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Analysis of Small and Medium Scale Enterprises (SMEs) Financing and Economic Growth: Which Way for Nigeria

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Abstract
Perfectly structured SMEs can contribute significantly to employment generation, wealth creation, poverty alleviation and sustainable economic growth and development. SMEs lack of access to effective source of finance has been identified as one of the major quagmire hindering their contributions to economic growth. On this premise, this paper assesses specific financing options available to SMEs in Nigeria and contribution to economic growth. The paper uses secondary sources of data which were generated from the publications of Central Bank of Nigeria (CBN) statistical Bulletin and World Development Indicators (WDI). Ordinary Least Square (OLS) estimation technique is employed to determine the effect of SMEs financing on economic growth in Nigeria. The analysis of the results suggested that there is an insignificant direct relationship between SMEs financing and Economic growth in Nigeria, this can be adduced to policy inconsistencies in SMEs financing. The paper recommended that strenuous effort should be made by the government by easing access to SMEs finance via subsidized interest rate in order enhance economic growth and development.
Keywords: Small & Medium Scale Enterprises, Financing Options, Economic Growth and Nigeria

1.0 Introduction

The diverse role of small and medium enterprises (SMEs) in third world countries as catalyst through which the growth objectives can be achieved has long been documented. SMEs are pertinent agent of economic transformation as they account for more than 50 percent of GDP of developing economies. They are main source of modernization and technological development, source of supply of both human capital and raw materials to larger businesses and main source of entrepreneurship and enterprise (Sanusi, 2003) and (PECC, 2003). SMEs as a form of business sector are known as an essential component of economic development and an imperative ingredient in the alleviation of poverty in an economy (Wolfenson, 2001).

There is a rapid growth in the number of privately owned small and medium-sized companies worldwide; however, this category of business is beleaguer by several issues that hinder their growth. A key challenge for most SMEs is the problem of financing. According to Da Silva et al (2007), all small firms live under tight liquidity constraints, therefore making finance a major dilemma for them. Generating an entrepreneurial idea is one thing but accessing the necessary finance to translate such ideas into reality is another. Many novel entrepreneurial ideas have been known to die simply because their originators could not fund them, and banks could not be convinced that they were worth investing in. Finance, whether owned or borrowed, is needed to expand so as to maximize profit and given the nature of SMEs, there is a need for financing. As described by the South African Reserve Bank (2004), SMEs generally have four key funding requirements: initial infrastructure investments, lumpy operations costs, "next-step‟ expansions, and unexpected opportunities requiring quick access to funds. Despite what the funding requirement may be, SMEs often prioritize the source of financing from internal (cash flow or entrepreneur's own capital) to external, depending on the relative availability and opportunity cost (Ogujiuba, Ohuche and Adenuga, 2004). This is because for most firms, the internal funds are always insufficient to undertake the required level of transactions for profitable projects hence the call for external finance to fill the finance gap.

The formal financial institutions have been organised to finance SMEs through venture capital financing in the form of a SMIEIS fund In Nigeria. This was in response to the Federal government's desire to aid SMEs as vehicles for rapid industrialization, poverty alleviation, employment generation and sustainable economic development. Venture capital financing supplements takes the place of credit facilities that the conventional banks are unwilling to give. The provider of the funds may initially part with the funds as a loan, but specifically with the idea of converting the debt capital into equity at some future period in the enterprise. The return from such investment should be high to compensate for the high risk. Venture capital may be regarded as an equity investment where investors expect significant capital gains in return for accepting the risk that they may lose all their equity (Golis, 1998). With this incapacitation in term of credit supply to SMEs, the question is whether Nigeria (a rural based economy) still has the hope of becoming one of the leading economies in Africa by 2020. In the view of Nto and Mbansor (2011), the propensity of poverty alleviation in concomitant with Millennium Development Goals (MDGs) specification seems to be an arduous task, given the funding challenges that these small and less privileged firms that are supposed to be imperative approach for creating investments and job opportunities for the masses in Nigeria are facing.

