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FINANCING CONSTRAINTS OF SMALL AND MEDIUM ENTERPRISES IN SOUTH-WESTERN NIGERIA

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ABSTRACT: *This study focused on the investigation of the financing constraints of small and medium enterprises in South- Western Nigeria. The study determined how high bank changes, high legal documentation fees and collateral securities are related to financing constraints for small and medium enterprises in south- western Nigeria. The study was carried out using a quantities methodology through administration of a structured questionnaire. The data gathered was analyzed using descriptive and inferential statistics such as percentages, correlation analysis and multiple regression, with the aid of statistical package for social science (SPSS) version 20 with a cut off set a p= 0.05 level of significance. The study was conducted in six states of south – west Nigeria that is Lagos, Ogun, Oyo, Osun, Ondo and Ekiti. The result show that high bank charges constitute financing constraint since p-value is < 0.05; there is no significance evidence to conduct that high legal documentation fees is a constraint to financing small and medium enterprises since p-value is > 0.05 and there is positive but weak relationship between collateral securities and financial constraint of small and medium enterprises in south-west Nigeria. This study has contributed to literature on financing constraints of small and medium enterprises*

KEYWORDS: Financing, Financing Constraints, Small and Medium Enterprises

INTRODUCTION

Policy makers, scholars and practitioners alike consider attempt to alleviate financing constraints for small and medium enterprises as an important goal for policy across the world (Williams & Ramana. 2009). Financial assistance for small and medium enterprises is also high on the agenda in European Union, where member states are urged to promote the availability of risk capital financing for small and medium enterprises (OECD, 2004).

Small and medium enterprises account for a large share of enterprises and a large share of the private sector of Africa economies (World Bank, 2013). It is universally accepted that one of the government's major roles in promoting economic growth is the creation of an appropriate business environment (OECD, 2004). The business environment includes the trade regime. macroeconomic policies, infrastructure investments and the regulatory environment. Many small and medium enterprises rightly argue that weak factor markets and institutions in Africa are also to blame and that providing a conducive business environment may not he sufficient to raise the standard of Africa Small and Medium Enterprises (OECD, 2004).

Economic development requires the growth of productive firms, theoretical considerations and existing empirical evidence point to the existence of financial constraints that limits firms investment abilities (OECD, 2004).

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Fazzari, Hubbard & Peterson (1988) submit that large body of empirical literature have emerged to estimate financing constraints of firms. This literature relies on the assumption that external finance is more costly than internal finance due to asymmetric information and agency problems and that the premium on external finance is an inverse function of a borrower's net worth (Fazzari *el* a.. 1988). A firm is defined to be financially constrained if a windfall increase in the supply of internal funds results in a higher level of investment spending (OECD, 2004).

It is undoubted that SMEs are without track record and bank loans would definitely become too expensive for those firms, since young companies cannot rely on internal funds resulting from cash inflow from former product sales either, financing constraints may be more binding for such firms (Gompers & Lerner 1999; Rifler, 1991).

Small and medium enterprises has been the backbone of most developed and emerging economies of the 21st century, any country that refuses to take peculiar attention to unleashing and enhancing the entrepreneurial initiatives would be left behind(Oduro-Nyarko, 2000). Empowering people to take entrepreneurial initiatives and helping them to build formidable businesses has been one of the most effective ways of reducing poverty and putting the people's life into their own hands. Like the proverbial Chinese saying goes do not give a man fish rather teach him to fish" (Oduro-Nyarko, 2000).

There are also a number of empirical and conceptual studies on the consequences of small and medium enterprises, it is now widely accepted by society in general that the benefits of entrepreneurial activities are not restricted to small and medium enterprises alone. rather. small and medium enterprises have impact on the well-being of the economy as a whole(Oduro-Nyarko, 2000).

However, one of the greatest challenges facing the private sector and for that matter entrepreneurial development is the financing constraints, lack of accessibility of sufficient supply of finance for setting up. operations and growth of the business (Kerr & Nanda. 2009).

