestones of Vision 2010 was ensuring that the manufacturing sector accounts for about 24% of GDP and for the sector to be a major employer of labour. Also in recognition of the role of SMEs in providing employment to about 80% of the Nigerian labour force, the Vision Report (1997 p.viii) proposed the pursuit of planned efforts to enable SMEs overcome their financial, managerial and technological problems. This was to be achieved by encouraging substantial private sector investment and the attainment of not less than 90% capacity utilisation i.e. up from its less than 50% level in 1997. The Vision Report (1997) concludes by emphasising that, economically, Nigeria needs a change in philosophy in favour of a strong public and private sector partnership to achieve sustainable economic growth and development that is private sector driven with the government as an enabler.

4.3.4 Planning Focus and Strategies for 2003 - 2007

The current government in Nigerian supports "private-sector" led, "market oriented" economic growth (CIA Factbook, 2003). Nigeria along with other countries, at the United Nations General Assembly in 2000, committed itself to achieving the Millennium Development Goals (MDGs) by 2015. These are mainly the eradication of extreme poverty and hunger, and developing a global partnership for development amongst others.

Though the present government has not formally adopted the Vision 2010 report, several elements of the government's development strategies, as articulated in various policy documents, are consistent with its broad thrust. This reflects in, for instance, the "Economic Blueprint," produced in 1999 and two other documents entitled "Economic Policy and Strategy, the Way Forward," and "Nigeria: Poverty Reduction Plan," prepared by the government in 2000. In addition, government unveiled a self-styled home grown economic blueprint which has the objective of being committed to a prudent and transparent macroeconomic strategy that supports poverty reduction in achieving economic growth and price stability. The overall aim of the blueprint is the establishment of the basis for achieving steady, realistic and achievable optimal medium term economic growth, creating productive jobs and reducing poverty.
In the quest to build a viable market economy the government aims to optimise its provision of an enabling environment involving entrepreneurship development programs for promotion of self-employment among other priorities. It further aims to attain the society’s goals of attainment of a broader productive base of the economy to restore internal and external balance, poverty alleviation, promotion of small scale industries and capacity building amongst others.

Unlike the previous plans, the government has introduced a reform based strategy tagged New Economic Empowerment and Development Strategy, (NEEDS). The development and reform agenda of the current government is therefore captured in NEEDS, with poverty reduction, employment generation and wealth creation as the ultimate goals. The strategy therefore recognises that the SME sector is a veritable and strategic catalyst for the attainment of these goals because of its ability to create jobs, raise incomes, expand markets, facilitate healthy competition and disseminate knowledge. Consequently, the USAID increased its support for the programme’s targets in boosting economic management and coordination, small-scale and micro enterprise development, encouraging private sector development and economic reform, and improved agricultural technology and marketing.

The current planning framework is criticised for the continued use of the “top-down” approach which thrived under previous military dictatorships. Added to this are the issues of scarce resources, poor communications among partners, lack of capacity, inadequate data, and ineffective monitoring and evaluation mechanisms (Olojede and Lawal, 2001). hence, to reverse the trend of perpetual failures from past attempts at sustainable development, Olojede and Lawal, (2001) suggest that unlike earlier development strategies, the government should ensure that the plans would take place against the backdrop of the national planning system as well as the special attributes of the society, its political structures and settings as well as past experiences.

4.4 Performance of the Nigerian Economy

Nigeria has enormous potential for growth and development with its vast oil and gas resources, rich and expansive agricultural land, solid minerals and abundant human resources. However, Dike, (2003) argues that despite these factors and the various economic summits held annually since 1993, successive
governments have not done enough to put the nation's resources to effective productive use. Consequently the economy is performing below its potential with rising unemployment, inflation, poverty, crime, misery and insecurity in the society. This has resulted in the nation joining the league of the world's poor nations. Ranked for a time as a middle-income country, Nigeria rejoined the category of low-income countries from the mid-1980s.

Economic activity fluctuates in business cycles in every society with contractions and expansions representing short-term changes in a society. However, because of persistent bad leadership, the duration of economic contractions in Nigeria has always been greater than that of economic expansions. And this has negatively impacted economic growth, with increased hardship on the masses. Seeing as Nigeria is endowed with abundant human and natural resources, it is argued that the nation's "development failures," like those in many other developing nations, would be attributed to institutional failures and not lack of [human and natural] resources. Also bad governance and corruption amongst other equally serious reasons play a role in compounding development failures.

Without long-term economic growth, a nation's living standard (the economic well being of a nation's people) declines. Their living standard only improves when production per person increases faster than the total population. With this, people will have an increased supply of goods and services to choose from, and the means to live a meaningful life. However, with the perennial scarcity of goods and services this has not been the case in Nigeria. Thus, Dike (2003) concludes that continued economic growth is important to the welfare of Nigeria for many reasons, some of which include maintaining a higher standard of living, to compete effectively in global markets, and to provide the necessary resources to satisfy, or deal with domestic needs.

4.4.1 Post-Independence Economy 1960 to 1985
Prior to the oil boom in the mid 1970s, the Nigerian economy depended to a large extent on primary commodity exports for its national income. The dependence was on such commodities as cocoa, groundnuts, cotton, rubber and palm oil. The level of agricultural self-sufficiency at the time earned Nigeria a place in the league of nations that were net exporters of agricultural produce.
Available statistics indicate that approximately 60% of the country's labour force had traditionally earned their livelihood from farming (CBN, 2000).

As part of Nigeria's post independence general economic focus an industrial program was designed with the primary objective of promoting import substitution through the initiation and sole financing of industrial projects by government. This was due largely to the fact that the private sector was not adequately developed to face the challenge and was further weakened by the dearth of funds for capital investment. In realisation of the private sector's level of incapacity coupled with the desire to ensure the sector's participation in the industrialisation process, the government set up development banks to augment the sector's efforts. Consequently, the manufacturing sector's relative share of GDP rose from 4.4% in the financial year 1959 to 9.4% in 1970, before falling during the oil boom to 7.0% in 1973, increasing to 11.4% in 1981, and declining to 10.0% in 1988. Manufacturing increased rapidly during the 1970s as tariff manipulations encouraged the expansion of assembly activities dependent on imported inputs. These activities contributed little to indigenous value added or to employment, and reduced subsequent industrial growth (NIPC, 2002).

However, with the discovery of oil in 1975, which attained the position of major foreign exchange earner and GDP contributor, all other sectors of the economy were neglected with agriculture suffering the most abandon. This fact is supported by the decline of agricultural production from 60% to 30% of GDP (including oil) in 1960-1965 and the last half of the 1970s (i.e. from 1976) respectively. Agriculture provided 81% of export receipts in 1960 which also fell to 6% in 1977, although these figures perhaps overstate the decline because the result is affected in part by the rise in the petroleum sector. However even more realistic GDP figures showing the agricultural portion of GDP (excluding oil) show a sharp drop from 58% in 1960-65 to 36% in 1977 (Zartman, 1983 p15).

Conversely, private consumption's rate of increase in the four years after the oil revenue surge was more than thirteen times its rate of increase in the pre-civil war 1960s (i.e. over 8% per annum for 1974-77 compared to 0.6% per annum for 1960-66). Government consumption portion of GDP (i.e. government expenditures for purposes other than capital formation) also grew rapidly at an annual rate of 6.4% during the pre-civil war 1960s. Then after the price increase
it soared, tripling to 29.7% in the four years from 1974 to 1977. As a result of the growth in the rate of increase, the proportion of GDP devoted to government consumption also grew significantly: it was 6.1% in 1960-66; 13.8% in 1970-77; 15.9% in 1977; and 10% in 1979. Thus Nigeria revealed a higher degree of excess in government than private consumption (Zartman, 1983 p. 12-13).

There was equally an enlargement of the financial system and a marked improvement in its sophistication and service delivery. The growth witnessed in commercial bank branches is attributable largely to the introduction of rural banking in 1977 (CBN Reports, various years). Similarly, the capital market witnessed remarkable increases in the quantity of stocks quoted and traded on the exchange and likewise an increase in the number of traders registered to deal on the exchange, in sequence with the general trend in the economy. This resulted in the purposeful enhancement of the process of regulation and development of the capital market with the establishment of the Nigerian Securities and Exchange Commission (SEC) in 1978.

Notwithstanding the growth of numerous infrastructure and institutional developments witnessed, the economy posted poor performance, notably in 1978. While from 1970 through to 1977 the GDP grew annually by 7.3% on the average, the period 1978 to 1985 recorded deterioration in performance to a low average of 2.2% per annum growth rate of GDP (CBN, 2000).

Hence the declining trend observed in domestic output from 1980 continued unchecked and unresolved into 1984. This was a consequence of the negative occurrences in the global oil market in the early 1980s, which caused oil prices to plunge to considerably low levels. Consequently, the country's earnings from exports and budgetary receipts also dwindled significantly. There was no commensurate cutback in public expenditure during this period; consequently, a large build-up of fiscal and external deficits was recorded. This prompted government to resort to intense domestic borrowing from the local banking system, especially from the Central Bank of Nigeria, so as to fund domestic deficits. Similarly, the government engaged in colossal foreign borrowing and drawing down of external reserves to finance shortfalls in external trade and related overseas transactions (CBN, 2000). From 1974 to 1981, while real oil prices remained high, lending to major oil exporting countries, such as Nigeria,
was considered very safe. Indeed, Nigeria did not borrow extensively from abroad until 1978, when a fall in the price of oil necessitated a borrowing of $16 million on world capital markets. Thereafter, Nigeria continued international borrowing for ambitious investment programmes, anticipating an oil-price recovery. Nigeria experienced an external trade surplus only from 1973 to 1975 and 1979 to 1980, during two oil price peaks, and in the late 1980s, when debt servicing burdens forced import reductions (Library of Congress, 1991).

The World Bank ranked Nigeria 20th in global GDP size with a recorded GDP of $91.13 billion in 1980. Subsequent rankings recorded lower levels with the country's GDP sizes in 1983 and 1984 ranking at 23rd and 21st positions respectively. In real terms, the GDP value recorded for 1983 shrunk to $64.57 billion, while between 1984 and 1985 the GDP rose minimally with a value of $73.45 billion (World Bank, 1982).

Huge trade arrears became the resultant consequence of the plummeting in foreign exchange resources as the country's reserves were used to fund deficits and shortfalls. Furthermore, the non-oil sector experienced stagnation while oil earnings were not effectively and efficiently exploited to stimulate desired growth levels and sustainable economic development. The dwindling manufacturing sector became largely reliant on imported raw materials while inadequate progress was made in industrialisation. This is because manufacturing and production outlets generally faced low capacity utilisation and lacked the capability to compete with inexpensive imported goods and commodities. In addition the available infrastructure was continually crumbling and could no longer satisfy the strain of a fast growing populace and equally serve the deteriorating industrial segment of the economy.

4.4.2 Structural Economic Reforms in Nigeria from 1986-1992

Concerted efforts to remedy the problems that emerged and to diminish the country’s financial inequity led to the introduction of different budget-tightening austerity measures in 1982 to 1985 and later structural reform programmes. The structural adjustment programme (SAP) was initiated (to run for two years from July 1986 to June 1988) in reaction to the crash in the international oil market and the negative drift of the economy. The dwindling oil revenues resulted in deteriorating economic conditions, distortions in macroeconomic policies and the
urgent need to diversify the production base of the economy away from the obviously dangerous over-dependence on the oil sector.

SAP was designed to achieve fiscal balance and balance of payments viability by altering and restructuring the economy's production and consumption patterns, eliminating price distortions, reducing heavy dependence on crude oil exports and consumer goods imports, enhancing the non-oil export base and achieving sustainable growth. It also aimed to rationalise the public sector's role and to accelerate the private sector's growth potential. The programme's main strategies were the deregulation of external trade and payments arrangements, the adoption of a market-determined Naira exchange rate, substantial reduction in complex price and administrative controls and more reliance on market forces as major determinants of economic activity (CBN, 2000).

Accordingly SAP combined exchange rate and trade policy reforms with stabilisation policies designed to restore balance of payments equilibrium and price stability. It placed emphasis on a greater use of price signals, downsizing the parastatal sector, and improving the efficiency of public enterprises. Other policy measures undertaken included the elimination of import licensing, reduction in the scope of import prohibitions, the elimination of agricultural marketing boards and the removal of price controls. Under SAP the government sought to eliminate inefficient state intervention and obtain budgetary relief by abolishing agricultural commodity marketing boards and liberalising cash-crop exports. These measures, alongside devaluation of the Naira, increased the Naira prices of export crops, especially cocoa. The state also privatised many public enterprises and restructured other parastatals to improve efficiency. The government encouraged private investment in the late 1980s, allowed foreign ownership in most manufacturing, while it liberalised and accelerated administrative procedures for new investment (Library of Congress, 1991).

The SAP measures contributed to larger increases in manufacturing's contribution to GDP, which grew 8% in 1988. These measures included liberalized regulations governing the import of capital, raw materials, and components; the creation of import substitution industries; and, beginning in 1988, privatization. SAP increased production efficiency, cut into the black market, and reduced factory closures resulting from import bans on essential
inputs (Library of Congress, 1991). The strategy pioneered in the reform programmes, emphasized the necessity to promote the renewal of the non-oil sector's relevance so as to create innovative and supplementary sources of revenue intended at boosting the level of foreign exchange proceeds.

The outcome of the implementation of various policy reforms in the initial years showed considerable improvements in the Nigerian economy's performance. For instance, during 1987 to 1992, Nigeria's annual GDP growth averaged about 5%, well above an average decline of 2% during 1980 to 1986. Similarly, manufacturing, agriculture and the oil sectors experienced positive growth with an average GDP growth rate of about 5% per annum (Iyoha & Oriakhi, 2002). In addition, government introduced a second-tier foreign exchange market (SFEM) in September 1986, where foreign exchange is sold on auction for a near equilibrium price and used for export earnings and import trade requirements. Under SFEM, the Naira depreciated 66% to N1 = US$0.64 (N1.56 = US$1).

The effects of SAP propelled the country into more stringent economic hardships. SAP was accompanied by falling real wages, the redistribution of income from urban to rural areas, and reduced health, education, and social spending. The decrease in spending on social programs contributed to often severe domestic unrest, such as the urban rioting in April 1988 as a result of the reduction in petroleum subsidies, and student-led violence in opposition to government economic policies in May and June 1989. This further resulted in nation-wide crisis with workers virtually grinding the economy to a standstill through labour strife that spanned the length and breadth of the country.

The effect of the SFEM in breaking bottlenecks, together with the slowing of food price increases, dampened inflation in 1986. This trend continued, especially after the relaxation of fiscal policy early in 1988, but the easing of domestic restrictions in 1988 re-ignited it. Real interest rates became negative while capital flight and speculative imports resumed. Consequently, the economy witnessed some deviation in policy direction in the years 1988 and 1989 by way of a number of policy reversals. This was done in an attempt to cushion the effects of the belt-tightening measures that were executed in the years 1986 and 1987. Expectedly, some of the growth that the economy in general had attained within the two years progressively waned. This
necessitated the initiation of immediate negotiations with the IMF and Nigeria's foreign creditors. Agreements were entered into aimed at restoring tolerable external payments position while simultaneously serving to restore calm and douse rising tensions on the volatile domestic political terrain.

Table 4-3: GDP\(^1\) by Sector 1986 - 1992 (N Billions)

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</thead>
<tbody>
<tr>
<td>Agriculture (All)</td>
<td>31.2</td>
<td>31.9</td>
<td>32.3</td>
<td>33.8</td>
<td>35.3</td>
<td>36.5</td>
<td>37.1</td>
</tr>
<tr>
<td>Crude petroleum</td>
<td>11.4</td>
<td>10.2</td>
<td>11.3</td>
<td>11.0</td>
<td>11.7</td>
<td>12.7</td>
<td>13.2</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>0.4</td>
<td>0.4</td>
<td>0.5</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>7.3</td>
<td>7.7</td>
<td>8.3</td>
<td>8.8</td>
<td>8.4</td>
<td>8.1</td>
<td>8.3</td>
</tr>
<tr>
<td>Utilities</td>
<td>0.4</td>
<td>0.3</td>
<td>0.3</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.6</td>
</tr>
<tr>
<td>Construction</td>
<td>1.3</td>
<td>1.1</td>
<td>1.1</td>
<td>1.6</td>
<td>1.7</td>
<td>1.8</td>
<td>1.9</td>
</tr>
<tr>
<td>Transportation</td>
<td>2.7</td>
<td>2.7</td>
<td>2.9</td>
<td>2.8</td>
<td>2.9</td>
<td>3.0</td>
<td>3.1</td>
</tr>
<tr>
<td>Communications</td>
<td>0.2</td>
<td>0.2</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Wholesale and retail trade</td>
<td>12.1</td>
<td>13.6</td>
<td>14.1</td>
<td>12.2</td>
<td>11.5</td>
<td>11.9</td>
<td>12.2</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Finance and insurance</td>
<td>2.4</td>
<td>2.6</td>
<td>3.0</td>
<td>5.2</td>
<td>7.9</td>
<td>8.2</td>
<td>8.5</td>
</tr>
<tr>
<td>Real estate and business services</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Housing</td>
<td>1.9</td>
<td>1.9</td>
<td>2.0</td>
<td>2.0</td>
<td>2.1</td>
<td>2.2</td>
<td>2.3</td>
</tr>
<tr>
<td>Government services</td>
<td>5.0</td>
<td>5.0</td>
<td>5.0</td>
<td>6.7</td>
<td>7.6</td>
<td>7.9</td>
<td>8.9</td>
</tr>
<tr>
<td>Other</td>
<td>0.6</td>
<td>0.6</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td><strong>Total(^2)</strong></td>
<td>77.9</td>
<td>79.3</td>
<td>82.6</td>
<td>83.5</td>
<td>90.4</td>
<td>94.6</td>
<td>98.0</td>
</tr>
</tbody>
</table>

1 At 1984 factor cost.
2 Figures may not add to total because of rounding.


In 1989 the government again unified foreign exchange markets, depreciating (but not stabilising) the Naira and reducing the external deficit. Manufacturing firms increased their reliance on local inputs and raw materials, firms depending on domestic resources grew rapidly, and capacity utilisation rose, although it was still below 50%. Concurrently, non-oil exports grew from $200 million in 1986 to $1,000 million in 1988 which, however, represented only 13% of export value at the level of the 1970s (Library of Congress, 1991).
Table 4-3 gives the sectoral GDP trend as variously compiled for the years 1986 to 1992. In 1987 the GDP size had fallen to $24.39 billion ranking the country at the 44th position worldwide. By 1999 the GDP had shrunk to a paltry $35 billion, which was just about 38% of what it was in 1980. Similarly, GDP per capita that had achieved a peak position of over $1,000 in the 1980s increasingly plummeted, as proven by recorded level of $344 GDP per capita in 1996, and more recently in 2001 of a $316 level (World Bank, 2002).

However, Obadina (1999) suggests that opinion in Nigeria is divided on whether the failure of the reform process to turn the economy around was due to weak implementation or the inappropriateness of the policies. Some blame the failure of the programme on mismanagement, stemming from incompetence and corruption (Obadina, 1999). The National Centre for Economic Management and Administration (NCEMA), nonetheless, attributes the disappointing results of the adjustment effort to two major factors; misguided policies under SAP and an incoherent implementation of SAP policies (see www.gdnet.org).

On the other hand, others blame the IMF and World Bank prescriptions for Nigeria's current ailments. Former justice minister Chief Richard Akinjide is quoted as saying "They [the international financial institutions] said we should open up our markets and that investments would come in immediately. We opened up our markets, investments stopped coming in, we foolishly listened to them when they asked us to devalue the naira. Now, we don't have a middle class. What we have are the very rich and the very, very poor. No nation can develop without a middle class," continued Akinjide (Obadina, 1999). A common view among ordinary Nigerians is that SAP worsened poverty. The 1996 World Bank poverty study finds that the population’s percentage in poverty declined between 1985 and 1992, from 43% to 34%. However it also notes that poverty worsened for people with the lowest 20% incomes (World Bank, 1996).

In conclusion, SAP ushered in a number of economic reforms, which though well intended were poorly planned and executed. Its outcome only served to exacerbate the unprecedented level of corruption and international isolation that left the economy crippled. Poor implementation or the failure to observe conditionalities in the adjustment programmes led to deterioration in relations with multilateral financial institutions, particularly the IMF and World Bank, from
the early 1990s. In addition, SAP was implemented under difficult circumstances which included volatile oil prices, negative net resource transfers from foreign creditors and an unstable political environment. Hence, despite the initial successes, there were persistent lapses which occurred in the implementation of the reforms and therefore the policies could not be maintained.

4.4.3 Post-SAP (1993) Economic Performance

The happenings in the economy created the awareness that the economy was grunting under the hardships of implementing SAP as evidenced by some economic indicators in tables 2.4 and 2.5 below.

Table 4-4: Selected Indicators of Macroeconomic Performance 1996 - 2001

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</thead>
<tbody>
<tr>
<td>Real GDP Growth (%)</td>
<td>3.38</td>
<td>3.16</td>
<td>2.36</td>
<td>2.80</td>
<td>3.80</td>
<td>3.00</td>
</tr>
<tr>
<td>GDP per Capita (US$)</td>
<td>344</td>
<td>339</td>
<td>313</td>
<td>322</td>
<td>314</td>
<td>316</td>
</tr>
<tr>
<td>Growth in Money Supply (M1)</td>
<td>14.5</td>
<td>18.2</td>
<td>20.5</td>
<td>18.0</td>
<td>62.2</td>
<td>19.9</td>
</tr>
<tr>
<td>Average Inflation Rate (%)</td>
<td>29.3</td>
<td>8.5</td>
<td>10.0</td>
<td>6.6</td>
<td>6.9</td>
<td>19.0</td>
</tr>
<tr>
<td>Balance of Payments (US$ bn)</td>
<td>0.761</td>
<td>0.015</td>
<td>(2.873)</td>
<td>(3.537)</td>
<td>3.090</td>
<td>0.459</td>
</tr>
<tr>
<td>Balance of Payments (% of GDP)</td>
<td>(1.9)</td>
<td>0.0</td>
<td>(7.7)</td>
<td>(9.7)</td>
<td>8.0</td>
<td>1.3</td>
</tr>
<tr>
<td>External Reserves (US$)</td>
<td>4.1</td>
<td>7.6</td>
<td>7.1</td>
<td>5.4</td>
<td>9.9</td>
<td>10.4</td>
</tr>
<tr>
<td>Average Exchange Rate (N/$)</td>
<td>69.84</td>
<td>71.75</td>
<td>76.81</td>
<td>92.34</td>
<td>101.65</td>
<td>112.00</td>
</tr>
<tr>
<td>FG Deficit (-) or Surplus (+) (bn)</td>
<td>+32.0</td>
<td>-5.0</td>
<td>-133.4</td>
<td>-285.1</td>
<td>-103.8</td>
<td>+51.1**</td>
</tr>
<tr>
<td>External Debts (% of GDP)</td>
<td>90.1</td>
<td>80.8</td>
<td>91.1</td>
<td>83.8</td>
<td>82.8</td>
<td>78.6</td>
</tr>
<tr>
<td>Net FDI (US$ bn)</td>
<td>1.59</td>
<td>1.48</td>
<td>0.94</td>
<td>0.91</td>
<td>1.06</td>
<td>1.92</td>
</tr>
<tr>
<td>Maximum Lending Rate (%)</td>
<td>20.9</td>
<td>20.5</td>
<td>22.6</td>
<td>30.0</td>
<td>25.2</td>
<td>26.5</td>
</tr>
<tr>
<td>Prime Lending Rate (%)</td>
<td>20.2</td>
<td>18.3</td>
<td>20.2</td>
<td>25.8</td>
<td>20.6</td>
<td>18.5</td>
</tr>
</tbody>
</table>

** Figure for June 2001.


Table 4-4 shows that the marginal economic growth of 3% recorded in 2001 was lower than the 3.8% level recorded in 2000 and grossly lower than the 5% target set by government for the year 2001. Average inflation rate climbed from 6.6% in 1999 to 19% in 2001. While the foreign currency conversion rate of the Naira rose considerably against the US dollar, from about N70 to US $1 in 1996 to N112 in 2001, resulting in the serious depreciation of the Naira in value terms. The consequence of this was the implicit wiping out of sizeable levels of economic returns recorded over the years, considering the massively import
reliant characteristic of the nation's economy. This further resulted in the deflation of the resource base and economic assets of the nation.

Overall, major macroeconomic indices denote mixed economic performances, particularly in 2000 and 2001, with a growth in money supply (M1) of 62.2% and 19.9% respectively. This deepened inflationary pressures resulting in soaring inflation from a low 0.9% in June 2000 to 19% at the end of 2001. On the external sector, external reserves rose from $9.9 billion in 2000 to $10.4 billion by November 2001, which was equivalent to 9.5 months of imports. Furthermore, balance of payments deteriorated to a paltry surplus of $0.46 billion in 2001 from a higher surplus in 2000 of $3.09 billion, and as a percentage of GDP, it declined from 8% in 2000 to 1.3% in 2001 (CBN, 2001).

According to the World Bank (2000), Nigeria's per capita gross national product (GNP) was $260 in 1997, compared with an average of $500 for sub-Saharan Africa as a whole and $350 for low-income countries. Nigeria's per capita income in 1997 was below the 1960 level in real terms. In recent years economic growth barely kept pace with population growth, estimated at 2.8% per annum. Despite the country's immense human and natural resources, little social progress has been made. Two-thirds of a population of more than 130 million live below the poverty line, and one-third survive on less than a dollar a day. Over 40% of the adult population is illiterate. Life expectancy is 53 years, a decade below the average for developing nations, and less than half the population has access to safe water and adequate sanitation.

Furthermore, the GDP growth rate averaged 2.5% during 1993-97 while other macroeconomic indicators indicated a degree of stability since 1995. Inflation fell to 10-15% in 1998 from 72.8% in 1995. The Naira was relatively stable between 1995 and 1997, trading between N80 and N86 to US$1 at the autonomous market-influenced rate, for most of the time, in contrast to previous turbulent years. However, pressure on the naira increased in early 1999, in response to the increased demand for foreign exchange, resulting in the currency's devaluation in March from N86 to N90 in exchange for $1 (World Bank, 2000).
4.5 Sectoral Performance

In this section performance and developments in two major sectors, that is, the manufacturing and trade sectors are reviewed. These sectors have significant bearing on the economy in general and SMEs in particular.

4.5.1 Performance of Manufacturing Sector

Small scale businesses have been the long-established framework upon which the manufacturing sector in Nigeria is structured. Nonetheless the sector as a whole has remained very small, as it represented only 6.6% of GDP in 2000, it comprised of an estimated 16,000 firms in the late 1990s with an estimated labour force of over 350,000 workers (CBN, 2000). SMEs represent about 60% of the manufacturing sector’s formal composition. However, SMEs account for only 12% of the total employment whereas larger companies contributed about 53% of total employment in the manufacturing sector. Efforts to revive and restore the manufacturing sector to relevance commenced only when the oil market declined in the 1980s. In 1985 the government selectively relaxed the indigenization decrees to encourage foreign investment in neglected areas, such as large-scale agro business and local-content manufacturing. From 1982 to 1986, Nigeria’s value added in manufacturing fell 25% due partly to inefficient resource allocation caused by distorted prices (especially for exports and import substitutes) and prohibitive import restrictions (Library of Congress, 1991).

Over the years the manufacturing sector witnessed declines that gave rise to considerable de-industrialisation in the economy. This was an outcome of the depressing factors that afflicted the sector, most especially low capacity utilisation. CBN (2000) reports that capacity utilisation in the 1960s through to the 1970s was an average of 70% of total manufacturing capacity in the economy. The level however plummeted sharply in the 1980s and 1990s to lower averages of 41.6% and 30.8% respectively as shown in Figure 4.1 below. By and large, low oil revenues worsened the performance of the manufacturing sector coupled with high interest rates, continuous depreciation of the Naira exchange rate, shortage or outright lack of manufacturing inputs that are mostly imported, aggressive and unchecked competition from imports, infrastructure decays and low purchasing power.
The World Bank (2002) argues that for most of the past three decades the organised private sector suffered from inadequate infrastructure, under-investment in human resources, poorly conceived and executed development strategies, which reflected in the decline of the manufacturing sector from 8.8% of GDP in 1979 to only 5.4% in 1998.

Table 4-5: Production Indices

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</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>104.8</td>
<td>107.8</td>
<td>110.2</td>
<td>122.0</td>
<td>115.6</td>
<td>118.9</td>
<td>122.7</td>
<td>125.6</td>
<td>128.9</td>
</tr>
<tr>
<td>Oil GDP</td>
<td>109.2</td>
<td>112.1</td>
<td>109.2</td>
<td>109.4</td>
<td>112.2</td>
<td>119.9</td>
<td>121.6</td>
<td>115.7</td>
<td>110.9</td>
</tr>
<tr>
<td>Non-Oil GDP</td>
<td>104.0</td>
<td>107.2</td>
<td>110.5</td>
<td>112.6</td>
<td>114.9</td>
<td>118.2</td>
<td>122.3</td>
<td>126.4</td>
<td>131.0</td>
</tr>
</tbody>
</table>

| Of Which:       |      |      |      |      |      |      |      |      |      |
| Agriculture     | 103.5| 105.6| 107.1| 109.7| 113.7| 118.3| 123.3| 128.3| 133.6|
| Manufacturing   | 109.4| 104.1| 99.7 | 98.9 | 95.5 | 94.3 | 94.6 | 90.9 | 92.3 |
| Mining          | 100.0| 103.7| 111.1| 114.8| 114.8| 118.5| 125.9| 133.3| 137.0|
| Building & Constr| 104.0| 108.1| 113.3| 116.8| 119.7| 121.4| 128.9| 136.4| 142.2|
| Finance & Insurance | 104.1| 108.1| 112.3| 115.6| 120.4| 125.1| 130.5| 136.9| 141.6|
| Utilities       | 102.0| 112.0| 116.0| 120.0| 122.0| 124.0| 124.0| 120.0| 122.0|
| Services        | 101.5| 107.5| 119.4| 134.3| 156.7| 179.1| 206.0| 247.8| 297.0|

Source: World Bank, 2000

Table 4-5 presents the trends in the outputs of the economy's principal sectors by way of manufacturing sector production indices. The indices show that by 1999, manufacturing output in real terms had dropped to about 92% of the base rate of 100% in 1990, while other sectors were registering modest growth.
4.5.2 Trade Sector Performance

One of the most significant characteristics of the Nigerian economy is the rapid integration of the economy into the world market even before independence. Until the mid-1950s, agricultural commodity exports, mainly cocoa, groundnuts, palm oil, and palm kernels, earned more than the cost of imported merchandise. For instance, in 1963 Nigeria was the world's major exporter of groundnuts with over 600,000 tons (World Bank, 1974). The demand for imports remained limited by the country's low income, lack of industrialization, negligible use of foreign inputs in agriculture, and sterling bloc restrictions. Nigeria had continued to specialize in primary products (food, raw materials, minerals, and organic oils and fats) and to import secondary products, such as chemicals, machinery, transportation equipment, and manufactured goods, used in Nigeria's development as reflected in Table 4-6.

<table>
<thead>
<tr>
<th>Table 4-6: Major Imports 1985 – 1988 (N Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food and live animals</td>
</tr>
<tr>
<td>Beverages and tobacco</td>
</tr>
<tr>
<td>Animal and vegetable fats and oils</td>
</tr>
<tr>
<td>Crude materials (inedible)</td>
</tr>
<tr>
<td>Mineral fuels</td>
</tr>
<tr>
<td>Chemicals</td>
</tr>
<tr>
<td>Manufactured goods</td>
</tr>
<tr>
<td>Machinery and transportation equipment</td>
</tr>
<tr>
<td>Other</td>
</tr>
<tr>
<td>TOTAL</td>
</tr>
</tbody>
</table>

Source: Based on information from EIU, (1990, 43-44).

In 1955 primary commodities comprised 98% of exports and 21% of imports, 92% of exports and 19% of imports in 1975, and 98% of exports and 24% of imports in 1985 (Library of Congress, 1991). Table 4-7 indicates that minerals (largely petroleum) accounted for an increasing proportion of exports through the 1970s, increasing from 13% in 1955 to 35% in 1965, to 93% in 1975, and then to 96% in 1985.

The dependence on oil and a few other export commodities made Nigeria vulnerable to world price fluctuations. Nigeria's overall commodity terms of trade (price of exports divided by price of imports) declined substantially, from a base
of 100 (1980) to 83.8 (1984) and 35.5 (1986), before rising to 42.6 (1987) and then falling to 34.6 (1988). Meanwhile, export purchasing power (quantity of exports multiplied by the commodity terms of trade) declined from 100 (1980) to 48.3 (1984), 23.0 (1986), 23.1 (1987), and 20.4 (1988), a 79.6% reduction in the purchasing power of exports in eight years (EIU, 2001).

Table 4-7: Major Exports 1984 -1988 (₦ Millions)

<table>
<thead>
<tr>
<th>Commodity</th>
<th>1984</th>
<th>1985</th>
<th>1986</th>
<th>1987</th>
<th>1988¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cocoa beans</td>
<td>183</td>
<td>182</td>
<td>371</td>
<td>1,498</td>
<td>2,627</td>
</tr>
<tr>
<td>Cocoa products</td>
<td>32</td>
<td>57</td>
<td>54</td>
<td>62</td>
<td>66</td>
</tr>
<tr>
<td>Palm kernels and products</td>
<td>16</td>
<td>6</td>
<td>8</td>
<td>30</td>
<td>103</td>
</tr>
<tr>
<td>Petroleum</td>
<td>8,841</td>
<td>11,224</td>
<td>8,368</td>
<td>28,209</td>
<td>29,293</td>
</tr>
<tr>
<td>Rubber</td>
<td>17</td>
<td>4</td>
<td>29</td>
<td>61</td>
<td>290</td>
</tr>
<tr>
<td>Other²</td>
<td>-1</td>
<td>248</td>
<td>91</td>
<td>501</td>
<td>739</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>9,088</td>
<td>11,721</td>
<td>8,921</td>
<td>30,361</td>
<td>33,138</td>
</tr>
</tbody>
</table>

¹ Provisional.
² Includes statistical discrepancy, which accounts for negative figure.

Source: Based on information from EIU (1990, p.43).

Table 4-8: Major Trading Partners 1985 -1988 (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>Britain</th>
<th>Canada</th>
<th>France</th>
<th>Italy</th>
<th>Japan</th>
<th>Netherlands</th>
<th>Spain</th>
<th>United States</th>
<th>West Germany</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>5.2</td>
<td>n. a.</td>
<td>10.8</td>
<td>n. a.</td>
<td>4.2</td>
<td>5.4</td>
<td>19.8</td>
<td>13.7</td>
<td>40.9</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>1986</td>
<td>4.9</td>
<td>2.7</td>
<td>8.4</td>
<td>n. a.</td>
<td>0.3</td>
<td>2.9</td>
<td>26.9</td>
<td>12.6</td>
<td>41.3</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>1987</td>
<td>2.6</td>
<td>2.0</td>
<td>5.7</td>
<td>n. a.</td>
<td>3.9</td>
<td>8.3</td>
<td>37.7</td>
<td>7.7</td>
<td>32.1</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>2.3</td>
<td>2.8</td>
<td>5.1</td>
<td>n. a.</td>
<td>4.8</td>
<td>9.6</td>
<td>36.2</td>
<td>7.1</td>
<td>32.1</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Britain</th>
<th>Canada</th>
<th>France</th>
<th>Italy</th>
<th>Japan</th>
<th>Netherlands</th>
<th>Spain</th>
<th>United States</th>
<th>West Germany</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>17.3</td>
<td>n. a.</td>
<td>8.1</td>
<td>4.9</td>
<td>7.4</td>
<td>3.1</td>
<td>n. a.</td>
<td>9.6</td>
<td>9.2</td>
<td>40.4</td>
<td>100.0</td>
</tr>
<tr>
<td>1986</td>
<td>17.0</td>
<td>n. a.</td>
<td>10.1</td>
<td>5.2</td>
<td>4.0</td>
<td>5.1</td>
<td>n. a.</td>
<td>8.4</td>
<td>13.7</td>
<td>36.5</td>
<td>100.0</td>
</tr>
<tr>
<td>1987</td>
<td>16.4</td>
<td>n. a.</td>
<td>8.4</td>
<td>6.7</td>
<td>7.3</td>
<td>5.1</td>
<td>n. a.</td>
<td>6.2</td>
<td>11.2</td>
<td>38.7</td>
<td>100.0</td>
</tr>
<tr>
<td>1988</td>
<td>14.5</td>
<td>n. a.</td>
<td>9.8</td>
<td>6.4</td>
<td>6.4</td>
<td>3.8</td>
<td>n. a.</td>
<td>7.4</td>
<td>10.7</td>
<td>41.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

n. a. = not available.


As late as 1955, 70% of Nigeria's exports were to Britain and 47% of its imports were from Britain. By 1976 Britain's share of Nigerian exports and imports dropped to 38% and 32% respectively. However, in 1988 the USA was Nigeria's best customer, buying more than 36% of its exports (primarily petroleum
products); Britain was Nigeria's leading supplier, selling the nation more than 14% of its imports. In 1990 Nigeria had associate status, including some export preferences, with the EEC. As a result, it had a number of major EEC trading partners, including Germany, France, Italy, Spain, and the Netherlands. It also had an active trade relationship with some members of the OECD, notably the USA, Canada, and Japan (Table 4-8). Trade with adjoining African countries, mainly in ECOWAS, comprised only 3 to 4% of total trade. In the 1980s, trade with Eastern Europe and the Soviet Union was below 1% (EIU, 2001).

Some analysts believe that economic policy changes in Nigeria have not translated into much economic growth because the country has not really shifted to a market-based economy. The WTO (1998) argues that while Nigeria has taken steps towards trade and investment liberalization and macroeconomic stabilization, policy priorities remain divided between dependence on the public sector and import substitution strategies on the one hand, and greater reliance on the private sector and market-based reforms on the other. Nonetheless, the government maintains that the trade sector remains strategic in Nigeria's new policy orientation as it has the capacity to expand markets, create jobs and raise incomes. It is argued that increasing the country's trade sector performance is therefore critical for advancing both human and economic development goals.

4.6 The Nigerian Financial Sector
This sector comprises of a varied mixture of banking and non-bank financial institutions. It has the regulatory agencies such as Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC), Securities and Exchange Commission (SEC), National Insurance Commission (NAICOM), and the National Board for Community Banks (NBCB) on the one hand. Then it has the customer-serving institutions of the financial sector consisting of 90 banks with a total of 2,193 branches in the banking system, over 1000 rural oriented community banks, a Peoples' Bank (PBN), 7 development finance institutions (DFIs), 229 licensed finance companies, about 195 PMIs, over 100 insurance companies, 5 DHs, various pension schemes and over 100 officially recognised bureaux de changes. In addition, are the money and capital markets which are at their formative stages of development thus cannot favourably compete or compare with their counterparts in the global financial markets (CBN 2000).
4.6.1 The Regulatory Agencies
The regulatory and supervisory framework in the Nigeria financial sector is administered by the Financial Services Regulation Coordinating Committee (FSRCC), as the overall coordinating body. It is charged with the responsibility of coordinating the activities of all the regulatory institutions. The Governor of the CBN chairs the committee with the Director General of SEC, the Commissioner for Insurance, Registrar General of the CAC and a Director or representative of the Ministry of Finance as committee members. However the main regulatory institutions of interest to SMEs are the CBN and SEC which are discussed next.

4.6.1.1 The Central Bank of Nigeria
This is the apex regulatory authority in the Nigerian Financial System responsible for the formulation and implementation of monetary and fiscal policies. It is also charged with promoting monetary stability and ensuring a viable, stable and hitch-free financial system, acting as banker and advisor to the government and serving as banker and lender of last resort to the country's banking system. In 1997 the enabling statute (i.e. the Banks and Other Financial Institutions Decree), enlarged and strengthened its regulatory and supervisory responsibilities and authority to include and cover all Finance Companies, all Development Banks, all Community Banks, all Primary Mortgage Institutions (PMIs) and the Federal Mortgage Bank of Nigeria. In addition the CBN was bestowed with legal autonomy in the implementation of its regulatory and monetary policy tasks in 1999. Prior to this time the CBN could only undertake such tasks after recommending and obtaining due approval from the serving heads of the government in Nigeria at the different times.

4.6.1.2 The Securities and Exchange Commission
SEC has the primary role of regulating capital market operations with the principal goal of promoting a systematically organised and actively vibrant market to ensure satisfactory safeguard of the investing public. This it does through sustaining appropriate ethics of conduct and professionalism in the securities industry and sustaining a close watch over the market to boost effectiveness and efficacy. SEC was empowered, by the Companies and Allied Matters Decree of 1990, to approve and regulate mergers and acquisitions and also to grant approval for formation of Unit Trusts that qualify. Furthermore, the
Investment and Securities Decree of 1999 endowed the SEC with the added task of directly promoting and developing the capital market in Nigeria.

4.6.2 The Banking System
Though the Nigerian financial sector appears to have a diversified nature, the banking sub-sector dominates accounting for about 93% of financial assets held within the non-CBN banking industry. In addition, bank deposits represent the major forms of financial savings in the economy.

The banking system is the most organised and structured sub-sector and has existed longer than the other sub-sectors of the financial sector. It falls under the regulatory functions of the nation's CBN and NDIC whose existence and roles have in recent years significantly strengthened the financial conditions and soundness of the commercial and merchant banking system.

The two types of banking institutions that have direct bearing on the provision of financing to the SME sector are reviewed as follows.

4.6.2.1 Commercial and Merchant Banks
These banks basically perform the sector's task of financial intermediation; therefore they are mainly deposit taking and loan granting institutions that also offer other complimentary services. The commercial banks that essentially provide retail banking services apparently dominate the banking system and accounted for almost 80% of the total non-CBN financial assets in 1998. Merchant banks on the other hand are wholesale banking providers, however recent trends in the economy depict them taking on more of traditional commercial banking roles at the expense of the wholesale mode. This prompted the nation to adopt universal banking which allows all banks to provide both retail and wholesale banking services.

4.6.2.2 Community Banks
The CBs are an important component of the Nigerian financial system. Established in December 1990, their number grew rapidly from 104 in 1991 to 1,368 in 1995 when the issuance of provisional licenses by the NBCB was suspended. The NBCB (1998) details the objectives of the CBs to include the promotion of rural development, the promotion of an effective and integrated national financial system that responds to the banking needs at the grassroots
community level, the inculcation of disciplined banking habits among the low-income population, especially in the rural areas, and the fostering of a spirit of community ownership and the use of economic assets on a sustainable basis.

Essentially the orientation of these banks is to serve the rural area communities by providing needed financial services. They are therefore, owned and managed by the community or group of communities in which they are located. The CBs were founded on the basis of a private ownership structure with a Community Development Association (CDA) being the primary sponsor and shareholder plus at least 50 other shareholders. While collectively important, most CBs are individually weak, under-capitalised, too small and of limited outreach. Of the 1,368 CBs earlier set-up, 354 had closed down with only 881 CBs still existing at the end of 2000 (CBN, 2002).

4.6.3 Non-Bank Financial Institutions

These institutions differ from banks in that they are essentially barred from taking customers’ deposits but are allowed to mobilise savings which can be utilised in the financing of different activities. They include DFIs, PMIs, Finance Companies, the Insurance Industry, Pension Schemes, DHs and Bureaux-de-Changes. Notwithstanding their potential to mobilise and allocate significant amounts of long-term financing, they cumulatively only accounted for about 6% of the financial assets of the Nigerian financial system in 1998 (CBN, 2000).

4.6.3.1 Development Finance Institutions

In Nigeria DFIs have been used as important vehicles for the provision of specialised credit to priority areas on a targeted and often subsidised basis. They have been specially structured in such a way as to serve the major sub-sectors of the economy as follows:

a. Medium and Large scale industries – the Nigeria Industrial Development Bank (NIDB),
b. Small scale enterprises – the Nigerian Bank for Commerce and Industry (NBCI),
c. Agriculture – the Nigerian Agricultural and Cooperative Bank (NACB),
d. Export and Import Trades – the Nigerian Export-Import Bank (NEXIM),
e. Urban Infrastructure – the Urban Development Bank of Nigeria (UDBN),
f. Small and Medium scale Enterprises – the Nigerian Education Bank (NEB) and the Nigerian Economic Reconstruction Fund (NERFUND).
The NEXIM and NERFUND have fundamentally functioned as apex institutions in the sub-sectors they operate. They operate by lending to other institutions, such as banks, which subsequently on-lend to the final borrowers who are the customers of the banks. Thus such intermediary institutions serve to guarantee that repayments of the borrowed funds are obtained. The recent rationalisation of DFIs resulted in the merger of some of these institutions into stronger and more purposeful institutions. The NIDB, NERFUND and NBCI were restructured into the Bank of Industry (BOI). While the NACB, PBN and the Family Economic Advancement Programme (a poverty eradication agency), were reorganized into the Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB).

The BOI is primarily set up to promote the development of SMEs, particularly in agricultural, industrial and commercial finance, natural resource exploitation, long term investment financing and equity funding of SMEs and lending funds to banks to support SMEs. While the NACRDB had its functions consolidated and mandate expanded to include both development and retail banking.

4.6.3.2 Finance Companies

With the approval given by the government for the establishment of finance houses a total of 618 finance houses came into existence in 1992. Although, only 262 of these finance houses received full operational licences in 1993 from the CBN bringing the number of those licensed to 310. The total number in 1993 of such finance houses in operation was 752 of which 442 had not received full licences. At this early point, a problem emerged in terms of high rates of default and insolvency among the finance companies. At the end of 1993 the extent of default in meeting matured obligations stood at ₦468.1 million, leading to the closure of some of the finance companies (CBN, 1993).

4.6.4 The Financial Markets

Another important component of the financial system is the financial market, which is comprised of the money and capital markets. Here only the capital market’s second-tier securities market has a direct bearing on SME finance.

4.6.4.1 Money Market

Nigeria’s money market is the framework for buying and selling of short-term financial instruments, with maturity terms of less than 12 months. Thus it is a market for liquid or near liquid funds. In Nigeria the money market consists of
the inter-bank funds market and the market for instruments such as treasury bills (TBs), certificates of deposits (CDs), bankers' acceptances (BAs), commercial papers (CPs) and short-tenured eligible development stocks (EDS).

The main market participants are the banks, DHs, insurance companies, pension funds and other private corporations and individuals. The inter-bank market is the forum for trading funds between banks with surplus reserves and those in deficit on an overnight, 30-day or 90-day tenured trades basis. The overnight funds dominated the market for inter-bank funds by accounting for 95% of the total average transactions between 1994 and 1998. The CBN operated Autonomous Foreign Exchange Market's (AFEM) requirement for 100% Naira backing of all foreign exchange bids by banks substantially stimulated the activity on the market. This created a rise in demand for overnight funds by banks to back up such bids.

TBs are the dominant money market instruments and they account for 89.9% of the total value of outstanding money market assets in Nigeria by end of 2002 up from 88.6% in 2001. While the steady growth of inter-bank funds market recorded in 2001 was reversed in 2002 due to the punitive suspension of a number of banks from participation in the foreign exchange market, coupled with the liquidity glut in the banking system. Nonetheless, the inter-bank market activities continue to be dominated by the overnight call money (CBN, 2002).