The goal of this paper therefore is to examine the prospects of SMEs in Nigeria and to what extent they have been denied access to development finance and suggest ways out. In line with these objectives, this study seeks to improve on the past studies by making use of a broad data set spanning from 1981 – 2012, such data set is far more recent than those used in the previous studies. The rest of the paper is organized as follows: section II deals with the literature review and theoretical framework, section III contains the model specification and estimation techniques, section IV is the empirical analysis and results while section V summarizes and concludes the study.

2. Literature Review and Theoretical Framework

2.1 Review of Related Literature:

Small and medium scale enterprises dominate the private sector of the Nigerian economy, but almost all of them are starved of funds (Mambula, 2002). The persistent lack of finance, for establishment and operation of SMEs occasioned by the inability or unwillingness of the deposit money banks to grant long term credit to operators of the real sector of the economy, led to the establishment of development finance institutions and the introduction of numerous funding programmes for the development of SMEs in Nigeria. In spite of these institutions and funding programmes, there continues to be persistent cry against inadequate finance for the development of the SMEs in the country.

Njoku (2007) postulated that to forestall the imminent capital flight from the real sector to the banking sector, banks should begin to take second look at the industrial sector in terms of lending operations. Banks should plough back large proportion of the money available to them to the real sector of the economy as long-term loans at rates not exceeding 5%. This he said will encourage industrialists not only to remain in their present businesses but also to achieve their business expansion targets. Lammers, Willebrands and Hartog (2010) used econometric techniques to examine attitude towards risk and profits among small enterprises in Lagos State, Nigeria. Their results showed that the propensity to take risk is negatively related to profit. When risk perception is included, risk propensity no longer appears significant. They added that the perception of risk appears to be the most important risk attitude characteristic, with a positive effect on profit. On firms with only positive profits, the results indicated that the number of employees, the sector in which they operate, the number of months in business, and owner characteristics such as education, age, gender, are significant and consistent. In terms of access to finance, Kounouwewa and Chao (2011) conducted a survey on financing constraint determinants in 16 African countries including Nigeria. The results indicated that the sizes of firm and ownership structure are factors responsible for small and medium enterprises growth. These factors also limit their access to capital and consequently financial constraints. They concluded that there must be efficient financial institutions to tackle problems of financial constraints in entrepreneurship and MSMEs.

Evidence in the literature that finance can contribute to Growth is also essential in entrepreneurship and MSMEs to enable them contribute to the economy. This is because entrepreneurship and MSMEs must have resources, mobilize them and deploy them efficiently before they can generate growth and contribute to overall economic growth (Naude, 2007; OECD, 2010; Hemert, 2008).

Anderson and Tell (2009) citing Birch (1979) and Davidson et al.(2001) also submitted that fast-growing entrepreneurship and MSMEs contribute significantly to job creation and fast growing firms survive better than firms that do not grow. He argues further that "high-growth firms are heterogeneous groups, and there are number of factors and definitions that characterise the growth of this phenomenon" (citing Delmar etal, 2003). Goedhuys and Sleuwaegen (2009) examined the growth performance of a large set of entrepreneurial firms in ten manufacturing sectors of 11 Sub-Sahara African countries including Nigeria and the results show that the growth of entrepreneurship is being constrained by poor infrastructure, insecurity, transportation deficiencies, and financial constraints.

Obamuyi (2007) in a study conducted in Ondo State of Nigeria, observed that, the major determinants of loan supply to SMEs are regulatory requirements such as Capital Adequacy Ratio (CAR), Reserve Requirements (RR), Liquidity Ratio (LR), Interest Rate Development (IRD) and lending policies of the banks. These determinants have varied degrees of influence on the amount of money available for lending by the banks but failed to estimate the direction of the influence of identified policy instruments. Rahji and Apata (2012) adopted tobit model in a study on "Understanding the Credit Supply Decisions of Banks under the Small and Medium Enterprises Equity Investment Scheme in Nigeria" They found that interest rate was positively related to credit supply to SMEs at 1% probability level. This implies that increase in interest rate will stimulate savings in banks thus improvement in credit availability to SMEs. The findings of this analysis may be misleading considering that credit supply to SMEs may not respond to short run interest rate changes based on cross sectional data but on long run changes and time series approach in Nigeria are under nourished in credit supply by formal financial institutions, hence, the need for policy intervention to forestall the financial crisis that may befall the sector.