In the absence of credits from the bank, potential small and medium enterprises sometimes resort to the informal sources of finance such as the traditional money lenders, these informal money lenders charge exorbitant interest rates (Kerr & Nanda. 2009). In view of this problem among others, small and medium enterprises are not able to transform their ideas and plans into reality due to the financing constraints, while inadequate capitalization or poor financial management can destroy a business, even where the basic idea behind the business is good (Kerr & Nanda, 2009) These constraints may emanate from the fact that those potential small and medium enterprises have no capital base and also lack the appropriate collateral and other requirements to access credits from the banking institution.

It is now widely accepted that access to finance is crucial to the growth and expansion of small and medium entrepreneurship in developing nations and as a result governments have launched a variety of policies, programmes and projects geared towards promotion of businesses in most developing countries (Spath, 1993).

Problem Statement/Justification

As real incomes fell and employment opportunities in large firms and public sector diminishes, many people initiated part-time businesses or became self-employed. However. obtaining adequate funds at the inception or growing stages of the business has been difficult and in some instance not available at all. Most startups in Nigeria begin business with their own

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contributions in the form of savings which is mostly inadequate to support any expansion and growth. (OEED) More recently. capital constraints have been offered as an explanation for the pattern in the size distribution of firms and the relation between capital access and growth. Cabral & Mata (2003) developed a model of firm growth that depends upon investments and access to capital. Their model predicts that in the presence of capital constraint, the firm becomes small in size. as capital constraints worsened. firm size distributions will be smaller and this inhibits growth (Cabral&Mata,2003).

There are argument illustrating that financing constraints owing to asymmetry information between borrower and lenders may be particularly binding for small firms. Small firms may have disadvantages because they cannot exploit scale economics and have less overall physical assets to large capital intensive companies (Petersen & Raja. 1995). Moreover, older firms could benefit from their established bank contacts as bank use relationship lending to reduce problems of asymmetry information. Newly founded firms may not have built such relationships yet (Petersen & Raan,1995).

Also, bank financing may be limited for young firms because of the higher default risk of young companies (Fritsch, Brixy & Falck, 2006) since young companies cannot rely on internal funds resulting from cash inflow from former product sales either financing constraints may not be more binding for such firms (Gompers&Lemer,1999;Ritter,1991).

This study intends-once the financing constraints are identified between uneven and imperfect information between the borrowers and the financiers to prefer solution to problems of high bank charges and collateral securities requirements of financiers. Given that the existing literature did not dell much on the financing constraint of SMEs especially in developing countries like Nigeria, This study intends to fill that gap also.

The access to finance difficulties experienced by SMEs are from several sources: the domestic financial market may contain an incomplete range of financial products and services; the lack of appropriate financial mechanisms in itself by a function of. regulatory rigidities or gaps in the legal framework; monitoring difficulties such as principal\agent problems and asymmetric information (OECD, 2006). Suppliers of finance may rationally choose to offer range financial services that leave significant number of borrowers without access to finance. The group that is mostly going to be affected by this rational offer will be the SMEs because of their operational opacity. (Afolabi, 2005) The access to finance difficulty will even be made more worst if the business environment lacks transparency, weak legal system. reluctance to fund start-ups, young firms lack collateral and firms with risky activities (OECD, 2006). The financial institutions and other external sources of finance are reluctant, to finance SMEs in Nigeria because they are perceived as high risk borrowers, due to insufficient assets, vulnerability to market fluctuations and high failure rate; information asymmetries due to lack of good financial book-keeping or business plans to assess the viability of their proposals; and high administrative\transaction costs of lending or investing small amounts making SMEs financing un - predication (Abereijo and Fayemi, 2006).

Mambula (2002) study lists two other reasons, not included in Abereijo and Fayemi (2005) study and these are: judicial system is inefficient, contents cannot be easily enforced: and the business environment is generally uncertain and risk prove. Therefore. when banks lend to SMEs, they charge more and apply tougher requirements that make it difficult to access external finance (Abereijo and Fayemi, 2005)

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Research Objective

The aim of this study is to examine the financial constraints of small and medium enterprises in South Western Nigeria. while the specific objectives are:

- To determine, if high bank charges constitute a financial constraint for small and medium enterprises.
- To examine if. high legal documentation fee constitute a financial constraint small and medium enterprises in South-Western Nigeria.
- To analyse if collateral securities are related to financial constraint among small and medium enterprises in South — Western Nigeria.