4.6.4.2 Capital Market

The SEC is the overall supervisory and regulatory body in the capital market whereas the CBN as the apex institution in the financial system closely monitors both activities and developments in the market. While key players such as the Nigerian Stock Exchange (NSE), Issuing Houses (mainly merchant banks), over 150 stockbrokers, 14 unit trusts and company registrars undertake the trading of securities and debt instruments in the market. It consists of a first-tier securities market (FSM) and a second-tier securities market (SSM). The market trades in debt instruments and stocks, such as government development bonds and corporate debentures (debt instruments), and both ordinary and preference shares available (stocks).

The SEC was established in 1979 with the overall objective of promoting an orderly, active and transparent capital market. On its part, the NSE provides a
mechanism for mobilising private and public sector savings and makes such funds available for productive purposes. Thus it offers facilities for trading in both new and existing equities, corporate debentures and government development bonds. In 1997 the main trading floor (i.e. the Lagos floor of the NSE) accounted for 90% of the total deals of the NSE, 95% of the total volume traded and 92% of total value traded (CBN, 2000). In 2002 the NSE recorded significant achievements which included improvements in market infrastructure, restructuring and process re-engineering for enhanced efficiency, commencement of work on its trading, clearing and settlement systems, and the commissioning of its e-business platform (CBN, 2002).

In a bid to encourage SMEs to patronise the stock exchange by way of seeking quotation on the market, a Second-tier Securities Market was introduced in 1985. This market affords SMEs more relaxed listing requirements than those operating in the FSM. The relaxation of the listing requirements was planned to serve the purpose of assisting the SMEs in gaining access to the resources necessary for the modernisation and expansion of their activities.

The Nigerian capital market, though relatively small within the whole financial system with only 0.5% of the financial assets in 1997, grew by over 300% in the period 1993 to 1997. The primary market does not play a significant role in the mobilisation of fresh long-term capital. The low level of only 17 new share issues recorded in 1998 confirms this. The level fell from 28 and 40 new share issues in 1994 and 1996 respectively. A slight improvement was however recorded with 23 and 27 applications for new issues approved by the stock exchange in the years 2001 and 2002 respectively. In terms of the mode of issues, the market lacks diversification since new issues are dominated by the direct sales of new equities to the public. This is followed by ‘Rights Issues’ due to the low cost associated with this mode of issue in the market (CBN, 2002).

Compared to the market for equities, the primary market for debt instruments has been dull and inactive while new debenture issues have been small in both number and value and are minimally used by the private sector for sourcing corporate finance. Furthermore, there have been no new issues of government development bonds from 1994 as the federal government discontinued the annual floatation of development bonds or stocks for mobilisation of funds it
sources for subsequent lending to state and local governments. One striking feature of trading on the capital market is the relative dormancy of both industrial and government bonds on the bonds market as transactions are overwhelmingly dominated by trading in equities.

In terms of number of listed firms on the exchange an increase to 186 was recorded in 1998 from the 1993 level of 174. In 2002 the capitalisation of the market also rose by 20% to N763.9 billion from N662.6 billion in 2001. This is a reflection of the appreciation of the prices of equities as well as the impact of listings on the exchange during the year.

These results notwithstanding the Nigerian capital market lags behind other African capital markets in terms of capitalisation, as revealed by a World Bank report in 1998. The report gave the comparative 1998 Market Capitalisation to GDP ratios in some Sub-Saharan countries as 16% for Cote D'Ivoire, 18% for both Ghana and Kenya, 22% for Zimbabwe, 44% for Mauritius, 146% for South Africa and 9% for Nigeria (World Bank 1998).

4.7 The challenges of globalisation

Globalisation is the closer interaction between national economies through trade, investment and capital flows. It is made possible by technological development and advancement in telecommunications, which have increased global welfare and transformed the world into a global village. With the end of the cold war which represented the ideological polarisation of the world, increasing emphasis is placed on openness and liberalisation of national economies to secure maximum benefits from global economic prosperity.

Globalisation has both positive and negative effects. The positive effects are international specialisation, which results in high quality and low cost products, improvement in welfare and the closer interaction between national goods and services, and financial markets. This results in the free flow of investment capital to take advantage of opportunities for higher earnings across national boundaries. The adverse effects include the accentuation of macroeconomic imbalances, marginalisation of economies that fail to apply appropriate policies and destabilising impact of rapid short-term capital flows, especially when they cannot be absorbed in the production process.
The extent to which the efficacy of domestic economic policy can be dented if too little reflection is given to countervailing responses of other nations is a focal consideration for national economies. This is more important as the interdependence between nations indicates that growth could be undermined if nations build protective walls around their economies. The rapid flow of goods, services and capital has made national controls on these aggregates less effective without consideration for countervailing measures that other nations could impose in the absence of co-ordinated responses (Obaseki, 2000).

The world economy has been characterised by the rapid integration of financial markets in the last two decades. Financial globalisation has proved more difficult to contend with because of its peculiarities. The ease with which cross border financial transactions take place has often proved crucial for the economies experiencing the outflow and further compounds the problem of independent domestic macroeconomic management. Reductions in transport and telecommunication costs, capital account liberalisation, financial market deregulation and privatisation of state enterprises have created favourable environment for increased capital mobility (Fischer, 1998: 164).

The globalisation of financial markets has proved complex because the phenomenon encompasses both product and capital markets. The integration of financial markets has exerted considerable constraints on the conduct and effectiveness of macroeconomic policies in recent times, as depicted by the financial crisis in South East Asia in 1997. Financial globalisation has resulted in two distinct developments in global finance. Firstly, traditional banking institutions have evolved into financial services firms with new accounts. Secondly, non-bank financial institutions now actively compete with banks both on asset and liabilities sides of the balance sheet thereby blurring the distinction between banks and non-bank financial institutions (IMF, 1998: 180-182).

Therefore the strategies and policies adopted to moderate the adverse consequences of globalisation are the application of policy measures that would ensure the maintenance of macroeconomic stability, international coordination of policies to ensure convergence and the reform of the international monetary and financial system to ensure a level playing field for all participants in the global economy. Above all, countries must pursue sound policies, liberalise their
economies, reduce the role of government relative to that of the private sector and ensure good governance in order to reap the fruits of globalisation. Otherwise, poor policies will be rewarded by marginalisation in the global arena.

The encouragement of entrepreneurial activity is crucial to sustaining economic growth in a rapidly changing global economy. SMEs are the engines driving future growth as firms with the greatest potential for rapid expansion and fast reaction to changing consumer demands. Globalisation remains the key business issue as firms adapt to competition in the new global marketplace.

4.7.1 Nigeria in the Global Economy

Nigeria has become relatively more integrated within the global economic system. The pace of integration intensified from 1986 with the policy shift from trade and exchange controls to economic liberalisation. Nigeria is highly dependent on external trade, while rapid inflow of capital has been stemmed largely as a result of the relatively underdeveloped state of the financial markets.

Trade flows (i.e. the share of total trade in total output or GDP) in Nigeria's economy recorded increased openness between 1986 and 1987, reflecting a movement from 0.21 to 0.64 during the period. The trend showed a decline to 0.63 in 1988. The openness index nudged upwards; reaching 1.70 in 1990 it further increased in 1995 to 16.5. It reached 18.80 in 1997, before declining to 14.06 in 1998. The drop recorded in 1998 was accounted for by the decline in both exports and imports from their levels in the preceding year (Obaseki, 2000).

Although, the Nigerian economy has become more open over the years, its share of world trade has remained relatively low. Obaseki (2000) reports that the share of Nigeria's exports in total world export was often below and sometimes about 1% in the period 1970 to 1998. Similar trend was exhibited by Nigeria's import trade. Nigeria has applied various policies over the years to stimulate the productive and external sectors of the economy, not only to ensure export competitiveness, but also to expand the import capacity of the economy. The low share of Nigeria's imports in total world import trade was partly accounted for by the low export capacity of the economy.

The over-dependence of Nigeria on crude oil exports limits the scope for the diversification of the economy, while at the same time exposing the economy to shocks in the international oil markets. This resulted in the direct transmission of
instability in world oil prices into unstable and unpredictable revenue receipts by the government. Thus, development programmes for the economy are largely predicated on development in the world crude oil market.

The low level of primary commodity exports, owing largely to the crash in commodity prices and the low level of export of manufactured goods, contributed to the predominance of the oil sector. Nigeria's low export performance especially in manufacturing is a major factor preventing the country from benefiting adequately from the integration of goods and services markets across the globe. In addition, the lack of comparative advantage in manufacturing has limited the scope for specialisation. Consequently, Nigeria will continue to be marginalised in its economic relations with the rest of the world. To avoid marginalisation, Nigeria would have to diversify its economy and take appropriate measures to raise manufacturing exports.

Nigeria's position in the global economy would have been worse if financial markets integration had not been prevented from a full reign on the economy. This situation was not deliberately created but merely resulted from policy inactivity and the poor state of the financial markets. The Nigeria financial markets have not kept pace with developments in the global financial markets. The non-internationalisation of the capital market prevents the economy from exposure to developments in international financial markets. The financial turmoil in East Asian economies in 1997 and the wide spread contagion effects across the Asian continent, with some marginal effects on the USA and European economies would have had some impact on the Nigerian capital market. This does not, however, mean that the state of the Nigerian capital market is ideal. It is imperative that the capital market is developed to cope with the problems that may likely arise from the full integration of Nigeria's capital market into the global network. Considering that financial markets integration, which has been facilitated by the rapid advance in information technology, compounds the problem of monetary management. The injection of short-term capital into an economy, and the rapid withdrawal of such funds create a disequilibrium in the financial markets which then negatively impacts on the productive sectors of the economy. By linking the NSE with the major world financial centres, portfolio flows into Nigeria are expected to increase. However,
the internationalisation of Nigeria’s financial markets should be preceded by a strong domestic economy, and a competitive external sector, with a prevalence of manufactured exports (Ojo & Obaseki, 1998; Obaseki, 2000; Yusuf, 2001).

Nigeria’s share of global trade is rather low, indicating the country’s uncompetitive position in the context of globalisation in goods and services. In the area of financial integration, Nigeria is a late starter. The domestic financial markets are still rudimentary and the rate of economic growth has not been encouraging even with the adjustment efforts. The two way migration of capital which largely indicates the performance of an economy has eluded Nigeria owing to the unattractiveness of the domestic financial markets.

The problem of labour market integration also applies to Nigeria. However, many highly skilled Nigerians have migrated to other African countries where their skills are required. The problem with labour migration as it affects Nigeria is that highly skilled personnel that are in short supply in the country are moving out in search of better opportunities. It is therefore imperative that for Nigeria to benefit from globalisation, efforts should be made to develop human capital and have information technology progress in line with the global trend.

4.8 Summary

Nigeria being a traditionally agrarian society faced many post-independence challenges that bordered on political instability as evidenced by the civil war, coups and counter coups. These factors impacted negatively on the economic focus and growth of the nation. Agriculture was maintained as the primary sector of the economy in the early post-independence years; however, the discovery of oil reserves in commercial quantities in 1975 changed that status. The years that followed the oil discovery left the nation more battered than it was prior to that as it came to depend on oil for over 90% of its income while neglecting all other sectors that had hitherto provided the nation with its revenues. Successive governments therefore mismanaged the huge oil revenues through ambitious and ill-informed infrastructural and public-sector led industrial investments that failed to positively impact on the economy. Though national development plans were instituted they failed to check the negative trend in the economy.

The country failed to utilise the oil wealth in building and diversifying a solid foundation and economic base. Thus the economy witnessed increases in price
levels and unemployment, declining agricultural self-sufficiency and increasing widespread poverty, amongst other negative indicators. Furthermore the oil markets collapsed in 1980 resulting in severe debt problems and acute foreign exchange shortfalls throwing the country into economic distress. This led to the introduction of structural reform programmes in 1986.

SAP which was aimed at restoring the balance of payments equilibrium and price stability combined trade policy and exchange rate reforms, and stabilisation policies. The reform measures impacted harshly on the populace as they propelled the country into more stringent economic hardships thereby resulting in protests. These and other negative impacts and lapses in implementation that manifested later in the SAP reforms made them difficult to maintain thus they were abandoned in 1993.

As at 2003, the Nigerian financial sector is comprised of 5 regulatory institutions, 90 banks, over 1000 community banks, a peoples' bank, 7 DFIs, 229 finance companies, 195 PMIs, over 100 insurance companies, 5 DHs and over 100 bureau de changes. The financial markets comprise of the money market (which serves to trade in liquid or near-liquid short-term financial instruments) and a developing capital market that deals in debt instruments (government bonds and corporate debentures) and stocks (ordinary and preference shares).

Though Nigeria is evidently more integrated in the global economy, its share of world trade has been significantly low due largely to its low export capacity consequent in part upon the low level of comparative advantage in manufacturing and the underdeveloped state of its financial markets.

In this chapter the study outlined the structure of the Nigerian economy and reviewed the economy's situation in relation to economic growth and the real sector's contribution. The role of the real sector of the economy in economic growth and development is open to argument considering that the potential of the sector has been battered over the years not to even consider the attainment or sustainability of its full potential. Evidently there is crisis in the real sector which is largely represented by SMEs which we consider in the next chapter.
CHAPTER FIVE

THE SMALL AND MEDIUM SIZED ENTERPRISE REVIEW
5 SMALL AND MEDIUM SIZED ENTERPRISES REVIEW

5.1 Introduction
This chapter undertakes a review of general information on Small and Medium Enterprises (SMEs) commencing in section 5.2 with an overview that reviews the varied definitions and classifications of SMEs. Discussing their role and importance in the growth and development of national economies follows in section 5.3 with a three stage coverage on the basis of developed, less developed and African economies. In section 5.4 it also undertakes a brief review of some past initiatives and the current efforts in Nigeria aimed at supporting and funding SMEs by the financial Institutions and other government programmes and policies in the Nigerian economy. The review of literature on the sources of SME finance and the constraints to obtaining SME funding are covered in sections 5.5 and 5.6 respectively.

5.2 Overview

"Since the war, the Japanese economy has overcome various difficulties and continued to develop. It is thought that the SMEs comprising the foundation of the economy and society have played a large part by flexibly meeting the economic and social change in the environment according to the times and enabled a smooth transfer in industrial and economic structures" Japan (2004).

The importance of the role that SMEs play in an economy cannot be overestimated. They have over time proven to have led the development process in most of the developed economies. The SME sector has equally proved to be one of the most viable sectors that enjoy substantial economic growth potential. The developed economies have recorded considerable successes in this sector following the recognition and earnest pursuit of the potential rewards from sustained investments in the sector.

The size and scope of the operations of SMEs, which results in their concomitant need for relatively small initial capital investment but significantly high labour intensity makes them offer a relatively high Labour-to-capital ratio. Furthermore, they oftentimes demand basically low or unsophisticated technology and managerial skills, which are readily available in the society.
thereby providing for some level of local employment opportunities. However, the level and extent to which opportunities offered by SMEs are exploited and the maximum contributions to the economy are derived, is founded upon a strong and virile enabling environment created through the provision of requisite infrastructural facilities. These facilities include roads, power, telecommunications, ports, human resource development centres, etc. and the formulation and sustainable implementation of SME pro-growth policies that ensure availability of concessionary financing that would encourage and strengthen their growth in the economy.

Certainly SMEs have a crucial role to play in an economy so much that it would be negligent for any nation or economy to ignore. Rather it would be sound governance for a country desiring development and growth to unconditionally include the development of SMEs as one of its major development objectives.

5.2.1 SME Definitions
There is no regional or indeed global consensus on the definition of SMEs, nor is there a single and uniformly acceptable definition (Storey, 1994). Definitions differ widely among economies depending on their economic development phase as well as prevailing social conditions. Small firm definitions can vary in terms of size, finance, sector, and ownership which make consistent definitions of small firms, problematic (Curran and Blackburn, 2001; Storey, 1994).

Traditionally, a number of indexes, such as number of employees; amount of capital invested; total assets value; volume of sales; and production capacity are employed in defining SMEs. The most commonly used index however is the number of employees. In other cases, some economies distinguish between different types of SMEs. For instance, while China distinguishes between Township and Village Enterprises (TVEs) and SMEs, Singapore distinguishes between local and overseas SMEs (Harvie & Lee, 2002).

The World Bank SME Department defines SMEs using the following indexes (World Bank, 2001; Ayyagari et al., 2002):

1. **Micro enterprise**: up to 10 employees, total assets of up to $100,000 and total annual sales of up to $100,000;
2. **Small enterprise**: up to 50 employees, total assets of up to $3 million and total sales of up to $3 million;
3. **Medium enterprise**: up to 300 employees, total assets of up to $15 million, and total annual sales of up to $15 million.

While these definitions are admittedly subjective they are broadly consistent with those used by most other international financial institutions.

### Table 5-1: SME Definition by Nigerian Institutions

<table>
<thead>
<tr>
<th>Institution</th>
<th>Asset Value (N'm)</th>
<th>Annual Turnover (N'm)</th>
<th>No of Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fed. Min. of Industries</td>
<td>MSE &lt;200 SSE &lt;50 ME N/A</td>
<td>MSE N/A SSE N/A ME N/A</td>
<td>MSE &lt;300 SSE &lt;100 ME &lt;10</td>
</tr>
<tr>
<td>Central Bank of Nig.</td>
<td>MSE &lt;150 SSE &lt;1 ME N/A</td>
<td>MSE &lt;150 SSE &lt;1 ME N/A</td>
<td>MSE &lt;100 SSE &lt;50 ME N/A</td>
</tr>
<tr>
<td>Nig. Econ. Recon Fund</td>
<td>MSE N/A SSE &lt;10 ME N/A</td>
<td>MSE N/A SSE N/A ME N/A</td>
<td>MSE N/A SSE N/A ME N/A</td>
</tr>
<tr>
<td>Nat. Asso. of Small Scale Industries</td>
<td>MSE N/A SSE &lt;40 ME &lt;1</td>
<td>MSE N/A SSE &lt;40 ME N/A</td>
<td>MSE 3-35 ME N/A</td>
</tr>
<tr>
<td>Nat. Asso. of Small and Med. Entps.</td>
<td>MSE &lt;150 SSE &lt;50 ME &lt;1</td>
<td>MSE &lt;500 SSE &lt;100 ME &lt;10</td>
<td>MSE &lt;100 SSE &lt;50 ME &lt;10</td>
</tr>
</tbody>
</table>

MSE = Medium Scale Enterprise, SSE = Small Scale Enterprise, ME = Micro Enterprise


Table 5-1 above shows how SMEs are variously defined in Nigeria, as in other economies, on the basis of one or all of the following:

a. The size/amount of investment in assets, excluding real estate

b. Their total annual turnover, and

c. The number of employees.

Within this framework, the classification of enterprises as 'medium' and 'small' naturally varies from one economy to another and from one period to another in the same economy. In Nigeria, the responsibility of periodically revising the classification of SMEs rests with the National Council of Industry, under the Federal Ministry of Industries. Other institutions, such as the Central Bank of Nigeria (CBN), the Nigerian Association of Small Scale Industries (NASSI) and the Nigerian Association of Small and Medium Enterprises (NASME), adopt classifications that vary from those of the Federal Ministry of Industries. There is however, greater concurrence of opinion when it comes to defining SMEs in
terms of value of total assets than on any other basis. This is because in case of an economic downturn, the impact on turnover and the number of people employed is greater than the impact on assets' values. For instance, during a depression, there is a tendency for turnover to fall substantially and the number of employees to drop, but assets values may comparatively remain unchanged.

The 1992 review by the Nigerian National Council on Industrial Standards defines SMEs as enterprises with total cost (including working capital but excluding cost of land) above N31 million but not exceeding N3,150 million, with a labour size of between 11 and 100 employees. It is clear that most SMEs are usually small and owner or family-managed businesses. SMEs also tend to lack the organisational and management structures which characterise Large Scale Enterprises (LSE). More often than not, Urban SMEs tend to be more structural than their rural counterparts (Carpenter, 2001).

The Federal Ministry of Industries defines a medium scale enterprise as any company with operating assets of less than N200 million, and employing less than 300 persons (Table 5-1). A small-scale enterprise, on the other hand, is defined as one that has total assets of less than N50 million, with less than 100 employees. Annual turnover is not used in its definition of an SME. The National Economic Reconstruction Fund (NERFUND) on the other hand defines a Small Scale Enterprise as one whose total assets are less than N10 million, making no reference to either its annual turnover or the number of employees. The NASME definition categorises Small Enterprises as those with asset value below N50 million and that employ between 10 and 50 workers, while the Medium Enterprises are those with asset value below N150 million and between 51 and 100 employees. Definitions of SMEs by the Nigerian Association of Small Scale Industries (NASSI) and the CBN are also indicated in Table 5-1.

5.2.2 SME Classification

In addition, the SME sector is categorised in terms of informal, organised and innovative cluster classifications as summarized in Table 5-2 below: Although national and regional economies define and classify SMEs differently, in common, the vast majority of SMEs are relatively small which still enables broad comparisons of their roles across countries. In addition, while different definitions are adopted, they do not fundamentally affect the issues pertinent to
SMEs. Firms differ in their levels of capitalisation, sales and employment. Hence, definitions which employ measures of size (number of employees, turnover, profitability, net worth, etc.) when applied to one sector could lead to all firms being classified as small, while the same size definition when applied to a different sector could lead to a different result (Kayanula & Quartey, 2000).

Table 5-2: SME Cluster Classification

<table>
<thead>
<tr>
<th>Informal Clusters</th>
<th>Organized Clusters</th>
<th>Innovative Clusters</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size of Firms</td>
<td>Micro (ME)</td>
<td>Small Scale (SSE)</td>
</tr>
<tr>
<td>Skills</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Technology</td>
<td>None</td>
<td>Low</td>
</tr>
<tr>
<td>Innovation</td>
<td>Little</td>
<td>Medium</td>
</tr>
<tr>
<td>Competition</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Products</td>
<td>Retail, Arts and Crafts, Textiles, Services e.g.-salons, tailoring</td>
<td>Manufacturing, Chemicals and Pharmaceuticals, Mining, Organized Retail</td>
</tr>
<tr>
<td>Markets</td>
<td>Local</td>
<td>Local and National</td>
</tr>
<tr>
<td>Links with Consulting Organisations and support institutions</td>
<td>None</td>
<td>Limited: in-house technical training, accounting and some routine functions e.g. legal, management and technical consultancy</td>
</tr>
<tr>
<td>Characteristics</td>
<td>Uneducated but dynamic. Sole ownership</td>
<td>Have technology competence, engage in training and invest in apprenticeship system. Basic education at least-High School or Trade Technical Certificate</td>
</tr>
</tbody>
</table>

Source: NIPC (2002)

5.3 Role and Importance of SMEs in Economies of Nations

SMEs, all over the world, are known to play the major role of socio-economic development. National and regional economies recognise the importance of SMEs and their contribution to economic growth, employment creation, and social cohesion, regional and local development (OECD 2004). It is considered that SMEs can achieve this because of their flexibility, innovative capacity and above all their profitability (Burns & Dewhurst, 1989). This is from the viewpoint of their capacity at creating employment, generating export opportunities and as a source of both innovation and as incubators for future successful medium and large enterprises (Harvie, 2002). Apart from their economic contribution in terms of GDP, Export trade and value addition in local production, SMEs have been
contributing substantially on the social front. The greatest contribution to economic efficiency by small firms is dynamic and evolutionary in nature as they are perceived to serve as agents of change (Audretsch, 2002). Overall, these factors have the impact of heightening the universal perception of SMEs as the engines of national growth in many countries (Degryse & Cayseele, 2000).

In comparison to large enterprises, SMEs are considered to be more flexible (i.e. they adapt more easily to market conditions and prospects) and are more attuned to competition which requires constant innovation. In addition, they tend to use less capital per worker and have the capacity to use capital productively when compared to larger firms. For example, it has been found that in Colombia, Ghana, and Malaysia small firms have significantly higher value-added to fixed assets ratios. Their choice of techniques is thus consistent with factor availability in African countries, which are labour-abundant economies (Hussain, 2000). They also have better capability of responding rapidly to demand fluctuations, act as the seed-bed for the development of entrepreneurial skills, curb the monopoly of large enterprises and offer complimentary services to the large enterprises. SMEs also play an effective role in streamlining state enterprises thus contributing to privatisation. Where they are located in urban areas, they activate untapped resources and skills, contributing to a more equitable distribution of income, play a positive role in sectoral balance and regional development and hence help to strengthen political stability in an economy. Also, the number of SMEs in an economy is an indicator of its entrepreneurial health. A large number of SMEs in an economy is an important asset as it can increase the degree of competitiveness of the country; exactly what any economy desires to be, once trade and investment barriers are reduced.

The European Commission has for long emphasised the importance of SMEs in job creation as published in the 1997 annual report of the European Observatory of SMEs. Acs (1999) points out that, small firms are important not so much because of their job creating prowess, or their organizational flexibility, than their ability to innovate and affect industry structure. Harvie (2002 p7) acknowledges that, SMEs play a larger structural role in economies like Taiwan, China, Japan, Thailand and Vietnam where they contribute over 70% of employment as opposed to only about 40% in Indonesia and Malaysia. Likewise, Harvie and
Lee (2002) report that the contribution of SMEs to employment growth is evidently high as depicted by available studies in mature economies which conclude that as much as 70% or more of net employment creation was attributable to SMEs in the 1990s. In the same vein, the OECD (1997) reports that SMEs accounted for over 95% of the number of enterprises and 60 to 70% of employment while also generating a large share of new jobs in the OECD economies. Similarly, Birch (1979) argues that small firms, in their roles of aiding economic growth and poverty reduction, are particularly important in job creation. He reports that over the 1970s small firms generated 80% new jobs in America. In Sub-Saharan Africa, Biggs and Shah (1998) find that large firms were the dominant source of net job creation in the manufacturing sector.

However a wide array of evidence rejects the view that small firms are the engines of job formation (Dunne, Roberts & Samuelson, 1989; Leonard, 1986; Brown, Medoff & Hamilton, 1990). Furthermore, Davis, Haltiwanger & Schuh, (1993) show that while gross rates of job creation and destruction are higher in small firms, there is no systematic relationship between net job creation and firm size. Furthermore, empirical evidence suggests that firm size is not a good predictor of labour intensity and that labour intensity varies more across industries than across firm-size groups within industries. Many small firms are more capital intensive than large firms in the same industry (Little, Mazumdar, & Page 1987; Snodgrass & Biggs, 1996).

In terms of job quality, microeconomic evidence does not support the view that small firms create better quality jobs than large firms. Rather empirical evidence shows that large firms offer more stable employment, higher wages and more non-wage benefits than small firms in developed and developing countries, even after controlling for differences in education, experience and industry (Brown, Medoff & Hamilton, 1990; Rosenzweig, 1988).

New firm formation and its economic impact are also affected by the prevailing economic conditions in a country. A comparison of studies on Africa by Liedholm and Mead, (1987) and on Latin America by De Soto (1987) shows that many small firms are created by people in need of income, as a last resort rather than as first choice and therefore have limited growth potential.
Furthermore, SMEs have the potential to make a major impact on workforce training (Hall, 2000 p2). In the UK, the National Skills Task Force Final Report in 2000 and the subsequent response from the Department for Education and Employment, also in 2000 recognise the key role played by SMEs in the learning and training system of the United Kingdom (Johnson & Devins, 2001).

Some previous studies reveal that small firms and entrepreneurs play a much more important role in economic development and growth than had been previously acknowledged (Whittaker 1997; Acs 1996; Admiraal 1996; OECD 1996; Storey 1994). Harvie and Lee (2002) further acknowledge that in a world faced with endemic unemployment due principally to slow economic growth, there has been too little MNC investment to go round all interested economies. They therefore, maintain that as a more viable alternative, policy makers have been driven to focus on small and medium scale owned businesses rather than the Multi-National Corporations (MNCs) for job creation and economic growth. Hence SMEs are perceived as being of particularly great importance to countries or regions which cannot attract, or do not desire to attract MNCs.

In most major economies, the critical role of SMEs is recognised and special agencies of government are created to provide support to SMEs. The funding requirements of SMEs are also given special consideration by both the formal funding institutions; Banks; Micro-credit Agencies; Venture Capital funds and the non-formal funding agencies like the Donors and specialised NGOs. Thus the OECD (1997) asserts that as the world moved towards the 21st century, the emerging conventional wisdom seemed to suggest that small firms are necessary for long-run macroeconomic prosperity.

As globalisation and technological change reduce the importance of economies of scale in many activities, the potential contribution of SMEs is enhanced. Regional SMEs have even greater opportunities for growth, considering developments in information technology and movements towards greater global trade and financial integration (Harvie and Lee, 2002). They however contend that many of the traditional problems facing SMEs, such as lack of financing, difficulties in exploiting technology, constrained managerial capabilities, low productivity, and regulatory burdens, become more acute in a global environment. Because all economies have the potential to gain from a more
dynamic SME sector and because they have specific strengths and weaknesses, policy frameworks and the role of governments must evolve for SMEs to reap the benefits and adapt to pressures of globalisation.

In response, governments of OECD member countries, as well as in emerging and developing economies, accord high priority to encouraging entrepreneurship. This stems from the understanding that entrepreneurs "are the catalysts of growth, marrying capital, innovation and skills" (OECD, 2004). In this age of innovative change it is considered fundamental, in the role of entrepreneurship, to foster a climate of dynamism in firm creation. Particularly in emerging and developing economies, where conditions for entrepreneurship are generally still insufficient (OECD, 2004). In 2000, Global Entrepreneurship Monitor (GEM) assessed 21 countries and found that entrepreneurship is closely related to small business and economic growth (Reynolds et al, 2000).

Nonetheless, Acs & Audretsch, (1988) in examining firms in USA, conclude that although SME advocates argue that small firms are more innovative than large firms, the microeconomic evidence is at best inconclusive. They find that small firms have higher innovation rates in "high technology" skill-intensive industries while larger firms have the innovative edge in "lower technology" capital-intensive industries. For European industries however Pagano and Schivardi (2001) show that a larger firm size is more associated with faster innovation rates. In developing countries, there is little research and development activity, such that it is technology transfers from abroad and imitation that drive productivity improvements (Rosenberg, 1976; Baumol, 1994). While research findings indicate that in developing countries large exporting firms are typically the primary mechanism through which technologies are adapted from abroad for local circumstances (Biggs et al., 1996; Pack and Westphal, 1986).

Audretsch, (2003) acknowledges that globalization has impacted on SMEs in two major ways. It has facilitated the trans-national activities of SMEs which range from exports to foreign direct investment to participating in global value chains which have become easier as a result of globalization. Also globalization has shifted the source of competitiveness towards knowledge-based economic activity, which has led to an increased role for SMEs.
Beck et al (2003) highlight the important role of SMEs in the following three core arguments proffered by SME advocates. They indicate that the advocates argue that SMEs enhance competition and entrepreneurship thereby having external benefits on economy-wide efficiency, innovation and aggregate productivity growth. They also frequently claim that SMEs are generally more productive than large firms but that financial market and other institutional failures impede SME development. Some argue that SME expansion boosts employment more than large firm growth as SMEs are more labour intensive.

Conversely, Biggs (2002) and Tambunan (2005) expound the views of some sceptics who question the arguments of the SME advocates. Some authors stress the advantage of large firms, most especially the view that large enterprises may exploit economies of scale and more easily undertake the fixed costs associated with research and development with positive productivity effects (Pagano and Schivardi, 2001; Pack and Westphal, 1986). Some also argue that large firms provide more stable and therefore higher quality jobs than small firms with positive ramifications for poverty alleviation (Rosenzweig, 1988; Brown et al., 1990). Another group of sceptics directly challenge the arguments of the SME advocates on the grounds that some research find that SMEs are neither more labour intensive nor better at job creation than larger firms (Little et al., 1987). Furthermore, recent studies have found that under-developed financial and legal institutions do not only hurt SMEs, rather such under-developed institutions constrain firms from growing to their efficient sizes (Beck, et al., 2002; Kumar, et al., 2001). They equally also question the validity of considering firm size as an exogenous determinant of economic growth.

Literature on industrial organisation indicates that natural resource endowments, technology, policies and institutions help determine a nation’s industrial composition and optimal firm size (Kumar, et al., 2001).

5.3.1 Role of SMEs in Developed Economies

Acs and Audretsch (1993) find that a distinct and consistent shift, away from large firms and towards small enterprises, occurred within the manufacturing sector of developed western country. While the magnitude of the shift varies considerably among nations, the direction does not (Acs et al, 1999).
In the European Union (EU), SMEs are seen as largely essential for European employment with one million new SMEs set up each year. SMEs account for 99.8% of all companies and 65% of business turnover in the EU. A 1997 survey by the European SMEs Observatory reports that SMEs create more jobs than larger firms though the rate of liquidation of SMEs is also high. Similarly, in the whole of Europe an annual increase of 1.8% in the number of enterprises between 1988 and 1993 was totally accounted for by the growth in the small business sector (Mulhern, 1995). It is further indicated that approximately 70% of the European workforce is employed in companies (Schwalbach, 1994).

Throughout the world interest in the SME sector has increased, particularly during the recent decade. One reason behind this is that they are expected to contribute in the areas of new employment and technological innovations (Hendry et al. 1995, Storey 1994). The statistical evidence is obvious, for instance, in Sweden 420,000 small businesses employ 64% of the work-force of the non-primary private sector with Small businesses contributing with seven out of ten new jobs in 1985-90 (Ylinenpaa and Havenga, 1997).

Edwards and Gilman (1999) state that at the start of 1997; there were 3.7 million businesses in the United Kingdom with 99% of these having less than 50 employees. They further state that census of production data for manufacturing show a rise in the proportion of employees working in establishments with 1 – 49 employees. While the proportion was 13.5% in 1979, it rose to 19.8% in 1990. These businesses do not only form the bedrock of the British economy, but they are also widely accepted as the main hub of economic activity in the country. They are seen not just as job creators, but as creators of wealth. Above all, the UK government firmly believes that SMEs are crucial to a successful enterprise economy. Thus the government is fully committed to stimulating the creation, competitiveness and growth of new and existing small businesses (Ariyo, 2000).

Similarly, Acs (1999) argues that the governments of UK and other advanced economies see their SME sector as crucial to their continued growth and development. The Bolton Committee (1971) also argues that new firms in an industry would promote new products and ultimately shape the evolutionary path of the industry, as well as constrain any market power exercised by the
entrenched firms. This “seedbed” function appears to be a vital contribution of the SME sector to the long-run health of the economy (Acs, 1999 p12).

Mole (2002) opines that over time, SMEs have contributed to overall UK productivity in three ways.

1. Small firms act as a seedbed for innovations. This role is most noticeable in small manufacturing firms with between 5-9 employees.
2. The growing small firm can disrupt the ‘cosy relationships’ built up within an industry, and heighten competition.
3. Entrants compete with older firms and cause poor performers to exit.

In the OECD economies, SMEs account for over 95% of enterprises and 60 – 70% of employment and they equally generate a large share of new jobs in such economies (OECD, 2004). Additionally, OECD (2004) points out that in Denmark, international orientation is a characteristic of Danish SMEs. Thus in response to the relatively small size of the domestic market, Danish SMEs are very experienced in working with the global economy. Therefore between 2 and 4% of Danish SMEs are global market players as they accounted for one-third (1/3) of total exports from Denmark in 1993. Similarly, Wignaraja (2003) indicates that SMEs make up an average of 24.4% of manufactured exports from the OECD economies, with Denmark having the largest SME share of 46% and the smallest share of 11% in the USA.

A significant portion of the employment growth in the United States of America (USA) is credited to small firms. It is estimated that there are approximately 23 million small businesses in the USA which altogether employ more than 50% of the private workforce, and generate more than half of the nation’s GDP (Ariyo, 2000; Brown et al., 1990). Whereas, Carpenter (2001) estimates that in 2001 there were about 25 million small businesses in the USA which provide approximately 75% of new jobs. This, as Wetzel (1983) explains, is because in the USA the small firms are more effective than established larger firms in the area of technology as the small firms are more innovative, develop and use modern technology that serves international trade and create new jobs. Small and micro-businesses are estimated to account for 60% of all job creation and produce 55% of all innovations in the United States (SBA, 2000). Thus some scholars documented the crucial role played by SMEs in the USA to include, but
which are not limited to, serving as the driving engines of growth, job creation, and competitiveness in global markets (Audretsch 1995).

Japanese SMEs play many significant roles in the economy by ensuring dynamism in the economy and the crucial role of promoting economic growth. Being flexible and versatile, SMEs have adjusted to changing business environments better than large firms. In many cases it is SMEs that enter new markets first, and some of them become large as a result of successful operation. For instance, in Japan the electronics industry had 120 large firms in March 1979, whose paid-in capital exceeded 1 billion Japanese yen. Of these 120 large firms, 54 firms (i.e. 45% of the total) were SMEs in March 1955. In addition six large firms were established as SMEs between March 1955 and March 1979. These figures indicate that more than 50% of large electronics firms existing in March 1979 had grown from the level of SMEs (Small and Medium Enterprise Agency, 1979, p.336; Kawai and Urata, 2001).

Additionally, Kawai and Urata (2001) maintain that the share of Japan’s SMEs in the total number of establishments has been remarkably constant for the last four decades, fluctuating between a high of 99.7% in 1957 and a low of 98.8% in 1996. They further observe that a similar pattern can be noted for the share of employment, although that fluctuates over a slightly larger range. Within this overall constancy, however, one can detect much variation across sectors, enterprise size groups, and periods.

Similarly, SMEs in Japan also play an important role as subcontractors. According to a 1987 survey by the SME Agency 55.9% of SMEs were engaged in subcontracting. Most large firms depend on SMEs for the supply of parts and components. The competitiveness of Japanese automobile, electronics, and other machinery production comes from an efficient subcontracting system involving SMEs. SMEs also have an important position in a number of regional production networks, or clusters, that are an integral part of regional economic activities in many parts of Japan. Indeed, it is often the case that subcontracting arrangements take place within clusters (Kawai and Urata, 2001 p.3).

SMEs represent a significant percentage of economic participation in Canada, as most Canadians in the private sector are employed by SMEs. They are where most Canadians are often introduced to, exposed to and trained with
respect to new processes and technology. Hence, while targeting innovation and e-business adoption among SMEs is strategic to enhancing Canada's productivity, it also represents a key vehicle to increasing social goals such as technical literacy in the citizenry (Canadian Chamber Of Commerce, 2002).

SMEs making up 97.5% of all Canadian firms account for about 64% of total private sector employment. Canadian small businesses contribute significantly to the economy. According to an estimate by B.C. Stats for 1999 SMEs account for approximately 24% of Canada's GDP (Canada SME Policy, 2003).

In Russia the number of SMEs, especially in the manufacturing sector, is almost negligible and sometimes referred to as the “Socialist Black Hole” (Vahcic and Petrin, 1989). Small firms accordingly provide employment for only 3.5% of the active labour force, which are 2.5 million people (Shulus 1996). The heritage from a command economy based on large, state-owned conglomerates, is an absence of a wide range of SME suppliers and sub-contractors (Bateman, 1994), and a stated lack of entrepreneurial spirit (Hisrich and Grachev 1993).

Therefore, the small business sector in the Russian transition economy is in focus, but for different reasons. From a very low level, the number of SMEs in Russia is increasing: 60 000 firms in 1993, 100,000 firms in 1994 and 200,000 firms in 1995 (Kirillova & Kolesnikov, 1995). According to EEC estimations Russia, in relation to its potential and population size, should however have 10-12 million SMEs (Shulus 1996). Thus one way for Russia to use in “catching up” with the economic development in western countries is through substantial investments in educational and training programs in entrepreneurship and small business management (Savtchenko 1995; Shulus 1996).

The economic benefit of helping to develop the SME sector of national economies is important but beyond that SMEs can serve as one of the first and most effective anchors for a market-based system. A case in point is Russia, where the work of IFC to privatise and develop small business is helping to move reforms forward and create a large entrepreneurial class with a stake in the new system (IFC SME Dept, 2003).
5.3.2 Role of SMEs in Less Developed Countries

Although SMEs are important in all global economies, there are considerable differences in their roles between the developed and the Less Developed Countries (LDCs) and between the various economies within the LDCs. Hence the dynamic role of SMEs in developing countries as engines through which the growth objectives of developing countries can be achieved has been stressed over time. For several decades rapid industrialisation was regarded as an attractive and effective strategy for transforming developing economies and maximising their rates of economic growth (Chuta and Liedholm, 1985). Consequent upon which they argue that developing economies early in the 1950s commenced the pursuit of industrialisation drives based generally on an import-substitution strategy. This resulted in the establishment of large-scale capital-intensive industries in urban areas.

The developing economies discovered in the early 1980s that apparently the strategy was producing disappointing results. In most developing countries the trend of low overall rate of economic growth and in some economies decline in absolute economic terms was evident. More so that employment in the industrial sector of those economies was not keeping pace with the high rate of population growth. The poor performance in the effort to improve the level of employment therefore prompted such economies to adopt employment generation as an independent and essential policy goal. This led many developing countries to become increasingly aware of and interested in assessing and promoting the role that the establishment of SMEs contributes to their industrialisation strategies. They recognised the positive and strong economic justification in promoting SMEs which are more labour intensive, more widely dispersed, generate more output per unit of capital, require less foreign exchange and produce a higher ‘economic’ profit than large enterprises.

It is estimated that SMEs employ 22% of the adult population in developing countries (Daniels & Ngwira, 1992; Daniels & Fisseha, 1992; Fisseha, 1991; Fisseha & McPherson, 1991; Robson & Gallagher, 1993). Due to their flexible nature, SMEs are able to withstand adverse economic conditions. They are more labour intensive than larger firms and therefore, have lower capital costs associated with job creation (Anheier & Seibel, 1987; Liedholm & Mead, 1987;
Schmitz, 1995). SMEs perform useful roles in ensuring income stability, growth and employment. Since SMEs are labour intensive, they are more likely to succeed in smaller urban centres and rural areas, where they influence more even distribution of economic activity and assist to slow the flow of migration to large cities. Because of their regional dispersion and labour intensity, SMEs promote a more equitable distribution of income than large firms. They also improve the efficiency of domestic markets and make productive use of scarce resources, thus, facilitating long-term economic growth.

SMEs also play an important role in entrepreneurial development (Hussain, 2000). They are particularly helping both the developing and least developed countries to address the growing problems of unemployment and poverty through generating employment opportunities at a time when large enterprises are either downsizing or closing down. Furthermore they assist in developing social harmony and facilitating the use of local resources and talents. Thus, Steel & Webster, (1991) argue that promoting the SME sector in developing countries creates more employment opportunities, leads to more equitable income distribution and ensures increased productivity with better technology.

Additionally, SMEs are playing an increasingly important role in the process of export-led industrialisation in the developing world. They are the largest group in terms of the number of industrial units in most developing countries and make a significant contribution to manufacturing output and employment (Wignaraja, 2003). Underlying these achievements SMEs are widely held to have advantages in income growth, entrepreneurial training, creation of technological capabilities, greater flexibility to changing market circumstances, job creation and lower wage inequality and dispersion of industry away from urban areas and regional development (Little et al, 1987; Berry, 1992; Humphrey, J. and Schmitz, 1996; Liedholm and Mead, 1999; Katrak and Strange, 2002; Weeks, 2002).

The contribution of the SME sector to exports, and hence the extent of their global integration, also varies widely. They are relatively more export oriented in China, Korea and Taiwan than they are in Japan, Thailand, Malaysia, Indonesia and Singapore. Evidence suggests that SMEs are actively participating in the export efforts of developing countries but their contribution to exports varies across countries (Badrinath, 1997; Levy, Berry and Nugent, 1999; O’Neil &
Thus, Wignaraja (2003) concludes that with some few improvements SMEs could increasingly pose direct competitive threats to large firms on international markets. Wignaraja, (2003) further suggests that some benefits of globalisation, in terms of a significant SME export response, have impacted on certain developing countries while others have yet to witness significant gains. In Taiwan SMEs contribute 56% of manufactured exports while in China and Korea they exceed 40% of manufactured exports. The contribution of SMEs varies between 10-20% in other East Asian economies, which include the second-generation tiger economies as well as Singapore. SMEs only account for 2.2% of manufactured exports in Mauritius and less than 1% in Tanzania and Malawi (both least developed economies). Interestingly, the figure for India (31.5%) is closer to East Asian than African levels suggesting that SMEs are also prominent in India’s manufactured exports. In addition, Hall (1995) suggests that SMEs contribute up to 35% of direct exports in Asia as a whole.

In contrast, the majority of SMEs in developing countries (particularly in Sub-Saharan Africa) have not made the required investments in export capabilities nor have they attempted to engage in industrial clustering. Furthermore, such SMEs are also increasingly under threat in domestic markets from cheap imports and the entry of foreign firms (Wignaraja, 2003).

Prior to the Asian financial crisis, which commenced in 1997-98, SMEs made up well over 90% of enterprises in East Asia (APEC 1994, Hall 1995, 2000). These SMEs were estimated to contribute from 40% to 85% of the total employment in individual regional economies of the region. While Hall (1995) acknowledges the difficulty of obtaining SME contribution to GDP for the East Asian region, he maintains they are still estimated to contribute between 30 and 60% of GDP in the region. He further states that SME wage payments typically make up over half of GDP in the regional economies. Though SMEs in Singapore are not as significant in terms of numbers and employment, they are important in providing a flexible skilled production base that attracts larger multinational corporations (MNCs). While recently in Vietnam, entrepreneurial private SMEs were pivotal to some extent in the transition process from a planned economy to a market-oriented economy. They are held to have contributed to more efficient resource
allocation, the marketisation of the economy and are increasingly important in creating new jobs and expanding exports (APEC 1994, Hall 1995, 2000).

In Taiwan SMEs play a pivotal role and make important contributions to the country's economic development (Harvie 2002). By 2001 Taiwan had 1.07 million SMEs in, accounting for 98.18% of all enterprises. The total number of persons employed by these SMEs was 7.28 million, accounting for 77.67% of all employed persons in Taiwan (OECD 2004, Fischer and Reuber 2003, Hou and Gee 1993, Kuo and Wang 2001). The SMEs accounted for 28.38% of the total sales of all enterprises and for 20% and 62% of total exports and manufactured export sales respectively. Furthermore, 94,000 new SMEs were established in 2001 which accounted for 3.38% of total SME sales. Over the years SMEs are reported to have accounted for approximately 45% of total production value in Taiwan. From the foregoing, it is clear that SMEs in Taiwan have made an important contribution towards promoting economic growth, the development of export trade, job creation and raising income levels (OECD 2004).

The merits of the small businesses sector in the context of LDCs are logically sound. These enterprises take advantage of the LDCs' abundant labour supply characteristics to better maximise the capital to labour function. For instance, India's industrialisation stemmed from SMEs which account for at least 25% of the country's total export (Carpenter, 2001).