As a remedy to the above shortcoming, the present study attempt to fill the loophole of SMEs In summary, the evidence so far have shown the extent to which SMEs have been denied access to development finance. However, the subsequent sections picked up the issue of financial constraint and how it will impact economic growth in Nigeria

2.2 Theoretical Framework

In discussing the contribution of SME in overall development in LDCs, two theories are predominant in the literature viz; the classical and the modern theories. The seminal articles by Hoselitz (1959), Staley and Morse (1965), and Anderson (1982), among some others works are often classified as the 'classical' theories on SMEs' development. The 'classical' theories predict that advantages of SMEs will diminish over time and large enterprises (Les) will eventually predominate in the course of economic development marked by the increase in income. From the 'modern' theories perspective, MSMEs have two important roles to play simultaneously: to accelerate economic growth through the growth of their output contributions to gross domestic product (GDP), and to reduce poverty through employment creation and income generation effects of their generated output growth. In addition to these direct effects, SMEs have also indirect effects on economic growth and poverty reduction through their growth linkage effects. Output and employment increases in MSME lead output and employment to increase in the rest of the economy through three main linkages: production (forward and backward), investment, and consumption. The World Bank gives three core arguments in supporting SMEs in LDCs, which is in line with the arguments of the 'modern' paradigm on the importance of SMEs in the economy (World Bank, 2002, 2004). First, SMEs enhance competition and entrepreneurship and hence have external benefits on economy-wide efficiency, innovation, and aggregate productivity growth. Second, SMEs are generally more productive than LEs but financial market and other institutional failures and not-conducive macroeconomic environment impede SME development. Third, SMEs expansion boosts employment more than LEs growth because SMEs are more labor intensive. In other words, the World Bank believes that direct government support for SMEs in LDCs help these countries exploit the social benefits from their greater competition and entrepreneurship, and their MSMEs can boost economic growth and development (World Bank, 2004). The above arguments do not mean, however, that LEs are not important, or MSMEs can fully substitute the role of LEs in the economy. Even, there are skeptical views from many authors about this World Bank's pro-MSME policy. Some authors stress the advantages of LEs and challenge the assumptions underlying this pro-MSME policy. Specifically, LEs may exploit economies of scale and more easily undertake the fixed costs associated with research and development (R&D) with positive productivity effects. This study adopts the modern theory paradigm.

3. Methodology

The study utilized secondary sources of data. Time series data which was collected from Central Bank of Nigeria (CBN) statistical bulletin was analyzed using Ordinary least square (OLS) estimation technique. The data collected was from 1981-2012 due to paucity of data.

The data for relevant variables comprises of growth rate of real gross domestic product, growth rate of commercial bank loans to small and medium scale enterprises, unemployment rate and interest rate.

The theoretical frame work adopted in this paper is based on the modern economic theory on SMEs, that SMEs play two important roles, to accelerate economic growth through the growth of their output contributions to gross domestic product (GDP), and to reduce poverty through employment creation and income generation effects of their generated output growth.