LITERATURE REVIEW

Concept of Financing

Firms choose funding that minimizes the cost and maximizes the benefits with different sources. firms may select funding sources of debt and equity that allow them to transfer risk, maintain control, or signal information asymmetries. Other firms search for the cheapest available funding while maintaining control of the business (Harris & Riviv, 1991).

The pecking order model of capital structure directly addresses issues of information asymmetries. With the theory. firms do not aim for a target dept ratio. Rather. a capital structure emerges as the firms select from funding sources that minimize the cost of capital (Myers, 1984; Myers and Majiluf, 1984). Internal sources (e.g. retained earnings) are used first since information asymmetry problems are non-existent: debt is sought next, followed by outside equity (Myers, 1984: Myers and Majiluf, 1984). The presence of significant information asymmetry cause the outside investor to charge a higher rate of return on equity than on dept (Frank and Goyal, 2003).

Despite the establishment of the SME division by the financial institutions, the financing problem faced by the SME’s especially the micro entrepreneur still persist owing to problems such as the facilities packaged by the banks. They were found not suitable to finance the working capital requirement. The participating agency provides limited financial assistance to micro companies where the financing amount is relatively small and the type of facilities sometimes do not suit the micro companies business needs (Nurbani, Susan, Jian and Noor, 2010). If the micro, small and medium enterprises do manage to get the facilities from the financial institutions, they will face with set of financial charges such as high cost of borrowings high bank charges and fees high legal documentation fees, and other charge as imposed by the financial institutions (Nurbani *et al.,* 2010).

Metrics of financial market development quantify the ease with which individuals in need of internal finance can access the required capital and the premium they pay for these funds (William & Ramana, 2009).

There is growing consensus in the academic literature that the financing environment plays an important role in explaining cross-country difference in economic growth. in part through its role in facilitating high quality small and medium enterprises. Although this relationship is well

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articulated at the cross-country level, the micro-mechanisms through which the financing environment affects small and medium enterprises have received much less attention (King and Levine. 1993a. 1993b; Levine, 1997).

Small and Medium Enterprises

Small and medium enterprises account for a large share of enterprises and a large share of overall employment in the private sector of most economies. Employment in enterprises with up to 250 employees constitutes over 60% of total employment in manufacturing in many countries, which justifies the statement that “SMEs are the emerging private sector in poor countries and thus form the base for private sector-led growth” (Hallberg, 2001). Cross-country evidence, however, also shows that small and medium enterprises are more constrained in their operation and growth than large enterprises and access to financial services features importantly among the constraints (Ayyagari. DemirgUç-Kunt and Maksimovic, 2006).

This paper summarizes recent empirical evidence on SMEs’ financing constraints and patterns. While offering broad cross-country comparisons, it should be noted that this paper focuses mainly on developing and emerging markets. It offers a conceptual framework to understand why financial institutions in most countries are so reluctant to reach out to these enterprises and discusses different policies and reform that can increase SMEs’ access to external finance. Based on this framework, the paper goes on to discuss government’s role in enhancing access to finance, ranging from institution building over providing regulatory frameworks to market-friendly activist policies, while at the same time noting potential pitfalls in governments’ attempts to enhance SMEs’ access to credit.