The Brunei Economic Bulletin (2004) states that SMEs play a significant role in economic development, as engines of growth, by ensuring the long-term objective of diversification is achieved. the bulletin highlights Brunei's SME share of private sector employment at 59%, which makes it higher than United States, Singapore and Canada at 41.5%, 43.1% and 49.5 % respectively, while it is similar to those of Hong Kong and new Zealand with 59.6% and 60% respectively. It further indicates that in 2002 out of a total 6,817 establishments in Brunei, 97% were SMEs. From 1994 to 2002, the number of SMEs had grown by about 68% from 3,990 in 1994 to 6,711 in 2002. However, in terms of the number of persons per SME (i.e. entrepreneur density ratio), Brunei does not score well at 50.6% which means only one person in every 51 in Brunei is an entrepreneur. Most developed countries have an average of 20 persons per SME (Brunei Economic Bulletin, 2004).
5.3.3 Role of SMEs in the African Continent

The high prevalence of negative social indicators and persistent political instability, resulting in violence, corruption, frequent regime and policy changes, amongst many other hurdles form the basic image of most African countries. The existence of these problems hinders national economies on the African continent attracting meaningful patronage from foreign capital investors. They are therefore left with the option of looking internally for ways of solving their economic problems. The consequence of which is the growing importance attached to the development of SMEs. This has resulted in the appreciation of the role SMEs have played in some African countries by previous studies. Although this sector is largely not enumerated, available estimates suggest that SMEs account for roughly 60% of the workforce and 25% of industrial output in value terms in Africa (Hussain, 2000).

Chuta and Liedholm (1985 p1) indicate that, like in other developing economies, small scale industries in Sierra Leone dominated the industrial sector in terms of both the number of firms and total employment. The SME sector accounted for approximately 2.9% of the country’s GDP in 1974 to 1975 thereby contributing about 43% of the entire industrial sector’s value added making SMEs a significant component of the country’s industrial sector.

In South Africa it is estimated that 91% of the formal business entities are SMEs (Haasbroeck, 1996). Department of Trade and Industry figures released in 1995 indicate that there were 793,000 enterprises in the employment size-span 1 to 200 employees (Havenga, 1996). These SMEs had an estimated employment of 6.1 million people. Apart from this figure another 1.26 million people were employed in the informal business sector. In that sector the most prevalent types of businesses appear to be grocery and butcher shops, hairdressers, seamstresses and liquor establishments. Although in South Africa SMEs already play a significant role, there is a commonly held belief that entrepreneurship and development of small firms play a key role for the further growth and development of the economy and employment (Havenga, 1991).

It is estimated that about a third of Tanzania’s GDP originates from the SME sector. According to the informal sector survey of 1991, small businesses operating in the informal sector alone consisted of more than 1.7 million
businesses engaging about 3 million persons which constituted about 20% of the Tanzanian labour force (SME Development Policy, 2002). Accordingly, in Tanzania, it is recognised that SMEs play a crucial role in significantly contributing to the stimulation of growth in both urban and rural areas, employment creation and income generation. SMEs all over the world and in Tanzania in particular, are easily established since their requirements in terms of capital; technology, management and even utilities are not as demanding as it is the case for large enterprises. These enterprises are also established in rural settings to facilitate the dispersal of enterprises. Indeed the development of SMEs is closely associated with more equitable distribution of income and therefore important as regards poverty alleviation. At the same time, SMEs are seen to serve as a training ground for emerging entrepreneurs in Tanzania.

As unemployment is a significant problem that Tanzania has to deal with and the fact that Tanzania is characterised by low rate of capital formation, SMEs have therefore been recognised as the best option to assist the nation address this problem. This is due to the realisation that the SME sector has a higher potential for employment generation per capita invested.

The importance of SMEs in Mauritius is indicated by a total of 5,320 SMEs in the manufacturing sector which accounted for 21.7% of manufacturing employment and for manufactured exports worth US$23.5 million in 1997 (Lall & Wignaraja, 1998; Wignaraja, 2002; O'Neil & Wignaraja, 1999).

There were about 900,000 MSMEs firms in Kenya which employed 1,175,230 people in 1995 and by 2003 the MSME employment had risen to 5,545,200. In the Kenyan SME sector 30% of the firms are engaged in manufacturing, while 55% are in retail and commercial activities (Nyongo, 2004).

In Ghana the contribution of SMEs to the development and growth of the country is evidenced by the growth in exports. The increase in exports by about 14% from $2,015.2 million in 2002 to $2,297.2 million in 2003 arose due to the growth of SMEs. The SME sector employs about 15.5% and 14.09% of the labour force in Ghana and Malawi respectively (Parker et al, 1995) and has experienced higher employment growth than micro and large scale enterprises (5% in Ghana and 11% in Malawi). In Ghana, the sector's output accounted for 6% of GDP in 1998 (Kayanula and Quartey 2000). Research in Ghana and many other
countries have shown that capital productivity is often higher in SMEs than is the case with Large Enterprises (Steel, 1977). This is because SMEs are labour intensive with very small amount of capital invested. Thus, they tend to witness high capital productivity which is an economically sound investment.

Lerchs (2001) reports that in Egypt, SMEs account for 99% of all non-agricultural private enterprises in Egypt, provide 80% of the total value-added businesses in the Egyptian private sector, and account for the employment of more than 66% of the total labour force. It therefore recognises that the only way to achieve the country's established employment and GDP goals seems to be through trade liberalization and encouragement of growth of the SME sector.

5.4 Nigeria's Small and Medium Sized Enterprise Sector

Nigeria's challenges in development are vast, including SME development. But enormous oil wealth has brought few if any benefits to the average person. As a combination of corruption, crime and poor physical infrastructure keep local entrepreneurs from creating enough jobs. About two-thirds of Nigerians live below the poverty line; about half are unemployed and overall GNP per capita falls below the average for sub-Saharan Africa (World Bank, 2002).

Ariyo (2000) states that at the forefront of recent efforts to modernise and improve Nigeria's ailing economy has been a strong focus on macroeconomic stabilisation and the pursuit of a massive trade and investment liberalisation programme to encourage foreign direct investment in the country. In terms of revenue generation, large multi-nationals do help to bring in the much needed foreign exchange and help create the much needed jobs. But in reality, how much they contribute to the nation's economic development and how much they assist in attaining lasting and sustainable prosperity are merely speculative.

Consequently, for Nigeria to attain its full potential in terms of economic and social development, it cannot afford to ignore the importance of its indigenous SMEs, and the contributions that they make to the country's economy. Therefore, the policies of trade liberalisation and the encouragement of foreign direct investment have to be pursued in conjunction with a systematic and resolute effort to help the growth and development of SMEs.
Nigeria, like other developing countries with relatively low per capita income, looks forward to industrialisation to give it the structural transformation which is imperative in its quest for growth and development. Consequently, one of the most critical development issues in Nigeria is the need to design and implement policies and strategies for an efficient, competitive and diversified economy that will create employment, generate wealth and eradicate poverty. To achieve these goals therefore, a strong and viable entrepreneurial base is seen as being essential for the attainment of growth and prosperity in the economy.

The entrepreneurship development aspect of SMEs bears direct relevance to empowerment of the population for sustainable development. It also provides greater possibilities for the use of available local raw materials for vertical and horizontal linkages. Therefore it is expected that the growth of SMEs would improve the economy and welfare of Nigerians. Also, new businesses bring new or improved products and services thereby increasing competition and challenging existing business to improve their performance (Carpenter, 2001).

The Nigeria Corporate Affairs Commission estimates that about 90% of all Nigerian businesses in 2001 employed less than 50 people. Whereas, a study by the Nigerian Federal Office of Statistics indicates that 97% of all businesses in Nigeria employ less than 100 employees. Looking at our earlier definition of SMEs, it then means that 97% of all businesses in Nigeria are "small businesses". Similarly, a study by the International Finance Corporation (IFC) in the same period estimates that 96% of all businesses in Nigeria are SMEs, compared to 53% in USA and 65% in the EU (World Bank, 2002).

Carpenter (2001) and Kalanje (2002) argue that SMEs are significantly contributing to the Nigerian economy, with about 10% of total manufacturing output and 70% of industrial employment. Similarly, Owualah (1999) indicates that SMEs account for 40% of total output and 30% of value-added in the manufacturing industries. He further states that in 1972, SMEs contributed 74% of national employment with 15% of that being contributed by manufacturing establishments with fewer than 100 employees. The current status of the contribution of the manufacturing sector to GDP is 7% with a 1.4 million employment level (The Nigerian Financial Standard, May 3, 2004 p. 1 & 18). The SME sector provides, on average, 50% of Nigeria's employment, and 50%
of its industrial output. SMEs represent about 90% of the industrial sector in terms of number of enterprises; however they contribute a meagre 1% of GDP. This is insignificant when compared to countries like Indonesia, Thailand and India where SMEs contribute almost 40% of GDP (Ariyo 2000).

SMEs in Nigeria also promote industrial and economic development through the utilisation of local resources; production of intermediate goods and the transfer/ transformation of rural technology. Whilst SMEs are an important part of the business landscape in any country, they are faced with significant challenges that compromise their ability to function and contribute optimally to the economy. In this regard, Aregbeyen (1999) argues that the industrial development of Nigeria depends, to a large extent, on the growth and development of SME potentials. Although the industrial sector in Nigeria witnessed reasonable but fluctuating growth as the contribution of the manufacturing sector to GDP which was only 2% in 1957 rose to 10% in 1972 and further to 16% by 1981. It is acknowledged that these industries helped reduce unemployment, provided a base for agro-based industrial take off and generally helped the Nigerian economy to grow.

Nonetheless, the efforts of SMEs to grow, modernise and rapidly expand are still being constrained by their inability to mobilise funds for expansion. He suggests that in order to survive, grow, expand and modernise in the increasingly competitive business sector, it is essential for Nigerian SMEs to have access to long-term funding. Similarly, Ariyo (2000) identifies some of the bottlenecks faced by the indigenous SMEs to include serious undercapitalisation with difficulty in gaining access to bank credits and other financial markets; corruption and a lack of transparency; and very high bureaucratic costs. This, she argues, is further compounded in the earlier years of the oil boom by a seeming government indifference in and support for the roles that SMEs play in national economic development and competitiveness. Ariyo (2000) further argues that, with the benefit of hindsight, within the oil boom period, there was no real attempt on the part of government to effectively promote any tangible and lasting policies and/or programmes to support the small business sector.

Similarly, Uzodika (1999) argues that the lack of support for SMEs is negatively complemented by misplaced government intervention in the economy. This
intervention manifests in the concentration of efforts and resources on large, wasteful and white elephant public projects and enterprises, and on creating large import substitution manufacturing businesses. The woeful failure of such capital projects like the Iwopin Paper Mill, the about $10 million Ajaokuta Steel Complex investment, the Bachita Sugar Factory and Leyland Daf are good examples of such failed public projects in Nigeria. In this regard the EIU (1999) cites the long neglect of private SMEs and the past exclusive concentration of state resources on failed public enterprises as possible reasons why supply response to financial support may remain poor. Therefore it is concluded that the assessment of the past contributions of Nigerian governments to SMEs and to the manufacturing sector of small business shows a poor performance.

5.4.1 Historical Patterns and Trends
From the time of independence Nigeria has had series of policies and programmes, which highlighted the excellence, importance and need to facilitate the establishment and sustenance of SMEs. All the National 4-Year Development Plans laid strong emphasis on strategies of government-led industrialization hinged on import-substitution. With the initiation of the SAP in 1986 the state downgraded its active involvement in industrialization by a process of commercialisation and privatisation. The focus of the economy therefore shifted from large-scale industries to small and medium scale industries, which were expected to have viable potentials for developing domestic linkages for rapid and sustainable industrial development. Thus more emphasis was placed on the organized private sector to spearhead subsequent industrialisation programs (NIPC, 2002).

The dominance of and over-reliance on the oil sector in the Nigerian economy has been a major source of concern for successive Nigerian governments thereby necessitating efforts at diversifying industrialisation and export policies. To this end, the different governments initiated various policies and programmes aimed at promoting SMEs (NIPC, 2002). These include:-

1. a small-scale industries credit guarantee scheme established in 1971;
2. establishment of the Nigerian Bank for Commerce and Industry (NBCI)
3. CBN credit guidelines in 1979 requiring banks to allocate stipulated minimum credit to SME sector;
4. establishment of the NERFUND in 1989;
5. the World Bank SME II loan scheme 1990;
6. fiscal incentives, as tax relief, to all SMEs during the first six years of operation, pioneer status involving non renewable tax relief for five years and periodic downward adjustment of tariffs to reduce production costs;
7. A second-tier window on the capital market, designed to accommodate small enterprises that cannot satisfy the listing requirements on the main capital market window.

5.4.2 Efforts at Promoting SMEs in Nigeria
The Nigerian government and a number of committed international agencies and NGOs are collaborating to promote an effective development of the SME sector for Nigeria. In addition to putting enabling policies in place, the Nigerian government also pursues viable cooperation with other interested stakeholders for the positive development of the SME sector in Nigeria.

5.4.2.1 Government Initiatives
Support for SMEs in Nigeria has a fairly long history and various recent policy documents have highlighted the importance of the sector in employment generation, contribution to income growth and sectoral flexibility in adapting to fluctuating demand patterns (Oyelaran-Oyeyikan, 2001).

Previously, macroeconomic factors (such as exchange rate regime) and poor access to industrial financing from the Nigerian finance sector were cited as factors responsible for the persistent poor performance of Nigeria’s manufacturing sector. More recently, however, analysts attribute the problem to the sector’s lack of dynamism. In Nigerian policy making circles the SME sector’s failing is mainly linked to poor access to finance and, to some extent, poor physical infrastructure (Nigerian Guardian Newspaper, April 5, 2001).

Accordingly the new industrial policy in Nigeria states that “SMEs form the nucleus of industrialisation and ... that given the structure of the industrial sector, SMEs hold the greatest prospect for growth.” To tackle the constraints to the growth of SMEs, the policy plans to:

1. Merge all poverty alleviation agencies comprising the Nigerian Bank for Commerce and Industry (NBCI), the National Economic Reconstruction Fund (NERFUND), and the Nigeria Industrial Development Bank (NIDB) into one agency (i.e. the Bank of Industry) that will run loan schemes to SMEs at “lower than commercial rates”;
2. Set up the Small and Medium Enterprise Development Agency of Nigeria (SMEDAN) as an umbrella agency to co-ordinate the development of the sub-sector;

3. Establish a National Credit Guarantee Scheme (NCGS) for SMEs to facilitate access to credit without stringent collateral requirements;

4. Develop new industrial estates nation-wide;

5. Revive the Entrepreneurship Development Programme/Working-For-Yourself Programme.

While the establishment of SMEDAN and the development of industrial estates are non-finance support initiatives, the policy debate in Nigeria continues to centre on the paucity of credit to SMEs (Oyelaran-Oyeyikan, 2001).

A check of policy initiatives and statements reveals that while there is an acknowledgement of past policy deficiencies and failures, coupled with the role of the recession that hindered growth in the economy, it is questionable if industrial policy is facing up to the specific challenges presented by the new competitive environment. Oyelaran-Oyeyikan et al (1996) and CBN Annual Reports (various years) emphasise that with the introduction of SAP in 1986, the liberalisation of the exchange rate market, privatisation of public enterprises, downsizing of the public sector, financial sector reforms and trade liberalisation were undertaken. Expectedly, since the introduction of SAP, the national currency recorded serious depreciation in value and fell to ₦130 to US$1 as at April 2001. The manufacturing sector, largely unprepared for the new market regimes, suffered massive close downs of factories and exits of firms from manufacturing to trading. Manufacturing decline ensued with the onset of SAP because import-dependent firms were unable to export to earn foreign currency thereby being forced to cut spending on technical assistance, overseas training and import of spare parts. Consequently, capacity utilisation dropped from an average of about 38% before the introduction of SAP to below 30% through the early 1990s. The abolition of preferential interest rate lending to SMEs affected the capacity of firms to grow and subsequently mostly led to layoffs and to abandonment of expansion plans (NIPC, 2002).

Consequently, in trying to mitigate the extenuating conditions of the Nigerian SMEs, the American Small Business Administration (SBA) is collaborating with the NIPC to assist Nigerian SMEs midwife Direct Foreign Investment in Nigeria. This could result in partnerships; joint ventures and other collaboration for the
export of SME products to the USA in an attempt to replicate an impact similar to what occurred in the Asian economies. The growth of the Asian economies in the 1980's was largely driven by exports from SMEs (Carpenter, 2001).

5.4.2.2 World Bank Micro, Small and Medium Enterprise Project

World Bank (2002) acknowledge that a bad business climate drives much entrepreneurial energy underground and that informal sector owner-managers have little or no access to the financing, training and consulting services that are readily available to big businesses. Therefore the IFC responded to the situation in Nigeria by commencing the Support and Training Entrepreneurship Programme (STEP) in October 2000. It seeks to build productivity of enterprises by providing technical assistance and training, and facilitating access to finance. The IFC initially undertook surveys then proceeded to offer training programs for promising firms with 2 to 25 employees in Lagos and the Niger Delta region.

The World Bank group MSME project in Nigeria is a US$32 million credit facility approved on December 16, 2003 for the government of Nigeria with the Nigeria Investment Promotion Council (NIPC) as the implementing agency. The project aims to increase the performance and employment levels of MSMEs in selected non-oil industry sub-sectors and in Lagos, Abia and Kaduna states of Nigeria. To achieve this, the project aims to develop and strengthen the capacity of local intermediaries to deliver financial and non-financial services to MSMEs; reduce selected investment climate barriers that constrain MSME performance; and mobilise through these efforts an increase in private investments in MSMEs and the intermediaries. Accordingly, the project has the following five components:

1. to broaden and deepen the financial services available to MSMEs through the provision of grants to qualifying institutions and companies.

2. to develop the market for Business Development Services (BDS) by supporting intermediaries to respond to unmet MSME demand for BDS in the three target states.

3. to provide technical and capacity building support through the International Development Association (IDA) credit to assist in particular initiatives of the Nigerian government.

4. to allocate IDA resources so as to provide the federal and target state government agencies responsible for MSMEs development the opportunity to access global best practices.

5. to allocate IDA funds to financing the execution, reporting, review and monitoring of project components.
5.4.3 Past SME Financing Schemes in Nigeria

In Nigeria, the policy framework for the support of SMEs is in its infancy while the funding institutions are not favourably disposed to SMEs. SMEs remain unattractive due to the association of the high risk to them by the financing institutions such as banks. In addition, banks have significantly reduced lending to the real sector of the economy as loanable funds are used to finance consumer imports and to speculate in the foreign exchange market extensively. Consequently, most LSEs have reduced their borrowings from banks due to the high interest rates and the short tenors of such loans.

The challenges in funding SME became apparent by 1992 after Nigeria embarked on SAP which resulted in the demise of many businesses both large and small. While banks were willing to support large enterprises, SMEs were largely unsupported. Nigeria was expected to emulate the general world-wide practice whereby government as a matter of deliberate policy, institutes schemes for providing concessionary finance to SMEs in recognition of their highly disadvantaged position against big companies in open market competition for finance and other resources.

Table 5-3: NBCI: Total loans approved and disbursed (1981 - 1990)

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<tr>
<th>Year</th>
<th>Approvals</th>
<th>Disbursements</th>
<th>Actual Gap</th>
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<tr>
<td>1981</td>
<td>55.47</td>
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<td>1982</td>
<td>29.88</td>
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<td>1983</td>
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<td>1984</td>
<td>0.20</td>
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<td>1985</td>
<td>2.87</td>
<td>9.64</td>
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<td>1986</td>
<td>16.88</td>
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<tr>
<td>1987</td>
<td>117.75</td>
<td>21.15</td>
<td>96.60</td>
</tr>
<tr>
<td>1988</td>
<td>142.96</td>
<td>15.92</td>
<td>127.04</td>
</tr>
<tr>
<td>1989</td>
<td>189.72</td>
<td>52.10</td>
<td>137.62</td>
</tr>
<tr>
<td>1990</td>
<td>132.40</td>
<td>87.70</td>
<td>44.70</td>
</tr>
<tr>
<td>Total</td>
<td>710.49</td>
<td>281.62</td>
<td>428.87</td>
</tr>
</tbody>
</table>

Source: Aluko, Aguntoye and Afonja (1973)
Table 5-3 indicates that of the total loans approved and disbursed between 1981 and 1990 by NBCI only 40% of the total approved loans were disbursed. The three years immediately preceding the introduction of SAP (1983-1985) and the year of its introduction (1986) show considerably low approvals while disbursements were in excess of the approvals.

5.4.3.1 Development Finance Initiatives
The government established the National Economic Reconstruction Fund (NERFUND) in 1990 whose key role was to enable SMEs have access to funds from international funding agencies. These agencies are the World Bank, African Development Bank (ADB) and other international lending agencies. It was also to facilitate access to low cost long-term finance for the promotion of SMEs development and growth. Between 1990 and June 1996, NERFUND disbursed $114 million (foreign exchange component) and N3,468 million (local currency component) to support 218 projects.

Other funding windows available to SMEs were the National Bank for Commerce and Industry (NBCI) and the Family Economic Advancement Programme (FEAP). These agencies were also not successful primarily because being exclusively government initiatives, beneficiaries were unwilling to repay loans preferring to consider the financing as grants rather than repayable loans. There was also the problem of lending to poorly packaged projects, and complete lack of entrepreneurial skills by the promoters, who were mostly highly-placed government and society leaders.

5.4.3.2 CBN Credit Guidelines Sectoral Lending
Past efforts at SME funding included sectoral lending by banks in accordance with the CBN credit guidelines. The sectoral allocation of credit, which SMEs benefited from, was reasonably successful in channelling credit to SMEs. The critical drawback was the reluctance by banks to assume such credit risk without an appropriate Credit Guarantee Scheme. Some banks refused to comply with the scheme and rather paid the penalty for default or falsely prepared their returns to the CBN in compliance with the guidelines.

5.4.3.3 Second-Tier Securities Market
In recognition of the need for SMEs to survive, grow, expand and modernise in the increasingly competitive business sector, the Second-tier Securities Market
SSM) was established and launched on April 30, 1985 to provide a platform for SMEs to have easy access to a pool of investment funds by seeking quotation at the capital market. However, 15 years after its take-off the SSM has only about 29 SMEs listed (Aregbeyen, 1999).

5.4.3.4 Other Private Sector Initiatives
A funding window for SMEs outside of government efforts is the credits extended by Credit Unions; Cooperative Societies and other moneylenders to SMEs. Since these are largely informal and un-structured funding windows, the basis to determine their impact is grossly lacking. However, it is noteworthy that this form of lending is very popular and vital to rural SMEs. Recently, local banks like Citibank, United Bank for Africa, and Guaranty Trust Bank also piloted new specialized SME lending initiatives to support the sector.

5.4.4 Current State of the Sector
In recognition of the role of SMEs in the promotion of economic growth and employment generation, government put in place various measures and schemes to assist the SMEs, including the establishment of sector specific Development Finance Institutions (DFIs) like the Bank of Industry (BOI) and Nigeria Agricultural, Cooperative and Rural Development Bank (NACRDB).

Realizing that SMEs hold the greatest prospects of growth for the Nigerian economy, the government began to address the constraints that impede their growth with the following measures:

1. Merging of NBCI, NERFUND, and NIDB to form BOI.
2. Setting up of SMEDAN.
3. Establishing a NCGS for SMEs to check stringent collateral requirements.

Furthermore another initiative by Growing Businesses Foundation (GBF) ensured no fewer than 770 SMEs received a total of ₦18.1 million credit financing between January and September 2001. This initiative aims at enhancing the capacity of SMEs in line with GBF's goal of bridging the gap between the formal and informal sectors of the economy by raising funds from the formal and passing same to the informal sector. GBF maintains that the repayment and recovery rates of the micro credit extended to SMEs since inception remained at 100% (Financial Standard, December 12, 2001, p.32).
5.4.4.1 The Small and Medium Enterprise Development Agency of Nigeria

Government's new initiative, the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) was created to serve as a national focal point for issues relating to the promotion and development of SMEs.

SMEDAN was established in 2003 to promote and facilitate the development of programmes in the SMEs sub-sector of the country. The agency is structured into two main divisions, that is, the SME division and the Industrial Development Centre (IDC) division, with specific roles and responsibilities. SMEDAN has the responsibility to initiate and articulate ideas for SMEs policy through the promotion and facilitation of development programmes, instruments and support services to accelerate the development of SMEs, plus serving as a vanguard for rural industrialisation, poverty reduction and job creation. It is aimed complement the government's Poverty Alleviation Programme (PAP) which is expected to be at the core of the government's renewal efforts at industrialization of the country. It also has the responsibility of linking SMEs to internal and external sources of finance, appropriate technology and technical skills, in addition to creating linkages between SMEs and research institutions. Also, it is mandated to mobilise, sub contract, network and evaluate strategic linkages between SMEs and other economic sub-sectors (Daily Trust Newspaper, April 23, 2004).

To ensure an effective implementation of the SME development programmes, including the rehabilitation and repositioning of the IDCs to play their expected role, the government approved the sum of ₦784.2 million. In addition, the SME sector was allocated ₦282 million or 0.7% of the estimated capital expenditure in the 2002 budget (Financial standard, December 12, 2001).

5.4.4.2 Development Finance Institutions

To enhance the SME sector's growth government also established the Bank of Industry (BOI) which provides long-term loan funds to SMEs and other manufacturing companies, with a paid-up capital of ₦35 billion. The bank in addition to enabling SMEs have access to funds at affordable interest rates, is helping improve the capacity of SMEs to give support for the much needed subcontracting arrangements between small and large industries. This linkage potential between SMEs and LSEs is expected to play a key role in the revitalization of ailing industries in the country. Similarly, the Nigerian
Agriculture, Cooperative and Rural Development Bank (NACRDB) is another of government’s effort at supporting the growth and development of SMEs.

5.4.4.3 The Small and Medium Industries Equity Investment Scheme

As discussed earlier, banks have historically been averse to lending to SMEs in Nigeria due to the perceived high risk inherent in lending to the sub-sector. Nonetheless with active pressure from the CBN, the banks set up a committee, comprising of 11 banks, to review the challenges in lending to SMEs and advice on how to support SMEs. The committee’s key recommendations resulted in the agreement by banks to commit 10% of their profits before tax to the funding of equity investments in SMEs. The goal of this scheme is to reduce SME borrowing and consequently relieve them from interest and other bank charges that are not favourable to their capital structure. It advocates the provision of financial, advisory, technical and managerial support to SMEs.

In collaboration with the CBN and other government agencies, the Small and Medium Industries Equity Investment Scheme (SMIEIS) was launched in August 2001 as a voluntary initiative of the bankers’ committee. Their objective was to address some of the factors impeding the attainment of the full potentials of SMEs. It is anticipated that as banks get involved in SME funding and management, confidence in the sub-sector will improve, such that international financial institutions will be encouraged to provide needed financial support for SMEs in Nigeria (CBN, 2003). Also, the CBN had sought and obtained the cooperation of SEC, in enhancing the registration of venture capital companies being set up by banks for participation in the scheme.

CBN (2003) enumerated the trend of the investments that have been made under the scheme. The 68 banks whose year 2000 accounts were approved by CBN had ₦6.119 billion set aside for the scheme. Of the amount, ₦337 million had been invested in quarrying, petroleum and gas, telecommunications, advertising and training/manpower development. It is also reported that 70% of the investments made as of July 2002 to the tune of ₦1.7 billion, out of the ₦10.7 billion pooled, were banking-industry related. Besides 35 out of the 39 projects invested in are located in Lagos, in addition only 21 out of the 87 banks that set aside funds under the scheme invested in one or more of these projects. Furthermore as at December, 2003 over ₦20 billion was set aside by 83
participating banks, out of which only N7 billion (i.e. 35%) was invested by 49 banks. The balance of 13 billion (65%) is awaiting investment (Financial Standard, May 3, 2004). This gap between funds available for investment and funds actually invested is comparable to the 60% gap in Table 5-3 above.

However, CBN (2003) criticized the slow pace of investment in SMEs under the scheme as only six deals were struck in 2002, noting that a number of industries which were in dire need of working capital were yet to benefit from the scheme. Also the investment profile was more on invisible enterprises such as the provision of services rather than in the real sector of the economy, even though the major objective of the scheme was to direct more investments into productive sectors of the economy. It further noted that the investment focus of the banks was more on medium scale rather than small-scale industries. It is however argued that although there was need for investment in the real sector, it did not appear that it would be viable due to the high cost of doing business in Nigeria especially in the real sector. It is suggested that some of the incentives specified in the scheme’s guidelines should be implemented to make it a level-playing field for investors. Eke (2003) observes that fewer SMEs in Nigeria are approaching banks for funds under the SMIEIS scheme in fear of their firms being taken over by banks through large equity investments. While in separate and independent findings, the US commercial service and the SBA cited lack of basic understanding of the concepts, principle and practice of equity investment management as the most significant factor negatively affecting SMIEIS.

Banks indicate that they would not disburse funds to any SME without a well-articulated and persuasive business plan. Moreover they would not risk equity on enterprises that cannot guarantee the safety of such investments and ensure good returns and eventually assure a safe exit strategy. However some Nigerian economists note that the objectives of the bankers’ committee for establishing the scheme may not be fully achieved if the banking sector continues to be averse to risk which is the reason they avoid high-risk sectors (Eke, 2003).

5.4.4.4 National Credit Guarantee Scheme
One major constraint to bank financing of SMEs is the inability of entrepreneurs to provide required collaterals to reduce the risk of defaults (CBN, 2003). Consequently, the call for the establishment of a National Credit Guarantee
Scheme (NCGS) continued to grow especially from the financial sector. Despite the inauguration of SMIEIS, there was still some scepticism amongst a lot of banks about the security of investments and loans to SMEs. The banking industry continued to advocate for the scheme as a prerequisite in banks funding SMEs under the new SMIEIS initiative. The overwhelming desire for the establishment of such a scheme was therefore met in January 2004 by the introduction of the NCGS for SMEs. Up to 80% of the investments of banks in SMIEIS are guaranteed by the scheme (The Punch Newspaper, March 3, 2004, p.23, and CBN, 2003). The scheme is intended to further complement SMIEIS in channelling funds to the real sector of the economy, particularly SMEs. In this regard a bank would be compensated under the scheme on the condition that it extends credit to SMEs (CBN, 2003).

The credibility of CBN to effectively operate the scheme is questioned by credit managers (under the aegis of the Institute of Credit Administration). They noted that from records CBN lacked the credibility and integrity to perform as it had previously failed to fulfil its obligations under a similar scheme. They propose that the CBN distance itself from the scheme as it still owes some banks on the Agricultural Credit Guarantee Scheme. They suggest that the scheme be legally formed and operated as an independent entity and department in the CBN devoted to meeting SME needs (Vanguard Newspaper, March 1, 2004).

5.4.4.5 Micro-Credits and Donor Agencies Support to SMEs

Most SME support from state governments are in the form of Micro-Credit Schemes. These schemes are either managed independently or in collaboration with financial institutions or donors. Carpenter (2001) gives examples of such schemes as the N31 billion SME scheme by the Delta state government and four banks (Standard Trust Bank Limited; Oceanic International Bank Limited; Zenith International Bank Limited and Societe Generale Bank Ltd) and the N30.5 billion scheme by Lagos State Government. Except in the instances where bank funds are involved, these schemes may not be sustainable due to the culture of non-repayment of government loans.

Donor programmes to support SMEs have been in the form of Micro-Credit funds with a capacity development component. Being grant funds, these schemes have a history of not being sustainable. The major donor in this
scheme is the United Nations Development Programme (UNDP). Some oil companies have also initiated SME Funds, for instance, Shell oil company established a N31.12 billion (i.e. $14 million) programme for the development of SMEs. Such programmes are traditionally implemented by NGOs on behalf of the oil companies (Carpenter, 2001).

5.4.4.6 Support by Multilateral Agencies
Multilateral agencies have and will continue to provide support to SMEs in Nigeria. The African Project Development Facility (APDF) provides credit analysis support and also assists SMEs in raising long term credit usually from foreign investors. The African Management Services Company (AMSCO) provides managers to SMEs in Nigeria and most African countries. Such managers help strengthen the managerial and productive capacity of SMEs and provide training facilities to these SMEs. The World Bank Group has also set up various funds to support SMEs worldwide.

In solidarity with the efforts to support the development of Nigerian SMEs the US Exim Bank has extended a credit guaranty facility worth $30million to Standard Trust Bank Plc (STB) for use in financing the SMEs in the country. The credit is not restricted to STB customers only; other customers from other banks are entitled to apply, provided they are able to show commitment in repayment. (Vanguard Newspapers, June 23, 2004).

5.4.5 The Future of SME Funding in the Nigerian Economy
Despite the realization that SMEs are the growth engine of the Nigerian economy, policy thrust had hitherto not been adequately focused on their growth and development. Consequently the FMI which is the co-ordinating government agency for the promotion of industrial development has developed a new policy to promote SME development as a more appropriate strategy for achieving the nation's targets for industrial self-reliance, employment generation and poverty alleviation. This policy is ultimately aimed at supporting the revival of the manufacturing sector of the Nigerian economy. Industrial Development Centres (IDCs) will be established as the technical arm of SMEDAN, which is the main agency to implement this policy thrust.
5.4.5.1 Use of Credit Bureau

In the past few years there have been calls for the establishment of Credit Bureau to provide credit references on SMEs. The Bureau will rely on credit reports from banks and the analysis of SMEs' financial reports. There are difficulties in implementing this scheme as most SMEs do not keep or have poor and incomplete financial records and most of them have no track records with financial institutions.

5.5 Sources of SME Finance

Availability of finance is crucially important in entrepreneurship development and industrialisation, notwithstanding the fact that many enterprises have successfully created and developed their enterprises with their "sweat equity" (Edet, 2004). It is generally accepted that at the earliest stages of development SMEs are critically dependent on internal financing sources from owners (personal savings) and borrowed funds from relatives, friends and close business associates for financing (Roper, 1998).

As SMEs grow, their business funding needs and structure change over time. Considering that the SMEs start to develop and establish a track record, they soon outgrow the internal sources of equity and graduate to external capital and financing which include equity finance, venture capital, corporate investments and bank debts. Thus as a result of the positive impact of the SMEs' track records investors, willing to inject equity or provide bank funding to SMEs, are attracted through the capital market or bank lending.

Financing problems become very important when a company is growing rapidly, for example, when contemplating investment in capital equipment, expansion or an acquisition. Few growing companies are able to finance their expansion plans from cash flow alone, rather they need to consider raising finance from other external sources. In addition, managers who are looking to buy-in to a business ("management buy-in" or "MBI") or buy-out (management buy-out" or "MBO") a business may not have the resources to acquire the company. They will need to raise finance to achieve their objectives.

SMEs have a financial growth cycle in which financial needs and available options change as the business grows and/or gains further experience and becomes less informationally opaque. A general idea of which sources of
Finance become important at different points in the financial growth cycle, and the points in the cycle at which different types of funding become relevant are shown in Figure 5-1. Start-up and informationally opaque firms lie near the left end of the continuum indicating that they must rely on initial insider finance, trade credit, and/or angel finance (Carey et al., 1993). Initial insider finance is funds provided by the SMEs' owner(s), family, and friends at the firm's start-up. As firms grow, they gain access to intermediated finance by way of equity (from venture capital funds) and debt (from banks, finance companies, etc.). Where the firms grow further, they may gain access to public equity and debt markets.

**Figure 5-1: Firm continuum and sources of finance**

<table>
<thead>
<tr>
<th>Firm Size</th>
<th>Firm Age</th>
<th>Information Availability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small firms, possibly with no collateral and no track record.</td>
<td>Small firms, possibly with high growth potential but often with limited track record.</td>
<td>Medium-sized firms, some track record, collateral available, if necessary.</td>
</tr>
<tr>
<td>Large firms of known risk and track record.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **Initial Insider Finance**
- **Angel Finance**
- **Venture Capital**
- **Public Equity**
- **Trade Credit**
- **Commercial Paper**
- **Short-Term Financial Institution Loans**
- **Intermediate-Term Financial Institution Loans**
- **Mezzanine Fund**
- **Medium Term Notes**
- **Private Placements**
- **Public Debt**

**Source:** Berger et al., 1998 p55 and Carey et al., 1993, Fig. 10

The potential structure of financial service provision to SMEs of different size, risk and collateral profile is illustrated in Figure 5-2 as follows:
Start-up financing is heavily dependent on initial insider finance, trade credit, and angel finance (Sahlman, 1990; Wetzel Jr., 1994) because start-up firms are arguably the most informationally opaque and, therefore, have much difficulty in obtaining intermediated external finance. Venture capitalists often invest in companies that have already received one or more rounds of angel finance. Empirical evidence show that external private equity such as venture capital is more likely to be used to finance intangible assets and activities that generate little collateral while external private debt is more likely to be used to finance tangible assets (Brewer and Genay, 1994; Brewer et al., 1997).

Costly state verification (Townsend, 1979; Diamond, 1984) and adverse selection (Myers, 1984; Myers and Majluf, 1984; Nachman and Noe, 1994) arguments suggest the optimality of debt contracts after exhausting insider finance. These debt contracts could include trade credit, commercial bank loans and finance company loans. However, Berger et al. (1998) argue that moral hazard can make debt contracts quite problematic. They maintain that moral hazard problems are likely to occur when the amount of external finance needed is large relative to the amount of insider finance. This suggests that external equity finance, specifically angel and venture capital, may be particularly important when these conditions hold and the moral hazard problem is acute. The fact that high-growth, high-risk new ventures often obtain angel and/or venture finance before they obtain significant amounts of external debt finance suggests that the moral hazard problem may be particularly acute for these firms. Other arguments also affect the choice between external equity and external debt. As examples, entrepreneurs may choose external debt in order to
keep ownership and control of their firms, or they may choose external equity to help share the risk with less risk-averse investors (Berger et al. 1998).

Conventional wisdom argues that bank or commercial finance company lending would typically not be available to SMEs until they achieve a level of production where their balance sheets reflect substantial tangible assets that might be pledged as collateral, such as accounts receivable, inventory, and equipment.

5.5.1 Equity Finance

At the earliest development stages, the finance of small and medium enterprises is critically dependent on the owners and individuals close to them. As successful SMEs develop, they soon outgrow sources of internal equity and graduate to external capital, which include but are not limited to, venture capital and corporate investment. The funds provided by the "principal owner" and most of the "other equity" represent insider finance and are critical at the "seed financing" and "start-up" stages when information problems are most acute. Insider funding is also usually a necessary condition for any infusions of external finance to reduce adverse selection and moral hazard problems. At later stages of growth retained earnings are often an important source of additional funding and serve as a source of strength to assure flows of external finance.

Angel financiers and venture capitalists invest very selectively by targeting small firms with significant growth potential. In terms of the financial growth cycle paradigm, the big successes are usually those that are taken public in an IPO. In the 1980s, about 15% of all IPOs were backed by venture capital, since 1990, this share has about doubled to 30% (Fenn et al., 1997). The importance of the external private equity can best be judged not by the quantity of this equity, but by the eventual success of the firms that utilised such equity financing.

**Business Angel Equity Financing:** Angel finance is not an intermediated finance; it is an informal market for direct finance where individuals invest directly in SMEs through an equity contract, typically common stock. Because angels by definition are high net worth individuals, the funds that an angel invests in an SME are often consistent with the amount that the firm needs. They typically provide finance in a range of about $50,000 to $1,000,000 below that of a typical venture capital investment (Wetzel Jr., 1994). However, angels
do not always act alone as they sometimes work as a small investment group where they coordinate their investment activity (Prowse, 1998).

The risk capital provided by a business angel plays an important role in the finance market for SMEs. In essence, business-angel risk capital forms a bridge between internal finance and access to formal venture capital. It is often cheaper and more readily available than venture capital, given the lower transaction and due diligence costs involved in individual investments of this type. Some surveys conducted in the UK, indicate that business angels invest some £650 million annually in around 1.3 million SMEs. This is significantly larger than the investments made by formal venture capital funds in seed, start-up and early-stage enterprises (Cruickshank Commission, 2000).

There is disagreement over the extent to which angels are active investors. Barry (1994) describes angels as investors who do not take on the consulting role of venture capitalists. In contrast, Wetzel Jr. (1994) argues that angel deals typically involve a close group of co-investors led by a successful entrepreneur familiar with the venture's technology, products, and markets. He notes that the advice and counsel that angels provide to entrepreneurs can be quite important.

**Venture Capital Equity Financing:** Venture capitalists perform the typical functions of financial intermediaries, taking funds from a group of investors and redeploying those funds by investing in informationally opaque firms. In addition to screening, contracting, and monitoring, venture capitalists also determine the time and form of investment exit (Tyebjee and Bruno, 1984; Gorman and Sahlman, 1989). In performing these functions, the venture capitalist is the consummate active investor, often participating in strategic planning and even occasionally in operational decision making.

At origination, venture capitalists confront a significant adverse selection problem associated with providing external finance to opaque firms and therefore spend a considerable amount of time evaluating prospective issuers (Amit et al., 1990; Fried and Hisrich, 1994; Fenn et al., 1997). Syndication may also help solve the adverse selection problem (Lerner, 1994). Furthermore, agency problems may arise in the relationship between the entrepreneur and the venture capitalist in which the entrepreneur may expend insufficient effort, exhibit expense preference behaviour, or lack sufficient information or skill to
make optimal production decisions. The problem may be compounded by the fact that information in general about the value of the project is imperfect and revealed over time (Cooper and Carleton, 1979; Bergemann and Hege, 1998).

The menu of contract features that characterize venture capital investing may be explained as solutions to this agency problem. These include the staging of venture capital investments to assure optimal exercise of production options and efficient stopping (Sahlman, 1988, 1990; Chan et al., 1990; Admati and Pfleiderer, 1994; Gompers, 1995; Bergemann and Hege, 1998), control and the choice of equity/debt instrument (Gompers, 1993; Marx, 1993; Cornelli and Yosha, 1997; Trester, 1998), entrepreneur compensation (Sahlman, 1990), restrictive covenants (Chan et al., 1990, Gompers and Lerner, 1996), board representation (Lerner, 1995), and the allocation of voting rights (Fenn et al., 1997). In addition, venture capitalists expend considerable resources monitoring their portfolio firms (Gorman and Sahlman, 1989), and they tend to specialize in particular industries in which they develop expertise (Ruhnka and Young, 1991; Gupta and Sapienza, 1992; Norton and Tenenbaum, 1993).

The Cruickshank Commission (2000) found that there is market failure in the provision of small-scale equity finance to high potential SMEs. The result of this market failure is evident in: (i) insufficient small-scale risk capital being available to SMEs (in particular to high-growth potential SMEs); and (ii) illiquid equity markets for small firms. They saw the shortcomings in the equity market as being more significant than access to debt and other financial services.

5.5.2 Debt Finance

It is noted that the capital structure decision between equity and debt is different for small firms than for large firms in part because small businesses are usually more informationally opaque than large firms. In addition, since small businesses are usually owner-managed, the entrepreneurs often have strong incentives to source external debt rather than external equity so as to retain full ownership and control of their firms.

Contrary to common perception, a bank is by far not the only source of debt finance for SMEs, Figure 5-3 illustrates the multiplicity of options and players in the provision of debt finance to SMEs (though not exhaustive):
Figure 5-3: Sources of debt finance for SMEs and the role of banks

Source: Falkena et al., 2001 p81

The commercial loan, or corporate loan, is typically the most common form of business debt financing and includes the following: (i) term loans; (ii) operating loans or lines of credit used to finance day-to-day activities and held for shorter periods; (iii) sales financing and conditional sales contracts; and (iv) letters of credit (loans used for international trade financing).

While lease contracts commonly encompass two types: (i) the operating lease and ii) the finance or capital lease. Operating leases run for a shorter term, often less than the duration of the acquired asset’s life. In contrast the finance or capital lease is a long-term instrument which is used for larger value items and whose duration generally matches the life of the acquired asset.

Individual’s debt represents debt funding from the principal owner in addition to his/her equity interest. Finally, small business funding is also provided by loans from other individuals, that is, from family and friends or other insiders.

**Trade Credit Financing:** Trade credit though extremely important to SME finance, has attracted much less research interest than commercial bank lending. Although relatively expensive, a small amount of trade credit may be optimal from the viewpoint of transactions costs, liquidity, and cash management.
and may help give the borrowing firm and supplier information that helps predict cash flows (Ferris, 1981). It is not clear, however, if working capital finance is best provided by suppliers or a financial institution through a line of credit. Often, suppliers have advantages over financial institutions as they may have better private information about the SME’s industry and production process, or use leverage in terms of withholding future supplies to solve incentive problems more effectively (Biais and Gollier, 1997). Suppliers may also be better positioned to repossess and resell the supplied goods (Mian and Smith, 1992).

Trade credit also provides a cushioning effect during credit crunches, monetary policy contractions, or other shocks that leave financial institutions less willing or able to provide small business finance (Nilsen, 1994; Biais and Gollier, 1997). During these times, large businesses may temporarily raise funds in public markets, such as commercial paper, and lend these additional funds to small businesses through trade credit (Calomiris et al., 1995).

Recent evidence from Russia suggests that trade credit provides a signal that leads to more bank credit (Cook, 1997). This suggests that in economic environments with weak informational infrastructure and less developed banking systems, trade credit may play an even more important role because of its strength in addressing information problems.

**Financial Institutions Debts:** Banks, finance companies, and other financial institutions provide most of the external debt finance to small businesses. These financial institutions specialize in screening, contracting, and monitoring methods to address information and incentive problems. Obviously, many small businesses without financial institution debt would qualify for loans or leases, but choose not to borrow (Levenson and Willard, 2000). Most small firms that borrow tend to specialize their borrowing at a single financial institution, with only some few having loans from two or more institutions. Several studies found that smaller firms tend to have single banking relationships and larger firms tend to have multiple banks (e.g., Detragiache et al., 2000; Machauer and Weber, 1998; Ongena and Smith, 2000). In a study Farinha and Santos, (2000) found that smaller firms are less likely to switch from single to multiple banking providers, and that the probability of switching increases with age. In 86.95% of cases surveyed, small businesses identify commercial banks as their "primary"
financial institution, since banks dominate other institutions in providing transactions/deposit services, and also provide most of the loans to the small businesses that receive financial institution credit (Berger et al. 1998).

Small businesses have long relied heavily on banks for credit thus Brewer et al. (1997) find that the smaller firms in their sample are more "loan-dependent" than larger firms, which rely more heavily on equity finance. Cole et al. (1996) reported that in 1993 about 60% of credit extended to small businesses came from banks confirming the widely held view that banks have remained the primary source of credit for small businesses.

Levonian & Soller (1995) and Peek & Rosengren (1995) argue that smaller banks seemed to be the primary lenders to small businesses. Berger et al. (1995) also reported that smaller banks had larger proportions of their loans devoted to small businesses than larger banks. Berger & Udell (1996) noted that the type of lending to small businesses may also differ by bank size. They found that when large banks do issue credit to small businesses, they typically offer lower interest rates and fewer collateral requirements. Research found that large banks are associated with low interest rates (about 1% less on small business loans) and low collateral requirements (about 25% less often than do small banks) for the small businesses that receive loans (Berger & Udell, 1996). Some studies found that large banks tend to devote a lower proportion of their assets to small business lending than smaller banks (e.g., Berger et al., 1995; Berger & Udell, 1996; Peek & Rosengren, 1996; Strahan & Weston, 1996; Berger et al., 1998). While still some found that to the extent that large banks extend small business loans, these banks tend to skew their loans away from relationship-dependent small borrowers (Keeton, 1995, 1996).