The ordinary least square (OLS) estimation technique is adopted in this study. The aim is to ascertain how finance of SMEs impact on Economic Growth. As such the following linear relationship is
Specified as;

$$GRGDP = f(GSMES, UER, INT) \quad \ldots\ldots 1$$

This is explicitly stated as;

$$GRGDP = \emptyset_0 + \emptyset_1 GSMES + \emptyset_2 UER + \emptyset_3 INT + \mu_t \quad \ldots\ldots 2$$

Where $\emptyset_0, \emptyset_1, \emptyset_2, \emptyset_3$ are to be estimated

$GRGDP$ = Growth Rate of Real Gross Domestic Products
$GSMES$ = Growth Rate of Commercial Bank Loans to Small and Medium Scale Enterprises
UER = Unemployment rate
INT = Interest rate
μ= stochastic error term

3.2 Estimation Techniques:

Empirical research in financial economics is largely based on time series data which have two central properties i.e non-stationarity and time varying volatility. Therefore, Philips (1986) reported that regression analysis with variables that contain such properties may produce misleading and spurious results thereby causing biased economic analysis. As such, stationarity tests were adopted to eliminate the problem. The unit root test adopted to check whether the time series data were stationary or not was Augumented Dickey Fuller (ADF) (Nto and Mbanasor 2011; and Peter and Philips, 1995).

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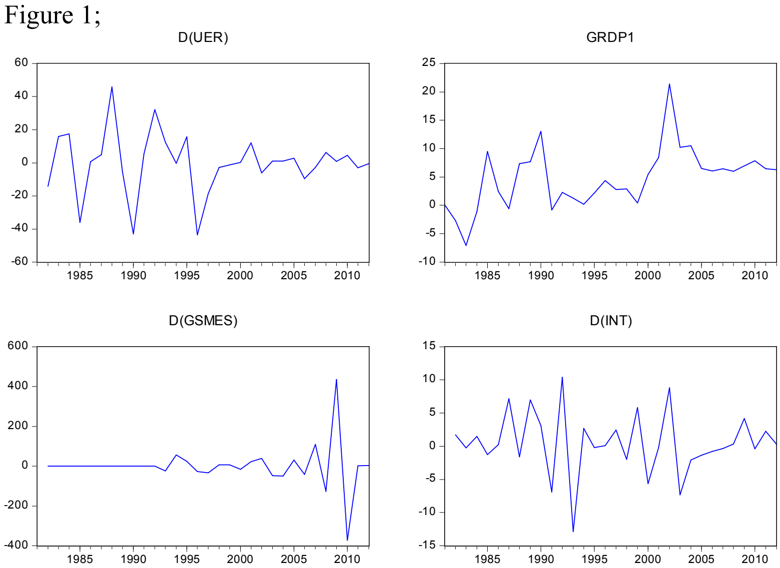
This section provides some prelude analyses involving the description of relevant statistical properties of the variables under consideration namely; growth rate of real gross domestic product (**denoted as GRGDP**), growth rate of commercial bank loans to small and medium scale enterprises (**denoted as GSMES**) ,unemployment rate (**denoted by UER**) and interest rate (**denoted by INT**).

4. Analysis and Discussion of Results:

4.1 Unit Root Test:

The time series properties of the variables were ascertained informally through their graph plot as shown in figure 1 below

Figure 1;



NB: Line Graphs of Variables at their level of integration from figure 1 above.

Formal unit root test was carried out using Augmented dickey fuller (ADF) and the result is as shown in table 1 below.

Table 1: Result of Unit Root Test

Variables	Augmented-Dickey Fuller (ADF) Test			
	Prob. Value (level)	Prob. Value(1st.Diff)	Prob. Value(2nd.Diff)	Remarks
GRDP	0.0349*			$I_{(0)}$
GSMES	0.7026	0.0000*		$I_{(1)}$
INT	0.8077	0.0000*		$I_{(1)}$
UER	0.0606**			$I_{(0)}$

* Rejection of null hypothesis of unit root at 5%.

** Rejection of null hypothesis of unit root at 10%.

$I_{(1)}$ Stationarity of the variables at first order or at first difference.