Policy efforts targeted at SMEs have often been justified with arguments that (i) SMEs are an engine of innovation and growth. (ii) They help reduce poverty as they are more labor-intensive, but (iii) They are constrained by institutional and market failures. While country-level and micro-economic studies have not provided conclusive evidence on these arguments. recent cross-country evidence does not support the claim that countries with a larger share of SMEs in the manufacturing sector grow faster or see their poverty rates fall faster (Beck, Demirguç-Kunt and Levine, 2005). Specifically, there does not seem to be any robust relationship between the share of small, medium or large enterprises and economic development. On the other hand, cross-country research has pointed to the institutional and business environment in which enterprises operate as an important factor for economic development. The business environment includes among other elements - well-defined property rights, both between private parties and protection against government expropriation, effective contract enforcement, competitive product. labor and capital makers, and a legal framework that allows for relatively easy entry and exit of enterprises. Klapper, Laeven and Rajan (2006) show how different elements of the business environment affect economic growth through the entry of new firms. Specifically, high firm registration costs hamper new firm creation and growth. while property right protection and regulations fostering access to finance are conducive to firm creation and growth. The effect of policies might also explain the absence of a robust relationship between the size of the SME sector and growth as a comparison between Italy and the UK illustrates. On the one hand, Italy has high registration costs and many old. inefficient and slow growing SMEs, while the UK with low entry barriers has firms that enter at a lower scale than in Italy but grow more rapidly.

Taking together, this implies the policy focus shifting away from size-oriented policies toward policies that level the playing field between firms of different sizes and allow for entry of new

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enterprises. While small firms suffer more from financing and other constraints than large firms, it is not size itself that justifies intervention, but rather the potential of small firms to grow into medium and large enterprises and to contribute to the economy and the fact that institutional and market failures create an uneven playing field between firms of different sizes. As we will argue below, the focus should therefore be both on reforms of the business environment that affect all enterprises and foster entrepreneurship (Klapper and Quesada-Delgado, 2007), but also on policies that can help SMEs overcome financing constraints particular to their firm size and risk. The focus should be less on subsidies to small enterprises per Se.

Sources of Financing

To finance their investments, established firms raise both debt and equity. Within the broad categories of debt and equity. there are a variety of instruments and vehicles that firms can use. Most commonly. loans are raised through short or long-term bank loans, bond loans or leasing. Equity can be obtained from current shareholders, venture capitalists, private equity investors and new investors by issuing common stock. The latter is only available for public traded firms (Ang, 2000).

New ventures have more difficulties in raising financial capital compared to established and large companies. Start-ups have no prior financial or operating history and hence. no reputation or track-record (Cassar. 2004; Huyghebaert and Van de Gucht, 2007) and therefore face unique problems at almost every stage of their development (Walker, 1989; Ang. 2000; Cassar, 2004). New ventures may not be able to obtain all of the desired capital if they lack significant assets that can be used as collateral (Cosh, Cumming and Hughes, 2009). Korosteleva and Mickiewicz (2011) state that one of the common problems for SMEs is raising sufficient capital to launch and operate successfully and thus is one of the major constraints for small and medium enterprises. Therefore, the choices of funding are narrower for new and small private firms.

In the context of new ventures, the categorization of debt and equity is blurred and consequently previous studies propose the internal and external capital framework (Myers, 1984: Myers, 2001). In this framework, internal and external capital are divided into debt and equity. Usually. firms use internal sources (i.e. internally generated cash flows) to fund their investments (Darnodarafl, 2004). However, this kind of funding can be insufficient, and external sources are used to cope with additional financing needs. To finance their businesses on very early stages. small and medium enterprises use their own personal savings and raise funds from friends and family. At this stage. the finances of the firm are intertwined with those of the entrepreneur (Coleman, 2008) and business bankruptcy can cause personal bankruptcy (Ang, 1992). Bank loans, which arc usually guaranteed by the small and medium enterprises' personal assets, and trade creditors, have also been shown to be important sources of finance on ventures' early stages. Over time. retained profits and short-term financing become the main sources of financing for small firms (Lucey and Bhaird, 2006). In fact. Robb & Robinson (2010) find that owner-backed bank loans and business credit cards are the primary source of financing for start-up firms during their first year. although informal investors are also important. Their evidence refute the commonly held idea that start-ups lack access to formal capital markets and thus are forced to rely on informal financing and bootstrap financing. Bootstrapping methods are generally used as a reactionary measure to financial constraints, and firms that are more likely to bootstrap are highly-leveraged. underperforming and cash constrained. Young firms tend to use owner-related. joint-utilization and delayingpaymeflt5

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methods of bootstrapping. which may be detrimental to subsequent firm performance particularly in periods of financial constraint (Ebben, 2009).