In most literature, SMEs, particularly small enterprises, often do not fulfil the criteria to obtain the required amount of debt finance for longer-term growth. Typical problems are the lack of appropriate collateral, excessive outstanding debt and lack of proven business skills. Usually, unsecured credit is forthcoming only after some time has passed and against a proven track record of successfully operating one or more small-scale business undertakings for the business person's own account.
5.6 Constraints in SME Financing

The efficient functioning of the financial system (which is characterised by three components; financial instruments, financial markets and financial institutions) works to increase savings and investments (Kolari, 1994). Unfortunately many firms, particularly SMEs, have difficulty in accessing the financial resources in the financial system. Incomplete information and the high cost of gathering the information make potential investors and financial institutions back away from funding SMEs. This further makes the credibility of the SMEs less transparent and thus more difficult to convey. Therefore there is the tendency for asymmetry of information to exist in this regard between the owner-manager of the SME and the potential external investor and/or lender.

Binks et al., (1992b) contributing to the debate on finance gap argue that the smaller the firm, the larger the proportionate increase in capital base required to respond to an increase in demand for its products but it is faced with a lower capacity to attract financing for such capital increase through loan or equity finance. A finance gap arises due to a firm’s inability to satisfactorily meet an existing and confirmed viable level of demand. Consequently, due to increasing demand, growing firms confronted by the dilemma of the need for additional funding, must source finance from external sources due to limited resources.

Tarka (2004) identifies four main stages in a firm’s life cycle, which are the seed, start-up, early growth and sustained expansion stages. He argues that financing requirements and the difficulties encountered by firms in accessing finance are likely to change as the firm progresses through the four stages.

Binks and Ennew (1996; 1997), opine that the negative effects of information asymmetries which afflict SMEs can be improved by the use of collateral as a ‘signalling and bonding mechanism and/or by the cultivation of a good working relationship between lender and borrower’. But even if this were to be the case, younger firms are still at a greater disadvantage. They have little accumulated assets to use as collateral on one hand and have a poorer reputation because it takes time to acquire it on the other (Martinelli, 1997). Information asymmetry is however diminished to some extent by the fact that banks maintain a fiduciary relationship with borrowers and, as such, keep all information confidential. Lending their support to the above, Evans and Jovanovich (1989) also argue
that with scarce bank capital available, many small firms are rationed out of the loan market for reasons motivated by information problems. Older firms with more established relationship are, therefore, more likely to gain greater access to bank credit because of the opportunity banks have to obtain information relevant for their lending decisions (Binks and Ennew, 1997).

Thus the main problem faced by SMEs when trying to obtain funding is that of uncertainty as SMEs rarely have a long history or successful track record that potential investors can rely on in making investment decisions. This problem is further compounded by the fact that banks are particularly uncomfortable of SMEs due to a perception that they represent a greater credit risk. A common problem is often that the banks will be unwilling to increase loan funding without an increase in the security given (which the SME owners may be unable or unwilling to provide). A particular problem of uncertainty relates to businesses with a low asset base. These are companies without substantial tangible assets which can be used to provide security for debt financing.

Both the Bank of Industry and NASME acknowledge that the applications of some of their members were turned down by BOI because of the poor quality of the proposals. The BOI indicates that as at September 2003 it had received 514 applications for loans worth about ₦90 billion, which represents a 25% increase over applications received in April 2003. More than 80% of the applications could not be appraised due to the poor information and scanty presentation of proposals and business plans, while only less than 20% have received appraisal" (Nigerian Vanguard Newspaper, 23rd October 2003).

5.6.1 Challenges in Lending to SMEs

Though SMEs present opportunities to banks to support the growth sector of the economy, the banks have historically and until recently been very averse to supporting SMEs. Some of the common reasons for the lack of enthusiasm in financing of SMEs by banks include the following:

- Unfavourable bank lending strategies.
- High risk associated with lending to SMEs.
- Lack of adequate collateral by SMEs.
- Low returns on SME investments due to high operating cost.
- Promoters' low education, management and entrepreneurial skills.
- Competition from cheap imports which erode the market for SMEs'.
- Poor and unreliable financial records, which make financial review both difficult and unreliable.
- Both financial and other business records are not adequate to meet capital market (stock exchange) listing requirements.

5.7 Summary
The roles SMEs play in an economy have over time proven to pilot the development process in most of the developed economies thus the SME sector is seen as a very viable sector that has substantial economic growth potential. However there is no consensus on their definition, nor is there a single and uniformly acceptable definition of SMEs (Storey, 1994). Small firm definitions vary in terms of size, finance, sector, and ownership though the most commonly used index is the number of employees.

SMEs contribute to economic growth, employment creation, and social cohesion, regional and local development because of their flexibility, innovative capacity and above all their profitability. They also have better capability of responding rapidly to demand fluctuations, act as the seed-bed for the development of entrepreneurial skills, curb the monopoly of large enterprises and offer complimentary services to the large enterprises. Where they are located in rural areas, they activate untapped resources and skills, thereby contributing to a more equitable distribution of income, play a positive role in sectoral balance and regional development and hence help to strengthen political stability in an economy. SMEs in their roles of aiding economic growth and poverty reduction are noted to be particularly important in job creation. Thus the high priority accorded to encouragement of entrepreneurship stems from the understanding that entrepreneurs "are the catalysts of growth, marrying capital, innovation and skills" in economic development.

Consequently, developing economies recognise the positive and strong economic justification in promoting SMEs which are more labour intensive, widely dispersed, generate more output per unit of capital, require less foreign exchange and produce a higher 'economic' profit than the large enterprises. Although in African countries this sector is largely not enumerated, available estimates suggest that SMEs account for roughly 60% of the workforce and 25% of industrial output in value terms in Africa (Hussain, 2000).
SMEs are significantly and practically contributing to the Nigerian economy, with about 10% of total manufacturing output and 70% of industrial employment and, on average, they provide 50% of Nigeria’s employment, and 50% of its industrial output. It is argued that the efforts of SMEs to grow, modernise and rapidly expand are unfortunately still being constrained by their inability to mobilise funds for expansion. Thus the Nigerian government and a number of committed international agencies and NGOs are collaborating to promote an effective development of the SME sector for Nigeria. Consequently the government has established sector specific DFIs such as the BOI and the NACRDB to assist the SMEs. Also SMEDAN was created to serve as a national focal point for the promotion and development of SMEs.

SMEs are dependent on internal financing sources from owners (personal savings) and borrowed funds from relatives, friends and business associates for start-up financing. They later move to external capital and financing which include equity finance, venture capital, corporate investments and bank debts. Start-up financing is heavily dependent on initial insider finance, trade credit, and angel finance (Sahlman, 1990; Wetzel Jr., 1994) because start-up firms are arguably the most informationally opaque and, therefore, have much difficulty in obtaining intermediated external finance. The commercial loan, or corporate loan, is typically the most common form of business debt financing and includes term loans; operating loans or lines of credit; sales financing and conditional sales contracts; letters of credit and finally lease finance.

SMEs have difficulty in accessing the financial resources in the financial system due to poor information and the high cost of gathering the information which make potential investors and financial institutions back away from funding SMEs. Thus the main problem faced by SMEs when trying to obtain funding is that of uncertainty as SMEs rarely have a long history or successful track record that potential investors can rely on in making investment decisions. This problem is further compounded by the fact that banks are particularly uncomfortable of SMEs due to a perception that they represent a greater credit risk. Another common problem is often the unwillingness of banks to increase loan funding without an increase in collateral which the SMEs are unable to provide.
CHAPTER SIX

ISLAMIC BANKING AND FINANCE
6 ISLAMIC BANKING AND FINANCE

6.1 Introduction

Islamic financing was largely practiced in the middle-ages to foster trade and business activities in the Muslim world (Iqbal, 1997). In recent history, reference is often made to the Mit Ghamr Egypt Savings Association set up in 1963 as being the first formal Islamic financial institution (IFI) that initiated the re-emergence of the Islamic financial industry (Ali, 2002; Archer & Ahmed, 2003). Globally, the Islamic financial industry has rapidly expanded over the past few decades. The rapid growth of Islamic banks gained significant attention in international financial circles where market participants recognized their promising potentials. With over a billion Muslims worldwide and annual growth rates in Islamic finance of up to 15%, the potential for this sector is considered vast. The market has been estimated at up to $250 billion and close to 10% of global GDP (El-Hawary, Grais, & Iqbal, 2004). In order to cater for the financial need of over a billion people, thousands of specialised interest-free financial institutions and many well-developed local and international markets are needed. However, Wilson (2000) argues that compared to the apparent need, the Islamic finance industry is utilising only a fraction of its true potential.

Although the growth in Islamic finance is considered to have coincided with the current account surpluses of oil-exporting Islamic countries, its continued growth is rooted in a desire for socio-political and economic systems based on Islamic principles. These include risk sharing, the promotion of entrepreneurship, and the prohibition of riba or interest (Rogers, 2004).

Warde (2000) points out that in Islamic countries, Islamic finance has rapidly grown as a component part of their financial systems. It has also spread to countries that are not Islamic but contain a sizeable Muslim population in the offerings of their financial systems. The degree of Islamization of the financial sectors of many Muslim countries varied dramatically across countries with Muslim populations. The Islamic Republic of Iran, Sudan and Pakistan are at one extreme, where their entire financial sectors have been made officially Islamic (Bank-Markazi-Jomhouri-Islami-Iran, 1983; Pakistan, 1984). Malaysia, Saudi Arabia, Bangladesh, Egypt, Indonesia, Jordan, and some other Arab countries have developed hybrid financial systems where Islamic banks coexist.
with regular financial institutions, and both types of financial institutions are regulated by the monetary authorities of those countries (El-Gamal, 1997).

Additionally, a number of global financial institutions offer instruments conforming to Shari‘ah through Islamic windows and the setting up of separate banks, branches, or subsidiaries specializing in Islamic financial products. To capitalize on the potential of that market, some global financial institutions, including but not limited to, Citibank, Goldman Sachs, BNP-Paris-Bas, and UBS, have established Islamic banking Shari‘ah compatible services in several countries (Sundarajan & Errico, 2002). While Samad, Gardner & Cook, (2005) explain that according to the General Council for Islamic Banks and Financial Institutions (CIBAFI) there are currently 275 institutions worldwide that follow Islamic banking and financing principles, collectively managing in excess of $200 billion. These institutions, they maintain, are spread across 53 countries including Europe and United States. They maintain that the United States alone has 20 institutions now offering a variety of Islamic financial services. In Europe the Islamic Bank of Britain was licensed in September 2004 while in April 2005 the European Islamic Investment Bank was funded. The total worldwide assets reached USD $260 billion, the number of Islamic banks operating in over 60 countries as at 2004 were 267 and the average growth rate of the last 5 years have been 23.5% (Bahrain Monetary Agency, 2004; Gassner, 2004).

Islamic finance encompasses banking, mutual funds, securities firms, insurance companies, and other non-bank institutions. Warde, (2000) explains that Islamic finance goes beyond “interest-free” banking as it takes into account operations that may or may not be interest-free, but are nonetheless imbued with certain Islamic principles. These principles are the avoidance of riba (in the broad sense of unjustified increase) and gharar (uncertainty, risk, speculation); the focus on halal (religiously permissible) activities; and more generally the quest for justice, and other ethical and religious goals.

Thus Islamic capital invested in global financial institutions is currently estimated at $1.3 trillion, and over 105 Islamic equity funds globally are managing assets in excess of $3.5 billion (Association of Islamic Banking Institutions Malaysia, 2004). One indicator of the high market demand for investment according to Islamic rules and principles is the Dow Jones family of Islamic Market Indexes.
These indexes were created to facilitate investment in Shari'ah compliant stocks around the world. Dow Jones now has 31 Islamic Market Indexes and 1,667 stocks were included in the global index as of March 2004 (Rogers, 2004). El-Hawary et al., (2004) indicate that according to a study by the Association of Islamic Banks, 29% of Islamic banks were in South Asia, 20% in Africa, 18% in South East Asia and 15% in the Middle East, 12% in the GCC countries, 5% in Europe and America and 1% in Asia as of 1997 - (see Archer & Ahmed, 2003).

**Figure 6-1: The Islamic Financial System**

Source: El-Hawary et al. (2004 p.7)

Figure 6.1 classifies contracts governing economic activities into transactional and intermediation contracts. Transactional contracts govern real sector transactions that include exchange, trade and the financing of economic activities. The role of intermediation contracts is to facilitate an efficient and transparent execution of transactional contracts. Transactional contracts combined with intermediation contracts offer a set of instruments with varying purposes, maturities and degrees of risk to satisfy a diverse group of economic agents (El-Hawary et al., 2004).

Intermediation contracts include mudarabah, kifala, amana, takaful, wikala and ju'ala. In a mudarabah contract, an economic agent with capital (rabb-ul-mal) develops a partnership with another economic agent (mudarib) who has
expertise in deploying capital into real economic activities, on a PLS agreement basis. Losses are borne by the capital owner only as the mudarib does not make any capital contribution. The latter may however be liable for a loss in case of misconduct or negligence on his part. However, though the capital owner is exposed to a loss of capital, he is not entitled to participate in the management of the funds, which is exclusively left to the mudarib.

On the other hand transactional contracts are based on commodity trade based contracts like murabahah (mark-up or cost-plus), Bai Salam and Bai Mu'ajjal, which ultimately create instruments to provide financing of such economic transactions. It would not be an exaggeration to claim that the resultant financing techniques are somewhat similar to modern day asset-backed securities. Whereas a typical asset-backed security in the conventional system is a claim against a pool of assets, Islamic instruments are claims against individual assets. A distinct feature of such financial securities is that they resemble conventional debt securities characterized by a pre-determined pay-off with the difference that Islamic instruments are collateralized against a real asset. The result is that a financial claim is created against a real asset with a short-term maturity and relatively low risk.

In contrasting the Islamic and the conventional financing systems, Ariff (1988) attributes the main difference between Islamic and conventional banks to the basis of their operations. He argues that while the contemporary banks are based on conventional interest-based principle, the Islamic banks follow the principle of interest-free and profit and loss sharing (PLS) in performing their business as intermediaries. The conception of a model for an Islamic bank conducting business on a PLS principle is based on the notion that the prohibition of Riba means the elimination of all fixed-fee debt contracts. This is therefore an indication that the Islamic financial system would have to be primarily equity-based (Iqbal & Mirakhor, 1999). In the same context, Warde (2000) argues that Islamic financial institutions are different from conventional lenders insofar as they take into account social and development factors in the process of transforming savings into investments.

In addition, Warde (2000) and Rogers (2004) single out two aspects of Islamic finance that distinguishes it from conventional finance:
- Risk-sharing philosophy: the lender must share in the borrower's risk. Fixed, predetermined interest rates are considered exploitative, socially unproductive, and economically wasteful. The preferred mode of financing is PLS.

- Promotion of economic and social development through specific business practices and zakat (almsgiving). Most Islamic institutions have a shari'ah board (a committee of religious advisers) and other features reflecting their religious status. Conventional finance typically focuses on profit-maximization within a given regulatory framework.

It is enlightening, to note that the abolition of interest-based transactions is a subject that is not alien to western economic thought (Khan, 1986). Consequently, Fisher (1945), Friedman (1969) and Simons (1948), among others, argue that the current (one-sided liability) interest-based financial system is fundamentally unstable and expounded the evil results of the system (Robertson, 1990 p.130-131). Conversely, Khan (1986) and Zarqa (1983) illustrated the macroeconomic stability of a PLS system, which would replace interest-based transactions in an Islamic economy. Similarly, Robertson, (1990 p.54) and Tomlinson, (1993 p.115; 118) strongly advocate replacing the interest-based system with an equity-based financing system.

On the other hand, Presley & Sessions, (1994) and Dar & Presley, (1999) contend that although the theoretical treatment of Islamic finance offers much support for its introduction, its practical implementation has however proven extremely difficult. This is further confirmed by the fact that the euphoria that manifested at the time of the re-emergence of Islamic banking created expectations which have not been fully attained due to the inability of Islamic banking to effectively implement risk-sharing financial techniques. Many observers, even those sympathetic to the idea of Islamic banking, point out that the Islamic banks are reluctant to invest in long-term projects. These observers argue that by concentrating on financing of working capital and short-term trade in commodities, Islamic banks negatively discriminate long-term investment projects and therefore reduce the prospects for economic growth and development – (see Iqbal & Mirakhor, 1987 p.23-4).
6.2 Previous studies in Islamic banking and Finance

A study by Erol & El-Bdour (1989) in Jordan, aimed at establishing the attitude of local people towards Islamic banking. They also sought to establish, and then compare, the bank selection criteria of customers of conventional and Islamic banks in Jordan (Erol & El-Bdour, 1989; Erol, Kaynak, & El-Bdour, 1990). While, Noman (2002) explains that in some studies it has been reported that customers are generally satisfied with their (Islamic) banks. Naser, Jamal, & Al-Khatib, (1999) find that in Jordan more than 75% of the customers of Jordan Islamic Bank for Finance and Development were either 'very satisfied' or 'satisfied' with their bank. As for the bank selection criteria, the study finds that the bank's reputation is the highest important factor for customers to join the bank, followed by its commitment to observing Shari'ah principles (i.e. the religious factor). Noman, (2002) notes that the studies mentioned above refer to the strong powerbase Islamic banks have among religiously motivated customers amongst other factors of concern to them reported in the same studies. There is also a section of Muslim population who may choose to bank with an Islamic bank on profitability and efficiency grounds. For example a study in Jordan shows 75% customers of an Islamic bank also have accounts in conventional banks so as 'to diversify their investments' (Naser et al., 1999).

Sudin et al., (1994) who pioneered the research on bank patronage in Malaysia sought to establish the selection criteria used by Muslim customers in Malaysia when selecting their banks. They find that almost 100% of Muslims and 75% non-Muslims were aware of the existence of Islamic banks. Most of them wished to have a relationship with these banks if they had a complete understanding of this system. Also in their study Sudin, Norafifah & Planisek (1994), sought to, establish the relative importance of certain bank selection criteria among other things, using a sample of Muslims and non-Muslims in Malaysia, none of whom had to be patronizing an Islamic bank at the time of the study.

On their part, Gerrard & Cunningham, (1997) undertook a study of Islamic banking in Singapore, a country which has a minority of Muslims in its population. The study sought to particularly establish the level of awareness that Singaporeans had in relation to the culture of Islamic banking, the attitude of Singaporeans towards Islamic banking and a ranking of the bank selection
criteria of Singaporeans – and for each part of the study, to see if Muslim responses are different from non-Muslim responses. In a later study conducted in Bahrain focused on customers of Bahrain Islamic Bank and Faisal Islamic Bank of Bahrain; Metawa & Al Mossawi, (1998) find that the religious factor occupies the highest degree of importance in the bank selection criteria followed by return on investment. Their study also indicates that socio-demographic factors such as age, income and education were important criteria in bank selection. The study by Metawa & Al Mossawi, (1998) confirms the findings of Sudin, et al., (1994) and Gerrard & Cunningham, (1997) which indicate that religion is the most important reason for customers patronizing Islamic banks.

However, Aggarwal and Youssef (2000, p. 99) find that while Islamic banks are expected to “favour small entrepreneurs who do not have access to credit in the conventional banking system”, they rarely offer finance to these segments of the market, contrary to Islamic injunctions to promote the development of the under-privileged echelons of society. They infer that this is a rational response by Islamic banks in the face of severe agency problems in providing funds to entrepreneurs. Consequently they conclude that economic incentives shape the structure of Islamic banking more so than religious norms. On a different note, Darrat (2000) conducted an empirical study on the efficiency of an interest free monetary system using data on Iran and Pakistan from 1960-1999.

6.3 Islamic banking and financial intermediation

Financial systems are crucial for efficient allocation of resources in a modern economy. As the system’s landscape is determined by the nature of financial intermediation, i.e. how intermediation is performed and who intermediates between suppliers and users of the funds (El-Hawary et al., 2004).

The functions of Islamic banks are and will remain essentially that of financial intermediaries (Kahf, 1999) as Islamic societies need services of financial intermediaries as much as any other society. Financial intermediation based on charging and paying interest (riba) is explicitly prohibited by religious injunctions thus it is not allowed in any Islamic society. The emergence of Islamic banks is, therefore, a reflection of the commitment to offer an alternative to conventional interest-based financial intermediation. Financial intermediation based on the
principles of Islam has an established historical record and has made significant contributions to economic development over time (El-Hawary et al., 2004).

Islamic banking is rated as being one of the fastest growing in the global finance industry (Yudistira, 2004) and is further argued to have gained momentum worldwide (Naser et al., 1999). The popularity of the Islamic banking system is not limited to the Islamic banks alone, rather large international conventional banks are exhibiting growing interest in the Islamic banking system as well. For instance, Citibank has established branches in countries like Bahrain and Sudan to operate in accordance with Islamic Shari’ah principles. Consequently, Islamic banks operating in Islamic countries are faced with strong competition not only from Islamic banks but also from non-Islamic rivals (Naser & Moutinho, 1997).

Consequently, Zaher & Hassan, (2001) make a bold prediction that Islamic banks are set to control some 40% to 50% of Muslim savings by the years 2009/10. The worldwide Muslim population is at over one billion; therefore Islamic banks have many potential customers and opportunities in this niche area. Predictions put the value of Islamic banking at some USD 200 billion (Hassoune, 2002). However the size is difficult to measure given that many commercial banks may have ‘Islamic window’ operations, which are not necessarily reported separately in financial statements (Brown, 2003).

Othman & Owen, (2001) define an Islamic bank as a non-interest based financial institution which complies fully with Islamic Laws. It has creative and progressive financial engineering to offer efficient and competitive banking, investment, trade finance, commercial and real estate financing services. Shari’ah encourages risk and profit sharing in the sphere of financial activities as ‘the essential principle of interest-free banking is PLS’ (Metwally, 1997). Similarly, Dar & Presley (2000) maintain that an Islamic bank is an intermediary and trustee of other people’s money with the difference that it shares profit and loss with its depositors. This difference introduces an element of mutuality in Islamic banking, giving its depositor customers some ownership rights in it.

Dar (2003) classifies financing used by Islamic banks as alternatives to interest into four types; these are; investment-based, sale-based, rent-based and service-based. Likewise, Iqbal & Mirakhor, (1999) also group the theoretical
models of a financial intermediary operating on Islamic principles into two-broad categories; these are the two-tier Mudarabah and two-window models.

- The two-tier Mudarabah model is an arrangement by which the Islamic bank enters into separate Mudarabah contracts with depositors and users of funds. The bank acts as a financial intermediary solely on the basis of PLS on both the assets and liabilities side (see Chapra, 1985; Siddiqi, 1980; Siddiqi, 1982; Uzair, 1980).

- The two-window model is also based on PLS on the assets side but recognises the need of depositors on the liabilities side who wish to choose between transaction deposits and investment deposits (Khan, 1985). Hence, this model divides the liabilities side of the bank's balance sheet into two windows, one for demand deposits and the other for investment balances, with the depositor choosing which window to use.

Though in both models any losses incurred by the bank will be reflected in the value of the depositor's wealth depreciating, however, both models ensure that the probability of losses are minimised through portfolio diversification, careful project selection, monitoring and control (Iqbal & Mirakhor, 1999).

El-Hawary et al., (2004) assert that Mudarabah (a trustee finance contract) and Musharakah (equity partnership) are the most popular contracts and are suitable for conducting financial intermediation. It is claimed that these instruments were used not only by Muslims but also by Jews and Christians to the extent that interest-bearing loans and other overly usurious practices were not in common use (Chapra & Ahmed, 2002; Udovitch, 1981).

Notwithstanding the utility of the PLS models of Islamic finance discussed earlier, Islamic banks are seen to be reluctant to enter into PLS contracts (Bjorvatn, 1998). One very important explanation for this is the existence of asymmetric information between bank and entrepreneur. Additionally, some scholars have warned that if this trend of relying on fixed return modes remains, Islamic banks would lose ground against conventional banks as they are also offering products with similar, if not the same, characteristics. Furthermore, Dar & Presley (2000) argue that the structure of Islamic banks has been a major hindrance in the equity-based (or PLS) modes of financing. Consequently, Errico
& Farahbaksh (1998) argue that eventually, Islamic banks would 'lose their distinctive features and tend to resemble conventional banks'. Thus Tag el-Din (1999) recommends that in order to gain competitive advantage and product differentiation, Islamic banks have to evolve better mechanisms for successful application of variable returns modes.

6.4 Islamic banking and agency problems

In their intermediation function, Islamic Financial Institutions (IFI) face risks that affect their ability to compete and to meet the interests of their stakeholders, that is, depositors, shareholders and regulators (El-Hawary et al., 2004).

In PLS activities, use of mudarabah on the assets side of the balance sheet gives rise to moral hazard problems. While the rabb-ul-mal (in this case the IFI) bears all the losses in case of a negative outcome, it cannot oblige users of the funds (mudarib) to take the appropriate action or exert the required level of effort needed to generate the expected level of returns. Such situations can be exploited by users of IFI's funds (Lewis & Algaoud, 2001). Also, the bank has no right to monitor or participate in managing the project and hence may loose its principal investment in addition to its potential profit share if the entrepreneur's books show a loss (Errico & Farahbaksh, 1998). Additionally, for the bankers it may be very difficult, and at least very costly, to verify the true profitability of the various projects. This problem is particularly serious in developing countries where systematic accounting is rare, or where companies for reasons of tax evasion keep several accounts. There is clearly an incentive on the part of the entrepreneurs to under-report true profits and in this way reduce the transfer to the bank. This incentive to cheat makes banks reluctant to enter into joint ventures with entrepreneurs (Bjorvatn, 1998).

Mudarabah can also expose an Islamic bank to principal-agent problems where the bank enters into the mudarabah contract as rabb-ul-mal or principal, and the mudarib is the agent. The agent may have incentives to expand the expenditures on the projects and to increase the consumption of non-pecuniary benefits at the expense of returns since the increased consumption is partly borne by the bank while the benefits are entirely consumed by the entrepreneur. A similar problem arises on the liabilities side, where investment account holders place their money with IFIs on a mudarabah basis.
Likewise, in a Musharakah, the asset class has an associated cost in the form of adverse selection and therefore requires extensive screening, information-gathering and monitoring. Each Musharakah contract would require careful analysis and negotiation of PLS arrangements leading to higher cost of intermediation for an IFI. Sadr & Iqbal (2002) provide empirical evidence that increased monitoring resulted in an increase in the portfolio size of Musharakah contracts on the assets side of the balance sheet of an IFI. Additional monitoring recovered its costs in higher returns. As a result of the problems associated with Mudarabah and Musharakah, IFIs tend to allocate limited funds to these asset classes. This implies an increased reliance on asset-backed securities limiting IFI’s choice of investment, and may ultimately hamper their ability to efficiently manage risks and diversify their portfolio.

In undertaking a comparison of the two PLS modes of financing, Khan (1995) maintains that within the PLS technique, Musharakah may have an edge over Mudarabah in the sense that the in the former, the capital-owner has a right to enter into the management and hence have some level of control over the problems created by information asymmetry and moral hazards. The latter is however devoid of any possibility at such control.

Sarker (1999) explains in some detail the implications of agency problem in Islamic Contracts. He argues that from the perspective of the corporate finance literature, the obvious advantage of Islamic banking is its greater ability to allocate risk optimally through the sharing of project returns between owner of the capital and entrepreneur. Despite this positive risk-sharing benefit, Islamic or PLS banking also faces severe principal-agent problems arising from asymmetric information and costly monitoring. These are:

1. Firstly, such a bank would face difficulties resulting from ex-ante information limitations concerning project quality. Entrepreneurs have inside information about their personal activities and projects' likelihood of success that cannot be credibly signalled to the bank because every PLS applicant will claim to be of the highest quality. The banks' difficulty in determining the quality of the applicants produces various adverse selection problems, especially when debt finance is available from competing sources' (Mills & Presley, 1999). Those borrowers who expect their projects to supply high non-monetary
benefits but low realised profits will choose PLS financing because they will enjoy high total returns at an artificially low cost of capital (Pryor, 1985). Similarly, PLS banks will attract applicants with inside knowledge that their project is highly risky, and applicants who will inflate their profit expectations in the hope of the bank accepting a lower PLS ratio (Nienhaus, 1983).

2. Secondly, in PLS contracts, applicants have the incentive to under-report or reduce declared profit. They can deflate profit by taking excessive perquisites or extra leisure or resort to accounting tricks. This ex-post information asymmetry leads to a moral hazard problem for Islamic banks.

3. Thirdly, an Islamic bank's susceptibility to moral hazard and adverse selection would probably make it uncompetitive with its conventional rivals, because of the additional dead-weight costs in information-gathering and project appraisal, reduced work incentives for entrepreneurs and higher production costs (see Goodhart, 1987).

Dar & Presley (2000) indicate that it is often asserted that agency problems are more severe in Islamic banks than conventional banks and Non Bank Financial Institutions (NBFIs). They also state that modern finance literature provides some solutions which include monitoring and bonding arrangements (Jensen & Meckling, 1976), separation of management (initiation and implementation of decisions) and control (ratification and monitoring of decisions) (Fama & Jensen, 1983) and staging of capital provision (Sahlman, 1990).

Some solutions to employ in overcoming the agency problems in Islamic banking are expounded by Sarker (1999) as follows:

1. Incorporate ignored behavioural consideration in the contract. The principal-agent problem can be solved in the banking system by attaching reward to co-operation which might induce the agent to behave honestly.

2. Some researchers argue that, for two reasons the principal-agent problem will be at a minimum in an Islamic economy. Firstly, Muslims believe in the eternal concept of life, in which honesty is rewarded and dishonesty punished. This is a non-material incentive for people to be honest. Secondly, if all financial operations are based on sharing (and a continuing rather than one time relationship is developed between financiers and entrepreneurs),
honest entrepreneurs will force dishonest entrepreneurs out of the market. So, there is also a financial incentive for being honest.

3. The formats of contracts should be designed as honesty-compatible by including some specific incentive mechanisms such as providing a stake in the ownership, linking transfer of ownership through granting bonus shares on the performances, etc. to reduce the agency problem.

4. The redeeming PLS can be effectively used for the promotion of entrepreneurs and projects. Islamic banks can undertake projects with infant entrepreneurs and gradually transfer their sole ownership (in Mudarabah contracts) and partial or shared ownership (in Musharakah contracts). The contracts may therefore be referred to as diminishing Mudarabah or diminishing Musharakah to the entrepreneurs.

5. Long-standing bank-borrower relationships would improve the efficiency of PLS banking in other ways. For instance, repeated interactions will reduce monitoring costs as banks become familiar with the borrower’s auditing systems, and handle their transactions over an extended period. It should then be able to develop a more accurate opinion of borrower performance relative to other similar firms and so be better able to know if a low reported return is the result of borrower inefficiency, cheating or a sectoral downturn.

6. Actively supervised credit by the branch banking system is an opportunity to minimise the information asymmetries that result from distance. Where Islamic bank’s credit officers work and live in the vicinity of the borrowers, they are able to gauge their reputation and inspect operations more easily and closely, agency problems might be minimised substantially.

The moral hazard problem would however be reduced in Musharakah where the capital of the entrepreneur/partner will also be at stake. Furthermore, equity partnership would minimize the problem of informational asymmetry as the IFI would have the right to participate in the management of the project in which it is investing. Thus Khan (1994) claims that an IFI is able to invest in large enterprises because the users of the funds owning large stakes in the business would not put the banks in a detrimental position in terms of risk, which may reduce overall risk and thus improve the profitability of the bank.
6.5 Islamic banking and financing of SMEs

A number of research findings give a strong indication that SMEs generate higher returns on capital than their large-scale counterparts (Ibrahim, 2003). They also have higher total factor productivity (high output-capital ratios). In spite of this it is generally recognised that banks have not extended enough credit to the SMEs especially in developing countries like Nigeria. Also, Dhumale & Sapcanin, (1999) consider the elements of microfinance to be consistent with the broader goals of Islamic banking and finance, such as the advocacy of entrepreneurship, risks sharing, and disbursement of collateral free loans. As Islamic investment arrangements put great emphasis on the transaction itself, rather than the creditworthiness of the partner, no strict security should be demanded (Ibrahim, 1997 p. 4). If the operation ends in a loss the partner does not bear this loss alone. If he or she is unable to settle his or her bills, a grace period is given without any additional fees (Awad, 1994; Khalifa & Al-Shazali, 1988) Islamic financing does not require the partner to present securities against possible losses. Since the Islamic principle is basically based on PLS arrangement then "any security demanded by the Islamic bank is against possible fraud or repayment-evasion, and not against the risk of losses" (Awad, 1994 p.3). Hence, Ibrahim (2003) argues that the Islamic financing modes are better suited for meeting the needs of SMEs.

In acknowledgment of the participatory nature of Islamic financing, which benefits the recipient and encourages client loyalty, it is considered to have greater suitability for SME support than conventional financing methods. Where there is an ongoing dialogue between the financier and the entrepreneur, business decision-making is improved, as two parties working together produce a superior outcome than each working in isolation.

In its effort to finance small entrepreneurs, the privately-owned Sudanese Islamic Bank (SIB), by December 1994, financed over 500 projects of which about 17% were financed through Musharakah, in which the bank's share was 20% of the total money invested. Murabahah constituted only 6% of the total finance while Murabahah was the dominant financing mode in the Bank, with about 74% of the total finance. The Sudanese Islamic Bank experience in financing productive entrepreneurs illustrates the way Islamic principles of
banking (namely the social role of money and the dual nature of Islamic investment) could be applied to SMEs to achieve both social objectives and profit. The bank does this by mobilising deposits from a specific geographical location, and lending that money in the same location. This is contrary to the traditional way the banking system usually works whereby it mobilises deposits from rural savers to be invested in urban areas (Harper, 1998 p.20).

Ibrahim (2003) indicates that the Faisal Islamic Bank of Sudan (FIBS) is noted to specialise in financing craftsmen within small enterprises. The only formula used in Sudan by both Faisal Islamic Bank and the Islamic Co-operative Development Bank in financing the MEs was Murabahah. The total number of projects financed by FIBS during the period 1993 to 1994 was 1,400 (Ibrahim, 2003). Additionally, Stiftung (1995 p.71) indicates that the Islamic Co-operative Development Bank (ICDB) in Sudan financed craftsmen, productive families and small producers with up to 10% of its total finance between 1991 and 1993.

Bjorvatn (1998) maintains that experience from the Sudan seems to indicate that Islamic development banking in the rural area has been rather successful. While, Stiansen (1995) reports that two of the Islamic banks in the country have been involved in Musharakah partnerships with small-scale farmers, in which the banks supply the necessary financial and physical capital in return for a share of the harvest, in other words, a share-cropping agreement. In the same vein, Ibrahim (2003) notes that Sudanese Islamic banks are rare examples of formal institutions, which are engaged on a significant scale in the application of Islamic modes of finance to SMEs. This represents a unique, fully-fledged practical experience of the Islamic financing system to small enterprises. He argues that this represents one of the rare occasions in the world in which this system has worked in practice and has been heavily supported by specific banking legislation. He therefore concludes that the most important lesson from the Sudanese experience might be that PLS formulae and mark-up financing techniques are useful in solving outstanding constraints in small business financing. Consequently, the principle of Islamic PLS is deliberately adopted by the Sudanese Islamic banks as a step towards achieving the goal of adapting commercial banks to the SME customers.
Similarly, the lines of credits offered by the Islamic Development Bank (IDB) have not only made significant contributions towards developing SMEs in Islamic countries like Malaysia but also enhanced the role of DFIs (The Muslim News, 2005). Also Bank Islam Malaysia Bhd (BIMB) expects to increase its annual financing to SMEs substantially as indicated by Fazlur Rahman BIMB's chief operating officer who reported that the bank would increase the amount of SME financing by 100% from RM100 million at present (Bernama, 2005).

Rogers (2004) explains that beyond the appeal of compliance with Islamic law, Islamic finance is important in its capacity to offer alternative financing routes for projects. He argues that the special characteristics of Islamic finance can provide alternative means to reaching 'under served' groups such as small, rural, and agricultural producers. Projects that could be turned down by conventional banks due to lack of collateral, may be financed by Islamic banks on a PLS basis. In this regard, Islamic finance can catalyze economic development and reduce poverty.

6.6 Islamic financing modes applicable to SMEs

The major modes of Islamic finance that have been in operation amongst Islamic banks and financial institutions are Mudarabah (agency joint venture/limited partnership); Murabahah (purchase or resale of debt/mark-up/deferred payment sales); and Musharakah (joint partnership, credit/partnership). Islamic banks also resort to other modes of finance on a deferred payment basis (Bai mu'ajjal), leasing (Ijarah), and pre-paid purchase of goods (Bai' Salam) amongst others.

Samad et al., (2005) explain that among the Islamic financing modes, mudarabah and Musharakah are the most distinct. They suggest that the unique characteristics of these two financing modes make Islamic banks and financing viable alternatives to the conventional interest-based financial system.

In comparison to interest-based lending, Ibrahim (2003) presents the following as advantages Islamic modes of finance have in funding small entrepreneurs:

- In most cases financing is granted without an obligation on the part of the partner to pay back.
- No strict security is demanded.
• If the operation ends in a loss the partner does not bear this loss alone. If he or she is unable to settle his or her bills, a grace period is given without any additional financial obligation.

6.6.1 Musharakah
Musharakah is a "form of partnership where two or more persons combine either their capital or labour together, to share the profits, enjoying similar rights and liabilities" (Al Harran, 1993 p.74; Sudanese Islamic Bank, undated). It is a limited period contractual agreement between the bank and the partner, to use both human and financial resources and distribute whatever profit and loss they make in accordance with capital and human resources invested. Both parties are allowed to charge a fee or wage for any management or other labour put into the project (Khan, 1996). All providers of capital are entitled to participate in management but are not necessarily required to do so. Losses are shared in the exact proportion of the capital invested by each party (Sarker, 1999). Except where it is otherwise proved that such losses arose as a result of the neglect, abuse or violation of terms agreed upon by the party undertaking the management and operation of the venture.

Musharakah can take another form, in which the bank enters into partnership with the client on the basis of diminishing Musharakah, through which the full ownership of the business assets passes to the partner after a certain period. Under this type of agreement, the client is given the right to gradually buy, as much as he can, from the bank's shares until such client becomes the sole owner of the business (Abdalla, 1997).

The findings in Ibrahim (2003) indicate that Musharakah has the following advantages for entrepreneurs and their SMEs:

• It is a form of financing that is flexible, fair (according to the Islamic standard) to both parties and easily understandable.
• It caters for management, thus leading to increased incomes for the poor who do not own capital.
• It is a suitable mode of financing for both working and fixed capital.
• It preserves the real value of capital invested.
• It does not require strict collateral guarantees and does not leave the partner with a heavy burden of debts.
• In Musharakah the client does not have to contribute cash in case his/her share might be in kind (inputs).
It avoids repayment from an entrepreneur who has already lost his livelihood in the case of a total failure.

Where the bank is the partner it may also take an active role in marketing the SME's products, thus reducing the marketing burden on small entrepreneurs.

On the other hand using partnership arrangements, however, does not mean providing finance to SMEs on concessional rates. In contrast, partnership has a better rate of return on capital investment to the bank compared with the conventional interest-based lending (Ibrahim, 2003).

However, Bjorvatn (1998) argues that Islamic ideal of risk sharing in practice has not been implemented at all in the Iranian banking sector. In fact, the contracts classified as PLS in the Iranian Central Bank statistics are based on what is called a 'minimum rate of return'. He maintains that for all practical purposes, this ex ante-determined rate of return is equivalent to interest.

Also, Islamic banks were supposed to adopt new financing policies and to explore new channels of investment which may encourage development and support of small scale traders to lift up their economic level (Usmani, 2002 p. 116). Thus such Islamic banks should have advanced towards PLS (musharakah) in gradual phases and thereby should have increased the size of musharakah financing (Usmani, 2002). However, very few Islamic banks and financial institutions have paid attention to this social aspect.

6.6.2 Mudarabah
Another form of a joint venture Shari'ah credit used in financing MEs in Sudan is Mudarabah. It involves two parties - the bank (which owns the finance) and the partner/entrepreneur (who applies his/her skills to use it). Mudarabah is a profit and loss-sharing contract that entails one person (called the investor) handing over money to another (the Mudarib, trustee or agent) for the purpose of investment. The net profits realised are divided between the two parties according to certain ratios agreed upon in advance. The profit sharing ratio mutually agreed upon between finance-provider and finance-user is determined by the market forces (Sarker, 1999). In the case of a loss, the owner of the money looses his capital and the trustee looses his effort and the profits he was expecting from the venture. The loss, if any, incurred in the normal process or course of business and ascertained not to have been due to negligence or
misconduct on the part of the entrepreneur is borne by the capital-owner. To reinforce this assertion, (Sarker, 1999) quotes Ibn Qudama as having noted that ‘...If, however, the loss is a result of a misuse or a violation of the conditions of the contract on the part of the working partner, then he alone will be liable to cover it’. The finance-user guarantees to return funds only on two conditions, that is, if he is negligent in the use of the funds or if he breaches the conditions of mudarabah (Iqbal & Mirakhor, 1987).

Mudarabah contracts are considered to be risky and require a great deal of confidence from the two parties, which is why it is usually conducted with a partner who is well trusted, professional and with good track records. It is recognised that without collateral requirements, virtually any entrepreneur, even one who is risk averse and without wealth can receive financing (Kazarian, 1993 p.98). With the bank exposed to financial risk, ideally it should try to minimize its vulnerability by investing in a large number of investments, that is, in a diversified portfolio guided by project viability, not speculation. Given the developing countries’ lack of functioning stock markets and the high concentration of capital, such a measure could increase both the number of investments and the number of entrepreneurs (Kazarian, 1993 p.98). However, Ibrahim (2003) indicates that the application of this Islamic formula is not without constraints. The appropriate guarantee for Mudarabah suitable for small entrepreneurs poses a real problem. Partnerships financing has singled out the high costs of following up and monitoring of projects as a major problem.

6.6.3 Murabahah

Murabahah, often referred to as cost-plus or mark-up financing, involves the resale of a working capital item or means of production after adding a specific profit margin. Instead of a small entrepreneur having a loan (which he may divert into a different purpose than the business), in this contract the financier will purchase the desired asset or raw material for the entrepreneur and add a profit. In this mode of finance, and according to Islamic Shari’ah law the financier must first own the commodity (through procurement) before reselling it; the commodity must be a tangible one and the buyer must know and agree to the purchase and resale prices (Abdulla, 1997 p.58).
Murabahah mode of finance differs from interest finance, as its margin is commodity or asset-specific cost based with the financing being provided to the firm as real assets and/or raw materials rather than in cash. This therefore ensures that the small entrepreneur is protected against unfair exploitation. While the financier is protected against diversion of cash, by the entrepreneur, to other purposes than that for which the financing is sought.

However, Bjorvatn (1998) notes that the council charged with the design and implementation of Islamic banking in Pakistan, admits that 'there is ... a danger that the mark-up techniques could eventually be misused as a means for opening a back door for interest along with its attendant evils'. The council therefore strongly recommends that 'their use as general techniques of financing must never be allowed'. Bjorvatn (1998) further maintains that PLS is hardly implemented at all in the declared Islamic economies (Pakistan, Sudan and Iran). Instead, Islamic banks base their operations on the mark-up techniques, known as Murabahah. He therefore, argues that the back door for interest, which the Pakistani Council of Islamic Ideology warned about, appears to be wide open. From his study and interview findings in Pakistan, Kuran (1993 p.310) reports that Pakistani bankers routinely tell their clients that mark-up financing is equivalent to interest. He also reports that in Pakistan PLS contracts never rose above 2% of the total assets in the banking sector.

6.7 Islamic finance and globalisation
The first Islamic banks were created in the 1970s, at the time when Islamic banks were typically commercial banks operating on an interest-free basis. Today, as a consequence of broad changes in the political and economic environment a new generation of Islamic financial institutions, more diverse and innovative, is emerging. Islamic financial institutions now operate in over 75 countries. Their assets have increased more than 40-fold since 1982 to exceed $230 billion (Warde, 2000). Perhaps the most important development has been the growing integration of Islamic finance into the global economy. This is now apparent in the existence of a Dow Jones Islamic Market Index, which tracks 600 companies (from inside and outside the Muslim world) whose products and services do not violate Islamic law. Foreign institutions such as Citibank have established Islamic banking subsidiaries, and many conventional banks, not only
in the Muslim world but also in the United States and Europe, are now offering "Islamic products" that are sometimes aimed at non-Muslims. Islamic finance is thus in many ways well suited to the global economy (Warde, 2000).

This is all the more striking and paradoxical as it is often said that Islam is incompatible with the "new world order" that emerged with the end of the cold war. Questions have been raised as to how a medieval economic system could be so relevant in a world of revolutionary, technology-driven global finance. Some writers have also wondered how an interest-free system could fit into and within the broader interest-based financial system.

The globalization of finance has in fact allowed Islamic finance to thrive, especially since there has been in recent years a fusion of sorts between Islamic and conventional banking. Whereas the traditional world of finance, dominated by commercial, interest-based, banking could raise potentially troublesome theological issues, the new world of finance, characterized by the blurring of distinctions between commercial banking and other areas of finance, the downgrading of interest income, and financial innovation, has been rife with opportunities for Islamic financial institutions. Indeed, Islamic finance has driven financial modernization in many parts of the Muslim world.

Islamic finance is complex as a brief overview of a leading Islamic banking group suggests the limits of simplistic and sweeping generalizations. For instance, Dar al Maal al Islami (DMI), the largest transnational Islamic group is headquartered in the Bahamas and operates primarily out of Geneva yet uses the language of the Islamic "ummah". Although controlled by Prince Mohammed Al-Faisal al-Saud (the second son of the late King Faisal of Saudi Arabia), the group does not operate a commercial bank in Saudi Arabia. Though Saudi Arabia is a "fundamentalist" country that is instrumental in bringing about modern Islamic banking, yet it is thought to be one of the least hospitable countries to Islamic banks. Furthermore, the DMI group is nonetheless a significant conduit of Saudi money and influence throughout the Islamic world. In sum, the story of Islamic finance is a vastly complicated one, and cannot be captured without a full understanding of religion and finance, but also of history, politics, economics, business and culture (Warde, 2000).
6.8 Summary

Finance is often the greatest difficulty facing SMEs, as conventional banks prefer to lend to larger, less risky businesses. Where there is trust between financial institutions and the SMEs they are supporting, the transactions costs of such funding are considerably reduced, as moral hazards, and hence risks, are reduced. One of the major advantages that Islamic financial institutions enjoy over their conventional competitors is that moral suasion can be used to ensure repayment and full disclosure of all information relevant to the financing. Given these more favourable conditions for Islamic financing, funding of SMEs becomes viable. The musharakah and Mudarabah partnership arrangements can enhance the ability and incentives of Islamic banks to reach SMEs, thus overcoming the conventional banks’ reluctance to lend to small producers.

The study by Ibrahim, (2003) on the financing of small businesses in Sudan by Islamic banks therefore demonstrates how Islamic financing can be valuable in supporting SMEs and in covering the gap that is often left by conventional funding. One major advantage of Islamic finance is that risks are shared between the financing institution and the beneficiary, which means entrepreneurs are better placed to concentrate on what they do best. Entrepreneurship is restrained if those involved in businesses are distracted by unnecessary worries over risk management.

Ibrahim (2003) concludes that SMEs seem to provide the basic necessities of life and extending finance to them can help in alleviating poverty and achieve the dualistic characteristics of Islamic finance, that is, for the benefits of both the investors and the community at the same time.