Source: Researcher's Computation from EViews 7

4.2 Table 2: Result of OLS Estimation

Dependent Variable: GRDP1
Method: Least Squares
Date: 01/14/15 Time: 00:59
Sample: 1981 2012
Included observations: 32

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.272122	3.402133	-1.255718	0.2196
GSMES	0.002634	0.012078	0.218077	0.8290
INT	0.508957	0.157914	3.222992	0.0032
UER	-0.062316	0.044264	-1.407820	0.1702

R-squared	0.310270	Mean dependent var	4.772756
Adjusted R-squared	0.236370	S.D. dependent var	5.313612
S.E. of regression	4.643348	Akaike info criterion	6.025217
Sum squared resid	603.6990	Schwarz criterion	6.208434
Log likelihood	-92.40347	Hannan-Quinn criter.	6.085948
F-statistic	4.198532	Durbin-Watson stat	1.356534
Prob(F-statistic)	0.014241		

Source: Researcher's Computation from EViews 7

Table 2 above shows the OLS estimation of the model specified in equation 2 above, OLS estimation above was done to ascertain the role of small and mediumscale financing on the growth and development of Nigeria economy, the result above shows that a one percent increment in the growth rate of commercial bank loans to small and medium scale enterprises, growth rate of real Gross Domestic Product increases by 0.003 percent, this is consistent with modern economic theory on SMEs, that SMEs have two important roles to play simultaneously: to accelerate economic growth through the growth of their output contributions to Gross Domestic Product (GDP), and to reduce poverty through employment creation and income generation effects of their generated output growth. It should be noted however that SMEs financing plays an insignificant role to economic growth, this can be adduced to policy inconsistency of government towards SMEs financing. The model also hypothesized a converse relationship between unemployment rate and Real Gross Domestic Products, speculating that one percent increase in unemployment rate decreases real gross domestic product by 0.06 percent, it conforms with our a priori expectation. When the level of unemployment is very high, the result of this is the non-utilization of idle human resources (capital). When resources are not optimally and efficiently utilized, Real Gross Domestic Product will continue to diminish and this would hand down growth both in the short and long run.

The result of interest rate surrogated as bank lending rate (maximum) has positive relationship with real gross domestic product; this is not in accordance to economic theory. The insignificance of the interest rate Variable in the model can be linked to the policy inconsistencies in interest rate policies over the years.

The coefficient of determinant, this suggests that the regressand was not adequately explained by the behaviour of the explanatory variables adopted in the model. It shows that approximately 31% of the variation in the dependent variable was explained by the independent variable, and 69% are explained by other macroeconomics variables outside the scope of the study. The F-test results, Prob. (F-statistic) is 0.000000 at 5% level of significance, suggesing that the model is adequate for prediction and policy analysis. Finally the Durbin-Watson value of **1.35** suggests the presence of first order Auto-correlation i.e Autocorrelation is a problem.

5.0 Summary and Conclusions:

Availability of adequate funds to grow and supplement their activities has been acknowledged a great challenge faced by many SMEs in Nigeria as shown in this study, no doubt emphasis on improving the access to finance of theSMEs is extremely critical in fostering entrepreneurship, competition, innovation and growth. It is a popular view that the challenge of access to finance is made even worse by the attitude of many financial institutions, especially formal, who have considered SMEs financing to be a high-risk activity that may generate high transaction costs and or low returns on investment. The financing combination of SMEs in Nigeria is majorly from informal sources of finance. This is shown by the use of this option more than the formal sources by the SMEs. A comparative analysis of the inherent problems of the formal and informal sources of finance to SMEs shows that the formal sources are inherently more problematic to SMEs in Nigeria than the informal sources. Most of the banks in the country do not pay sufficient attention to the development of SMEs via financing because of the inherent risk in them. Concluding from the above discussion, the Nigerian government must develop measures to offset the effects of the financial crisis in SMEs financing. Furthermore, any solution to stimulate the Nigerian economy should include easing SME access to finance. There is also the need for macroeconomic policy to be specifically directed to SMEs financing and growth. An assortment of agencies and institutions must be formed with a view to protecting and enhancing activities and growth of SMEs. By this, the capacity and capability of SMEs in term of employment generation, contribution to industrial production and its influence on economic growth can be well sensed.

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