METHODOLOGY

The study area covers the six states in the south-west Nigeria namely: Lagos, Oyo, Ogun, Osun, Ekiti and Ondo. The study adopt a survey research design which provides a general frame work for the collection of appropriate data that implores financing constraints of small and medium enterprises in south-western Nigeria. It uses quantitative approach to determine how high Bang Charges, high legal documentation fees and collateral securities are related to financing constraints for small and medium enterprise in rely on primary data sourced from the respondents. The study population covers total 7, 47SMEs and the simple size taking was 518 SMEs in the study area. The data was fathered using survey questionnaire that was administered on the owner managers of SMEs.

The questionnaire was made up of fore – point rating scales ranging between strongly agree, agree, undecided, disagree and strongly disagree.

Then tools of analysis of the collected data was both descriptive (percentages and bar chart) and inferential (correlation analysis and multiple regression. This was done using statistical package for social sciences (SPSS) with a cut- off set of p=0.05 level of significant.

RESULT/ FINDINGS AND DISCUSSION

Table 1: Are You financial constraint?

	FREQUENCY	PERCENTAGE %
Yes	421	81.31%
No	97	18.7%
Total	518	100%

Source: Survey Study, 2017

From the table it was deduced that 421 or 81.3% of the respondent submits that they are financially constraints. Which means fast majority of the small and medium enterprises in south- western Nigeria faces difficulty in obtaining adequate amount of funds in order to establish and run their business such as issue of collateral and high interest rate.

Table 2: High bank charges lead of financial constraints of small and medium enterprise.

	FREQUENCY	PERCENTAGE %
Strongly agree	303	58.5%
Agree	168	32.4%
Undecided	16	3.1%
Disagree	18	3.5%
Strongly disagree	13	2.5%
Total	518	100%

Source: Survey Study, 2017

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High bank charges lead to financial constraints of small and medium enterprises. The table shows that 303 or 58.5% and 168 or 32.4% strongly agree and agree that high bank charges lead to financial constraints of small and medium enterprises in south- western Nigeria.

Table 3: High legal documentation fees is constraint to financing small and medium enterprises

	FREQUENCY	PERCENTAGE %
Strongly agree	162	31.3%
Agree	224	43.2%
Undecided	48	9.3%
Disagree	49	9.5%
Strongly disagree	35	6.8%
Total	518	100%

Source: Survey Study, 2017

High legal documentation fees is a constraint to financing small and medium enterprises in south- western Nigeria. The table indicate that 224 or 43.2% and 162 or 31.3% agree and strongly agree that high legal documentation fees is a constraint to financing small and medium enterprises in south- western Nigeria.

Table 4: Collateral securities leads to financing constraint of small and medium enterprises

	FREQUENCY	PERCENTAGE %
Strongly agree	190	36.7%
Agree	204	39.4%
Undecided	54	10.4%
Disagree	50	9.7%
Strongly disagree	20	3.9%
Total	518	100%

Source: Survey Study, 2017

Collateral securities leads to financing constraint of small and medium enterprises. The table shows that 204 or 39.4% and 190 or 36.7% agree and strongly agree that collateral securities leads to financing constraint of small and medium enterprises in south- western Nigeria.

REGRESSION

Table 5: Regression

Model	R	R square	Adjusted R Square	Std Error of the Estimate
1	.180	.032	.009	.389

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ANOVA

Model	Sum of square	df	Mean square	f	Sig
Regression	2.553	12	.213	1.409	.158
1 Residual	76.283	505	.151		
Total	78.836	517			

a. Dependent variable: are you financial constraint
b. Coefficient

Model	Unstandardized coefficient		Standardized coefficient	t	Sig.
	B	Std. Error	Beta		
(constant)	1.164	.068		17.20	.ooo
High bank charges leads	.041	.020	.095	2.037	.042
to financial constraint of					
small and medium					
enterprises	.011	.016	.034	.705	.481
High legal					
documentation fees is					
constraint to financing	-.016	.017	-.046	-.961	-.337
small and medium					
enterprises	-.010	.016	-.028	-	.563
Collateral securities				.0579	
leads to financing	.015	.016	.045		.349
constraint of small and				.938	
medium enterprises	-.037	.018	-.105		.038
Lack of good business				-	
plan to asses the viability				2.083	
of their	.002	.017	.005		.923
proposals. requirements					
is another constraint				.097	
Regulatory burdens (e.g.					
high tax, high entry					
costs, strict labour					
regulatorys) constitute					
financial constraints					
Information asymmetry					
leads to financing					
constraints of small					
medium enterprise					