One of the most important developments in the Islamic finance market has been the growing integration of Islamic finance into the global economy. Foreign institutions have been known to establish Islamic banking subsidiaries, and many conventional banks, not only restricted to the Muslim world, now offer "Islamic products" that are sometimes aimed at non-Muslims. Islamic finance is thus in many ways well suited to the global economy.

The following two chapters of this study will present the results based on the application of the techniques highlighted in the research methodology chapter.
CHAPTER SEVEN

DESCRIPTIVE DATA ANALYSIS
7 DESCRIPTIVE DATA ANALYSIS

7.1 Introduction
Data analysis is concerned with sensitising researchers to the use, interpretation and evaluation of relevant data. A proper understanding of data analysis improves the way in which we think, interpret, evaluate and plan empirical research (Rose and Sullivan, 1996). Thus it is simply the means by which we test our theories and attempt to specify the nature of the relationships between the observations our theories allow us to make.

Having introduced the study’s research methodology in the chapter 3, the data collected from respondents to the questionnaires administered are analysed in this chapter. It starts with a descriptive analysis of the results, giving the basic features of the data in the study, by simply describing what the data shows. This will be achieved by describing the characteristics of SMEs, their owner-managers and the SMIEIS fund through the use of frequency distributions, frequency tables, cross tabulations, charts and graphs.

7.2 Survey Data Overview
Survey questionnaires totalling 980 were equally divided and despatched between the northern and southern regions of the country with each receiving 50% of the questionnaires. Overall the questionnaires were allocated with 35.71% questionnaires each to both the manufacturing and trade sectors, and 28.58% to the services sector. Of the total questionnaires distributed 12.35% could not be delivered while 30.71% were not responded to. However, a total response rate of 56.94% was obtained from the entire survey sample of which 51.22% were deemed usable responses while 5.72% were classified unusable (Table 7-1). They were deemed unusable because they were poorly or scantily completed creating difficulty in understanding. This therefore rendered them unsuitable as the needs of the research were not served.

Also the response varied by region and industry sectors, as shown in Table 7-1, with the northern region having 50.41% and the southern region having 52.04% response rates. On industry sector basis, the manufacturing, services and trade sectors’ response rates of 38.57%, 50.71% and 64.29% respectively, were obtained. The sample is representative of SMEs in the selected industry sectors.
as they reflect the relative importance of the sectors in the lists of SMEs obtained from the three associations (MAN, NASSI and NASME). Also because it is easier and cheaper to establish SMEs in the trade and service sectors as that the need for capital funding is lower than in the manufacturing sector.

### Table 7-1: Questionnaire Distribution Summary

<table>
<thead>
<tr>
<th></th>
<th>North</th>
<th>South</th>
<th>Total</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total questionnaires despatched</strong></td>
<td>490</td>
<td>490</td>
<td>980</td>
<td></td>
</tr>
<tr>
<td><strong>Less:</strong> Undelivered</td>
<td>79</td>
<td>42</td>
<td>121</td>
<td>12.35</td>
</tr>
<tr>
<td><strong>Total questionnaires delivered</strong></td>
<td>411</td>
<td>448</td>
<td>859</td>
<td></td>
</tr>
<tr>
<td><strong>Less:</strong> Non-responses</td>
<td>141</td>
<td>160</td>
<td>301</td>
<td>30.71</td>
</tr>
<tr>
<td><strong>Total questionnaires returned</strong></td>
<td>270</td>
<td>288</td>
<td>558</td>
<td>56.94</td>
</tr>
<tr>
<td><strong>Less:</strong> Unusable responses</td>
<td>23</td>
<td>33</td>
<td>56</td>
<td>5.72</td>
</tr>
<tr>
<td><strong>Usable responses</strong></td>
<td>247</td>
<td>255</td>
<td>502</td>
<td>51.22</td>
</tr>
</tbody>
</table>

Questionnaires representing about 12.4% were not delivered due to:

- The closure of the SMEs the questionnaires were addressed to.
- Relocation of business premises.
- Poor delineation of streets, and
- Lack of a comprehensive directory of business addresses.

In addition 30.71% questionnaires were not responded to at all despite having been delivered. An attempt to ascertain the reasons for this revealed the following causes for the non-responses:

- Absence of the entrepreneurs as a result of extended travel or being inaccessible altogether despite repeated calls and visits.
- Apathy for surveys of any sort. Some entrepreneurs or managers refused to cooperate completely as they no longer attach importance to research. They indicate that previous similar surveys did not yield the anticipated results by way of improving the business environment or SME policies.
- Some non-respondents indicate that they had no time to reply and so returned the empty questionnaire form.
- The inclusion of Islamic banking and finance in the survey resulted in some non-Muslims perceiving this survey as a deliberate attempt to promote Islam and its values. All attempts to reassure them otherwise failed thus resulting in the failure of some to respond.

The usable survey responses, representing 51.22% compares favourably with usable responses in similar SME studies conducted by Al-Kharusi (2003) in
Oman and Hajjar (1989) in Saudi Arabia who achieved overall responses of 48.2% and 40.36% respectively. Another study of SMEs in Eastern Finland by Pasanen (2003) obtained 53.7% response rate.

Figure 7-1: Map of Nigeria Showing Regions

Nigeria is divided into two distinct geographical regions by the rivers that traverse the country (Figure 7.1). The northern region is bounded in the south by the rivers Niger and Benue which also form the boundary for the southern region. These divisions are used in this research for ease of reference.

7.3 Characteristics of SMEs

<table>
<thead>
<tr>
<th>Table 7-2: Descriptive Statistics - Firm Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firm</td>
</tr>
<tr>
<td>Mean Age</td>
</tr>
<tr>
<td>13</td>
</tr>
<tr>
<td>Std. Deviation</td>
</tr>
<tr>
<td>1.397</td>
</tr>
<tr>
<td>Variance</td>
</tr>
<tr>
<td>1.951</td>
</tr>
<tr>
<td>Skewness</td>
</tr>
<tr>
<td>.737</td>
</tr>
<tr>
<td>Kurtosis</td>
</tr>
<tr>
<td>-.095</td>
</tr>
<tr>
<td>N</td>
</tr>
<tr>
<td>502</td>
</tr>
</tbody>
</table>

In this section, the background information that relates to the SMEs is analysed. SMEs were analyzed in terms of their industry sector, location, age, size (using the number of employees and firm's total assets), ownership type and use of
business plan. On financing the source of start-up financing used and any external financing sought post start-up will also be analysed.

7.1.1 Industry Sector
The three main sectors of the economy in which SMEs are substantially engaged were used in the survey. Figure 7.2 shows the response rates from the trade, manufacturing and services sectors.

![Figure 7-2: Sectoral Distribution of Survey Respondents (%)](image)

The trade sector plays a dominant role in the Nigerian economy and thus accounted for about 44.8% of the overall study respondents. Another 26.9% SMEs in the manufacturing sector responded to the survey. Similarly the response rate in the services sector was 28.3%. Hajjar (1989) in his study had obtained 53.9% and 37% sectoral responses from the manufacturing and trade sectors of the Saudi Arabian SMEs respectively. This study however obtained 38.57% and 64.29% as sectoral responses from SMEs in the manufacturing and trade sectors respectively as depicted in Figure 7.3.

![Figure 7-3: Questionnaire Distribution and Responses by Sector (%)](image)

The sectoral distribution of SMEs indicates that the SMEs studied represent certain proportions of firms in their industry sector in the country.
7.1.2 Location
Figure 7.4 gives a breakdown of the percentage response from the regions:

The regional spread of the responses given in Figure 7.4 show the south with a response rate of 52.04% compared to 50.41% in the north. The survey in the north was undertaken on SMEs located in some selected states (such as Kano, Kaduna, Bauchi, Plateau) and Abuja (the federal capital city). In the south SMEs in Anambra, Enugu, Rivers, Lagos, Oyo and Ogun states.

Table 7-3: Sectoral responses by regional spread

<table>
<thead>
<tr>
<th>Sector</th>
<th>Detail</th>
<th>North</th>
<th>South</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>Count</td>
<td>52</td>
<td>83</td>
<td>135</td>
</tr>
<tr>
<td></td>
<td>% within sector</td>
<td>38.5%</td>
<td>61.5%</td>
<td>100%</td>
</tr>
<tr>
<td>Services</td>
<td>Count</td>
<td>59</td>
<td>83</td>
<td>142</td>
</tr>
<tr>
<td></td>
<td>% within sector</td>
<td>41.5%</td>
<td>58.5%</td>
<td>100%</td>
</tr>
<tr>
<td>Trade</td>
<td>Count</td>
<td>136</td>
<td>89</td>
<td>225</td>
</tr>
<tr>
<td></td>
<td>% within sector</td>
<td>60.4%</td>
<td>39.6%</td>
<td>100%</td>
</tr>
<tr>
<td>Total</td>
<td>Count</td>
<td>247</td>
<td>255</td>
<td>502</td>
</tr>
<tr>
<td></td>
<td>% within sector</td>
<td>49.2%</td>
<td>50.8%</td>
<td>100%</td>
</tr>
</tbody>
</table>
The regional location of the sample firms studied along industry sector gives a fair idea of and is representative of the structure of SMEs in the regions. With the north being more trade sector dominated than the south while the manufacturing and services sectors dominate in the southern region. The locational decisions of firms in the business service sector often favour bigger centres of population, because such firms are usually more dependent on local demand. Figure 7.5 shows that in the service sector, 58.5% of the firms studied were located in the southern region (with concentration in Lagos) and 41.5% in the northern region (with concentration in Abuja). Also in the manufacturing sector, 61.5% and 38.5% of the firms studied were mostly located in Lagos (southern region) and Kano (northern region) respectively. In the trade sector, 60.4% of the firms studied were located in the northern region. These results are also confirmed in Table 7-3. Invariably, the tradition of industrialisation is younger and therefore weaker in the North than in the southern region.

7.3.1 Firm Age

One of the most studied demographic factors in small business is the firm’s age as it has an important impact on the perception of the stability, viability and survival of the firm. Thus, Moore (1994) maintains that because of its impact on the sources and types of external financing available, firm age is considered to be an important factor. A firm’s age influences the availability of external financing and its ability to easily access such financing in relation to its inability to have established a track record (Binks & Vale 1990). Consequently, the younger the enterprise is, the lower its ability to command loans and external equity. Furthermore, Jomo (1998) argues that small businesses encounter higher average costs of credit than larger enterprises.

The firms in the study had a mean (average) age of about 13 years (Table 7-2). According to their age, more than three quarters of the SMEs are classified as established and on-going firms, i.e. more than five years old, rather than new ventures. However, about half of these firms were those categorised as ‘adolescent firms’, i.e. ‘5 to 12 years’ old (see Biggadike 1979; Bantel 1998; Smallbone et al. 1993). Figure 7.6 reveals that a little over 75% of the firms are
of the younger age range, (i.e. ranging 15 years and below) while 23.5% were younger than or barely up to five years old.

Figure 7.7 depicts the firm age in industry sector terms showing that most of the firms studied were mostly within the 'up to 15 years' age group. The trade sector reveals firms that are younger in the first three age ranges with the number of firms decreasing as age increased. The manufacturing sector however reveals the highest surveyed firms with 40.7% in the '11 to 15 years' range followed by the '16 to 20 years' range with 23%.
7.3.2 Size of SMEs

Based on earlier definition of an SME 62.9% of the respondents had up to 50 staff in their employment thus rendering them as small enterprises. The remaining 37.1% respondents represent those with more than 50 employees which categorises them as medium enterprises in our study (Figure 7.8).

The average number of full-time personnel is 38 as shown in Table 7-2, while the modal class (i.e. the range with the highest number of respondents) is the ‘over 50 employees’ class (Figure 7.8). This indicates the direction of the distribution of the SMEs by their size, i.e. that there were more small-size SMEs than medium-sized ones in the sample. Also 51.3% of the firms employed between 11 and 30 persons.

![Figure 7-8: Total Staff Number (%)](image)

About 4% of the SME respondents employed fewer than 10 employees which classifies them as micro enterprises and not a part of this study. They were however included in the analyses because their total assets value fulfilled the size criteria for SMEs as defined in the analytical framework chapter. Figure 7.9 presents the distribution of the SMEs based on the size of their total assets. Medium enterprises accounted for 28.6% of the respondents who responded to the question on their asset values while about 71.4% had various asset levels falling within the asset category of small enterprises.
7.3.3 Ownership Type

The results on legal ownership of SMEs as shown in Table 7-4 reveal that 52.4% of the respondents are private limited liability companies which are in dominant the manufacturing sector. Firms that are partnerships in ownership type accounted for 24.1% while sole proprietorships made up the remaining 23.5% of all the respondents. A survey in 2001 of Nigeria’s manufacturing enterprises by Soderbom and Teal (2002) finds that 76% of the small firms are either sole proprietorships or partnerships, while 61% and 93% of the medium-sized and large/macro firms, respectively, are limited liability enterprises.

<table>
<thead>
<tr>
<th>Legal Form</th>
<th>Detail</th>
<th>Manufacturing</th>
<th>Services</th>
<th>Trade</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sole Proprietor</strong></td>
<td>Count</td>
<td>0</td>
<td>41</td>
<td>74</td>
<td>115</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>.0%</td>
<td>29.7%</td>
<td>34.1%</td>
<td>23.5%</td>
</tr>
<tr>
<td><strong>Partnership</strong></td>
<td>Count</td>
<td>19</td>
<td>52</td>
<td>47</td>
<td>118</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>14.1%</td>
<td>37.7%</td>
<td>21.7%</td>
<td>24.1%</td>
</tr>
<tr>
<td><strong>Limited Liability</strong></td>
<td>Count</td>
<td>116</td>
<td>45</td>
<td>96</td>
<td>257</td>
</tr>
<tr>
<td><strong>Company</strong></td>
<td>% within Industry</td>
<td>85.9%</td>
<td>32.6%</td>
<td>44.2%</td>
<td>52.4%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>Count</td>
<td>135</td>
<td>138</td>
<td>217</td>
<td>490</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

The highest proportion of SMEs in manufacturing and trade sectors are the limited liability firms with 85.9% and 44.2% respectively. While more services sector SMEs are owned by partnerships with 37.7% than in the other two
sectors. This is in view of their need for a less detailed formal organisational structure and very few line managers, a feature that manufacturing firms must have in view of their need for departmentalisation of functions and operations.

Figure 7.10 gives the ownership structure of SME by sector indicating that of the total 135 firms surveyed in the manufacturing sector 85.9% (116 SMEs) are private limited liability companies. The rest are partnerships while no firm is owned by sole proprietorship. In the services sector, a significant 37.7% of the firms are partnerships in view of the nature of the industry where a mix of different professions are needed to synergise for better service delivery. The remaining firms 29.7% are sole proprietorships. The trade sector on the other hand has more sole proprietorships with 34.1% than partnerships with 21.7%.

7.4 Characteristics of Entrepreneurs
This phase involves a descriptive analysis of the backgrounds of the owner-managers of the SMEs studied in terms of five main factors; these are status, age, education, previous experience and management training.

Table 7-5: Descriptive Statistics - Owner-Manager Characteristics

<table>
<thead>
<tr>
<th></th>
<th>Age</th>
<th>Years of experience</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>44</td>
<td>8</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>1.500</td>
<td>818</td>
</tr>
<tr>
<td>Variance</td>
<td>2.251</td>
<td>.668</td>
</tr>
<tr>
<td>Skewness</td>
<td>.418</td>
<td>1.628</td>
</tr>
<tr>
<td>Kurtosis</td>
<td>-.918</td>
<td>3.129</td>
</tr>
<tr>
<td>N</td>
<td>502</td>
<td>222</td>
</tr>
</tbody>
</table>
7.4.1 Status

Questionnaires were addressed to the Managing Directors of SMEs so as to ascertain the status of the respondents. The survey finds as shown in Table 7-6 that 65.3% of the respondents combined the status of both firm owners and managers. However, only the manufacturing sector with 38.5% recorded a higher proportion of salaried managers within the industry sector than in the other sectors. More firms in the trade and services sectors were managed by their owners with 84.0% and 65.5% respectively, whereas 23.2% of the firms in the service sector and 38.5% in the manufacturing sector were managed by salaried professionals.

<table>
<thead>
<tr>
<th>Status</th>
<th>Detail</th>
<th>Manufacturing</th>
<th>Services</th>
<th>Trade</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner/Proprietor</td>
<td>Count</td>
<td>37</td>
<td>16</td>
<td>11</td>
<td>64</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>27.4%</td>
<td>11.3%</td>
<td>4.9%</td>
<td>12.8%</td>
</tr>
<tr>
<td>Manager</td>
<td>Count</td>
<td>52</td>
<td>33</td>
<td>25</td>
<td>110</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>38.5%</td>
<td>23.2%</td>
<td>11.1%</td>
<td>21.9%</td>
</tr>
<tr>
<td>Both - Owner &amp; Manager</td>
<td>Count</td>
<td>46</td>
<td>93</td>
<td>189</td>
<td>328</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>34.1%</td>
<td>65.5%</td>
<td>84.0%</td>
<td>65.3%</td>
</tr>
<tr>
<td>Total</td>
<td>Count</td>
<td>135</td>
<td>142</td>
<td>225</td>
<td>502</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

7.4.2 Respondents Age

The respondents' ages (Figure 7.11) ranged from '20 to 75 years', and a little over half of them i.e. 51.6% were between the ages '21 to 40 years' old. While those respondents over 60 years old accounted for 16.3%. The mean age of the respondents was 44 years (Table 7-5). The age group '21 to 30 years' (modal class) had the highest number of respondents with 28.3%. This group represents the age group within which most of the respondents that graduate from both academic and technical skills acquisition proceed to either set up their businesses or go into employment. This therefore explains why the group has a higher response rate as they are still very enthusiastic about their ventures.
7.4.3 Education

The result of the survey on the educational background of the respondents' shows 10.5% had no formal education (Figure 7.12) because most entrepreneurs in the trade sector started off in retail business without any formal education. However, almost 90% had some form of formal education, ranging from primary school education to post-graduate education. While secondary school education had the highest number of respondents with 29%, another 24.2% and 17% had attained graduate and diploma level education respectively.

Table 7-7 shows that the educational background varied between the entrepreneurs in the different industry sectors. In the manufacturing sector about 66% had graduate or post-graduate education while in the services sector, over 90% had mid-level qualifications ranging from secondary to diploma and graduate education. In contrast the trade sector had respondents with just basic primary and secondary education accounting for 58.9% while about 23% had no
formal education which links to and confirms the assertion in the previous section that most retail entrepreneurs had no education.

### Table 7-7: Respondent’s Education by Sector

<table>
<thead>
<tr>
<th>Education Level</th>
<th>Detail</th>
<th>Manufacturing</th>
<th>Services</th>
<th>Trade</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary School</td>
<td>Count</td>
<td>4</td>
<td>3</td>
<td>49</td>
<td>56</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>3.0%</td>
<td>2.1%</td>
<td>23.1%</td>
<td>11.5%</td>
</tr>
<tr>
<td>Secondary School</td>
<td>Count</td>
<td>16</td>
<td>49</td>
<td>76</td>
<td>141</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>12.0%</td>
<td>34.5%</td>
<td>35.8%</td>
<td>29.0%</td>
</tr>
<tr>
<td>Diploma Level</td>
<td>Count</td>
<td>22</td>
<td>36</td>
<td>25</td>
<td>83</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>16.5%</td>
<td>25.4%</td>
<td>11.8%</td>
<td>17.0%</td>
</tr>
<tr>
<td>Graduate Level</td>
<td>Count</td>
<td>56</td>
<td>48</td>
<td>14</td>
<td>118</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>42.1%</td>
<td>33.8%</td>
<td>6.6%</td>
<td>24.2%</td>
</tr>
<tr>
<td>Post-Graduate Level</td>
<td>Count</td>
<td>32</td>
<td>6</td>
<td>0</td>
<td>38</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>24.1%</td>
<td>4.2%</td>
<td>.0%</td>
<td>7.8%</td>
</tr>
<tr>
<td>No Formal Education</td>
<td>Count</td>
<td>3</td>
<td>0</td>
<td>48</td>
<td>51</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>2.3%</td>
<td>.0%</td>
<td>22.6%</td>
<td>10.5%</td>
</tr>
<tr>
<td>Total</td>
<td>Count</td>
<td>133</td>
<td>142</td>
<td>212</td>
<td>487</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

#### 7.4.4 Management Experience

The survey sought to find out the years of prior experience the respondents had in managing SMEs before starting their current SMEs. In Table 7-8 on the whole 45.8% respondents indicate that they had obtained some previous management experience while about 54% had no prior experience in managing an enterprise. The average years of management experience as shown in Table 7-5 is 8 years for the respondents. This is attributable to the incidence of high unemployment that has been in the Nigerian economy since the mid 1970s forcing most entrepreneurs into business without prior management experience.

### Table 7-8: Respondent’s Management Experience by Sector

<table>
<thead>
<tr>
<th>Prior Experience</th>
<th>Detail</th>
<th>Manufacturing</th>
<th>Services</th>
<th>Trade</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Count</td>
<td>83</td>
<td>46</td>
<td>94</td>
<td>223</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>62.4%</td>
<td>33.6%</td>
<td>43.3%</td>
<td>45.8%</td>
</tr>
<tr>
<td>No</td>
<td>Count</td>
<td>50</td>
<td>91</td>
<td>123</td>
<td>264</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>37.6%</td>
<td>66.4%</td>
<td>56.7%</td>
<td>54.2%</td>
</tr>
<tr>
<td>Total</td>
<td>Count</td>
<td>133</td>
<td>137</td>
<td>217</td>
<td>487</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

A higher proportion of SME entrepreneurs in manufacturing had previous management experience with 62.4%, than those entrepreneurs in trade and services sectors with 43.3% and 33.6% respectively. This is for the reason that in manufacturing the need for previous experience in industry processes and
personnel organisation is more necessary as the manufacturing process is more structured and would involve losses if not efficiently managed.

Table 7-9: Respondent's Years of Management Experience by Sector

<table>
<thead>
<tr>
<th>Years</th>
<th>Detail</th>
<th>Manufacturing</th>
<th>Services</th>
<th>Trade</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to 5</td>
<td>Count</td>
<td>33</td>
<td>21</td>
<td>61</td>
<td>115</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>40.2%</td>
<td>45.7%</td>
<td>64.9%</td>
<td>51.8%</td>
</tr>
<tr>
<td>6 to 10</td>
<td>Count</td>
<td>35</td>
<td>23</td>
<td>29</td>
<td>87</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>42.7%</td>
<td>50.0%</td>
<td>30.9%</td>
<td>39.2%</td>
</tr>
<tr>
<td>11 to 15</td>
<td>Count</td>
<td>6</td>
<td>2</td>
<td>1</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>7.3%</td>
<td>4.3%</td>
<td>1.1%</td>
<td>4.1%</td>
</tr>
<tr>
<td>16 to 20</td>
<td>Count</td>
<td>6</td>
<td>0</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>7.3%</td>
<td>.0%</td>
<td>3.2%</td>
<td>4.1%</td>
</tr>
<tr>
<td>21 to 25</td>
<td>Count</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>2.4%</td>
<td>.0%</td>
<td>.0%</td>
<td>.9%</td>
</tr>
<tr>
<td>Total</td>
<td>Count</td>
<td>82</td>
<td>46</td>
<td>94</td>
<td>222</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Correspondingly, Table 7-9 shows the duration for which the respondents' who had prior management experience obtained the experience. Of the 223 respondents a little over 50% fall within the 'up to 5 years' range while about 39% had prior management experience ranging from 6 to 10 years.

7.4.5 Management Training

Table 7-10 illustrates that on the question of having obtained post start-up training on managing SMEs about 40% of the respondents indicate that they had participated in obtained some form of post start-up training on SME management. Conversely, 58.4% of the respondents indicate that they had not attended any training on management of SMEs.

Table 7-10: Owner-Manager's Business Management Training by Sector

<table>
<thead>
<tr>
<th>Management Training</th>
<th>Detail</th>
<th>Manufacturing</th>
<th>Services</th>
<th>Trade</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Count</td>
<td>68</td>
<td>52</td>
<td>24</td>
<td>144</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>66.0%</td>
<td>46.8%</td>
<td>18.2%</td>
<td>41.6%</td>
</tr>
<tr>
<td>No</td>
<td>Count</td>
<td>35</td>
<td>59</td>
<td>108</td>
<td>202</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>34.0%</td>
<td>53.2%</td>
<td>81.8%</td>
<td>58.4%</td>
</tr>
<tr>
<td>Total</td>
<td>Count</td>
<td>103</td>
<td>111</td>
<td>132</td>
<td>346</td>
</tr>
<tr>
<td></td>
<td>% within Industry</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>
7.5 SME Financing

In this section the descriptive results of the survey on financing of the firms at start-up and post start-up are discussed with a view to providing a general overview of the different factors in relation to debt financing of SMEs.

7.5.1 Start-Up Finance

Table 7-11 shows that 28.3% of the respondents indicate that they used only personal savings and finances to commence their business ventures. More than 71% of the respondents had used a mix of other sources of finance at start-up in some cases together with the personal savings.

<table>
<thead>
<tr>
<th>Use Personal Savings</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>141</td>
<td>28.3</td>
</tr>
<tr>
<td>No</td>
<td>358</td>
<td>71.7</td>
</tr>
<tr>
<td>Total</td>
<td>499</td>
<td>100</td>
</tr>
</tbody>
</table>

According to Nnanna (2001), out of the 1,498 SMEs surveyed in recent studies in Nigeria by the UNDP and FMI, 69% of the entrepreneurs surveyed relied on personal savings for the funding of their enterprises. This is higher than the 28.3% recorded in this study obtained because only the entrepreneur's own resources are classified as personal savings in this study. This classification excludes other sources available to the entrepreneur (such as loans from friends, family and relatives or moneylenders and cooperatives). Furthermore, this study attempted to know other types of financing used than personal savings by the entrepreneurs at start-up, the difficulties encountered in raising such financing and the types of collateral (if any) used for such financing.

Some of the respondents as earlier indicated used a mix of sources of financing at start-up. The mix, mostly, involved the use of personal finances in addition to the other external sources or sometimes a mix of different external sources of finance. Thus, of the 358 respondents who indicate having used other sources of finance at start-up, 44.69% had primarily used financing from friends and relatives at start-up. Furthermore, 29.33% respondents had obtained funding
from moneylenders and cooperative associations they belong to, while only 12.01% had actually obtained any funding from banks. This is an improvement over the findings of the study in Nigeria by UNDP and FMI where only 3.6% respondents obtained credit facilities from banks (Nnanna, 2001). Also only 3%, 3%, and 7% respondents indicate having obtained financing through hire purchase, venture capital and lease financing arrangements respectively.

Asked if they encountered any difficulties in raising external financing at start-up, 345 respondents that used external financing responded variously. While 29.3% of the respondents indicate not encountering any difficulties, 70.7% signify having experienced some level of difficulties.

Table 7-12: Difficulty in Obtaining Start-up Finance

<table>
<thead>
<tr>
<th>Difficulty Level</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extreme</td>
<td>139</td>
<td>40.3</td>
</tr>
<tr>
<td>Some</td>
<td>105</td>
<td>30.4</td>
</tr>
<tr>
<td>None</td>
<td>101</td>
<td>29.3</td>
</tr>
<tr>
<td>Total</td>
<td>345</td>
<td>100</td>
</tr>
</tbody>
</table>

Further analysis reveals that while 40.3% of the respondents experienced extreme difficulties in raising external finance at start-up, the difficulties encountered by 30.4% respondents were of lesser severity (Table 7-12). The difficulty encountered the most was that associated with lack of project or business feasibility studies as indicated by 48.36% respondents. A further 33.20% of respondents' difficulties were collateral related, while 12.29% and 10.24% respondents had problems with the amount of their personal financial input and previous experience in SME management respectively.

Figure 7.13 shows the type of collateral the respondents presented to the various providers of the external financing. The respondents indicate that in most cases third party guarantee was provided thus it accounted for 42.3% followed by real estate property collateral with 26.2% while the entrepreneur’s personal guarantee was third in significance with 19.2%.
7.5.2 Post Start-up External Finance for SMEs
The survey sought to find out those SMEs that had applied for external financing after having started-up the enterprise (Table 7-13). The respondents that had applied for external financing made up 69.4%. Conversely, 30.6% respondents indicate that they have not applied for external finance since starting up the business enterprise.

Table 7-13: Application for External Finance by the SMEs

<table>
<thead>
<tr>
<th></th>
<th>Applied</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>347</td>
<td>69.4</td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>153</td>
<td>30.6</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>500</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>
In Figure 7.14 bank overdrafts and short term loans represent the type of external financing that is most applied for with 44.96% of the respondents. Long and medium term loans followed next with 22.19% and 17% applications from SMEs. Lease finance had 10.37% of the SME applications while venture financing obtained the lowest requests with 5.48% of the respondents applying.

Table 7-14 reveals that out of the SMEs that applied for one type or another of external financing, only 41.2% were successful in obtaining approval for such financing, while a higher number of about 58% respondents were declined due to one reason or another.

<table>
<thead>
<tr>
<th>Application Status</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Successful</td>
<td>143</td>
<td>41.2</td>
</tr>
<tr>
<td>Declined</td>
<td>204</td>
<td>58.8</td>
</tr>
<tr>
<td>Total</td>
<td>347</td>
<td>100</td>
</tr>
</tbody>
</table>

The research proceeded to examine the status of those applications that were successful and then attempted to obtain reasons advanced to the SMEs by the financiers for those requests that were declined. In the first instance, the SMEs whose applications were successful received offers for the financing. However only 47.55% of the successful firms actually accepted and utilised the financing offers. It was found that about 52% of such firms rejected the offers made to them for the financing due to varying reasons. The first reason being the high cost of such funds due to interest charges, hence of those who rejected the offers 36% signified it was due to having problems with payment of interest on financing. Another 30.67% declined the offers because the financiers had imposed collateral requests that the entrepreneurs deemed difficult or impossible to provide. In the same vein, 12%, 10.67% and 9.33% of the respondents rejected the offers because they had problems with the duration of the financing offered, the inadequacy of the amount of financing offered and issues of sharing ownership/loss of control respectively.

The SMEs that were declined financing were asked to state what major reasons were advanced to them for the rejections. Up to 35.78% respondents were declined due to lack of business plans and/or viable feasibility studies. This was
followed by 28.92% and 19.61% respondents who totally lacked or had inadequate collateral and those with poor credit history or records respectively. Other reasons advanced were poor personal financial contribution by the entrepreneurs with 5.88% and high business risk with 4.9%, while poor or insufficient prior management experience and excessively hasty business expansion were reasons advanced to 2.45% of the respondents in each case. Conversely, the study explored the opinions of entrepreneurs on what they considered as the obstacles to SMEs access to finance. The major obstacles respondents signified were analysed with about 38% indicating that charging interest in financing is their major obstacle to accessing finance. A further 22.91% disclose that the collateral requirements of financiers posed the major obstacle. A further 15%, 13% and 11% indicate that lack of access to external equity financing, lease finance and long term loans respectively as the major obstacles faced by their SMEs in accessing financing.

Next the study measures the overall confidence level of respondents in the Nigerian financial system's ability to provide the required SME financing. Figure 7.15 shows a decline in confidence levels as 27.3% SMEs who felt that three years earlier the system was capable in that respect fell to 9% only. Equally the 25.3% SMEs that fairly agreed fell to 14.3% SMEs. Likewise, those SMEs that signified lack of confidence with the Nigerian financial system in meeting SME financing needs increased significantly. Within a 3 years period, SMEs that disagreed fully increased from 28.1% to 42.2%, while those that had fairly disagreed also rose to 28.9% from 15.3% SMEs.
7.6 SMIEIS Equity Fund

The SMIEIS venture capital fund, launched in August 2001 by the Nigerian government, is an equity participation fund derived from a 10% contribution by Nigerian banks from their profits before tax. In this section the research attempts to explore the characteristics of the fund and the survey results in relation to awareness, operation and performance rating by respondents.

7.1.3 Fund size

The total funds set aside by participating banks in the SMIEIS fund stood at ₦30.998 billion at the end of February 2005 as shown in Table 7-15.

Table 7-15: SMIEIS Fund Utilisation - February 2005

<table>
<thead>
<tr>
<th>Detail</th>
<th>Amount (₦'bn)</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total SMIEIS funds set aside</td>
<td>₦30.998 billion</td>
<td>100%</td>
</tr>
<tr>
<td>Less: Total funds invested</td>
<td>₦8.956 billion</td>
<td>28.89%</td>
</tr>
<tr>
<td>Un-invested funds</td>
<td>₦22.042 billion</td>
<td>71.11%</td>
</tr>
<tr>
<td>Less: Un-invested funds due for withdrawal</td>
<td>₦9.826 billion</td>
<td>31.70%</td>
</tr>
<tr>
<td>Funds awaiting investment</td>
<td>₦12.216 billion</td>
<td>39.41%</td>
</tr>
</tbody>
</table>

7.6.1 Amount Invested

At the end of February 2005, of the 89 banks in existence, only 58 banks made a total investment in some SMEs of 28.89% from the total amount set aside. A further 31.7% of the total funds set aside had exceeded the time allowed within which the banks could invest them in SMEs directly. The amount was therefore due for withdrawal by the CBN as a punitive measure to the defaulting banks. These withdrawn funds would then be channelled to the BOI for investment in SMEs, denying the banks any revenues from such funds.

Table 7-16: SMIEIS Investment by Sector

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>ENTERPRISE</th>
<th>INVESTMENT</th>
<th>PERCENT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Amount (₦'m)</td>
<td>Number</td>
</tr>
<tr>
<td>REAL</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agro-Allied</td>
<td>22</td>
<td>707</td>
<td>12.22</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>86</td>
<td>3,933</td>
<td>47.78</td>
</tr>
<tr>
<td>Construction</td>
<td>10</td>
<td>1,111</td>
<td>5.56</td>
</tr>
<tr>
<td>Solid Minerals</td>
<td>3</td>
<td>59</td>
<td>1.67</td>
</tr>
<tr>
<td>SUB-TOTAL</td>
<td>121</td>
<td>5,810</td>
<td>67.22</td>
</tr>
<tr>
<td>SERVICE RELATED</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IT &amp; Telecomms</td>
<td>14</td>
<td>1,105</td>
<td>7.78</td>
</tr>
<tr>
<td>Educ Estabs</td>
<td>4</td>
<td>134</td>
<td>2.22</td>
</tr>
<tr>
<td>Services</td>
<td>36</td>
<td>1,649</td>
<td>20.00</td>
</tr>
<tr>
<td>Tourism Leisure</td>
<td>5</td>
<td>258</td>
<td>2.78</td>
</tr>
<tr>
<td>SUB-TOTAL</td>
<td>59</td>
<td>3,146</td>
<td>32.78</td>
</tr>
<tr>
<td>GRAND TOTAL</td>
<td>180</td>
<td>8,956</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: CBN SMIEIS Fund Report February 2005

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This result also shows that some banks did not invest the funds for reasons and uncertainties similar to those discussed above in relation to debt financing. Also 39.41% was the outstanding balance due for investment which had not exceeded the allowed period for investments in the SMEs.

7.6.2 Number of Investments
The amounts invested were spread over 180 enterprises from the two main sectors of the Nigerian economy manufacturing and services sectors. Table 7-16 shows the real sector as having the higher investments of 67.22% (with manufacturing sector making up 47.78% of these investments) and the services related enterprises following with 32.78% investments.

7.6.3 Investments by Sector
The sectoral classification of SMEs used here has been further split into sub-sectors for a more detailed understanding of the coverage by the fund. The real sector of the economy received the highest investments both in terms of numbers of SMEs invested in and amount of investments with 67.22% and 64.87% respectively. The investments, as shown in Table 7-16, were further spread within four sub-sectors of the real sector with manufacturing enterprises recording the highest patronage with 47.78% in numbers of investments and 43.91% in invested funds. SMEs in the construction sub-sector followed next in value of investments with 12.41% invested in 5.56% of the enterprises. In investments quantity however, the agro-allied sub-sector recorded the second highest number of investments with 12.22% but was third in amount invested with 7.89%. The solid minerals sub-sector recorded the least investments both in numbers and value with 1.67% in number of investments and 0.66% in values of invested funds. Similarly, in the services related sector the equity fund investment values were spread between the SMEs in the Services, IT/Telecommunications, Tourism/Leisure and Educational Establishments sub-sectors with 18.41%, 12.33%, 2.88% and 1.5% respectively.

Therefore, in both quantity and value of investments in the SMEs, the real sector recorded equity funds investments that were about 2:1 in terms of ratio to those of the services related sector.
7.6.4 Awareness and Utilisation of the Scheme

The survey respondents were requested to indicate their awareness or otherwise of the existence of the SMIEIS fund, consequent upon which 85.3% entrepreneurs signified awareness of the scheme, while 14.7% reported being unaware of the scheme (Table 7-17). On further probing most of those who indicate being unaware of the scheme attribute that to lack of interest in bank financing due to constant rejections in the past.

Table 7-17: SMEs Awareness of SMIEIS Fund's Existence

<table>
<thead>
<tr>
<th>Aware</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>423</td>
<td>85.3</td>
</tr>
<tr>
<td>No</td>
<td>73</td>
<td>14.7</td>
</tr>
<tr>
<td>Total</td>
<td>496</td>
<td>100</td>
</tr>
</tbody>
</table>

Of the respondents who signified awareness 69.03% had already approached their various bankers for equity investments in their firms from the scheme. In addition, a further 29.79% who indicate awareness of the scheme had no interest in applying for the scheme’s investments in their firms mostly for fear of loss of control and possibility of rejection. Out of the 69.03% who applied only about 33% were successful in obtaining the desired patronage. While, about 67% of the SMEs that applied for the scheme’s investments failed to secure such investments from their bankers for varying reasons.

Table 7-18: Banks’ SMIEIS Equity Investment in SMEs

<table>
<thead>
<tr>
<th>Investment Range (%)</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to 10</td>
<td>4</td>
<td>4.4</td>
</tr>
<tr>
<td>11 to 20</td>
<td>27</td>
<td>29.7</td>
</tr>
<tr>
<td>21 to 30</td>
<td>33</td>
<td>36.3</td>
</tr>
<tr>
<td>31 to 40</td>
<td>16</td>
<td>17.6</td>
</tr>
<tr>
<td>41 to 50</td>
<td>11</td>
<td>12.1</td>
</tr>
<tr>
<td>Total</td>
<td>91</td>
<td>100</td>
</tr>
</tbody>
</table>

Table 7-18 reveals that about 66% of the banks took up between 11% and 30% equity share in the benefiting SMEs. Another 29.7% took up between 31% and 50% equity share but no bank obtained above 50% shareholding thus none obtained majority shareholding status in the SMEs.
The form in which the investment by the banks in the successful SMEs was supplied to them was next explored. Figure 7.16 depicts conversion of debt to equity as the form most used with 46.15% respondents indicating that already existing debts were converted by the banks to shareholding stakes in the firms. The actual introduction of new and additional funds as equity was achieved by 27.47% and 16.48% of the firms through the financing of their working capital requirements and physical cash investments respectively. The remaining 9.89% SMEs obtained their investments through the direct procurement of required equipments by the banks rather than through cash payment to the firms. This was attributed to the fear of the diversion of such funds to other uses than what was applied for by the respondents.

The reasons advanced by the bankers for declining the 67% of the applications were in most cases similar to those advanced by the bankers for declining post start-up financing applications by SMEs though with a few additions. Of the four major reasons advanced, the existence of poor credit history/records was most recurring with 36.90% respondents followed by 22.99% respondents whose businesses were adjudged too risky by the bankers. A further 17.11% and 11.23% of the respondents were turned down due to lack of business plans and poor management experience respectively.

7.6.5 SMIEIS Performance

The survey then sought the opinion of the 423 respondents who had awareness of the SMIEIS fund to assess if the performance of the scheme had been satisfactory on a three point scale of high, average or low satisfaction rating.
### Table 7-19: Assessment of SMIEIS Performance by Entrepreneurs

<table>
<thead>
<tr>
<th>Performance</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>58</td>
<td>14.5</td>
</tr>
<tr>
<td>Average</td>
<td>73</td>
<td>18.3</td>
</tr>
<tr>
<td>Low</td>
<td>268</td>
<td>67.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>399</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Only 14.5% respondents were highly satisfied with the equity scheme's performance, while 18.3% respondents report that the performance was only averagely satisfactory. A substantial 67.2% of the respondents scored the scheme as being below the level of satisfactory performance (Table 7-19). This is attributable to the respondents whose applications were declined and those who have fear of rejection so did not even apply.

### 7.7 Islamic Banking

In this section the study describes the results obtained in relation to Islamic finance awareness and the choice of the different modes of Islamic finance that respondents would utilise in financing their SMEs. In addition the awareness and use of the non-interest banking window services provided by HNB and the intention to set up a full-fledge Islamic bank in Nigeria known as Jaiz Bank are also discussed. This section also describes the respondents' opinions on the viability of Islamic financing as an option for SMEs and a comparison of the SMIEIS fund and musharakah Islamic finance mode.

### Table 7-20: Desire of Entrepreneurs to Use Islamic Finance in their SMEs

<table>
<thead>
<tr>
<th>Use Islamic Finance</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>212</td>
<td>72.9</td>
</tr>
<tr>
<td>No</td>
<td>79</td>
<td>27.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>291</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
The awareness of the existence of Islamic finance was signified by 59% of the respondents (Figure 7.17). It also shows about 37% of the respondents were, however, unaware of such type of financing while about 4% chose not to respond (because some of the non-Muslim participants were unaware of the financing type). In addition some of those who are aware indicate they were not interested in the type of financing as they associated it with a planned promotion of Islamic principles. Table 7-20 gives an indication that a majority almost 73% of respondents aware of Islamic finance desire to use it while about 27% indicate otherwise.

Figure 7.18 shows that from the 59% in Figure 7.17 who indicate awareness of Islamic finance about 73% signified their willingness to use different Islamic finance modes in financing their SMEs where available. The use of Musharakah mode of Islamic finance model topped the list with 93 respondents, with the Mudarabah mode of finance following with 48 respondents. For the Ijarah finance mode 33 respondents who were mostly SMEs that use heavy
equipments and vehicles, indicate their willingness to use the financing mode. 7 respondents were however willing to use all the available types of Islamic financing modes.

Habib Nigeria Bank (HNB) is the only bank in Nigeria that introduced a non-interest banking window in its services. Asked if they were aware of the existence of the non-interest banking services in HNB, about 65% of the respondents answered in the affirmative, while about 35% indicate their unawareness of the non-interest window. Of the about 65% respondents who know, 42.11% had utilised the non-interest banking services provided by the bank, with 52.94% of such respondents expressing their satisfaction with the services. Those who are aware of the services but have not used them accounted for 57.9% (a higher percentage than respondents who used the services). On further interviewing some of these respondents the research understood that some were not interested because they did not perceive any added advantage to them while others being non-Muslims felt the services have been aligned to Islamic principles and therefore of no interest to them. Furthermore some of the Muslims amongst them were divided along two issues. The first is the feeling that the appropriate foundation had not been laid for applying the funds deposited in ways that were consistent and in compliance with Islamic principles. The second is scepticism making respondents to wait and assess compliance of the services with the Islamic principles before deciding whether or not to get involved.

Table 7-21: SMEs' Awareness of JAIZ Bank Set-Up in Nigeria

<table>
<thead>
<tr>
<th>Aware</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>471</td>
<td>94.6</td>
</tr>
<tr>
<td>No</td>
<td>27</td>
<td>5.4</td>
</tr>
<tr>
<td>Total</td>
<td>498</td>
<td>100</td>
</tr>
</tbody>
</table>

Through an initial public offer (IPO) the shares of Jaiz bank were traded on the Nigerian stock exchange. Thus the survey explored respondents' awareness of the move to set up an Islamic bank (Jaiz bank) to which about 95% of the respondents confirmed awareness (Table 7-21). This is attributable to the wide publicity and interest the issue raised in the media, banking sector and the capital market. Only 5.4% of the respondents had no knowledge of the move.
Of the 94.6% respondents that indicate a awareness of the move to set up Jaiz bank, about 43% signified willingness to move all their banking business to the Islamic bank. In addition, about 20% also indicate they would move some part of their banking business to the Islamic bank when it commenced business. Nonetheless, about 34% responded that they would not move their banking business to the Islamic bank due to reasons as already stated regarding interest and perception of promoting Islamic principles.

Table 7-22: Perception of Islamic Finance Viability for SMEs

<table>
<thead>
<tr>
<th>Islamic Finance Viable</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>224</td>
<td>77.8</td>
</tr>
<tr>
<td>No</td>
<td>64</td>
<td>22.2</td>
</tr>
<tr>
<td>Total</td>
<td>288</td>
<td>100</td>
</tr>
</tbody>
</table>

Furthermore, when the 59% respondents who acknowledged awareness of Islamic finance were asked if they perceived Islamic financing as a viable option for financing SMEs, of the 288 that answered, about 78% responded positively while about 22% indicate the opposite (Table 7-22).

The similarity of the SMIEIS fund and musharakah Islamic finance mode was next surveyed. Respondents who do not know and those who are uncertain about the existence of similarities between the two types of financing account for 41% and 5.18% respectively as shown in Figure 7.19. However, 38.05% SMEs either fully or fairly agreed that similarities do exist between the two, whereas 15.74% also either fully or fairly disagreed with the notion that there exist similarities between the two types of financing.

Figure 7-19: SMIEIS Fund and Musharakah Finance Mode Similar (%)
Naser, Jamal and Al-Khatib (1999) in a customer satisfaction and preferences study in Jordan Islamic banks find that a vast majority of respondents were satisfied with most aspects of the Islamic bank's products and services. The Islamic bank thus had competitive advantage in terms of enjoying customer confidence. For example, in general, satisfied customers are likely to engage in repeat patronage and reflect strong loyalty towards the Islamic bank. Also they are most likely to engage in personally selling the bank to their relatives, friends and business associates.

7.8 Summary
An overall usable response rate of 51.22% was achieved with a regional response rate of 50.4% and 52.04% in the northern and southern regions respectively. Sectoral response rate obtained were 44.82%, 28.29% and 26.89% for the trade, services and manufacturing sectors respectively.

SMEs in the survey had a mean age of 13 years with small-sized firms accounting for 62.9% and medium-sized firms for the remaining 37.1% of the respondents. Also 52.4% of the SMEs are limited liability companies while the rest were accounted for by 24.1% and 23.5% ownership held by partnerships and sole proprietorships respectively.

Respondents' status results indicate that 65.3% combine ownership and manager roles in their SMEs while 12.7% are owners only. In addition, 21.9% are salaried managers with manufacturing sector recording the highest in this category with 38.5%. Respondents mean age is 44 years and the age range of between 21 to 30 years accounting for the highest respondents with 28.3%. About 90% respondents have had some level of education with those that have a secondary level education being the highest with 28.3%. In addition, 45.8% have had prior experience in SMEs with those who have had experience for 'up to 5 years' recording 51.8% respondents as the highest. While about 40% of the respondents have also participated in training sessions after starting their firms for the acquisition of managerial skills.

Most SMEs surveyed used a mix of different financing sources, such as bank loans, venture capital, lease finance and loans from friends, relatives, moneylenders and cooperatives, at start-up with the exception of 28.3% which used only the personal savings of the owners. Post start-up application for
external finance was resorted to by 69.4% of the respondents with up to 44.96% having been sought from banks. Declined applications accounted for about 58% of the respondents. While amongst the about 42% that were approved about 52% rejected the offers due in most cases to interest charges and stringent collateral requirements.

From the total SMIEIS equity fund set aside by February 2005 only 28.89% had been invested with the real sector accounting for 67.22% while the services related sectors obtained 32.78% of the investments. About 85% of the respondents signify familiarity with the scheme with about 33% of the respondents that applied for the scheme signifying they were successful. About two-thirds of the respondents however indicate below average satisfaction with the performance of the scheme.

Familiarity of Islamic finance was reported by 59% of the respondents, with about 73% of that group indicating willingness to use this type of finance in their SMEs if available. Also 94.6% signify their awareness of the effort to set up an Islamic bank in Nigeria, with about 63% indicating their willingness to move some or all their banking business to the bank when it commences business.
CHAPTER EIGHT

STATISTICAL DATA ANALYSIS
8 STATISTICAL DATA ANALYSIS

8.1 Introduction
Having carried out the descriptive analysis of the survey data in the preceding chapter further statistical analysis is undertaken in this chapter to test the research hypotheses outlined in chapter two. Statistics tests for relationships between variables using correlation and regression analysis. Tests are run to explore association between two variables by establishing how they co-vary. For instance, if values in the dependent variables correspond to higher or lower values on some independent variable or how the independent variables enable the explanation of a dependent variable (Morgan et al 2004).

The study explores the existence of linkages between the factors that impede access to debt finance by SMEs and the performance of the recently introduced SMIEIS fund in Nigeria in this chapter. This is so as to obtain a detailed understanding of the behaviour of Nigerian SMEs and their owner-managers on use of external finance. Additionally, an attempt is also made to ascertain whether or not the same factors that influence access to external debt financing have or will have the same effect on access to the SMIEIS fund.

8.2 Exploring Association - Hypotheses Testing
The set of hypotheses that follow are tested for association between the dependent variables and each individual independent variable of interest using the spearman’s correlation analysis. In addition, the hypotheses in this section will be tested within the null hypothesis that no relationship exists between the variables of interest.

This phase of the analysis is undertaken taking into consideration that parametric testing methods are based on the assumption that the data are samples from a population with a normal distribution and that the assumptions upon which the parametric analysis are based are not markedly violated. Due to the suspicion of extreme values in the sample, the nonparametric method of testing is employed using the spearman’s correlation coefficient. Spearman’s Rho assumes that the variables under consideration are measured on an ordinal (rank order) scale, that is, that the individual observations can be ranked into two or more ordered series. Spearman’s correlation is viewed as the regular
Pearson product moment correlation coefficient, that is, in terms of proportion of variability accounted for, except that Spearman's Rho is computed from ranks (Siegel & Castellan, 1988).

8.2.1 Application for Debt Finance

For any firm to continue its normal operations and indeed expand in future it needs to finance its planned investments. The choice of financing for firms in developed countries has been shown to follow a "pecking order" (Myers, 1984) where the first choice is internal sources of funds (e.g. retained earnings), then external sources using additional debt or equity from both private and public markets (Batten & Hettihewa, 1999 p.206). There is a consensus that small growing firms usually face liquidity problems (Wilson, et al. 1996, p.3) with 70% of small businesses indicating that banks give them insufficient support (Deakins et al, 2001). In this study about 59% SMEs indicate banks rejected their applications for debt financing while about 71% express a lack of confidence in the banking and financial system to satisfy their finance needs.

Furthermore, external equity (e.g. venture capital) is generally available to a minority of small firms that show prospects of outstanding capital growth. Whereas low capital growth small firms represent too great a risk for too little return hence fail to attract equity funds from the general public. As a result these firms resort to sourcing of debt finance to fund their operations and/or expansion, through credit from financial intermediaries, particularly the commercial banks (Berger and Udell, 1995). Also, SMEs may prefer debt to equity when seeking external funding because local banking institutions continue to represent the most readily-accessible source of outside capital for small businesses both at start-up and expansion (Larry 1992). In addition, small firms are much more familiar with banks and other sources of debt finance having a wide variety of debt products (Forsaith and McMahon, 2002 p.2). Consequently, Barkham et al (1996) conclude that debt finance is the most easily accessible source of long term funds for the growing small firm. The Barclays Review (1997) supports this claim, demonstrating that banks supported 72% of all start-up businesses while family and friends remained an important secondary source of finance.
This study therefore proceeds to answer the research question as to whether or not there is a relationship between the decision to apply for debt finance and Firm, Entrepreneur or Financing Characteristics. Table 8-1 below gives the results of the tests for association between application for external debt finance and some firm, owner-manager and financing characteristic variables.

Table 8-1: Debt Finance Spearman's Correlations

<table>
<thead>
<tr>
<th>Variable Name</th>
<th>Description</th>
<th>Applied for Debt Finance</th>
<th>Correlation Coefficient (r)</th>
<th>Sig. (2-tailed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FAG</td>
<td>Firm Age</td>
<td></td>
<td>-.063</td>
<td>.158</td>
</tr>
<tr>
<td>FLF</td>
<td>Legal Form</td>
<td></td>
<td>-.122**</td>
<td>.007</td>
</tr>
<tr>
<td>FSZE</td>
<td>Size (Staff)</td>
<td></td>
<td>-.153**</td>
<td>.001</td>
</tr>
<tr>
<td>FSZA</td>
<td>Size (Total Assets)</td>
<td></td>
<td>.028</td>
<td>.535</td>
</tr>
<tr>
<td>FIS</td>
<td>Industry Sector</td>
<td></td>
<td>.177**</td>
<td>.000</td>
</tr>
<tr>
<td>FBP</td>
<td>Business Plan</td>
<td></td>
<td>.096*</td>
<td>.034</td>
</tr>
<tr>
<td>ESTAT</td>
<td>Status</td>
<td></td>
<td>.117**</td>
<td>.009</td>
</tr>
<tr>
<td>EAG</td>
<td>Entrepreneur's Age</td>
<td></td>
<td>.042</td>
<td>.351</td>
</tr>
<tr>
<td>EHE</td>
<td>Highest Education</td>
<td></td>
<td>-.035</td>
<td>.440</td>
</tr>
<tr>
<td>EME</td>
<td>Previous Experience</td>
<td></td>
<td>.157**</td>
<td>.001</td>
</tr>
<tr>
<td>EYE</td>
<td>Years of Experience</td>
<td></td>
<td>-.197**</td>
<td>.003</td>
</tr>
<tr>
<td>EMT</td>
<td>Management Training</td>
<td></td>
<td>.137*</td>
<td>.011</td>
</tr>
<tr>
<td>CNFS1</td>
<td>Confidence in Nigerian Financial System</td>
<td></td>
<td>.184**</td>
<td>.000</td>
</tr>
<tr>
<td>COLREQ</td>
<td>Collateral requirements of banks</td>
<td></td>
<td>-.020</td>
<td>.668</td>
</tr>
<tr>
<td>UINTF</td>
<td>Use of Interest in financing</td>
<td></td>
<td>-.115**</td>
<td>.010</td>
</tr>
<tr>
<td>LALF</td>
<td>Lack of access to lease finance</td>
<td></td>
<td>.105*</td>
<td>.025</td>
</tr>
<tr>
<td>LAEE</td>
<td>Lack of external equity/Partners</td>
<td></td>
<td>.101*</td>
<td>.025</td>
</tr>
<tr>
<td>UIF</td>
<td>Use of Islamic Equity Finance</td>
<td></td>
<td>-.155**</td>
<td>.008</td>
</tr>
<tr>
<td>UHNS</td>
<td>Use of HNB Non-interest Window</td>
<td></td>
<td>-.161**</td>
<td>.004</td>
</tr>
<tr>
<td>REG</td>
<td>North-South Region</td>
<td></td>
<td>-.348**</td>
<td>.000</td>
</tr>
<tr>
<td>AWHNW</td>
<td>Aware of Habib bank Non-Interest Window</td>
<td></td>
<td>-.130**</td>
<td>.004</td>
</tr>
<tr>
<td>MBRJ</td>
<td>Move banking business to Jaiz bank</td>
<td></td>
<td>-.270**</td>
<td>.000</td>
</tr>
<tr>
<td>IFVIAB</td>
<td>Islamic finance viable option for SME finance</td>
<td></td>
<td>-.125*</td>
<td>.034</td>
</tr>
</tbody>
</table>

** Correlation is significant at the .01 level (2-tailed).
* Correlation is significant at the .05 level (2-tailed).

The firm characteristics tested are firm size, age, legal form and use of business plan, while the entrepreneur characteristics involved are highest education and management training. Also the relationship between the decision to apply for debt finance and the awareness of other alternative sources of equity finance are tested. Variables highlighted boldly in the table give significant correlations to the dependent variable ADF.

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8.2.1.1 Firm Size

Hypothesis 1.1: There is a relationship between the decision to apply for debt finance and the size of the SMEs.

Some studies indicate that whilst bank finance is the most important source of external finance for the small firm, many such firms, particularly start-ups, often are reluctant to borrow from the banks. For example, Cressy (1993), in a U.K. small firm study, shows that only about a third borrow at start-up and this proportion rose to about a half in three years. Similarly, using U.K. data, Binks et al., (1992b) reveal that, even amongst the mature small firms, only 33% borrow on overdraft. Thus it is expected that in the early stages of a small firm at least, owner equity plays a major role in business operations.

In this case two variables FSZE and FSZA that are employed in determining the size of a firm are used in testing for association between the FSZ and ADF using the spearman’s correlation analysis. In the first instance, the null hypothesis is not rejected which indicates that there is no relationship between ADF and FSZA because Table 8-1 indicates a p-value of 0.535 and a correlation = .028. This may be linked to the opinion expressed by some of the respondents that, in the Nigerian SME sector, the need for debt finance is not dictated by a firm’s assets value. Thus the assets base of a firm does not rule out or diminish its need for finance, as SMEs require finance for different purposes ranging from expansion to meeting operational needs.

However, in the second instance the test found a significant but low negative correlation (r = -.153; p = .001) to exist between ADF and FSZE (Table 8-1). Thus the result indicates that the smaller an SME is, the more likely it is to seek debt finance. Conversely, the result then suggests that the larger a firm’s size is, the less likely it is to apply for debt finance. This is attributable to the fact that the smaller the firm’s size (employees), the lower its overheads and running costs which are more likely to be met through the use of internal finance but it lacks assets it can use to support finance application for expansion plans. Furthermore, Binks et al. (1992a) explain that such small firms may not seek external finance as they lack sufficient assets that can serve as collateral and may encounter difficulties because of insufficient track records.
8.2.1.2 Firm Age

Hypothesis 1.2: There is a relationship between the decision to apply for debt finance and the age of the SMEs.

Investigating the relationship between firm age and the use of financing from external sources, most studies established that younger firms which are characterised by short track records, apparently access and use less bank and institutional finance than older and more established firms which have better track records and information to support financing applications to finance providers (Oakey 1984, Kee & Sing 1986, Peterson & Schulman 1987, Hajjar 1989, University of Cambridge 1992).

A significant 75% of the SMEs in this study are in the age group '≤ 15 years' which are also small in size thereby limiting the capacity of such firms to own substantial assets for use as collateral. Consequently the study proceeded to test the association between ADF and FAG through the application of Spearman correlation analysis. The results in Table 8-1 show that $r = -0.063$; and $p = 0.158$ thus there is no grounds to reject the null hypotheses indicating there is no significant correlation between the two variables. This can be attributed to the young age of the firms serving as an impediment which makes the SME's reluctant to approach external sources of finance at that stage. This is to avoid the possibility of rejection as the SMEs lack sufficient collateral and have limited availability of track records to back up the request for such financing at their early stages. Additionally, it is inferred that when companies are young, they tend to have access to less debt finance as a result of supply-side problems. Since banks have no confidence in young firms that are relatively new in the market as they are required to establish credibility as customers just like the older firms established their credibility in the market.

8.2.1.3 SME Legal Form

Hypothesis 1.3: There is a relationship between the decision to apply for debt finance and the legal form of an SME.

Some previous studies in both developed and developing countries indicate that incorporated firms are more likely to succeed in accessing external finance (Freedman and Godwin 1992). Similarly, Storey (1994) signifies that private limited companies are more likely to rely on bank finance. Though, Udechukwu, (2003) notes that most Nigerian SMEs register as limited liability companies.
though their true ownership structure is either sole proprietorship or partnership. Thus in reality, one of the most widespread and universal features of SMEs is that they are either sole proprietorships or partnerships.

Here the study tests if ADF has a relationship with FLF (i.e. sole proprietorship, partnership, or Limited Liability Company). Thus applying spearman’s correlation test, the study finds that there is a negative correlation between the variables with a significance level \( p = 0.007 \) and correlation \( r = -.122 \) (Table 8-1) hence the null hypothesis is rejected.

### 8.2.1.4 Written Business Plan

**Hypothesis 1.4:** There is a relationship between the decision to apply for debt finance and using a written business plan.

The use of a business plan enables a business venture to plan ahead and identify the cash flow position of the business, which normally reveals periods of surpluses and deficits. This then provides the owner-manager with the prior knowledge of the need for finance, which if not readily available from internal sources may have to be sourced from external financiers.

Schuman et al, (1985) argue that the business plan acts as a guide for the firm in its endeavour to organise and control its daily activities and operations. Read (1998) identifies the usefulness and efficacy of the business plan in offering the owner-managers of SMEs the opportunity to demonstrate skill, experience and expertise. Consequently Berry et al, (1993) and Carty (1994) conclude that applications for loans that are not accompanied by suitably detailed and comprehensive business plans are usually not considered by lenders. Thus the business plan is seen by the lenders as a tool that can be applied in determining the ability and prospect of the applicant SMEs repaying any amounts that would be advanced to them by the lenders.

From the analysis the null hypotheses is rejected as the test for a relationship between ADF and FBP shows that \( r = .096, \ p = .034 \) (Table 8-1) which indicate significant positive correlation between the variables. This implies that those SMEs that use business plans are more likely to seek external finance because the plans reveal the need, while those firms that do not use plans are less likely to immediately realise and articulate their external funding requirements.
8.2.1.5 Highest Education and Management Training

**Hypothesis 1.5:** There is a relationship between the decision to apply for debt finance and owner-manager's education and training.

The relationship between education and entrepreneurship is a complex one. Storey (1982) argues that academic qualifications are a necessary, but not sufficient, condition for entrepreneurial success. Gibb and Ritchie, (1982) also argue that the owner-manager's ability to learn and respond to new experiences is critical to the success of the fledgling business. Furthermore, because the majority of entrepreneurs do not have financial training, they encounter difficulties in sourcing external finance as they are unable to forecast their financial requirements in detail and with any accuracy. It is therefore expected that the more highly educated an entrepreneur is, the more likely he is to apply for external finance as he is better placed to ascertain the needs of his enterprise.

More recent studies cite the association between access to capital and managerial competencies. For example, Equinox (2001) emphasizes that the primary reason given by lenders for default of loans is the poor management skills of borrowers. At this point therefore, this study investigates if a relationship exists between ADF on the one hand and either EHE or EMT on the other. Table 8-1 shows that the significance level $p = 0.440$ for the ADF and EHE variables does not give sufficient grounds to reject the null hypothesis. However in the case of the existence of an association between ADF and EMT the results indicate a positive correlation of $r = 0.137$, at $p = 0.011$ significance. Hence the null hypothesis is rejected in favour of the research hypothesis.

8.2.2 Application for Equity Finance

The Cruickshank Commission (2000) finds that there is a market failure in the provision of small-scale equity finance to SMEs with high potential. The result of this market failure is evident in: (i) insufficient small-scale risk capital being available to SMEs (in particular to high-growth potential SMEs); and (ii) illiquid equity markets for small firms. Similarly, Forsaith and McMahon, (2002 p.3) suggest that internal equity, through capital contributions and retained earnings, is a major, but usually inadequate, source of funding for growing SMEs. This reason compels such SMEs to seek out external finance sometimes resorting to
external equity. Nonetheless, external equity is relegated to a minor role as non-growth SMEs steer clear of it and growth SMEs, which comprise a small minority, may be unable to attract as much external equity as they might want.

Much of the historical discussion on the provision of equity to small firms has assumed that the problem of deficiency is on the supply side. It is thus assumed that providers of finance do not offer enough funds to small businesses that need them. However, from small business research literature it is indicative, that the vast majority of small firms in many European countries have closely-held share ownership (Cosh and Hughes, 1994). Small firms protect their independence and do not like bank interference in their activities, particularly disliking any form of equity stake (Bolton, 1971). Thus it is often assumed that at least part of the 'problem' may be that smaller firms are less likely to want external equity partners, so presenting a demand 'problem' rather than a supply one.

The strong desire for control by most SME owners makes the preference for internal finance and the aversion to external equity finance in particular that much stronger for SME financing decisions than for larger enterprises (Holmes and Kent, 1991). This led Cressy, (1995) to suggest that smaller firms (especially family-owned businesses) will be more control-averse (less open to outside equity involvement) than large firms, particularly typical start-up firms. For example, Cressy (1993) found that less than 1% of start-ups had Venture Capital input. Furthermore, a 1999 white paper on Japanese SMEs (referred to as Chusho Kigyo Hakusho) revealed that only about 11% of SME owners were favourably disposed to using equity capital by eventually going public. Thus entrepreneurs usually see equity partners as their last resort. Probably the best explanation for the existence of financial constraints could be lack of resource supply or the demand obstacles owing to a reluctance to dilute equity ownership coupled with other firm and entrepreneur characteristics.

Consequently, some variables are used to explore the existence of associations between the application for equity finance and Firm, Entrepreneur or Financing Characteristics. The firm characteristics tested are FAG, FLF and FBP, while the entrepreneur characteristics tested are EAG, EHE, EMT and EME. Also the
relationship between application for debt finance and the awareness of sources of equity finance is tested using the variables AWIF and AWHNW. The results of the tests for association are given in Table 8-2 below.

Table 8-2: Equity Finance Spearman's Correlations

<table>
<thead>
<tr>
<th>Variable Name</th>
<th>Description</th>
<th>Applied for Equity Finance</th>
<th>Correlation Coefficient (r)</th>
<th>Sig. (2-tailed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FAG</td>
<td>Firm Age</td>
<td></td>
<td>-.073</td>
<td>.137</td>
</tr>
<tr>
<td>FLF</td>
<td>Legal Form</td>
<td></td>
<td>-.045</td>
<td>.362</td>
</tr>
<tr>
<td>FSZE</td>
<td>Size (Staff)</td>
<td></td>
<td>-.082</td>
<td>.097</td>
</tr>
<tr>
<td>FSZA</td>
<td>Size (Total Assets)</td>
<td></td>
<td>-.064</td>
<td>.196</td>
</tr>
<tr>
<td>FBP</td>
<td>Business Plan</td>
<td></td>
<td>.037</td>
<td>.465</td>
</tr>
<tr>
<td>ESTAT</td>
<td>Owner-Manager Status</td>
<td></td>
<td>.112*</td>
<td>.022</td>
</tr>
<tr>
<td>EAG</td>
<td>Entrepreneur's Age</td>
<td></td>
<td>-.004</td>
<td>.930</td>
</tr>
<tr>
<td>EHE</td>
<td>Highest Education</td>
<td></td>
<td>.027</td>
<td>.583</td>
</tr>
<tr>
<td>EME</td>
<td>Previous Experience</td>
<td></td>
<td>.025</td>
<td>.618</td>
</tr>
<tr>
<td>EMT</td>
<td>Management Training</td>
<td></td>
<td>.157**</td>
<td>.007</td>
</tr>
<tr>
<td>DADF</td>
<td>Decision to Accept Approved Debt Finance</td>
<td></td>
<td>.241**</td>
<td>.007</td>
</tr>
<tr>
<td>RCOL</td>
<td>Collateral Requirement</td>
<td></td>
<td>.520**</td>
<td>.003</td>
</tr>
<tr>
<td>RTEN</td>
<td>Tenor inadequacy of finance</td>
<td></td>
<td>-.283</td>
<td>.349</td>
</tr>
<tr>
<td>RINT</td>
<td>Interest Charges</td>
<td></td>
<td>-.105</td>
<td>.538</td>
</tr>
<tr>
<td>ROSH</td>
<td>Ownership/Equity sharing</td>
<td></td>
<td>.102</td>
<td>.779</td>
</tr>
<tr>
<td>AWIF</td>
<td>Aware of Islamic Finance</td>
<td></td>
<td>-.032</td>
<td>.521</td>
</tr>
<tr>
<td>AWHNW</td>
<td>Aware of Habib Non-Interest Window</td>
<td></td>
<td>-.022</td>
<td>.654</td>
</tr>
</tbody>
</table>

** Correlation is significant at the .01 level (2-tailed).
* Correlation is significant at the .05 level (2-tailed).

8.2.2.1 Firm Age

**Hypothesis 2.1**: There is a relationship between the decision to apply for equity finance and the age of the SMEs.

Pecking order theory provides support for a relationship between firm age and capital structure (Myers 1984). Older firms have had more opportunity to accumulate retained earnings than younger companies and thus have more funds available to finance operational growth. Pecking order theory suggests that those funds will be used before external capital sources are tapped (Hall, Hutchinson, and Michaelas 2000).

Romano, Tanewski, and Smyrnios (2001) in their study of Australian family run small businesses indicate that firm age had a significant effect on the owners' financing decisions. In line with this finding this study tests hypothesis 2.1 and
finds no significant correlation between the variables with \( r = -0.073, p = 0.137 \) thus the null hypothesis is not rejected on these grounds.

8.2.2.2 Legal Form

**Hypothesis 2.2:** There is a relationship between the decision to apply for equity finance and the legal form of the SMEs.

Van Auken and Neeley (1998) argue that the ability of the firm to raise capital would be affected by the owner's financial objectives and type of firm. Thus Binks et al. (1986) argue that incorporated firms are more likely to succeed in accessing external equity markets than unincorporated firms. This is however not confirmed by the finding of this study which indicates \( r = -0.045 \) and \( p = 0.362 \) in a test for a relationship between AEF and FLF. Thus the null hypothesis is not rejected in this case as there is no significant correlation between the firm's decision to apply for equity finance and its legal ownership form.

8.2.2.3 Business Plan

**Hypothesis 2.3:** There is a relationship between the decision to apply for equity finance and the use of business plan.

Kudla, (1980) suggests that some writers indicate that there is an association between planning and SME growth and performance. While others conclude that the existence of a business plan is the most important step in the launching of a new concern (Knight and Knight, 1993). Though some of the writers argue that this is a positive relationship (Bamberger, 1983), it does not seem always to be the case as the relationship can be complex. More so O'Neil et al., (1987) maintain that planning does not improve performance in all environments. As one main reason SMEs seek additional or new finance is to fund expansion in high growth firms, the study tests for the existence or otherwise of a relationship between AEF and FBP. Table 8-2 indicates that \( r = 0.037, p = 0.465 \) which indicates no significant correlation between the variables is obtained thus the null hypothesis is confirmed meaning it is not rejected.

8.2.2.4 Owner-Manager's Status

**Hypothesis 2.4:** There is a relationship between the decision to apply for equity finance and the owner-manager's status.

The respondents of the study are categorised into owners, salaried managers or those who combine the role of both owner and manager. It is expected therefore that these categories will have different dispositions to additional equity in the
firms. Also the decision on applying for external equity finance will be dictated by the status of the respondent with the salaried manager not expected to have the power to decide on that. Thus the study, as shown in Table 8-2 found the existence of significant positive correlation between AEF and ESTAT with $r = .112$ and $p = .022$ so the null hypothesis is rejected.

8.2.2.5 Entrepreneur's Age

Hypothesis 2.5: There is a relationship between the decision to apply for equity finance and the age of the entrepreneurs.

Though some arguments suggest that the owner-manager's age is positively correlated to the survival of the enterprise, Hustede and Pulver (1992) signify that the age of the entrepreneur and success in obtaining finance are negatively related. Similarly, Cressy (1993) found that in comparison to the middle-age group of entrepreneurs, both the younger-aged and the older-aged groups are more likely to face difficulties in obtaining external finance. This is attributable to the perception that middle-aged entrepreneurs are more likely to have acquired some assets thereby accruing more collateral than their younger counterparts who are start-up entrepreneurs. Similarly though the older and middle-aged groups of entrepreneurs are both envisaged by financiers to have acquired some assets and useful business experience, they see the middle-aged group of entrepreneurs as still having some more useful time, than their older counterparts, to put such experience and assets into viable use.

The result in Table 8-2 of the test for association between the age of the entrepreneur and application for equity finance in the Nigerian SME sector did not indicate the existence of any significant correlation ($r = -.004$ $p = .930$). This corresponds with the result obtained in a similar study on SMEs in Oman (Al-Kharusi 2004) in which no association was found between the variables.

The result therefore indicates that no single owner-manager age group has an edge over another in seeking equity finance; thus entrepreneurs exhibit the same tendency to apply for equity finance (irrespective of age differences). The poor state of the Nigerian economy is the reason why most entrepreneurs' decisions relating to equity finance would not be associated with their ages.
Since there is no guarantee that having been in business for long the middle or older-age groups would have actually acquired any reasonable assets.

8.2.2.6 Education and Training

Hypothesis 2.6: There is a relationship between the decision to apply for equity finance and the entrepreneur's education and training.

Pickles and O'Farrell (1987) maintain that education beyond the secondary level may reduce the likelihood of an individual establishing a business as more employment opportunities are available for those with higher education. They also present empirical evidence which suggests that manufacturing firms attract more highly educated entrepreneurs because they claim that running a manufacturing company is more demanding than, for example, a retail store.

Thus, it is expected that management competencies, which are significantly enhanced by both education and management training, impact on the entrepreneur's ability to secure capital. For example, in a UK-based study of early stage equity finance, Mason and Harrison (2001) found no shortage of available capital. Nonetheless, among the 74 British business angels surveyed, 81% indicate that their ability to invest was limited by the quality of the opportunities they see. The two primary deficiencies were unrealistic assumptions or information that is not credible and the lack of credibility by the entrepreneur or management team.

This study finds that the association between the variables AEF and EHE shows $r = .027$, $p = .583$ establishing that no significant relationship exists in the variables hence the null hypothesis is not rejected. Conversely a significant positive correlation is found to exist between AEF and EMT with $r = .157$, and $p = .007$ establishing the existence of an association in the variables. Thus in this case the null hypothesis is rejected. The findings imply that the level of a respondent's education is not significant in determining the decision to apply for equity finance but obtaining management training is significant. Training enhances management skills thereby exposing the entrepreneur to a better understanding of financing options and their advantages to the firm.
8.2.2.7 Respondents’ Management Experience

Hypothesis 2.7: There is a relationship between the decision to apply for equity finance and the entrepreneur’s previous experience.

Two of the most serious problems SMEs face when trying to implement quality management are the owner/manager’s lack of business experience and knowledge, and a shortage of financial and human resources (Haskever, 1996). For any new or growing business funding is required some of which may have to be sought from outside the resources of the venture and its owners. However obtaining such financing is often contingent on the entrepreneur’s ability to convince the financiers that he has the requisite skills and management experience. It is argued that when potential lenders review and appraise requests for financing from proposed and/or new start-up firms, they seek to establish a linkage between the entrepreneur’s past experience and the skills desired to establish and manage such a venture. Thus it is argued that lenders attach a great deal of importance on the availability of such skills and experience in their lending considerations (Berry et al, 1993).

Hence, on-the-job training is considered to be important to entrepreneurs prior to setting up their own ventures because they would learn the rudiments of running a business or observing the processes involved. This is expected to enable them acquire the relevant skills and knowledge that will assist them in setting up their ventures. Fong (1990) supports this position with his findings that 46% of owner-managers surveyed were previously employed in the same or similar firms while only 6% started their ventures without any prior experience (i.e. immediately after graduation). Also contributing, Hustede and Pulver (1992) contend that the greater the inexperience of individuals, the less likely they are to acquire external finance.

The result of this test confirms that no significant association, between the AEF and EME variables, exists as evidenced by a correlation (r) of = .025 and significance (p) of = .618 (Table 8-2).
8.2.2.8 Debt Financing

Hypothesis 2.8: There is a relationship between the decision to apply for equity finance and debt financing applied for.

The study tests for an association between the decision to apply for equity finance and the entrepreneur's decision to accept the debt finance approved for the applicants. This is with a view to establish if the conditions of the debt finance indeed play a significant role in the decision to accept or reject the debt finance and thereby influence the decision to apply for the alternative equity finance. The study finds that there exists a significant positive correlation between the AEF and DADF variables with \( r = .241 \) and \( p = .007 \) thus the null hypothesis is rejected. Furthermore a positively significant correlation is established by the study in the relationship between AEF and RCOL with \( r = .520 \) and \( p = .003 \) as shown by the results in Table 8-2. Here also the null hypothesis is rejected because the decision to apply for external equity finance is found to be positively influenced by the entrepreneur's decision to reject the offered debt finance based on collateral requirements of the lenders/investors.

8.2.2.9 Other External Financing Options

Hypothesis 2.9: There is a relationship between the decision to apply for equity finance and the entrepreneur's awareness of other sources of equity finance.

The CBA (1998) reports that most entrepreneurs preferred not to seek equity capital for fear of the loss of control and that a majority of Canadian small business owners are unaware of sources of equity capital. This results in what Holmes and Kent (1991) referred to as a "knowledge gap" resulting from the lack of information about alternative financing sources. While, an entrepreneur's reluctance for external equity capital is thought to be an obvious characteristic of family businesses (Dunn & Hughes, 1995; Gallo & Vilaseca, 1996; Poutziouris, 2001) because it requires a dilution of the family control (Ang, James, & Floyd, 1995).

The decision to seek external equity finance in relation to the awareness of other alternative sources of such finance was next explored using the spearman's correlation analysis. The results show no significant association to exist between AEF and the awareness of the existence of other sources of finance such as the Islamic finance \( (r = -.032, p = 0.521) \) and Habib Bank's Non-Interest banking
window \((r = -.022, p = 0.654)\). This outcome only tests for the relation between the AEF and AWIF or AWHNW with the results that the null hypotheses are confirmed in both tests as there are no grounds to reject them. These do not however test for the benefit of these other sources or their patronage by the SMEs.

8.2.3 Difficulties in Obtaining External Finance

It is generally accepted that unless a firm has adequate finance at start-up, its chances of success are limited. It is argued that for entrepreneurship to thrive a vital element is the availability of capital for start-ups and growing firms (HM Treasury/SBS, 2002). However, Garlick (1971) provides evidence that family members, in family owned firms, are reluctant to provide additional savings to support new investment. On the whole, it is understood that owner-managed and family-owned firms are assumed to prefer bank loans to additional family equity (Batten & Hettihewa, 1999). There is little public information available on the financing of business in developing countries (White and Wignaraja, 1992). Furthermore, due to imperfections in capital markets, there are persistent concerns about the ability of smaller firms to raise sufficient external finance to meet their needs (Bolton, 1971; Wilson, 1979). Thus, in less developed countries, public markets are not available for financing, leaving only the bank-dominated private markets.

Fletcher (1995) suggests that the typical interaction between bankers and borrowers over prospective business loans is often inadequate for the small business owners. It is argued that the dissatisfaction with bank financing and services arises because the bankers spend insufficient time explaining to the entrepreneurs the basic principles behind commercial lending (Fletcher, 1995). Conversely, Sudin & Shanmugam (1994) identify some of the difficulties bankers encounter in appraising the requests of small business customers during the debt finance process. The first is the poor knowledge of accounting and working capital management which reinforces the applicant's inability to professionally articulate and present financial problems and needs. Other reasons include insufficient information on loan requests for debt finance compounded by a lack of proper business plans and the business being run in a one-man operation manner.
Van Auken and Neeley (1998) signify that some of the difficulties entrepreneurs confront in raising capital arise from two general groups of problems.

- The first group of problems relate to the personal characteristics and background of the entrepreneur. For example, many entrepreneurs are not knowledgeable in business and financial management of firms. As a consequence, many may accept greater business and financial risk than the potential rewards from the business. In addition, many entrepreneurs demonstrate a high need for control and avoid accountability.

- The second group of problems relate to the quality of the proposed business concept. Adverse reaction to the business idea by potential lenders/investors may occur due to the entrepreneur’s lack of experience, lack of or high cost of information on the proposed business, and relatively higher risk associated with financing SMEs as compared to larger firms.

A 1999 white paper on Japanese small and medium sized businesses (Chusho Kigyo Hakusho) reported that about 70% of SMEs in Japan experienced some difficulty in raising capital. Similarly, about 70% experienced a scarcity of capital at start-up and nearly all used the owner’s personal funds and debt financing in starting up their business ventures.

A test of significance of the reported difficulty in obtaining external finance in this study was then undertaken using the one-sample t-test. The test result reveals that the SMEs that indicate encountering difficulties are significant in the overall sample (t = 42.397; df = 344; p < .001). Consequently, at this stage the study proceeds to use spearman’s correlation to establish if there are relationships between difficulty in obtaining external finance on the one hand and Firm or Entrepreneur Characteristics on the other. The variables are FSZE, FSZA, FBP, FLF, FAG, FIS and REG for firm characteristics and EAG, EHE, EME, EYE and EMT for owner-manager characteristics.
**Table 8-3: Difficulty in Obtaining External Finance Spearman’s Correlations**

<table>
<thead>
<tr>
<th>Variable Name</th>
<th>Description</th>
<th>Difficulty in Obtaining External Finance</th>
<th>Correlation Coefficient (r)</th>
<th>Sig. (2-tailed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>REG</td>
<td>North-South Region</td>
<td></td>
<td>.162**</td>
<td>.003</td>
</tr>
<tr>
<td>FSZE</td>
<td>Firm Size (Employees)</td>
<td></td>
<td>.125*</td>
<td>.021</td>
</tr>
<tr>
<td>FSZA</td>
<td>Firm Size (Assets)</td>
<td></td>
<td>.023</td>
<td>.675</td>
</tr>
<tr>
<td>FAG</td>
<td>Firm Age</td>
<td></td>
<td>.071</td>
<td>.186</td>
</tr>
<tr>
<td>FLF</td>
<td>Legal Form</td>
<td></td>
<td>.106</td>
<td>.052</td>
</tr>
<tr>
<td>FBP</td>
<td>Business Plan</td>
<td></td>
<td>-.093</td>
<td>.089</td>
</tr>
<tr>
<td>FIS</td>
<td>Industry Sector</td>
<td></td>
<td>-.085</td>
<td>.115</td>
</tr>
<tr>
<td>EAG</td>
<td>Entrepreneur’s Age</td>
<td></td>
<td>.090</td>
<td>.095</td>
</tr>
<tr>
<td>EHE</td>
<td>Highest Education</td>
<td></td>
<td>-.004</td>
<td>.937</td>
</tr>
<tr>
<td>EME</td>
<td>Previous Experience</td>
<td></td>
<td>-.139*</td>
<td>.011</td>
</tr>
<tr>
<td>EYE</td>
<td>Years of Experience</td>
<td></td>
<td>.182*</td>
<td>.023</td>
</tr>
<tr>
<td>EMT</td>
<td>Management Training</td>
<td></td>
<td>-.026</td>
<td>.693</td>
</tr>
</tbody>
</table>

**Correlation is significant at the 0.01 level (2-tailed).**

**Correlation is significant at the 0.05 level (2-tailed).**

### 8.2.3.1 Firm Size

*Hypothesis 3.1: There is a relationship between difficulty in obtaining external finance and the size of the SMEs.*

Most empirical works devoted to size effect arrive at conclusions that are compatible with both the pecking order-theory approach (Calof, 1985; Holmes & Kent, 1991) and the lack of capital available to small and medium-sized family businesses, i.e. capital rationing (Coleman & Carsky, 1999; De Visscher, Aronoff, & Ward, 1995; Ennew & Binks; 1994; Harvey & Evans, 1995; Tamari, 1980). Most of these studies find a significant role of size on firm growth (Mata, 1994; Hall, 1987; Dunne et al., 1988). However, other earlier empirical works also note that size and age of the firms are inversely related to difficulties in raising finance. This group see the difficulties as being more for smaller firms than for larger firms (Barrow, 1993; Terpstra and Olson, 1993; Moore, 1994; Mirvis, 1994; Wiklund, 1998).

The results in Table 8-3 indicate, on the one hand, that there is a positive correlation between FSZE and DOEF (r = .125; p = .021). But using assets value as a size determinant, the results shows no significant correlation between FSZA and DOEF (r = .023; p = .675). The outcomes confirm the findings of a
similar study in Oman (Al-Kharusi, 2004) where the results suggest that a firm's assets value is not significant in the difficulties SMEs face in seeking external finance. This is because in most cases the banks realise that some of the assets purported to be owned by firms may either not exist or are unserviceable (i.e. out of order/use). Furthermore, where the assets actually exist and are serviceable, their values are often excessively inflated by the firms. Thus the asset values a firm reports in the process of seeking funding from external sources rarely eases the difficulties faced by SMEs.

8.2.3.2 Firm Age

Hypothesis 3.2: There is a relationship between difficulty in obtaining external finance and the age of the SMEs.

The age of a firm is amongst the dimensions that have been typically used to differentiate businesses in previous studies (Mirvis, 1994; Hillary, 1997; Petts, Herd and O'heocha, 1998). Some studies found a significant role for age on firm growth (Dunne et al., 1988) with Binks et al, (1992a) suggesting that younger SMEs face difficulties in raising larger loans due to the inadequacy of their size and the value of assets to be used as collateral for securing such loans.

At this point, an examination of the relationship between FAG and DOEF was embarked upon. The outcome of the test conducted reveals that there is no significant correlation existing between the two variables. Thus the null hypothesis is not rejected based on the result in Table 8-3 which shows \( r = 0.071 \) and \( p = 0.186 \). The result indicates that the age of an SME has no influence on the level of difficulty or otherwise the firm encounters in the process of seeking external finance. This is due to the fact that, though older firms may be seen to have better track record or information to supply financiers at the point of seeking financing, in reality there is generally a prevalence of poor and insufficient records of financial transactions being maintained by all firms. Thus in most instances financiers, most especially banks, realise that the records, which fail to reflect the true financial position of the SMEs, are just created or prepared for the purpose of applying for the external finance.
8.2.3.3 Ownership Structure

**Hypothesis 3.3:** There is a relationship between difficulty in obtaining external finance and SME legal form.

Both theoretical work (Short, 1994) and empirical studies (McConnel & Servaes, 1990) find that ownership structure is a relevant factor in determining performance of firms. However, Harhoff, Stahl and Woywode (1998) in their empirical work find that ownership structure (by itself) has no significant impact on firm growth using sample data from Germany.

The statistical test for the existence of a relationship between FLF and DOEFS did not yield a statistically significant result. Thus the result $r = .106$ and $p = .052$ (Table 8-3) justifies the study in not rejecting the null hypothesis, meaning there is no correlation established between the variables. The result implies that an SME's ownership type does not determine or influence the difficulties or otherwise it encounters in its quest for external finance.

8.2.3.4 The Use of Written Business Plans

**Hypothesis 3.4:** There is a relationship between difficulty in obtaining external finance and the use of business plan.

The planning process provides business owners with a better opportunity to gain a perspective on capital formation, funds allocations and risk management than those owners who do not use formal planning. The preparation of planning documentation enables new business owners to gain, plan for, and evaluate alternative sources of financing (Van Auken and Neeley, 1998). Though the foregoing relate to the planning process as it affects start-up firms the issues raised are also generally true for and applicable to the planning process in older firms. Similarly, Batten and Hettihewa (1999) suggest that the preparation of proficient financial proposals is considered important in obtaining external finance. For example, financial proposals require that the amount of short-term, medium-term and long-term requirements be precisely identified. Generally, Berger and Udell (1998) argue that small firms may be unable to "convey their credibility" without the use of business plans.

The result (Table 8-3) shows a correlation coefficient of -.093 and a significance level $p = .089$ which means the existence of a significant correlation between the
use of written business plans and difficulties in obtaining external finance is not established. Consequently the null hypothesis is not discarded or rejected.

8.2.3.5 The Owner-Manager's Age

Hypothesis 3.5: There is a relationship between the difficulty in obtaining external finance and the entrepreneur's age.

Kangasharju (1999) argues that firms run by older rather than younger owner-managers are more likely to survive, since the need for risk-taking is lesser due to lower motivation for growth and the possession of higher levels of skills and experience. Thus it is expected that the age of an entrepreneur has some influence on the firm's performance and by extension its influence on the ease or otherwise of access to external finance would also be influenced by it.

The result of the statistical test to ascertain whether or not an association exists between DOEF and EAG reveals that there is no significant correlation ($r = .090; p = .095$). This implies that the age of the entrepreneur does not play any significant role in easing or compounding the difficulties encountered in the process of applying for external financing by SMEs.

8.2.3.6 Education and Training

Hypothesis 3.6: There is a relationship between the difficulty in obtaining external finance and the entrepreneur's education and training.

It is expected that owner-managers with higher education also have a higher probability to run firms that grow than those with a lower level of education. In his study Kangasharju (1999) found that higher education positively affects growth probability. While Berry et al., (1993) also maintain that when evaluating companies, lenders generally regard both education and training as being vitally essential considerations.

In exploring for association between the educational attainment of the entrepreneur and difficulties in obtaining external finance using the spearman's correlation test this study found none as evidenced by $r = -.004; p = .937$ shown in Table 8-3. This implies that the educational level of the entrepreneur has no bearing with the difficulty level encountered by the SMEs in sourcing external finance meaning the null hypothesis is not abandoned or rejected.
8.2.3.7 Managerial Experience and Skills

**Hypothesis 3.7:** There is a relationship between the difficulty in obtaining external finance and the entrepreneur's experience.

As a result of the possession of higher levels of skills and experience the need for risk-taking is lower in firms run by older rather than younger owner-managers thereby presenting the firms run by the older owner-managers as having a higher likelihood for survival (Kangasharju, 1999). A study that examined the human and financial capital of the founders of new business ventures and their substitutability was undertaken by Chandler and Hanks, (1998). The study arrived at findings that suggested new business founders, who have considerable background experience, are more likely to start ventures that survive and even expand, even though they may have less financial capital, than those new business founders with less experience.

The study found a significant negative correlation to exist \( r = -.139; p = .011 \) between the management experience and skill attributes of the owner-managers and the difficulties faced in seeking external finance (Table 8-3). The null hypothesis is therefore rejected. By inference, from this result, financiers are more comfortable with requests from entrepreneurs that had more management experience than those who had no experience in managing similar ventures in the past.

8.2.4 Decision to Accept Approved External Finance

There is some evidence that SMEs have target debt-equity ratios although the constraints on the sources of funding available to SMEs or acceptable to their owners restricts the ability of many SMEs to pursue target capital structures (Scott et al., 1972; Buckland et al., 1989). Rather they obtain funding from the restricted sources that are available and acceptable to them. In most cases the decision to accept external finance that is offered to the SMEs is determined by the nature and type of the finance and the conditions that are attached to the finance which have to be met before the SMEs can be utilise the funds.

Consequently, at this stage the study uses spearman’s correlation to establish if relationships exist between the decision to accept approved external finance and collateral requirements and use of interest in external finance.
Table 8-4: Decision to Accept External Finance Spearman's Correlations

<table>
<thead>
<tr>
<th>Variable Name</th>
<th>Description</th>
<th>Decision to Accept Approved External Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Correlation Coefficient (r) Sig. (2-tailed)</td>
</tr>
<tr>
<td>COLREQ</td>
<td>Collateral requirements of banks</td>
<td>-.089 .292</td>
</tr>
<tr>
<td>UINTF</td>
<td>Use of Interest in financing</td>
<td>-.239** .004</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level (2-tailed).

8.2.4.1 Collateral Requirement

Hypothesis 4.1: There is a relationship between the decision to accept approved external finance and collateral requirement.

The possibility of credit rationing is increased when banks insist on taking collateral from SMEs. Collateral acts as a substitute for information, limits the downside loss for the lender, and signals that the entrepreneur believes the project is likely to succeed (Berger and Udell, 1990; Stiglitz and Weiss, 1981). Nevertheless, not all good quality borrowers can provide collateral which often results in worthwhile business proposals being declined. Thakor (1989) suggests that the balance of evidence from the US is tilted in favour of credit rationing as opposed to credit availability, although Berger and Udell (1990) argue that this phenomenon was prevalent only where collateral was a prime concern of lenders. The implication is that SMEs could encounter difficulties in gaining access to finance even in mature financial markets.

The statistical tests to determine the association that links the collateral requirement for external financing and its acceptability was also tested using spearman's correlation. The outcome (Table 8-4) shows that the variables DAEF and COLREQ are not significantly correlated (r = -.089; p = 0.292) confirming no association is established so the null hypothesis is not rejected.

8.2.4.2 Interest Charges by Banks

Hypothesis 4.2: There is a relationship between the decision to accept approved external finance and interest charges.

In a study conducted by Pissarides et al (2000 p.14) the "level of interest rates" was cited most often (by about 50% of both Russian and Bulgarian firms in the study) as being among the ten most important constraints that the small firms encountered in their search for external finance. In addition, 83% of the Russian
and 78% of the Bulgarian managers rate the "level of interest rates" as being "very important" and 67% in each country selected it as the "most important" problem. The level of interest rate is also one of the most highly ranked constraints in the overall ranking of all the highly rated constraints in the study (Pissarides et al., 2000 p.20-21). These findings indicate that firms which existed longer and have more educated managers tend to feel less acutely the interest rate constraint. However, it is also argued that for given loan size, interest rates will be likely to be higher for firms in the business services sector, as less collateral will be available for the loan (Cressy, 1996).

A statistical test to ascertain the correlation between the decision to accept the approved external finance (by respondents whose applications for external finance with their bankers were successful) and the use and level of interest being charged by the banks was undertaken. The result (Table 8-4) reveals a significant negative correlation ($r = -.239; p = .004$) between the DAEF and UINTF variables. The correlation being negative ($r = -0.239$) means that SMEs against the use of interest responded by declining the offer for external finance.

8.2.5 Islamic Finance Option

The study, in this section, investigates the general awareness of the existence of Islamic finance, the HNB non-interest window service and the effort to set up an Islamic bank (Jaiz Bank) in Nigeria. The different Islamic finance modes are also tested for acceptability and potential patronage. In addition, it also proceeds to explore the eventual perception of and probable desire for Islamic finance as a financing option that SMEs could use to finance their business ventures.