Y=bo+b1x1+b2x2+-------------------------------- b12x12

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Where y= financial constraint

X1= high bank charges

X2= high legal fees

X3 = collateral securities

If sig value (p- value (0.05)

It means that it is significant

Y=1.164+0.041x, + 0.011x2--------------+ 0.011x12

(vi) Since p- value for x1 (0.042) <0.05 then we accept the significant of the x1 meaning that high bank charges constitute financing constraint of small and medium enterprises in south-western Nigeria.

(vii) Since p- value for x2 (0.481) >0.05 then it means that there is no significance evidence to conclude that high legal documentation fess is a constraint to financing small and medium enterprises in south- western Nigeria.

CORRELATIONS

(vi) Collateral securities leads to financing constraint of small and medium enterprises in south western Nigeria.

Table 6

Correlations

			Are you financially Constraint?	Collateral securities leads to financing constraint of small and medium enterprises
Kendall's tau _b	Are you financial constraint?	Correlation coefficient	1.000	.021
		Sig. (2-tailed)	.	.613
		N	518	518
	Collateral securities leads to financing constraint of small and medium enterprise	Correlation coefficient	.021	1.000
		sig.(2-tailed)	.613	.
		N	518	518
Spearman's rho	Are you financially constraint?	Correlation coefficient	1.000	.022
		sig. (2-tailed)	.	.614
		N	518	518
	Collateral securities leads to financing constraint of small and medium enterprises	Correlation coefficient	.022	1.000
		Sig. (2-tailed)	.614	.
		N	518	518

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The correlation coefficient between y and x3 (r) = 0.021 meaning that the existing relationship is very weak though positive and asserted by the p- value 0.613 which is greater than 0.05. in conclusion, there is positive but weak relationship between collateral securities and financial constraint of small and medium enterprises in south western Nigeria.

IMPLICATION

It is believed that the outcome of this paper will be used by policy makers and stakeholder and to highlight the financing constraint of small and medium enterprises in South-Western Nigeria using the result of this study.

The outcome of this findings will better enhance the practice of 3enterpreneurship in terms of exposing small and medium enterprises to the financing constraints.

The study will also contribute to literature on financing constraint of small and medium enterprises and the perspective will be a valuable contribution to extant knowledge in entrepreneurial activities.

CONCLUSION

It has been established that high bank charges lead to financing constraint of small and medium enterprises in South-Western Nigeria, as also High legal documentation fees and collateral securities. The finding show that since P-value for X_1 (0.042) < 0.05 then we accept the significant of the X1 meaning that high bank charges constitute financing constraint of small and medium enterprises in South-Western Nigeria.

It was also submitted that since P-value for X2 (0.481) > 0.05 then it means that there is no significance evidence to conclude that high legal documentation fees is a constraint to financing small and medium enterprises is South-Western Nigeria.

The correlation coefficient by Y and X 3(v) = 0.021 meaning that the existing relationship is very weak though positive and asserted by the P-value 0.613 which is greater than 0.05 conclusively there is positive but weak relationship between collateral securities and financial constraint of small and medium enterprises in South-Western Nigeria.

FUTURE RESEARCH

Financing constraints are one of the biggest concerns impacting entrepreneurs around the world. Academic interactive has focused on under stanching several dimensions of financing constraints. This study pares the way for future research that holds the potential to make meaningful contributions to a number of literatures for example as discussed that high bank charges, high bank legal documentation fees and collateral security leads to financing constraints. However area of future research may be capital intensity and technological novelty to found a firm which may reflect a whole set of unobserved factors that researchers need to be careful about when they look at the question of financing constraints in entrepreneurship.

Future research should be more explicitly examine the theory of financing constraints and how it affect small and medium enterprises.

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