At this point, using spearman's correlation, the existence of relationships between the desire to use Islamic finance and application for or accepting external finance are explored. The following spearman's correlation matrix (Table 8-5 below) gives a broad overview of the test results some of which are subsequently discussed in more detail. This is done by looking at the associations between conventional finance application and decision to accept external finance on the one hand and Islamic finance variables on the other.
Table 8-5: Spearman Correlation Results for Islamic Finance

<table>
<thead>
<tr>
<th>Variable Name</th>
<th>Description</th>
<th>Statistic</th>
<th>Applied for Debt Finance</th>
<th>Use of Interest in finance</th>
<th>Applied for Equity Finance</th>
<th>Aware Islamic Finance exists</th>
<th>Use of Islamic Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADF</td>
<td>Applied for Debt Finance</td>
<td>Coeff</td>
<td>1.000</td>
<td>-.115**</td>
<td>.080</td>
<td>-.133**</td>
<td>-.155**</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td></td>
<td></td>
<td>.010</td>
<td>.105</td>
<td>.003</td>
</tr>
<tr>
<td>UINTF</td>
<td>Use of Interest in financing</td>
<td>Coeff</td>
<td>-.115**</td>
<td>1.000</td>
<td>.005</td>
<td>.261**</td>
<td>.343**</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td>.010</td>
<td></td>
<td>.921</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>DAEF</td>
<td>Decision to Accept Ext. Finance</td>
<td>Coeff</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-.224*</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>.049</td>
</tr>
<tr>
<td>AEF</td>
<td>Applied for Equity Finance</td>
<td>Coeff</td>
<td>.080</td>
<td>.005</td>
<td>1.000</td>
<td>-.032</td>
<td>.010</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td>.105</td>
<td>.921</td>
<td></td>
<td>.521</td>
<td>8.80</td>
</tr>
<tr>
<td>AWIF</td>
<td>Aware Islamic Finance exists</td>
<td>Coeff</td>
<td>-.133**</td>
<td>.261**</td>
<td>-.032</td>
<td>1.000</td>
<td>.000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td>.003</td>
<td>.000</td>
<td>.521</td>
<td></td>
<td></td>
</tr>
<tr>
<td>AWJB</td>
<td>Aware of Jaiz bank set up</td>
<td>Coeff</td>
<td>.058</td>
<td>.118**</td>
<td>.110*</td>
<td>.317**</td>
<td>.000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td>.194</td>
<td>.008</td>
<td>.025</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>AWHNW</td>
<td>Awareness of HNB Non-Int window</td>
<td>Coeff</td>
<td>-.130**</td>
<td>.257**</td>
<td>-.022</td>
<td>.882**</td>
<td>.000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td>.004</td>
<td>.000</td>
<td>.654</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>UHNW</td>
<td>Use of HNB Non-interest Window</td>
<td>Coeff</td>
<td>-.161**</td>
<td>.152**</td>
<td>-.001</td>
<td>.098</td>
<td>.339**</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td>.004</td>
<td>.006</td>
<td>.992</td>
<td>.079</td>
<td>.000</td>
</tr>
<tr>
<td>SATHNW</td>
<td>Satisfied with the HNB Non-interest Window</td>
<td>Coeff</td>
<td>-.007</td>
<td>.076</td>
<td>-.142</td>
<td>.213*</td>
<td>.017</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td>.934</td>
<td>.383</td>
<td>.141</td>
<td>.013</td>
<td>.849</td>
</tr>
<tr>
<td>MBRJ</td>
<td>Move banking business to Jaiz bank</td>
<td>Coeff</td>
<td>-.270**</td>
<td>.371**</td>
<td>-.032</td>
<td>.619**</td>
<td>.617**</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td>.000</td>
<td>.000</td>
<td>.527</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>SFSMSH</td>
<td>SMEIS Fund same with Musharakah</td>
<td>Coeff</td>
<td>-.203**</td>
<td>.283**</td>
<td>-.046</td>
<td>.709**</td>
<td>.528**</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td>.000</td>
<td>.000</td>
<td>.330</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>IFVIAB</td>
<td>Islamic finance viable option for SMEs</td>
<td>Coeff</td>
<td>-.125**</td>
<td>.359**</td>
<td>.042</td>
<td></td>
<td>.815**</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sig.</td>
<td>.034</td>
<td>.000</td>
<td>.520</td>
<td></td>
<td>.000</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).
Corr. Coeff. = Spearman's Correlation Coefficient
Sig. = Significance (2-tailed)

8.2.5.1 Conventional External Finance

Hypothesis 5.1: There is a relationship between the desire to use Islamic finance and the decision to apply for external finance.

Ibrahim (2003) argues that some aspects of the Islamic financing system can be used to overcome some problems of small business financing. As there are advantages that Islamic partnership modes of finance can offer to financing of small enterprises. Moreover, Islamic investment arrangements are identified as placing greater emphasis on the transaction itself, rather than the
creditworthiness of the partner, thus no strict security should be demanded (Ibrahim, 1997a, p. 4). He further maintains that Islamic banks utilise Islamic financing formulae to provide venture capital to small entrepreneurs. Ibrahim, (2003) therefore concludes that if the PLS formulae are taken as one form of venture capital; they will possibly have a great deal of universal application.

The association between the decision to use conventional external finance (represented by debt and equity finance applications) and the awareness and desire to use Islamic finance points the direction of the next hypothesis tested in this study. From the results in Table 8-5, significant negative correlations are found to exist between UIF, on the one hand, tested against the variables ADF \((r = -.155; p = .008)\) and DAEF \((r = -.224; p = .049)\) on the other hand. However the correlation test between the variables AEF and UIF is found not to be significant with \(r = .010; p = .880\). This therefore implies that the desire to use Islamic finance is considered to influence the decision to seek for and use debt finance but has no influence on the available SMIEIS equity fund. This is further supported by the significant negative correlation \((r = -.115; p = .010)\) found between SMEs who consider the use of interest in finance (UINTF) as a major problem and application for debt finance, while indicating a significant positive correlation \((r = .343; p < .001)\) between the UINTF and UIF variables.

The results (Table 8-5) further indicate that ADF is significantly negatively correlated to AWIF \((r = -.133; p = .003)\); AWHNW \((r = -.130; p = .004)\); UHNW \((r = -.161; p = .004)\); and MBRJ \((r = -.270; p < .001)\). These various significant results lead us to reject the null hypothesis. This implies that SMEs are influenced by the type and characteristics of conventional finance in their awareness and desire for the Islamic finance alternative. In addition, on the questions relating to the use of both Islamic finance modes and HNB non-interest window services the respondents, who had earlier indicated their need for and desire to apply for external finance, indicate significant willingness to patronise these sources. This is attributable to the desire to avoid the interest charges in conventional finance and loss of ownership and control to other individual investors as opposed to banks (corporate investors) who are mostly only interested in minority shareholding.
The desire for Islamic finance in relation to conventional finance is confirmed by the result in Table 8-5. The result indicates a significant positive correlation ($r = .617; p < .001$) between the desire by respondents to use Islamic finance in SMEs and the decision to move the firms' banking business to the Jaiz bank when it takes off. Also, the perception of Islamic finance as being a viable financing option for SMEs is found to be significantly positively correlated ($r = .815; p < .001$) to the desire to use Islamic finance in financing the SMEs.

### 8.2.5.2 Accepting approved external finance.

**Hypothesis 5.2:** There is a relationship between the desire to use Islamic finance and the decision to accept approved external finance.

The link between the desire for and use of Islamic finance and the response to the offer for external finance granted to those SMEs that applied was next examined in this section. This is aimed at ascertaining if the outcome of the debt finance process influences the desire of the respondent to use Islamic finance. The result in Table 8-5 shows a significant negative correlation ($r = -.224; p = .049$) between the DAEF and UIF variables thus the null hypothesis is rejected. This suggests that SMEs' response to the offer for external finance was influenced by the desire to use Islamic finance in their firms. SMEs that signified desire to use Islamic finance rejected the external finance offered.

To explore further why the SMEs that indicate a desire and preference for Islamic finance rejected the external finance, as offered to them, the study proceeded to examine the association between SMEs that indicate the use of interest in external financing as a major obstacle to the performance of their SMEs and the desire to use Islamic finance. In all variables tested, which are AWIF ($r = .261; p < .001$), UIF ($r = .343; p < .001$), AWHNW ($r = .257; p < .001$), UHNW ($r = .152; p = .006$) and MBRJ ($r = .371; p < .001$) against UINTF significant positive correlations were recorded. These are indicators that SMEs which are aware of and desire Islamic finance are not favourably disposed to obtaining and utilising interest-based external finance.

### 8.3 Exploring Regional and Sectoral Differences

This stage of the study demonstrates that individual groups may not necessarily have the same effect on a dependent variable even though when combined they
are found to have the same effect on the DV (Morgan et al, 2004). The measures of differentiation, which are the t-test or analysis of variance and the Mann-Whitney (for the two-region group) and the Kruskal-Wallis (for the three-sector group) tests, are used as approaches that explore for difference between groups particularly where nonparametric analysis is involved.

A structured grouping of the survey sample is applied to the analysis in this research to test for differences in SME behaviour as relates to the main areas of enquiry. Therefore the respondents are grouped on the basis of regional location (North versus South), and industry sector (Manufacturing, Services and Trade) to test for the differences. Differences between the industry sectors were tested by analysis of variance, non-parametric Kruskal-Wallis analysis of variance, or the chi-square ($\chi^2$) test. Also differences between the regions were tested using appropriate statistical tests: the t test, non-parametric Mann-Whitney U test, or chi-square test. These tests were conducted to test the differences between the three sectors and the two regions for each of the individual variables. However all the hypotheses in this section will be tested within the null hypothesis that no difference exists in the variables of interest.

The conventional and Islamic finance options are therefore tested in two phases as follows.

8.3.1 Conventional Finance
The impact of location on small firm performance, operation and growth has been indicated in recent research (Hitchens & O'Farrell 1988; Storey 1994). Thus having segregated the samples into two main regional groups (South versus North) it is intended to ascertain if differences exist between the samples in these areas most especially as relates to conventional finance.
Table 8-6: Mann-Whitney Test for External Finance Variables

<table>
<thead>
<tr>
<th>Test Statisticsa</th>
<th>Applied for Debt Finance</th>
<th>Applied for Equity Finance</th>
<th>Use of Interest in Obtaining External Finance</th>
<th>Difficulty in Accepting External Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mann-Whitney U</td>
<td>21230.000</td>
<td>20127.000</td>
<td>15404.000</td>
<td>12179.000</td>
</tr>
<tr>
<td>Z</td>
<td>-7.763</td>
<td>-1.485</td>
<td>-10.450</td>
<td>-3.008</td>
</tr>
<tr>
<td>Asymp. Sig. (2-tailed)</td>
<td>.000</td>
<td>.137</td>
<td>.000</td>
<td>.003</td>
</tr>
</tbody>
</table>

a. Grouping Variable: North-South Region

8.3.1.1 External Finance Sourcing

Hypothesis 6.1: There is a difference between the Northern and Southern region SMEs in applying for external finance.

Using the nonparametric Mann-Whitney-test for differences in medians the results in Table 8-6 indicate that an overall significant difference is established between the Southern and Northern regions in the decision of SMEs to apply for debt finance (z = -7.763; p < .001). However the variable AEF shows no significant regional difference (z = -1.485; p = .137).

Using the independent samples t-test to determine the significance of differences in the type of post start-up financing applied for by the SMEs in the Northern and Southern regions of Nigeria, the results in Table 8-7 are obtained. Significance here indicates the p-value of a t-test of differences in means between the regions for each of the individual variables. The results show that the northern region was significantly different from the southern region only in applying for venture capital finance (t = -3.361; df = 24; p = 0.003). Given that only 2 SMEs in the north as against 25 SMEs in the south applied for venture capital. The two factors identified as being responsible for the low level of patronage of venture capital in the north are first, the lack of such type of financing in the north and secondly, the reluctance to share ownership or loose control by entrepreneurs is higher in the north. This is attributable to the predominance of family-owned and sole-proprietorship ventures in the trade dominated sector of the northern region. The two regions did not show any significant difference in the remaining four types of financing tested.
Table 8-7: Types of External Finance Applied for by SMEs

<table>
<thead>
<tr>
<th>Independent Samples Test</th>
<th>Levene's Test for Equality of Variances</th>
<th>t-test for Equality of Means</th>
<th>Sig. (2-tailed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Post start-up - Long-term loans</td>
<td>Equal variances assumed .000 .988</td>
<td>-0.007 111 .994</td>
<td></td>
</tr>
<tr>
<td>Post start-up - Medium-term loans</td>
<td>Equal variances assumed .000 .988</td>
<td>-1.320 84 .190</td>
<td></td>
</tr>
<tr>
<td>Post start-up - Overdrafts/Sho</td>
<td>Equal variances assumed .000 .988</td>
<td>-1.371 69.474 .175</td>
<td></td>
</tr>
<tr>
<td>rt-term loans</td>
<td>Equal variances not assumed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Post start-up - Venture Capital</td>
<td>Equal variances assumed 12.437 .002</td>
<td>-0.934 25 .359</td>
<td></td>
</tr>
<tr>
<td>Finance</td>
<td>Equal variances not assumed</td>
<td>-3.361 24.000 .003</td>
<td></td>
</tr>
<tr>
<td>Post start-up - Lease Finance</td>
<td>Equal variances assumed .000 .988</td>
<td>1.355 44 .182</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Equal variances not assumed</td>
<td>1.291 31.890 .206</td>
<td></td>
</tr>
</tbody>
</table>

8.3.1.2 Difficulties in Obtaining External Finance

Hypothesis 6.2: There is a difference between the Northern and Southern region SMEs in the difficulty in obtaining external finance.

Table 8-8 gives the regional statistics on the level of difficulty encountered by those SMEs that applied for external finance.

Table 8-8: External Finance Level of Difficulty by Region

<table>
<thead>
<tr>
<th>Difficulty Level</th>
<th>Northern Region</th>
<th>Southern Region</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Count</td>
<td>%</td>
<td>Count</td>
</tr>
<tr>
<td>Extreme Difficulty</td>
<td>74</td>
<td>46.5</td>
<td>65</td>
</tr>
<tr>
<td>Some Difficulty</td>
<td>52</td>
<td>32.7</td>
<td>53</td>
</tr>
<tr>
<td>No Difficulty</td>
<td>33</td>
<td>20.8</td>
<td>68</td>
</tr>
<tr>
<td>Total</td>
<td>159</td>
<td>100.0</td>
<td>186</td>
</tr>
</tbody>
</table>

The analysis of variance (ANOVA) test result (Table 8-9) reveals a significant "Between Groups" (i.e. between the Northern and Southern regions of Nigeria) difference in level of difficulties being encountered by SMEs in obtaining external finance (F = 9.623; df = 1; p = .002). Similarly the Mann-Whitney test result in Table 8-6 shows a significant level of difference in the variable DOEF between the regions (z= -3.008; p = 0.003). These results confirm the position shown by the crosstabulation result in Table 8-8 in which about 80% of the respondents in
the northern region report encountering difficulties while a lower 63.4% are recorded in the southern region. Also 20.8% and 36.6% indicate not encountering any difficulties in obtaining debt finance in the northern and southern regions respectively. Thus the null hypothesis is rejected.

Table 8-9: ANOVA Test for Difficulty in Obtaining External Finance

<table>
<thead>
<tr>
<th></th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within Groups</td>
<td>229.379</td>
<td>343</td>
<td>.669</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>235.814</td>
<td>344</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

8.3.1.3 Decision to Accept Approved External Finance

Hypothesis 6.3: There is a difference between the Northern and Southern region SMEs in the decision to accept external finance.

A further analysis of the variables DAEF and UINTF is undertaken to establish if any difference exists between the respondents in the two main regions of the country using ANOVA statistical test.

Table 8-10: ANOVA Test on Interest Use and Response to External Finance

<table>
<thead>
<tr>
<th>Variable</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig</th>
</tr>
</thead>
<tbody>
<tr>
<td>DAEF</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Between Groups</td>
<td>1.233</td>
<td>1</td>
<td>1.233</td>
<td>5.047</td>
<td>.026</td>
</tr>
<tr>
<td>Within Groups</td>
<td>34.432</td>
<td>141</td>
<td>.244</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>35.664</td>
<td>142</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UINTF</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Between Groups</td>
<td>193.432</td>
<td>1</td>
<td>193.432</td>
<td>146.653</td>
<td>.000</td>
</tr>
<tr>
<td>Within Groups</td>
<td>659.486</td>
<td>500</td>
<td>1.319</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>852.918</td>
<td>501</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In both DAEF and UINTF significant differences were found in the two regions. The ANOVA results (Table 8-10) indicate statistically significant difference between the two regions in DAEF (F = 5.047; df = 1; p = .026) and UINTF (F = 146.653; df = 1; p < .001). Table 8-6 also shows similar significant differences with Mann-Whitney results for DAEF (z = -2.215; p = .027) and UINTF (z = -10.450; p < .001) which enables the study to reject the null hypothesis.

The results indicate that in terms of accepting or rejecting the approved external financing regions differed significantly. This is attributable to the predominance of Muslims in the northern region which is a factor that determines the
reluctance of most respondents from the region to use interest-based debt financing. Thus because they tend to avoid any form of interest-based financing a significant difference is recorded in the regions on the variable UINTF which in turn affects the DAEF. While in the southern region it is mostly collateral related problems or insufficient amount of approved financing that influences the rejection by SMEs of external financing in the few cases recorded.

8.3.2 Islamic Finance
The next stage involved an examination of the existence, if any, of differences between the SMEs on regional and industrial sector basis in relation to the awareness and desire to use Islamic finance. The Mann-Whitney and kruskal-Wallis tests are employed at this stage of the investigation.

8.3.2.1 Regional Difference
Hypothesis 7.1: There is a difference between the Northern and Southern region SMEs in the desire to use Islamic finance.

In terms of the reaction to the use of interest in financing, we have seen that there is a significant difference between the SMEs in the two regions (Tables 8.6 and 8.10). The test results further confirm the findings of the study that in using external finance to fund their business ventures, SMEs in the south are mostly indifferent to the use of interest-based external finance. Conversely, SMEs in the north are reluctant to use interest-based financing in their business ventures. This is consequent upon the fact that the respondents in the northern region are predominantly by Muslims who are prohibited to use interest-based finance. Though some SMEs in the southern region also indicate their aversion to interest-based financing they are quite few.

<table>
<thead>
<tr>
<th>Test Statisticsa</th>
<th>Aware of Islamic Finance</th>
<th>Use Islamic Finance</th>
<th>Aware of HNB Non-Int. Window</th>
<th>Use HNB Non-Int. Window</th>
<th>Aware of Jazl Bank</th>
<th>Move Banking Business to Jazl Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mann-Whitney U</td>
<td>18513.000</td>
<td>4016.000</td>
<td>18296.000</td>
<td>9206.500</td>
<td>28660.000</td>
<td>7217.000</td>
</tr>
<tr>
<td>Asymp. Sig.</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td>(2-tailed)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a' Grouping Variable: North-South Region

The different position on Islamic finance in the two regions is further confirmed by the Mann-Whitney test results in Table 8-11. The null hypothesis is rejected
as the results for each variable tested indicate significant differences between the regions with p being < .001 in each case. The foregoing supports the findings of follow-up interviews conducted that the SMEs in the north are more ready and enthusiastic to know about and have a higher potential to use Islamic financing in funding their firms.

Though the respondents indicate a desire to use the Islamic finance option in financing their SMEs, it was deemed important to investigate if any differences exist in the regional preferences for the various Islamic modes of finance applicable to SMEs. A Mann-Whitney test (Table 8-12) is undertaken which finds that there are significant differences recorded in the decision to use Islamic finance in the SMEs ($z = -10.412; p < .001$) and in the desire to use the Mudarabah mode of Islamic finance ($z = -2.055; p = .040$). Note however that there are no significant differences in the desire or need for the Musharakah, Murabahah, and Ijarah modes of finance nor for those who desired to use all applicable modes in their business ventures.

Table 8-12: Mann-Whitney Test for Islamic Finance Modes

<table>
<thead>
<tr>
<th>Test Statistics</th>
<th>Use Islamic Finance</th>
<th>Use Musharakah Mode</th>
<th>Use Mudarabah Mode</th>
<th>Use Murabahah</th>
<th>Use Ijarah Mode</th>
<th>Use All Finance Modes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mann-Whitney U</td>
<td>4016.000</td>
<td>564.500</td>
<td>259.500</td>
<td>57.500</td>
<td>57.000</td>
<td>6.000</td>
</tr>
<tr>
<td>Z</td>
<td>-10.412</td>
<td>-1.578</td>
<td>-2.055</td>
<td>-1.336</td>
<td>-.278</td>
<td>-1.000</td>
</tr>
</tbody>
</table>

a Asymp. Sig. (2-tailed)

The indication here is that though between the regions the desire to use Islamic finance by respondents shows a significant difference, there is however no significant difference between the two regions on the use of most of the different Islamic finance modes except the Mudarabah mode. This is attributable to the awareness of the features of the different finance modes by respondents who desire to use Islamic finance in both regions.
8.3.2.2 Sectoral Difference

**Hypothesis 7.2:** There is a difference between the industry sectors of SMEs in the desire to use Islamic finance.

At this stage, the study applies the Kruskal-Wallis test which differentiates the cases in different samples that are ranked together in one series. It is used to compare scores in three or more groups as opposed to Mann-Whitney test which compares scores in two groups only. Thus this test is appropriate to determine the sectoral differences in the Islamic finance variables since industry sector has three groups (i.e. manufacturing, services and trade sectors).

Table 8-13: Kruskal-Wallis Test for Sectoral Differences on Islamic Finance Variables

<table>
<thead>
<tr>
<th>Test Statistics (^a,b)</th>
<th>Aware of Islamic Finance</th>
<th>Use Islamic Finance</th>
<th>Aware of HNB Non-Int Window</th>
<th>Use HNB Non-Int Window</th>
<th>Aware of Jaiz Bank</th>
<th>Move Banking Business to Jaiz bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chi-Square</td>
<td>12.218</td>
<td>19.059</td>
<td>14.723</td>
<td>12.544</td>
<td>1.714</td>
<td>29.248</td>
</tr>
<tr>
<td>df</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Asymp. Sig.</td>
<td>.002</td>
<td>.000</td>
<td>.001</td>
<td>.002</td>
<td>.424</td>
<td>.000</td>
</tr>
</tbody>
</table>

\(^a\) Kruskal-Wallis test

\(^b\) Grouping Variable: North-South Region

The result of the test for the difference in AWIF \((\chi^2 = 12.218; p = .002)\), UIF \((\chi^2 = 19.059; p < .001)\), AWHWN \((\chi^2 = 14.723; p = .001)\), UHNW \((\chi^2 = 12.544; p = .002)\) and MBRJ \((\chi^2 = 29.248; p < .001)\) show significant differences between the three sectors (Table 8-13). However for the awareness of Jaiz bank set-up variable the result shows no significant differences \((\chi^2 = 1.714; p = .424)\). Hence the null hypothesis is rejected as all except one variable record significant difference in the sectors.

The outcome derives from Jaiz bank floating a public offering of its shares through an IPO on the Nigerian stock exchange in an attempt to raise the initial capital requirement for its set-up. Thus the attention of businesses was drawn to its effort at raising capital thereby creating awareness of its existence. Suffice it to say that though awareness of the intended set-up of Jaiz bank was not significantly different in the different sectors, the result for the decision to move
banking relationships to the new Jaiz bank obtained a result that shows a significant difference between the sectors.

A further Kruskal-Wallis test of the SME reaction to the use of interest in external financing on a sectoral basis reveals a significant difference ($\chi^2 = 13.023; \text{df} = 2; p = .001$) in the position of the SMEs on the use of interest in the financing of their business ventures between the different sectors.

### Table 8-14: Sectoral Differences in Use of Interest in External Finance

<table>
<thead>
<tr>
<th>Test Statistics$^{a,b}$</th>
<th>Use of Interest in financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chi-Square</td>
<td>13.023</td>
</tr>
<tr>
<td>df</td>
<td>2</td>
</tr>
<tr>
<td>Asymp. Sig.</td>
<td>.001</td>
</tr>
</tbody>
</table>

$^a$ Kruskal Wallis Test  
$^b$ Grouping Variable: Sector/Industry group

The difference in Table 8-14 is supported by the result shown in Table 8-15 in which 58.7% of the SMEs in the northern region consider the use of interest as a major obstacle to their use of external finance whereas in the entire sample only 18% indicate that as a major obstacle. The trade sector recorded the highest percentage in this category with 35.6% in the northern region while in the southern region only 6.7% respondents, show a significant difference. A further total 23.8% see the use of interest in external financing as being a moderate or minor obstacle effect on their efforts to obtain financing. While in the southern region, only 18% indicate having a major concern with interest-based external finance, whereas about 30.6% consider the use of interest as being either moderate or minor obstacles in their use of such finance.

Of SMEs in the northern region sample only 17.4% as against 51.4% in the south have no problems with the use of interest-based external financing, this shows a significant difference (Table 8-15). This difference is apparent in all the three sectors with the trade sector having the highest net difference of 12.7% between the regions, followed by the manufacturing and services sector with 10.8% and 10.4% respectively.
8.4 Regression Analysis

The analysis is taken further using binary logistic regression and ordinal regression in which one variable is explicitly identified as the 'dependent'. The objective in these tests is to explain variation in the 'dependent' variables by reference to other categorical 'independent' variables (Byrne, 2002 p.126). For each variable, we show the parameter estimate, the standard error, the Wald statistic and the P-value. The bold figures in all the tables that follow indicate the independent variables that have statistical significance in the regression models at the 5% level (i.e. .05).

The logistic regression equation is:

$$\logit[\theta(x)] = \log\left[\frac{\theta(x)}{1 - \theta(x)}\right] = \alpha + \beta_1 x_1 + \beta_2 x_2 + \ldots + \beta_i x_i$$

Where $\theta$ = the probability of presence of the characteristic of interest,
$\alpha$ = the constant of the equation
$\beta$ = the coefficient of the predictor variables, and
$x$ = the independent variables.
8.4.1 Applied for External Finance

Table 8-16 gives the logistic regression results using the above equation.

**Table 8-16: Logistic Regression - External Finance Application**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Applied For Debt Finance</th>
<th>Applied For Equity Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$\beta$</td>
<td>SE</td>
</tr>
<tr>
<td>REG</td>
<td>-8.787</td>
<td>2.092</td>
</tr>
<tr>
<td>FISMAN</td>
<td>.991</td>
<td>.832</td>
</tr>
<tr>
<td>FISTRD</td>
<td>-2.112</td>
<td>.799</td>
</tr>
<tr>
<td>FIS by REG</td>
<td>2.997</td>
<td>.810</td>
</tr>
<tr>
<td>FSZE1</td>
<td>5.326</td>
<td>17.853</td>
</tr>
<tr>
<td>FSZE2</td>
<td>-2.015</td>
<td>.799</td>
</tr>
<tr>
<td>FSZE3</td>
<td>-2.082</td>
<td>.883</td>
</tr>
<tr>
<td>FSZE5</td>
<td>8.142</td>
<td>31.211</td>
</tr>
<tr>
<td>FAG1</td>
<td>1.347</td>
<td>.683</td>
</tr>
<tr>
<td>FAG2</td>
<td>-2.780</td>
<td>.858</td>
</tr>
<tr>
<td>FAG3</td>
<td>-2.150</td>
<td>.762</td>
</tr>
<tr>
<td>FAG4</td>
<td>2.041</td>
<td>1.979</td>
</tr>
<tr>
<td>FAG5</td>
<td>-1.710</td>
<td>.743</td>
</tr>
<tr>
<td>FBP</td>
<td>1.041</td>
<td>.546</td>
</tr>
<tr>
<td>ESTAT1</td>
<td>4.973</td>
<td>1.399</td>
</tr>
</tbody>
</table>

**a.** The cut value is .500

* Significant at the 5% level.
Our focus is on the application or otherwise for conventional finance by SMEs. We ask how firm, entrepreneur and financing characteristics influence an SME's probability of seeking for external finance (debt and/or equity finance) from a bank/investor. The binary logistic regression is conducted to assess whether the independent variables used in each case are significant in explaining whether or not an SME applies for external finance i.e. if it has a significant association with the model. Prior to the actual test run, the backward-stepwise (likelihood-Ratio) process was used to select the variables that give the best overall results for the model. Table 8-16 shows that when all IVs (predictors) are considered together the model significantly shows whether or not an SME applies for debt finance, \( \chi^2 = 59.02, \text{df} = 15, N = 172, p < .001 \) and equity finance, \( \chi^2 = 45.98, \text{df} = 20, N = 131, p = .001 \). The chi-square goodness-of-fit tests the hypothesis that the step is justified. Here the step is from the constant-only model to the all-independents model. When, as here, the step is to use a variable or variables that give the overall best model results, the inclusion is justified if the significance of the step is below 0.05.

The Nagelkerke R-Square for ADF and AEF are 46.1% and 42.3% respectively representing the percentage estimates that the variables in the model help us in explaining whether or not an SME will apply for each type of external finance. This means we have a fairly good model which explains about 46% and 42% of the variance in ADF and AEF dependent variables respectively. This is supported by the result which shows that using the model we are able to make 87.8% and 81.7% correct predictions of whether or not an SME applies for debt and equity finance respectively.

Having found significant association between the dependent variables and most of the predictor variables in the earlier spearman's correlation analysis, this model confirms that the independent variables REG, FISTRD, FIS by REG, FAG1, EAG3, EHE1, EHE2 and EHE3 are significant in predicting whether or not an SME will apply for debt finance. Similarly the variables FSZE2, FSZE3, FAG2, FAG3, FAG4, EAG4, EMT and PALF are significant in predicting whether or not an SME will apply for equity finance.
8.4.2 Decision to Accept Approved External Finance

The decision by the SMEs on the offer for external finance is tested at this stage using the logistic regression model. The firm, entrepreneur and financing characteristics are used to explore an SME's probability of accepting or rejecting the external finance offered by the conventional finance sources.

Table 8-17: Logistic Regression - Response to External Finance Offer

<table>
<thead>
<tr>
<th>Variable</th>
<th>$\beta$</th>
<th>SE</th>
<th>Wald</th>
<th>p</th>
</tr>
</thead>
<tbody>
<tr>
<td>REG</td>
<td>-1.270</td>
<td>1.298</td>
<td>.957</td>
<td>.328</td>
</tr>
<tr>
<td>FIS</td>
<td>-.824</td>
<td>.825</td>
<td>.998</td>
<td>.318</td>
</tr>
<tr>
<td>FSZE</td>
<td>.909</td>
<td>.376</td>
<td>5.843</td>
<td>.016</td>
</tr>
<tr>
<td>FAG</td>
<td>-.403</td>
<td>.347</td>
<td>1.351</td>
<td>.245</td>
</tr>
<tr>
<td>FLF</td>
<td>-.585</td>
<td>.425</td>
<td>1.889</td>
<td>.169</td>
</tr>
<tr>
<td>FBP</td>
<td>-3.364</td>
<td>1.288</td>
<td>6.823</td>
<td>.009</td>
</tr>
<tr>
<td>ESTAT</td>
<td>-.557</td>
<td>.551</td>
<td>1.020</td>
<td>.313</td>
</tr>
<tr>
<td>EAG</td>
<td>.612</td>
<td>.402</td>
<td>2.325</td>
<td>.127</td>
</tr>
<tr>
<td>EHE</td>
<td>-.418</td>
<td>.412</td>
<td>1.030</td>
<td>.310</td>
</tr>
<tr>
<td>EYE</td>
<td>-.398</td>
<td>.662</td>
<td>.362</td>
<td>.548</td>
</tr>
<tr>
<td>EMT</td>
<td>.273</td>
<td>1.268</td>
<td>.046</td>
<td>.829</td>
</tr>
<tr>
<td>CNFS1</td>
<td>.712</td>
<td>.348</td>
<td>4.202</td>
<td>.040</td>
</tr>
<tr>
<td>PCOLL</td>
<td>.957</td>
<td>.460</td>
<td>4.328</td>
<td>.038</td>
</tr>
<tr>
<td>PINT</td>
<td>.143</td>
<td>.359</td>
<td>.159</td>
<td>.690</td>
</tr>
<tr>
<td>Constant</td>
<td>-2.194</td>
<td>3.608</td>
<td>.370</td>
<td>.543</td>
</tr>
</tbody>
</table>

-2 Log Likelihood: 52.087
Nagelkerke R²: .542
Model Chi-Square df: 31.672
p-value: .004
Predicted Correct%: 82.0%
Observations: 61

a. The cut value is .500
* Significant at the 5% level.

This test explored if the 14 independent variables have a significant effect in explaining the response of the SMEs to the external finance offered them by banks. When all the 14 IVs are considered together in Table 8-17 they significantly explain the outcome on SME decision to accept or reject the external finance offer ($\chi^2 = 31.67$, df = 14, N = 61, p = .004). The Hosmer and Lemeshow Goodness-of-Fit test computes a chi-square from observed and expected frequencies. The p-value = .004 here is computed from the chi-square distribution with 14 degrees of freedom (df) and indicates that the model is a good fit. That is, as the Goodness-of-Fit test result is less than .05 we reject the
null hypothesis that there is no difference between the observed and predicted values of the dependent. As here, this means that the model significantly explains much of the variance in the dependent.

The Nagelkerke R-Square for DAEF is 54.2% representing the percentage estimates that the variables in the model help us in explaining whether or not an SME will accept the external finance offered. Thus this means we have a fairly good model which explains about 54% of the variance in the DAEF dependent variable. Using the model we are able to make 82% correct predictions of whether or not an SME decides to accept the financing offered. Thus in this model four independent variables FSZE, FBP, CNFS1 and PCOLL are significant in predicting the outcome or dependent variable.

8.4.3 Willingness to Use Islamic Finance

The logistic regression model equation is also used to explore the willingness of SMEs to use Islamic finance in financing their business activities in comparison to conventional finance sources. The test aims to find those firm, entrepreneur and financing characteristics that influence the SME’s probability of using Islamic finance when available through the Jaiz Bank set-up. The logistic regression results shown in Table 8-18 indicate that the 14 independent variables in the model significantly explain an SME’s willingness to use Islamic finance ($X^2 = 72.955$, df = 14, N = 84, p < .001).

The Wald statistic in Table 8-18 and the corresponding significance level (p) test the significance of each of the covariate and dummy independents in the model. The ratio of the logistic coefficient ($\beta$) to its standard error (SE), squared, equals the Wald statistic. If the Wald statistic is significant (i.e., less than 0.05) then the parameter is significant in the model. Of the dummy independents, REG, EHE, EYE, PCOLL and FISMAN are significant while the remaining nine independent variables are not. The variables in the model help in estimating about 78% (Nagelkerke $R^2 = .781$) of the variance in the dependent variable (Table 8-18). Hence we have a good model which combines the predictor variables that explain to a large extent the desire to use Islamic finance by SMEs. The model also enables us to correctly predict 94% of those SMEs in our sample desirous of using Islamic finance.
Table 8-18: Logistic Regression - Willingness to Use Islamic Finance

<table>
<thead>
<tr>
<th>Variable</th>
<th>$\beta$</th>
<th>SE</th>
<th>Wald</th>
<th>$p$</th>
</tr>
</thead>
<tbody>
<tr>
<td>REG</td>
<td>4.499</td>
<td>1.614</td>
<td>7.776</td>
<td>.005</td>
</tr>
<tr>
<td>FLF</td>
<td>.484</td>
<td>.423</td>
<td>1.308</td>
<td>.253</td>
</tr>
<tr>
<td>EAG</td>
<td>-.328</td>
<td>.311</td>
<td>1.109</td>
<td>.292</td>
</tr>
<tr>
<td>EHE</td>
<td>1.793</td>
<td>.632</td>
<td>8.041</td>
<td>.005</td>
</tr>
<tr>
<td>EYE</td>
<td>-2.096</td>
<td>.962</td>
<td>4.745</td>
<td>.029</td>
</tr>
<tr>
<td>EMT</td>
<td>1.464</td>
<td>1.115</td>
<td>1.724</td>
<td>.189</td>
</tr>
<tr>
<td>CNFS1</td>
<td>.615</td>
<td>.419</td>
<td>2.152</td>
<td>.142</td>
</tr>
<tr>
<td>PCOLL</td>
<td>1.518</td>
<td>.771</td>
<td>3.874</td>
<td>.049</td>
</tr>
<tr>
<td>PINT</td>
<td>-.610</td>
<td>.369</td>
<td>2.733</td>
<td>.098</td>
</tr>
<tr>
<td>FAG1</td>
<td>-1.600</td>
<td>1.163</td>
<td>1.893</td>
<td>.169</td>
</tr>
<tr>
<td>FAG4</td>
<td>-4.673</td>
<td>2.828</td>
<td>2.731</td>
<td>.098</td>
</tr>
<tr>
<td>FAG5</td>
<td>1.451</td>
<td>1.493</td>
<td>.945</td>
<td>.331</td>
</tr>
<tr>
<td>FISMAN</td>
<td>-6.163</td>
<td>2.247</td>
<td>7.520</td>
<td>.006</td>
</tr>
<tr>
<td>FISER</td>
<td>-1.423</td>
<td>1.647</td>
<td>.746</td>
<td>.388</td>
</tr>
<tr>
<td>Constant</td>
<td>-4.620</td>
<td>3.224</td>
<td>2.054</td>
<td>.152</td>
</tr>
</tbody>
</table>

| -2 Log Likelihood | 41.149 |
| Nagelkerke R²     | .781   |
| Model Chi-Square  | 72.955 |
| df                 | 14     |
| p-value            | < .001 |
| Predicted Correcta| 94.0%  |
| Observations       | 84     |

a. The cut value is .500

* Significant at the 5% level.

8.4.4 Decision to Move Banking Relationship

To explore the decision to move an SME’s banking relationship to an Islamic bank, the ordinal regression analysis is used. This is because the categorical outcomes have an ordinal nature (i.e. All, Some or none – and we consider ‘All’ to be better than ‘Some’). Here we aim to determine the direction of the relationship between each predictor variable and the ordinal nature of the categorical outcome. The Threshold portion shows the constants/intercepts of the model while the location portion shows the model predictor variables (Table 8-19). Ordinal regression analysis is computed to examine the extent to which the model is able to predict intentions to move banking relationship to an Islamic finance institution. The test aims to find the firm, entrepreneur and financing characteristics that influence the SME’s probability of moving all, some or none of their banking relationship to an Islamic bank when available through the Jaiz Bank set-up. The dependent variable is MBRJ while the independent variables
are FBP, ESTAT, EHE, EYE, EMT, AWIF, CNFS, PCOLL, PINT, PALL and PLEE with REG and FIS as factors.

Table 8-19: Ordinal Regression - Move Banking Relationship

<table>
<thead>
<tr>
<th>Variable</th>
<th>Estimate</th>
<th>Std. Error (SE)</th>
<th>Wald</th>
<th>Sig. (p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Threshold</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MBJZ = 1</td>
<td>-6.227</td>
<td>3.293</td>
<td>3.575</td>
<td>.059</td>
</tr>
<tr>
<td>MBJZ = 2</td>
<td>-1.926</td>
<td>3.053</td>
<td>.399</td>
<td>.528</td>
</tr>
<tr>
<td>Location</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FBP</td>
<td>-.691</td>
<td>.837</td>
<td>.681</td>
<td>.409</td>
</tr>
<tr>
<td>ESTAT</td>
<td>.637</td>
<td>.543</td>
<td>1.374</td>
<td>.241</td>
</tr>
<tr>
<td>EHE</td>
<td>-1.257</td>
<td>.470</td>
<td>7.169</td>
<td>.007</td>
</tr>
<tr>
<td>EYE</td>
<td>3.150</td>
<td>1.048</td>
<td>9.028</td>
<td>.003</td>
</tr>
<tr>
<td>EMT</td>
<td>-2.900</td>
<td>1.030</td>
<td>7.918</td>
<td>.005</td>
</tr>
<tr>
<td>AWIF</td>
<td>-7.207</td>
<td>1.995</td>
<td>13.055</td>
<td>.000</td>
</tr>
<tr>
<td>CNFS1</td>
<td>.375</td>
<td>.273</td>
<td>1.892</td>
<td>.169</td>
</tr>
<tr>
<td>PCOLL</td>
<td>-1.835</td>
<td>.640</td>
<td>8.219</td>
<td>.004</td>
</tr>
<tr>
<td>PINT</td>
<td>.308</td>
<td>.322</td>
<td>.913</td>
<td>.339</td>
</tr>
<tr>
<td>PALL</td>
<td>.584</td>
<td>.337</td>
<td>3.008</td>
<td>.083</td>
</tr>
<tr>
<td>PLEE</td>
<td>-1.967</td>
<td>.651</td>
<td>9.129</td>
<td>.003</td>
</tr>
<tr>
<td>[REG=0]</td>
<td>7.381</td>
<td>2.036</td>
<td>13.137</td>
<td>.000</td>
</tr>
<tr>
<td>[REG=1]a</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>[FIS=1]</td>
<td>5.558</td>
<td>1.774</td>
<td>9.819</td>
<td>.002</td>
</tr>
<tr>
<td>[FIS=2]</td>
<td>.931</td>
<td>.909</td>
<td>1.048</td>
<td>.306</td>
</tr>
<tr>
<td>[FIS=3]a</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. This parameter is set to zero because it is redundant.

* Significant at the 5% level.

The ordinal regression results shown in Table 8-19 indicate that the 14 predictor variables significantly predict an SME's decision to patronize an Islamic finance institution through moving their existing banking relationship from the conventional banks or not ($\chi^2 = 156.592$, df = 14, N = 149, p < .001).

The independent variables, EHE, EYE, EMT, AWIF, PCOLL, PLEE, REG and FIS=1 (Manufacturing) significantly explain the direction of the relationship with the categorical outcome while the remaining six independent variables do not. A positive relationship exists between EYE, REG and FIS=1 (manufacturing) and
the ordinal outcome. This means that as the predictor variables increase so does the probability of being in one of the higher categories. On the other hand, EHE, EMT, AWIF, PCOLL and PLEE have a negative relationship. For REG, SMEs in the southern region compared to the northern region, had a lower probability to be in a higher category. The independent variables in the model assist in estimating about 74% (Nagelkerke $R^2 = .744$) of the variance in the dependent variable. Hence the model is good since it combines the predictor variables that significantly explain the decision by the SMEs to move their banking relationships to an Islamic bank.

In addition the test of parallel lines assesses whether the assumptions that all categories have the same parameters is reasonable or not, that is whether one set of coefficients for all the categories is appropriate. For a model to be suitable it is desired that the p-value (sig.) be greater than (> ) 05. The result in Table 8-19 indicates that the significance level is $p = .143$. Thus the assumption that all the categories have the same parameters is reasonable hence the model is considered suitable ($\chi^2 = 19.605$, df = 14, $p = .143$).

8.5 Summary
The statistical data analysis of the survey data obtained is undertaken in three stages. The study first explored for association, then differences and finally tested for the effect of the independent variables in predicting group membership. The respondents are the owner-managers of the SMEs in the manufacturing, services and trade sectors which predominate in the Nigerian economy. The data analysis entailed undertaking correlation and regression tests such as one-sample t-test and independent-samples test, ANOVA, the spearman's correlation, the Mann-Whitney test, Kruskal-Wallis tests, binary logistic regression and ordinal regression analysis at this stage. These are used to test the hypotheses earlier formulated in the analytical framework chapter.

To begin with, the dependent and independent variables are used to ascertain the existence of associational relationships using the spearman's correlation analysis. Significant positive correlations are established in the results between the ADF and FIS, FBP, ESTAT, EME, EMT, CNFS1, LALF and LAEE. Similarly FLF, FSZE, EYE, UINT, UIF, AHBNW, UHBNW, MBRJ, IFVIAB and REG are
found to be significantly negatively correlated with ADF. For AEF, only the independent variables ESTAT, EMT, DADF and RCOL are found to be significantly positively correlated with it while none is found to be significantly negatively correlated. Testing for association with the difficulties encountered in obtaining external finance (DOEF), the independent variables REG, FSZE and EYE are found to have significant positive correlations while EME is the only variable found to have a significant negative correlation. Only UINTF is found to have a significant negative correlation with the dependent variable DAEF.

The study then explored for differences between some of the variables based on regional and industry sector criteria. This stage largely utilised the Mann-Whitney (two groups) and Kruskal-Wallis (more than two groups) statistical tests. The data were grouped into regional (North and South) and sectoral (Manufacturing, Services and Trade) for this purpose. Significant differences are found to exist between the two regions in applying for debt finance, problem with the use of interest in external finance, difficulties encountered in obtaining external finance and the decision to accept external finance offered by finance providers. In all tests relating to Islamic finance (i.e. AWIF, UIF, AWHNW, UHNW, AWJB and MBRJ) significant differences are found between the two groups using the Mann-Whitney test. In addition tests for sectoral differences on Islamic finance variables using Kruskal-Wallis test found significant differences between the sectors in AWIF, UIF, AWHNW, UHNW and MBRJ while no difference was recorded for awareness of Jaiz Islamic bank. Also significant difference is found between the regions on the use of interest in external finance by providers.

Lastly, using binary logistic regression the DVs (ADF, AEF, DAEF and UIF) are found to be significantly predicted by a combination of some firm, owner-manager and financing characteristics. Similarly, the test to predict an SME’s willingness to move ‘All’; ‘Some’ or ‘None’ of its banking relationship to Jaiz bank upon take-off is significantly predicted by the model using ordinal regression with the predictors EHE, EYE, EMT, AWIF, PCOLL, PLEE, REG and FIS=1 being significant in determining the categorical outcome.
CHAPTER NINE

CONCLUDING DISCUSSION
9 CONCLUDING DISCUSSION

9.1 Introduction

The statistical data analysis was examined in the preceding chapter where results of the tests on the hypotheses were reviewed. This chapter first gives an overview of the research findings then draws conclusions and examines the contributions and implications of the research findings then finally makes recommendations. At this stage, it is aimed to demonstrate how this study has impacted on the research objectives and to further explore the implications of the results obtained in the empirical work.

SMEs significantly impact on national economies by playing a crucial role in economic development of both developed and developing economies. SMEs effectively contribute to jobs creation (thereby helping alleviate and reduce poverty), serve as incubators for industrial and economic growth and diversification, enhance income generation and distribution and serve to train and upgrade the entrepreneur’s skills in business management and operation. Nonetheless, SMEs are faced with unfavourable access to financial resources and markets making these benefits difficult, if not impossible, to realize. SMEs encounter hurdles in attempting to access and obtain appropriate financing which include, but are not limited to, information asymmetries between the SMEs and finance providers, higher risk of failure compared to the larger enterprises, the higher cost of administering advances to SMEs and the lack (or inadequacy) of assets to offer as collateral for financing.

One of the main issues identified with firm success or failure is availability of adequate financial resources in general. Most previous studies on the financing of SMEs have concentrated on the developed economies with little attention being focused on developing countries, such as Nigeria. With a view to contributing towards making the SMEs in Nigeria more viable and to effectively participate in the country’s quest for economic development and growth, this study set out to identify the main factors impacting on the availability and accessibility of external financing to SMEs in Nigeria.

The most significant policy implication of this study stems from the main finding that significant differences exist between the regions on access to and acceptability of the types of financing available. While the northern region SMEs
decline financing due to use of interest charges and desire to maintain control, southern region SMEs are more readily open to such financing but have problems with the high interest rates applied. A common finding amongst the entire SMEs is the promotion of easy access to financing and desire for alternative financing that satisfies region-specific needs of SMEs. Hence, due to sectoral difference in level of capital/ assets required, the minimum asset base of $2m across sectors, for applicants of the SMIEIS fund needs to be reviewed.

The key contribution of this study is the focus on SMEs in Nigeria considering that no study of this magnitude and with this level of response has been undertaken on the country to date. Thus highlighting the utility of the regional study approach in identifying region-specific distinctions on attitudes to available financing and desires for Islamic finance expands the level of knowledge of influences on access to finance by SMEs in Nigeria.

9.2 Summary of Research Findings and Conclusions

The empirical inter-sectoral material was based primarily on two sources of information: data of an extensive survey, and follow-up interviews to obtain further clarifications (where necessary). A mail survey was distributed to a total sample size of 980 SMEs operating in the manufacturing, services and trade sectors out of which 502 SMEs responded. Follow-up interviews were then used to increase the understanding of the survey results.

A majority of the respondents applied for one type of external finance or another with a view to satisfying the operational or business expansion related needs of their SMEs. Bank overdrafts and short-term loans were the two most sought for types of debt financing by SMEs. Only about 40% of the respondents succeeded in obtaining offers for debt finance with over 50% of the successful SMEs rejecting the offers made to them by the banks.

The findings on independent variables that affect access to SME financing in relation to the dependent variables are examined in the following sections. The results are tabulated showing the direction of significant association of each dependent variable to the relevant independent variables.
9.2.2 Application for External Finance

Here the external finance sources are split into two (debt and equity finance) with a view to clearly show the different variables that are associated with them.

<table>
<thead>
<tr>
<th>Positive association</th>
<th>Negative association</th>
</tr>
</thead>
<tbody>
<tr>
<td>• FIS: Firm Industry Sector</td>
<td>• FLF: Firm Legal Form</td>
</tr>
<tr>
<td>• FBP: Firm Business Plan</td>
<td>• FSZE: Firm size (Employees)</td>
</tr>
<tr>
<td>• ESTAT: Entrepreneur’s Status</td>
<td>• EYE: Years of experience</td>
</tr>
<tr>
<td>• EME: Previous management experience</td>
<td>• UINTF: Use of Interest in Finance</td>
</tr>
<tr>
<td>• EMT: Entrepreneur Management Training</td>
<td>• UIF: Use of Islamic Finance</td>
</tr>
<tr>
<td>• CNFS1: Confidence in Nig. Financial System</td>
<td>• AWHNW: Aware of Habib Bank Non-Int. Services</td>
</tr>
<tr>
<td>• LALF: Lack of Access to Lease Finance</td>
<td></td>
</tr>
</tbody>
</table>

The research finds significant positive association, as shown in Table 9-1, between ADF and FIS, FBP, ESTAT, EME, EMT, CNFS1 and LALF. On the other hand, FLF, FSZE, EYE, UINTF, UIF and AWHNW are significantly negatively associated to ADF. However, using binary logistic regression model, the study finds the following variables: REG, FISTRD, FIS by REG, FAG1, EAG3, EHE1, EHE2 and EHE3 to be significant in explaining or predicting the dependent variable ADF.

<table>
<thead>
<tr>
<th>Positive association</th>
<th>Negative association</th>
</tr>
</thead>
<tbody>
<tr>
<td>• ESTAT: Entrepreneur’s Status</td>
<td>None</td>
</tr>
<tr>
<td>• EMT: Entrepreneur Management Training</td>
<td></td>
</tr>
<tr>
<td>• DADF: Decision to Accept Approved Debt Finance</td>
<td></td>
</tr>
<tr>
<td>• RCOL: Reject for Collateral Requirement</td>
<td></td>
</tr>
</tbody>
</table>

For the dependent variable AEF, Table 9-2 reveals that only the independent variables ESTAT, EMT, DADF and RCOL are significantly positively associated
with it. However, no independent variable was found to have significant negative correlation with AEF. In explaining or predicting the SMEs that applied for equity financing, the variables FSZE2, FSZE3, FAG2, FAG3, FAG4, EAG2, EMT and PALF are found to be significant in the model applied.

9.2.3 Difficulties in Raising External Finance

The entire survey sample reveals the existence of significant difficulties in obtaining financing by SMEs in Nigeria.

Table 9-3: Significant results for DOEF (Difficulty in Obtaining External Finance)

<table>
<thead>
<tr>
<th>Positive association</th>
<th>Negative association</th>
</tr>
</thead>
<tbody>
<tr>
<td>REG: North-South Region</td>
<td>EME: Previous management experience</td>
</tr>
<tr>
<td>FSZE: Firm size (Employees)</td>
<td></td>
</tr>
<tr>
<td>EYE: Years of experience</td>
<td></td>
</tr>
</tbody>
</table>

In testing for association between the dependent variable DOEF, only REG, FSZE and EYE have significant positive correlations while only EME has a significant negative correlation (Table 9-3). Thus the variables FAG, FOT, EAG, EHE and FBP are found to have no significant association with DOEF.

9.2.4 Decision on External Finance

The decision to either accept or reject the offer for external finance made to the SMEs by banks is influenced by financing terms and constraints.

Table 9-4: Significant results for DAEF (Decision to Accept External Finance)

<table>
<thead>
<tr>
<th>Positive association</th>
<th>Negative association</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>UINTF: Use of Interest in Finance</td>
</tr>
</tbody>
</table>

In the main, only UINTF is found to have a significant negative correlation with DAEF (Table 9-4). The dependent variable (DAEF) was found to have no significant association with the collateral (COLREQ) being requested for by the financiers. However, in using the logistic regression model to explain an SME’s decision to accept external finance (DAEF) we find that only FSZE, FBP, CNFS1 and PCOLL are significant amongst the 14 dummy variables in the model.
9.2.5 SMIEIS Fund
This equity investment scheme set up by banks for SME financing. From inception in August 2001 of the total amount set aside by 89 banks only about 29% was invested in 180 enterprises as at 28th February 2005. Of total amount invested the real sector received about 65% in 121 SMEs while the services sector received about 35% in 59 SMEs. A majority of these beneficiary SMEs, i.e. about 93%, are located in the southern region compared to only 6.71% in the northern region. Lagos state alone (southern region) accounted for about 59% of the total amount invested and 64.44% in number of projects funded out of the 36 states in the country. This suggests that the level of difficulties encountered by SMEs in Lagos state was either negligible or non-existent compared to other states in the same southern region or the northern region SMEs.

The empirical results show that about 85% respondents are aware of the SMIEIS scheme's existence. Of the SMEs that applied for the equity scheme from their bankers, only about 33% were successful while about 66% were rejected. Reasons advanced by the banks for rejecting the equity investment applications are largely similar to those advanced by the banks in declining debt financing applications by SMEs. Expectedly about 67% respondents scored the scheme low in meeting the needs of SMEs while a cumulative 32.8% indicate an average or high score for the scheme's performance.

9.2.6 Islamic Finance Option
Awareness of Islamic finance is found in about 59% of the survey responses out of which about 73% expressed their desire to use Islamic finance. A majority of the respondents will use, either or both, Musharakah and Mudarabah Islamic finance modes. The need for alternative forms and types of financing that satisfy SMEs' needs while adhering to the prohibition of interest-based financing is the reason for this desire and preference for the Islamic finance modes, especially in northern region SMEs. Furthermore, most of the respondents (about 95%), notwithstanding religion or geographical location, had knowledge of the Jaiz bank set-up due largely to the 'public offer' of its shares on the Nigerian stock exchange. However, we find that less than half of the respondents aware of the HNB non-interest window used the services.
Table 9-5: Significant results for UIF (Use of Islamic Finance)

<table>
<thead>
<tr>
<th>Positive association</th>
<th>Negative association</th>
</tr>
</thead>
<tbody>
<tr>
<td>• UINTF: Use of Interest in Finance</td>
<td>• ADF: Applied for Debt Finance</td>
</tr>
<tr>
<td>• UHNW: Use of HNB Non-interest Window</td>
<td>• DAEF: Decision to Accept External Finance</td>
</tr>
<tr>
<td>• MBRJ: Move banking business to Jaiz bank</td>
<td></td>
</tr>
<tr>
<td>• SFSMSH: SMIEIS Fund same with Musharakah</td>
<td></td>
</tr>
<tr>
<td>• IFVIAB: Islamic finance viable option for SMEs</td>
<td></td>
</tr>
</tbody>
</table>

The variables UINTF, UHNM, MBRJ, SFSMSH and IFVIAB are shown in Table 9-5 to have significant positive association with UIF. However, UIF, AWHNW and UHNW are found to have significant negative correlations with ADF and DAEF. Using logistic regression model the dummy variables REG, EHE, EYE, PCOLL and FISMAN are found to be significant in explaining UIF.

Regional differences in the desire for and potential to use Islamic finance exist between the entrepreneurs in the northern and southern regions. This study found that more respondents in the northern region (about 61%) indicate a higher desire for use Islamic finance option in their SMEs than those in the southern region (i.e. 11.7%). This is largely due to the predominance of Muslims in the north compared to the south. In addition, the varying degrees of difficulties encountered in the regions in obtaining and subsequent utilisation of interest-based debt financing contribute to the differences in demand for Islamic finance. A majority (about 78%) of the respondents with knowledge of Islamic finance think it is a viable option for financing SMEs.

About 43% respondents are willing to move 'all' their banking business to Jaiz bank when it commences operation with another 20% indicating they would move ‘some’ but not all of their bank accounts. Consequently, using ordinal regression model the dummy variables REG, EHE, EYE, EMT, AWIF, PCOLL, PLEE and FISMAN are found to be significant in predicting or explaining those SMEs that intend to move their banking relationship to Jaiz bank.

9.3 Research Implications
The study findings are deemed to have implications which if appropriately reviewed and utilized may assist in promoting SMEs. This is subsequently
expected to impact positively on the growth and development of the Nigerian economy. The study finds no differences between regional or sectoral groups of SMEs on the need to promote the ease of access to available forms of external financing. Similarly, no differences were noted between the groups on the need to explore new sources of external finance for use by Nigerian SMEs.

Based on the findings, organizations fostering entrepreneurship and SME development can better direct their actions and develop their products, advisory services and entrepreneur training and education. For those responsible for public policy, in general, and SME policy in particular, the results raise areas for consideration in drawing up either finance or SME related policies. It further provides an opportunity to evaluate SMIEIS performance and policy guidelines.

9.3.1 Theoretical and Methodological Implications
This study is undertaken with a view to broadening the essence and quantity of scholarly understanding in the areas of business finance particularly finance for SMEs and Islamic finance. Several factors related to entrepreneur and firm characteristics, and their environment are associated with the ability of SMEs to obtain the type and form of finance required. This indicates a need for classification of SMEs along lines that differentiate them on financing issues. The study finds regional and sectoral grouping of SMEs a useful approach which can provide a solid basis for further analysis.

SMEs in the two regions differed significantly in decision to use interest-based financing and the SMIEIS scheme. The distinction between SMEs groups confirmed the usefulness of groups as the ways firms react to the available finance sources are largely region specific. This is an important distinction expanding our knowledge of influences on access to finance by Nigerian SMEs. However, further research could reveal factors affecting SME finance which are common to SMEs in several industry sectors and thus are not industry specific.

This study is intended to give academics, both in Nigeria and beyond, an insight into and basis for comparison of SME studies in Nigeria and other peer countries. In addition, it is expected that this study may provoke the interest of academics in Nigeria to develop and expand the scope of SMEs to be studied. For instance, the entrepreneurs of the SMEs that failed to secure external financing have provided valuable knowledge of the factors affecting SME access
to finance from suppliers of finance in this study. So far, ex-entrepreneurs have been an underutilized resource in trying to foster an increased and better understanding of SME pertinent issues. However, many of them have learnt much from their firm's failure and can provide useful knowledge for nascent and active entrepreneurs, and for SMEs' stakeholders.

This work is expected to also provoke more research so as to create base knowledge in Islamic finance through development of SME financing models to ensure their specific applicability, and viability in SME financing. Because immense potential benefits are accruable from the Islamic financing options to meet SME needs for enhanced achievement of national economic growth.

9.3.2 Managerial Implications
In reviewing this research, nascent and existing entrepreneurs can regard the results as business management benchmarks to be recommended and those to be avoided in sourcing finance. For instance, to ease access to finance entrepreneurs should ensure they have previous management experience and acquired sufficient education and skills through constant management training.

9.3.2.1 For the Firms
Business ventures are carefully designed at start-up with entrepreneurs considering several issues such as the available firm-internal and availability of firm-external financial resources. From the study findings it is expected that firms should be aware of the threats which might negatively impact on the business and try to mitigate them. Some of the root causes of failure to secure finance are identified as largely being firm-internal factors, which are under the control of management. SMEs should use business plans which should enhance operational efficiency and mainly identify the firm's financial needs. Also the prevalence of skilled owner-managers is considered critical for SME success in pursuing financing. In addition, a high level of know-how amongst owner-managers is important in mitigating the hurdles in sourcing finance.

For start-up firms, the findings suggest acquainting themselves with the pitfalls encountered by existing SMEs so as to avoid them in seeking external finance. They should also set-up in business friendly and growing regions or areas which provide an environment that supports firm growth through more business financing opportunities so as to foster ease of access should the need arise.
9.3.2.2 For the Entrepreneurs

The study has identified reasons advanced by external finance sources for declining SME requests which existing entrepreneurs can use to ensure they avoid the potential problems they may encounter. Thus the findings will serve to guide existing owner-managers in the process of applying for external finance in the future. This can be achieved through preparing comprehensive applications for finance (by using effective business plans) to meet the requirements of finance providers. Also, it is found that owner-managers who had further management training and/or skills acquisition have added advantage. Training and skills acquisition enhances managing their SMEs while reducing the difficulties they face with external finance providers.

In addition, entrepreneurs unaware of alternative sources and types of external financing are afforded this knowledge by the study’s findings. It identified and discussed sources and nature of non interest-based finance. This is expected to benefit SMEs that avoid using interest-based financing.

Also Nigeria’s potential entrepreneurs are expected to benefit from this study as the group comparative analysis find hurdles of access to finance associated with the different regions and sectors. These factors are likely to assist prospective entrepreneurs in selecting which sector to venture into depending on the region they reside in and the level of financial resources available to them. It further serves to explain the issues to be catered for to facilitate the start-up and eventual growth of their ventures with minimal hitches. The results suggest that lack of managerial experience and skills is associated with a firm’s failure to secure the approval of external financing. Thus it may be unviable for those entrepreneurs with inadequate education and prior experience to start-up new firms, as they are unlikely to easily succeed in obtaining external finance.

9.3.3 Policy Implication

Over time policy-makers have voiced concerns about poor access to external finance, among smaller firms, due to a market failure in credit markets (Bolton, 1971; Wilson, 1979; Graham, 2004). This market failure means that some businesses with viable propositions are unable to access any, or sufficient, external finance (Fraser, 2004). In contrast to the traditionally held perception by policy makers and financiers that the mere availability of finance will ease
access for SMEs the findings show that a firm can have several other considerations in seeking external finance for financing its operations and growth. Policy makers and organizations fostering entrepreneurship and SME development can benefit from the differences in the regional and sectoral results in planning public interventions and other actions. As SMEs are unique actors in the economy, their individual and group financing needs should be further investigated thoroughly for better economic impact.

9.3.3.1 For the Regulators and Policy-Makers

Government policy focus: if policy-makers review and act on the study findings, the Nigerian economy will benefit from a widening of the spread of equity financing. SMEs with small asset bases are being excluded by the banks because the policy set the minimum asset base for a firm to benefit at $2m. Also, reasons similarly to those advanced by banks for declining debt financing are considered by respondents to be responsible for the poor performance of the SMIEIS fund. A re-evaluation of the reasons that result in the scheme’s poor performance could ease the hurdles for the SMEs while enabling the government to appreciate and set reasonably obtainable SME related goals and targets. This will ensure SMEs’ growth and enhance the economy’s jobs and income creation activities, and growth of industrial and economic base, etc.

SMEs with a proven track record hardly ever experience a shortage of debt financing, so government interventions in the past overemphasised the provision of debt finance. This study suggests that public-policy interventions should be reoriented, away from debt-oriented interventions, to emphasise initiatives that facilitate the provision of equity to SMEs through the expansion and/or establishment of venture capital funds and Islamic finance.

Financial regulatory authorities: the findings on the performance of the SMIEIS fund indicate that a high proportion of SMEs had negative experiences in sourcing equity finance from banks. The CBN must find out where the problems emanate from and how the scheme’s operations could be improved.

The focus of microeconomic and regulatory policy in Nigeria has been more of sector and sub-sector focus in relation to SMEs. The study reveals regional differences in this respect which if articulated and properly harnessed in policy orientation massive gains would be obtained. This study believes public policies
are more likely to promote new business creation if they are territory-specific. It is imperative to identify the specific needs of local environments and to develop policies to match such needs in order to produce positive results in the long run. Consequently, it is hoped the findings regarding the SMEs that indicate their need for Islamic finance will be used by the CBN in ensuring the timely take-off of the Jaiz bank to serve this potentially viable niche market.

9.3.3.2 For the Islamic Banks and Investors
This study identified the potential need for Islamic finance by SMEs in Nigeria, particularly in the northern region. It is anticipated that this finding will influence Islamic banks and investors to take advantage of the available market for Islamic finance. The size of Muslim population in Nigeria is about 60% of the over 120 million population, thus there is the need for more than one bank (presently the upcoming Jaiz Bank) as there is a substantial proliferation of new and existing SMEs and other business ventures to be served.

Furthermore, the Islamic banks upon take-off might need to design products in order to capture the hitherto untapped potential in the Nigerian economy in general and the SME sector in particular and to serve all sections of the society (Muslims and non-Muslims alike). Targeting the Muslim population only may lead to loss of potential business and may result in inability to attain general acceptability in a country such as Nigeria, where non-Muslims constitute about 40% of the population. Islamic financial institutions located outside the Muslim world are known to target the entire local population to achieve critical mass.

9.4 Study Evaluation
SMEs and entrepreneurship, on the one hand, and Islamic finance, on the other hand, are young fields of research. One problem with these fields of study is that comparisons between the results of various studies are rarely possible due to differences in firm-external environmental influences in different economies. Consequently, the development of models and theory has been protracted and fragmented into numerous research issues. This is compounded by divergence in management of business ventures between different areas and regions due largely to cultural and other differences.

The study served to deepen our knowledge of identified groups on factors and mechanisms affecting firm access to and use of external finance at firm and
regional levels in Nigeria. Questionnaires were used to obtain the primary data. The number of questions and variables in the questionnaire was large because studying a substantial set of variables provides a significant view of application for, difficulties and available sources of SME financing which should serve as a comprehensive and tangible foundation for further research. Furthermore, personal interviews consolidated the research process and responses by providing valuable details that fine-tuned and improved the mail survey data. To further evaluate and confirm the reliability of the data obtained in this study it was scrutinised and compared with some documentary sources, such as policy documents, reports and publications of banks and the CBN and newspaper articles and statements of SME related associations and stakeholders.

The study research design succeeded in showing that significant differences exist between the groups studied on access to and acceptability of the types of financing available. These significant differences resulted in important theoretical, methodological, and practical implications. However, it would be useful in business planning to take into consideration the factors revealed in this study, although they may not represent sufficient conditions for ensuring that SMEs obtain finance in the nature and structure desired in Nigeria. Entrepreneurs can use the results as a checklist to evaluate how well their firms satisfy the requirements of financiers. The results may provide a basis for benchmarking one's own business. Both potential and existing entrepreneurs and organizations responsible for local SME development can learn from the results of this study. In local and regional development, paying attention to the foundations of SME performance and success and could direct development operations at the most critical targets.

9.5 Suggestions for Further Research

For further research, a natural step forward would be to study the sequential continuity of SME success in accessing finance among the sample SMEs and the change in factors influencing the availability, type and form of required SME finance over time. This requires a longitudinal study that might provide valuable information on the changes in the factors affecting SME access to external finance and overall performance. Time series data could be gathered over some time period providing panel data that could be employed in furthering the
analysis of SME financing using more sophisticated methods of econometric data analysis. Such a detailed and better analysis might provide a basis for better generalization of findings and results.

In addition, data from SMEs that failed due to financing problems can significantly expand knowledge of the influence of external finance on SME performance. Research into such SMEs might require multi-source interviews with key employees, entrepreneurs, financiers and regulators, amongst others.

Finally, there is need for more detailed study of the success factors for SMEs that had no difficulties in obtaining external finance. Also, more in-depth studies should explore those SMEs that neither applied for external finance to ascertain why. Also the reasons behind the desire for Islamic finance and the regional differences in use of Islamic finance could be further explored. Equally future research on the acceptability and performance of the SMIEIS equity finance scheme in respect to the identified concentration of financing in the south in general and Lagos state in particular is required. Furthermore, the sectors studied could be expanded or new sectors could be studied in comparison to those studied herein so as to understand fully and afford better generalisation of the findings on the sectoral impact of external finance.

When Islamic banking does eventually take off, its acceptability, performance and impact assessment and viability in comparison to the conventional banking system in Nigeria are possible areas for further and future academic endeavours. Evidently, before a model of Islamic finance can be articulated for better SME performance, much work is still essential. One way this can be pursued is by studying SMEs within identical groups in-depth.
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10 BIBLIOGRAPHY


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APPENDICES
6th December 2004

The Chairman,
Manufacturers Association of Nigeria
Sharada/Challawa Branch
Kano

Dear Sir/Madam,

Re: Participation in Doctoral Research on SME Financing in Nigeria

Having worked for over 8 years in the Nigerian banking industry and taking cognisance of the renewed interest by both the public and private sectors of the Nigerian economy in SME development and growth, Dabo, D. A. is undertaking a PhD research work under our supervision.

It is understood that the SME sector in Nigeria is a growing and needs to be thoroughly researched, most especially in the area of financing. It is hoped that this research will help the sector in identifying some of the crucial techniques and best practices in SME financing. We undertake to share the research findings with all participants while assuring the individual respondents of maintaining strict confidentiality of all their responses.

We appreciate that your time is extremely precious but we do hope that by sparing some time to participate in this research you will be greatly assisting the SME sector and be able to eventually share in the outcome of the Dabo’s research results. We would be obliged if you would respond to the enclosed questionnaire. You will notice that the questionnaire is quite detailed as it highlights the coverage required of a typical PhD research project.

The questionnaire is being forwarded to you in advance in order to enable you to complete it as much as possible at your convenience. Dabo will subsequently contact you within the shortest possible time and request a brief meeting with you where you can raise any issues for clarification, if need be.

We look forward to receiving your cooperation.

Best regards

Yours Sincerely:

Dr. Seif E. I. Tag el-Din
Director of Studies
17th December 2004

D. A. Dabo,
P.O. Box 966, Makama Ward, Jahun, Bauchi.

Dear Mallam,

RE: Ph.D RESEARCH QUESTIONNAIRE

With reference to the above subject, I wish to officially acknowledge receipt of your letter and I am delighted to inform you that your request has been granted.

Our members (415 members) have been informed and are ready to cooperate with you in this programme.

We therefore advise that you make copies of the letters to be despatched to them.

Wishing you good luck in your research work.

Thank you.

Yours faithfully,

for: MANUFACTURERS ASSOCIATION OF NIGERIA

JOSHUA KOKWI
EXECUTIVE SECRETARY
TO: ALL M.A.N MEMBERS
KANO SHARADA/CHALLAWA & BOMPAI BRANCHES

INTRODUCING THE RESEARCHER - D.A. DABO

The above subject refers;

D.A. DABO who had worked in the Nigerian Banking Industry for 3 years is undertaking a research work on the SME in Nigeria.

It is expected that by your participation in this research work you would be assisting in the development of SME in Nigeria and would also have input in the outcome of this research results.

It would be appreciated if you could co-operate with him by responding to his questionnaire and any brief meeting he may wish to engage you.

Thank you.

JOSHUA KUKWI
EXECUTIVE SECRETARY
11.3 Appendix 3: Sample Survey Questionnaire

A. BACKGROUND INFORMATION

1. Business Name: ____________________________

2. Business Address: __________________________

3. Date of Incorporation/Business registration: __________________________

4. Length of Enterprise active business life (i.e. excluding periods of temporary closures, etc.):

   0 – 5 years □ 6 – 10 years □
   11 – 15 years □ 16 – 20 years □
   21 – 25 years □ over 25 years □

5. What is the legal form of your enterprise?

   1. Sole proprietorship
   2. Partnership
      a. General Partnership
      b. Limited Partnership
   3. Corporation – (Shareholding Company)
      a. Privately held
      b. Publicly held (listed on Stock Exchange)

6. Staff Size (including owner-managers):

   0 – 10 □ 11 – 20 □
   21 – 30 □ 31 – 40 □
   41 – 50 □ over 50 □

7. What is the current approximate size of the total assets of your business (at N135 to $1)?

   Up to $100,000 □ $100,001 - $200,000 □
   $200,001 - $300,000 □ $300,001 - $400,000 □
   $400,001 - $500,000 □ Over $500,000 □

8. Estimated average annual turnover (at N135 to $1):

   Up to $100,000 □ $100,001 - $200,000 □
   $200,001 - $300,000 □ $300,001 - $400,000 □
   $400,001 - $500,000 □ Over $500,000 □

   **** (please provide published annual reports where available)
9. Industry/Sector (type of business description):
   i. Manufacturing:
      - Such as Textiles; Agro-processing; Heavy industry (Chemicals, Autos, Machine Tools); etc.
   ii. Services:
      - Such as Building & Engineering Contractors; Hospitality (Tourism, Hotel, Restaurant); Haulage (Transport and Storage); Communications & Information Technology; etc.
   iii. Trade & Commerce:
      - Such as Wholesale & Retail Trade; etc.

10. Does your enterprise operate in accordance with a formally written business plan and/or Budget? (i.e. a document that details the enterprises’ current position and intended future targets with an attendant road-map of how it plans to attain the targets)
   Yes ☐  No ☐  if No, please proceed to question 12

11. The business plan was (please circle the number in appropriate box):

<table>
<thead>
<tr>
<th></th>
<th>Always</th>
<th>Mostly</th>
<th>Sometimes</th>
<th>Seldom</th>
<th>Never</th>
</tr>
</thead>
<tbody>
<tr>
<td>useful in the future planning of my business</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>useful in obtaining finance from lenders and/or investors</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>the lender(s) primary interest for granting loan(s) to the firm</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>accepted by lender(s) as a substitute for collateral required in securing loan(s)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

B. OWNER-MANAGER BACKGROUND

12. Which of the following categories do you fall into?
   i. Owner/Proprietor
   ii. Manager
   iii. Both - (Owner & Manager)

13. Which of the following is your age group?
   Under 21 years ☐ 21 – 30 years ☐
   31 – 40 years ☐ 41 – 50 years ☐
   51 – 60 years ☐ over 60 years ☐
14. Which of the following best gives your highest educational qualification or its equivalent?
   a. Primary/Elementary School Certificate  
   b. Secondary/GCE Certificate  
   c. Diploma/NCE Certificate  
   d. Degree/Higher Diploma Certificate  
   e. Post-Graduate Education  
   f. None (No formal Education)  

15. Before starting or joining this enterprise did you have any experience in managing a business?
   Yes [ ] No [ ] if No, please proceed to question 17

16. How many of these years of prior management experience were spent in running a small and/or medium enterprise?
   0 – 5 years [ ] 6 – 10 years [ ]
   11 – 15 years [ ] 16 – 20 years [ ]
   21 – 25 years [ ] over 25 years [ ]

17. Have you received any form of training in business management and/or entrepreneurial development through any workshops, courses, seminars and/or conferences?
   Yes [ ] No [ ]

C. FINANCING INFORMATION

18. Did you use ONLY personal finances to set up your business?
   Yes [ ] No [ ] if Yes, please proceed to question 23

19. What other sources of finance did you use from the list below? (Circle all the source(s) used if more than one in order of priority)
   (1 = Main/First, 2 = Second, 3 = third; 4 = fourth, 5 = FifthSource)

   a. Borrowing from friends and relatives 1 2 3 4 5
   b. Borrowing from local moneylenders/cooperatives 1 2 3 4 5
   c. Bank Overdraft/Loan 1 2 3 4 5
   d. Hire-purchase 1 2 3 4 5
   e. Venture/Equity Capital Finance 1 2 3 4 5
   f. Lease Finance 1 2 3 4 5
20. Did you encounter any difficulty in obtaining external finance from the above sources for starting your business?

1. Extreme difficulty ☐
2. Some difficulty ☐
3. No difficulty ☐ if No difficulty, please proceed to question 22

21. What were the difficulty levels of the obstacles in obtaining the external financing?

(1 = Major; 2 = Moderate; 3 = Minor; 4 = Uncertain; 5 = No Obstacle)

a. Lack of or inadequate Collateral/Securities 1 2 3 4 5
b. Inadequate personal financial inputs 1 2 3 4 5
c. Lack of business feasibility report 1 2 3 4 5
d. Previous experience 1 2 3 4 5

22. What was the main security you provided for the above financing used at start-up?

a. Personal guarantee (of Owner-Manager) ☐
b. External Guarantors ☐
c. Stock exchange securities/shares ☐
d. Real estate/property ☐
e. Floating charges (Lien on firm’s movable assets) ☐

23. Have you ever applied or sought for any external financing for running of your business after start-up?

Yes ☐ No ☐ if No, please proceed to question 29

24. What Source(s) of external financing did you apply for?

a. Long-Term Loan (above five years) ☐
b. Medium-Term Loan (below five years) ☐
c. Bank Overdraft/Short-Term Loan ☐
d. Government Loan Finance/Aid ☐
e. Venture/Equity Capital Finance ☐
f. Lease Finance ☐

25. Was your application for such financing successful or declined?

Successful ☐
Declined ☐ if Declined, please proceed to question 28

26. Did you accept or reject the offer for external financing?

Accepted ☐
Rejected ☐ if accepted, please proceed to question 29
27. What reason(s) from the following impelled you to reject the offer for the external financing?

(1 = Main/First, 2 = Second, 3 = third; 4 = fourth, 5 = Fifth reason)

a. difficult/impossible security requirement 1 2 3 4 5
b. duration of financing inadequate for the firm 1 2 3 4 5
c. financing offered below firm requirement 1 2 3 4 5
d. high cost of financing/interest rates 1 2 3 4 5
e. financier's desire for shares/equity in the firm 1 2 3 4 5

28. Which of the following options were given as the reason(s) for declining your application for the external finance by the provider(s)?

(1 = Main/First, 2 = Second, 3 = third; 4 = fourth, 5 = Fifth reason)

a. Lack of or inadequate Collateral/Securities 1 2 3 4 5
b. Project/Business Venture too risky 1 2 3 4 5
c. Insufficient/Poor source(s) of repayment 1 2 3 4 5
d. Lack of viable and comprehensive business plan 1 2 3 4 5
e. Management inexperience 1 2 3 4 5
f. Poor personal financial contribution 1 2 3 4 5
g. Failure in previous business venture 1 2 3 4 5
h. Business expansion excessively hasty 1 2 3 4 5
i. Lack of or insufficient credit history/record 1 2 3 4 5

29. "I have full confidence in the ability of the Nigerian financial system to provide financing to SMEs like mine." To what degree do you agree with this statement?

Present

- Fully agree
- Fairly agree
- Uncertain
- Fairly disagree
- Fully disagree

3 years ago

- Fully agree
- Fairly agree
- Uncertain
- Fairly disagree
- Fully disagree
30. Using the four point scale given below, how problematic do you consider these different financing issues are for the operation and growth of your business (please circle the number that represents your opinion/view).

<table>
<thead>
<tr>
<th>Issue</th>
<th>Major Obstacles</th>
<th>Moderate Obstacles</th>
<th>Minor Obstacles</th>
<th>No Obstacles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Collateral requirements of banks/financial institutions</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Interest charges and costs</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Lack of access to lease finance for equipment</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Lack of access to long-term loans</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Lack of access to non bank equity, investors and/or partners</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>

D. SMALL AND MEDIUM INDUSTRY EQUITY INVESTMENT SCHEME (SMIEIS)

31. Are you aware of the Small and Medium Industry Equity Investment Scheme and how it operates?
   Yes □    No □    if No, please proceed to question 38

32. Have you applied for the scheme at your bank?
   Yes □    No □    if No, please proceed to question 37

33. If yes, was the request successful?
   Yes □    No □    if No, please proceed to question 36

34. What percentage of your firm's equity did the bank invest in?
   0 – 10 percent □    11 – 20 percent □
   21 – 30 percent □    31 – 40 percent □
   41 – 50 percent □    over 50 percent □

35. In what form was the bank's investment made available to your firm?
   a. Cash □
   b. Working capital finance □
   c. Equipment purchase □
   d. Debt conversion to equity □
36. Indicate in order of priority the reason(s) advanced by the bank for declining to invest in your firm?

(1 = Main/First, 2 = Second, 3 = third; 4 = fourth, 5 = Fifth reason)

a. Project/Business Venture too risky 1 2 3 4 5
b. Insufficient/Poor source(s) of repayment 1 2 3 4 5
c. Lack of viable and comprehensive business plan 1 2 3 4 5
d. Lack of management experience 1 2 3 4 5
e. Poor personal financial contribution 1 2 3 4 5
f. Failure in previous business venture 1 2 3 4 5
g. Poor business planning 1 2 3 4 5
h. Business expansion excessively hasty 1 2 3 4 5
i. Lack of or insufficient firm history/records 1 2 3 4 5

37. What is your assessment/score of the SMIEIS initiative in meeting its objectives to date?

High ☐ Average ☐ Low ☐

E. ISLAMIC FINANCING SURVEY

38. Are you aware of the existence of Islamic Banking and finance?

Yes ☐ No ☐ if No, please proceed to question 41

39. Would you be willing to use Islamic finance in your business if it is available as a financing option for SMEs in Nigeria?

Yes ☐ No ☐ if No, please proceed to question 41

40. Based on priority which modes or types of Islamic finance would you prefer to use in financing your business?

(1 = Main/First, 2 = Second, 3 = third; 4 = fourth, 5 = Fifth Choice)

a. Musharakah - Equity & Profit/Loss Sharing 1 2 3 4 5
b. Mudarabah - Profit-sharing finance 1 2 3 4 5
c. Murabahah – Cost-plus sale or Trade with mark-up 1 2 3 4 5
d. Ijarah - Lease financing 1 2 3 4 5
e. All the types of financing 1 2 3 4 5

41. Are you aware of the non-interest banking window services being provided by Habib Nigeria Bank Ltd in Nigeria?

Yes ☐ No ☐ if No, please proceed to question 44
42. Have you had a business relationship with Habib Bank's non-interest banking services?
   Yes ☐  No ☐  if No, please proceed to question 44

43. Has Habib Bank's non-interest banking service met your expectations by providing the service(s) you desired?
   Yes ☐  No ☐

44. Are you aware of the moves to commence full-fledge Islamic banking operation in Nigeria with the planned formation of JA'IZ BANK?
   Yes ☐  No ☐  if No, please proceed to question 47

45. How much of your banking relationships/operations would you move to the Islamic bank when it starts operations?
   1. All ☐
   2. Some/Part ☐
   3. None ☐

46. Do you consider Islamic finance as a viable financing option for financing of SMEs in Nigeria?
   Yes ☐  No ☐

47. Do you agree with the statement that "SMIEIS is similar to the Musharakah (equity participation) mode of Islamic finance"?
   ➢ Fully agree ☐
   ➢ Fairly agree ☐
   ➢ Uncertain ☐
   ➢ Fairly disagree ☐
   ➢ Fully disagree ☐
   ➢ Do not know ☐

*** END ***

THANK YOU FOR YOUR PRECIOUS TIME AND EFFORT
### 11.4 Appendix 4: Definition of Some Main Variables

#### DEPENDENT VARIABLES

<table>
<thead>
<tr>
<th>Variable</th>
<th>Description</th>
<th>1 =</th>
<th>0 =</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADF</td>
<td>Applied for Debt Finance</td>
<td>Applied</td>
<td>Otherwise</td>
</tr>
<tr>
<td>AEF</td>
<td>Applied for Equity Finance</td>
<td>Applied</td>
<td>Otherwise</td>
</tr>
<tr>
<td>DOEFS</td>
<td>Difficulty in Obtaining External Finance</td>
<td>Difficult</td>
<td>Otherwise</td>
</tr>
<tr>
<td>DAEFS</td>
<td>Decision to Accept External Finance</td>
<td>Accept</td>
<td>Otherwise</td>
</tr>
<tr>
<td>UIFS</td>
<td>Use of Islamic Finance</td>
<td>Use</td>
<td>Otherwise</td>
</tr>
</tbody>
</table>

#### INDEPENDENT VARIABLES

<table>
<thead>
<tr>
<th>Variable</th>
<th>Description</th>
<th>1 =</th>
<th>0 =</th>
</tr>
</thead>
<tbody>
<tr>
<td>AWHNW</td>
<td>Awareness of Habib bank Non-Int Window</td>
<td>Aware</td>
<td>Otherwise</td>
</tr>
<tr>
<td>AWHNW</td>
<td>Aware of HNB Non-Int Window</td>
<td>Aware</td>
<td>Otherwise</td>
</tr>
<tr>
<td>AWIF</td>
<td>Aware Islamic Finance exists</td>
<td>Aware</td>
<td>Otherwise</td>
</tr>
<tr>
<td>AWIF</td>
<td>Aware of Islamic Finance</td>
<td>Aware</td>
<td>Otherwise</td>
</tr>
<tr>
<td>AWIF</td>
<td>Awareness of Jaiz bank set up</td>
<td>Aware</td>
<td>Otherwise</td>
</tr>
<tr>
<td>AWF</td>
<td>Aware of SMIEIS Fund</td>
<td>Aware</td>
<td>Otherwise</td>
</tr>
<tr>
<td>CNFS1</td>
<td>Confidence in Nig Fin system - current</td>
<td>Yes</td>
<td>Otherwise</td>
</tr>
<tr>
<td>CNFS2</td>
<td>Confidence in Nig Fin system - 3 yrs ago</td>
<td>Yes</td>
<td>Otherwise</td>
</tr>
<tr>
<td>COLREQ</td>
<td>Problem of Collateral requirements of banks</td>
<td>Yes</td>
<td>Otherwise</td>
</tr>
<tr>
<td>EAG</td>
<td>Entrepreneur’s Age</td>
<td>1 = under 21 years</td>
<td>2 = 21 - 30 years, 3 = 31 - 40 years, 4 = 41 - 50 years, 5 = 51 - 60 years, 6 = over 60 years</td>
</tr>
<tr>
<td>EAG1</td>
<td>Entrepreneur’s age under 21 Years</td>
<td>1 = under 21 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EAG2</td>
<td>Entrepreneur’s age 21 - 30 Years</td>
<td>1 = 21 - 30 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EAG3</td>
<td>Entrepreneur’s age 31 - 40 years</td>
<td>1 = 31 - 40 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EAG4</td>
<td>Entrepreneur’s age 41 - 50 years</td>
<td>1 = 41 - 50 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EAG5</td>
<td>Entrepreneur’s age 51 - 60 years</td>
<td>1 = 51 - 60 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EAG6</td>
<td>Entrepreneur’s age over 60 years</td>
<td>1 = over 60 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EHE</td>
<td>Highest Education</td>
<td>1 = Primary Sch Education, 2 = Secondary Sch Education, 3 = Diploma Education, 4 = Graduate Education, 5 = Post-Graduate Education</td>
<td></td>
</tr>
<tr>
<td>EHE1</td>
<td>Primary Sch Education</td>
<td>1 = Primary Sch Education</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EHE2</td>
<td>Secondary Sch Education</td>
<td>1 = Secondary Sch Education</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EHE3</td>
<td>Diploma Education</td>
<td>1 = Diploma Education</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EHE4</td>
<td>Graduate Education</td>
<td>1 = Graduate Education</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EHE5</td>
<td>Post-Graduate Education</td>
<td>1 = Post-Graduate Education</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EME</td>
<td>Previous Experience</td>
<td>1 = Yes</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EMT</td>
<td>Owner-Manager's management training</td>
<td>1 = Yes</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>ESTAT</td>
<td>Status</td>
<td>1 = Manager</td>
<td>2 = Owner, 3 = Both</td>
</tr>
<tr>
<td>EYE</td>
<td>Years of Management Experience</td>
<td>1 = 0 - 5 years, 2 = 6 - 10 years, 3 = 11 - 15 years, 4 = 16 - 20 years, 5 = 21 - 25 years</td>
<td></td>
</tr>
<tr>
<td>EYE1</td>
<td>0 - 5 years Prior Management Experience</td>
<td>1 = 0 - 5 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EYE2</td>
<td>6 - 10 years Prior Management Experience</td>
<td>1 = 6 - 10 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EYE3</td>
<td>11 - 15 years Prior Management Experience</td>
<td>1 = 11 - 15 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EYE4</td>
<td>16 - 20 years Prior Management Experience</td>
<td>1 = 16 - 20 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>EYE5</td>
<td>21 - 25 years Prior Management Experience</td>
<td>1 = 21 - 25 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>FAG</td>
<td>Firm Age</td>
<td>1 = 0 - 5 years, 2 = 6 - 10 years, 3 = 11 - 15 years, 4 = 16 - 20 years, 5 = 21 - 25 years</td>
<td></td>
</tr>
<tr>
<td>FAG1</td>
<td>Firm age 0 - 5 years</td>
<td>1 = 0 - 5 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>FAG2</td>
<td>Firm age 6 - 10 years</td>
<td>1 = 6 - 10 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>FAG3</td>
<td>Firm age 11 - 15 years</td>
<td>1 = 11 - 15 years</td>
<td>0 = Otherwise</td>
</tr>
<tr>
<td>FAG4</td>
<td>Firm age 16 - 20 years</td>
<td>1 = 16 - 20 years</td>
<td>0 = Otherwise</td>
</tr>
</tbody>
</table>

**INDEPENDENT VARIABLES – Continued Overleaf**
**INDEPENDENT VARIABLES - Continued**

<table>
<thead>
<tr>
<th>Code</th>
<th>Description</th>
<th>Value Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>FAG5</td>
<td>Firm age 21 - 25 years</td>
<td>1 = 21 - 25 years, 0 = Otherwise</td>
</tr>
<tr>
<td>FAG6</td>
<td>Firm age over 25 years</td>
<td>1 = over 25 years, 0 = Otherwise</td>
</tr>
<tr>
<td>FBP</td>
<td>Business Plan</td>
<td>1 = Use, 0 = Otherwise</td>
</tr>
<tr>
<td>FIS</td>
<td>Industry Sector</td>
<td>1 = Manufacturing, 2 = Services, 3 = Trade</td>
</tr>
<tr>
<td>FISMAN</td>
<td>Manufacturing Sector</td>
<td>1 = Manufacturing, 0 = Otherwise</td>
</tr>
<tr>
<td>FISSER</td>
<td>Services Sector</td>
<td>1 = Services, 0 = Otherwise</td>
</tr>
<tr>
<td>FISTRD</td>
<td>Trade Sector</td>
<td>1 = Trade, 0 = Otherwise</td>
</tr>
<tr>
<td>FLF</td>
<td>Legal Form</td>
<td>1 = Sole Proprietor, 2 = General Partnership, 3 = Limited Partnership, 4 = Private Ltd Liab Co., 5 = Public Ltd Liab Co.</td>
</tr>
<tr>
<td>FSZA</td>
<td>Total assets value</td>
<td>1 = up to $100,000, 2 = $100,001 - $200,000, 3 = $200,001 - $300,000, 4 = $300,001 - $400,000, 5 = $400,001 - $500,000, 6 = $500,001 - $600,000.</td>
</tr>
<tr>
<td>FSZE</td>
<td>Size (Employees)</td>
<td>1 = 0 - 10 staff, 2 = 11 - 20 staff, 3 = 21 - 30 staff, 4 = 31 - 40 staff, 5 = 41 - 50 staff, 6 = over 50 staff</td>
</tr>
<tr>
<td>FSZE1</td>
<td>Firm size by staff number - 0 - 10 staff</td>
<td>1 = 0 - 10 staff, 0 = Otherwise</td>
</tr>
<tr>
<td>FSZE2</td>
<td>Firm size by staff number - 11 - 20 staff</td>
<td>1 = 11 - 20 staff, 0 = Otherwise</td>
</tr>
<tr>
<td>FSZE3</td>
<td>Firm size by staff number - 21 - 30 staff</td>
<td>1 = 21 - 30 staff, 0 = Otherwise</td>
</tr>
<tr>
<td>FSZE4</td>
<td>Firm size by staff number - 31 - 40 staff</td>
<td>1 = 31 - 40 staff, 0 = Otherwise</td>
</tr>
<tr>
<td>FSZE5</td>
<td>Firm size by staff number - 41 - 50 staff</td>
<td>1 = 41 - 50 staff, 0 = Otherwise</td>
</tr>
<tr>
<td>FSZE6</td>
<td>Firm size by staff number - over 50 staff</td>
<td>1 = over 50 staff, 0 = Otherwise</td>
</tr>
<tr>
<td>IFVIAB</td>
<td>Islamic finance viable option for SME finance</td>
<td>1 = Yes, 0 = Otherwise</td>
</tr>
<tr>
<td>MBJZ</td>
<td>Move banking business to Jaiz bank</td>
<td>1 = All, 2 = Some, 3 = None</td>
</tr>
<tr>
<td>PALF</td>
<td>Lack of access to lease finance</td>
<td>1 = Yes, 0 = Otherwise</td>
</tr>
<tr>
<td>PALL</td>
<td>Lack of access to long-term loans</td>
<td>1 = Yes, 0 = Otherwise</td>
</tr>
<tr>
<td>PLAPR</td>
<td>Loan Application Approved</td>
<td>1 = Approved, 0 = Otherwise</td>
</tr>
<tr>
<td>PLEE</td>
<td>Lack of external equity/Partners</td>
<td>1 = Yes, 0 = Otherwise</td>
</tr>
<tr>
<td>REG</td>
<td>North-South Region</td>
<td>1 = North, 0 = South</td>
</tr>
<tr>
<td>RCOL</td>
<td>Collateral Requirement</td>
<td>1 = Reject, 0 = Otherwise</td>
</tr>
<tr>
<td>RTEN</td>
<td>Tenor inadequacy of finance</td>
<td>1 = Reject, 0 = Otherwise</td>
</tr>
<tr>
<td>RINT</td>
<td>Interest Charges</td>
<td>1 = Reject, 0 = Otherwise</td>
</tr>
<tr>
<td>ROSH</td>
<td>Ownership/Equity sharing</td>
<td>1 = Reject, 0 = Otherwise</td>
</tr>
<tr>
<td>SFASST</td>
<td>SMIES performance assessment</td>
<td>1 = High, 2 = Average, 3 = Low</td>
</tr>
<tr>
<td>SFSMSH</td>
<td>SMIES fund same with Musharakah mode</td>
<td>1 = Same, 0 = Otherwise</td>
</tr>
<tr>
<td>SFSTAT</td>
<td>Status of SMIES application</td>
<td>1 = Approved, 0 = Otherwise</td>
</tr>
<tr>
<td>SHNS</td>
<td>Satisfied with the HNB non-interest services</td>
<td>1 = Satisfied, 0 = Otherwise</td>
</tr>
<tr>
<td>UAFM</td>
<td>Use All finance modes</td>
<td>1 = Use, 0 = Otherwise</td>
</tr>
<tr>
<td>UHNS</td>
<td>Use of HNB non-interest services</td>
<td>1 = Use, 0 = Otherwise</td>
</tr>
<tr>
<td>UIJR</td>
<td>Use Ijarah (Lease) finance mode</td>
<td>1 = Use, 0 = Otherwise</td>
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<tr>
<td>UINTF</td>
<td>Use of Interest in Financing</td>
<td>1 = Yes, 0 = Otherwise</td>
</tr>
<tr>
<td>UMDR</td>
<td>Use Mudarabah finance mode</td>
<td>1 = Use, 0 = Otherwise</td>
</tr>
<tr>
<td>UMRB</td>
<td>Use Murabahah finance mode</td>
<td>1 = Use, 0 = Otherwise</td>
</tr>
<tr>
<td>UMSH</td>
<td>Use Musharakah finance mode</td>
<td>1 = Use, 0 = Otherwise</td>
</tr>
</tbody>
</table>