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Full Length Research Paper

An empirical evaluation of small and medium enterprises equity investment scheme in Nigeria

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This study empirically evaluates the performance of the Small and Medium Scale Enterprises (SMEs). Equity Investment Scheme in Nigeria (SMEEIS), using Benue and Nassarawa States as case study. Secondary data of total credit to SMEs as percentage of banks total credit for a period from 1993 to 2008 were made available. Paired sample t-test was used as a technique to test the significance of bank loans before and after the introduction of SMEEIS. Mean scores and standard deviation was used to present and analyze the primary data obtained via questionnaires. The result shows that there was no significance difference between the loans disbursed by banks to SMEs before and after the introduction of SMEEIS and the conditions for accessing SMEEIS funds was beyond the reach of the predominant SMEs in Nigeria. This shows that SMEEIS, as a formal financing option, has not made any significant impact towards SMEs growth in Nigeria. The major recommendation is that both the government and the banking sector should mutually agree on a credit guaranteed scheme strategy that will incorporate a risk-sharing arrangement as a way of encouraging the banks to channel funds to the SMEs sub sector for their growth and development which would translate into the national economic growth and sustainable economic development of Nigeria.

Key words: Small medium enterprises, equity investment scheme, formal financing, risk-sharing and sustainable economic development.

INTRODUCTION

Generally, the united nation's millennium development goals (MDGs) are being pursued in Nigeria in line with the need to enhance the process of development in the country by making all the basic amenities of life at the disposal of the masses. Specifically, the present administration of Dr. Goodluck Ebele Jonathan is of the vision that, by the year 2020, Nigeria would be one among the first 20 largest economies of the world otherwise popularly called Vision 20-20-20. This is achievable if it is premised on a sound and committed economic policies implementation in the country. It must be emphasized that it is while attending to small matters that bigger things are created (Sule, 1986). Vision 20-20-20, for example, is economically a big and remarkable thing, but unless Nigeria attends to smaller economic matters, she cannot achieve it. There is, therefore, the need to assess the country's stand now to see if she is heading to the right direction in actualizing her dreams.

Small and medium enterprises (SMEs) play important roles in the economic growth and sustainable development of any economy (Ariyo, 2005). They may look small or inconsequential but are actually the foundation of any economically stable nation. The potential benefits of SMEs to any economy include contribution to the economy in terms of output of goods and services; creation of jobs at relatively low capital cost; provision of a vehicle for reducing income disparities; development of a pool of skilled and semi-skilled workers as a basis for future industrial expansion, among others. According to NCI (2003), a small-scale industry is an enterprise with total cost (including working capital but excluding cost of land) above N1.5 million but

not exceeding N50 million, with a labour size of between 11 and 100 workers, while the medium-scale industry has a total cost (including working capital but excluding cost of land) above N50 million but not exceeding N200 million, with a labour size of between 101 and 300 workers. On the other hand, the revised operational guidelines of SMEEIS (2005) defines a small and medium enterprises as an enterprise with a maximum assets base of five hundred million naira (N500m)(excluding land and working capital), and with no lower or upper limit of staff. The contradictions in the definition of SMEs as given by NCI and SMEEIS point to the different interpretations of what SMEs really are to different schemes. Hence, their approaches to the funding of SMEs are affected. In addition to this, bank lending habit does not in any way favour SMEs with respect to funding. Consequently, SMEs resort to informal sources of financing. In this context, the formal forms of financing are the ones regulated by the government, while the informal forms of financing are not so regulated by the government. Kpelai (2009) asserts that SMEs are the engine room for the growth of any developing economy, because they form the bulk of business activities in developed and developing economies like Nigeria.

Many economies like Canada, Croatia, etc have acknowledged that SMEs are crucial for industrial restructuring and have formulated national SME financing policies, targeted at developing the sub-sector. However, the small business' contribution to macro-economic development is inhibited by the fact that they have no, or only overpriced, access to finance institutions and other services (Schneider, 2002). More so the accessibility to funds and the cost of raising them have remained issues limiting the in-capitalisation requirement leading to premature collapse of SMEs (Mambula, 2002). Funding has therefore remained one of the key managerial problems that keep confronting business enterprises in Nigeria today. The two fundamental financing concepts of SMEs, the formal and informal forms of financing, have been identified by previous researchers, scholars and practitioners (Gelinas, 1998; Aruwa, 2004a). The findings were that, among the most popular of the formal sources of financing, the commercial banks and development banks remain the formal sources of finance for enterprises. The informal sources, which comprise borrowing from friends and relatives, and cooperative credits, have also been identified as potential sources of financing SMEs.

The problem of SME financing has received the most tremendous research efforts from researchers. Some notable works in this respect include Aernold (1998), Anic and Paus (1998), Inang and Ukpong (2002) and Aruwa (2004b). In their findings, four problems in financing SMEs have become recurrent: the cost of capital; risk; the inappropriate terms on bank loans; and the shortage of equity capital. They are of the suggestion that government should come to the rescue of SMEs. This call was seemingly answered when Small and Medium Enterprises Equity Investment Scheme (SMEEIS) came on board in 2001. SMEEIS is a bankers committee financing initiative that started in 2001 to finance SMEs in form of equity participation. Some of the works concerning financing of SMEs were done before SMEEIS came into existence while some were in the early operational years of SMEEIS, which some of the researchers felt was too early to assess the initiative objectively. Presently, it is over nine years since the inception of the scheme, which is a reasonable period to critically assess its performance. SMEEIS is the current sector driven economic policy thrust of government involving banks. It is an equity financing initiated by the federal government aimed at formalizing SMEs source of financing.

There is a noticeable steady decrease in the percentage of banks loans to SMEs from 1992 throughout the period of the operation of SMEEIS. What then is responsible for this unchallenged decrease of bank loans to SMEs and to what extent has SMEEIS been of help to SMEs? The need to assess the operational effectiveness of SMEEIS in Nigeria is, therefore, pertinent. The aim of this paper is to assess the impact of SMEEIS on SMEs and to examine the factors militating against accessing the SMEEIS funds by SMEs in Nigeria. The hypotheses tested in the study are stated in the null form as follows:

HO_1: There is no significant difference in the loans to SMEs before and after SMEEIS by Nigerian banks.
HO_2: Conditions for accessing SMEEIS funds are beyond the reach of most SMEs in Nigeria.

THEORETICAL FRAME WORK AND LITERATURE REVIEW

A well functioning financial system is a key enabler of economic growth. SMEs are an important part of Nigeria's economic growth and development and bank lending is the primary source of external finance for SMEs. Therefore, it is important that the banking sector responds efficiently and effectively to the needs of SMEs. According to Ohanga (2005) there are a number of features of lending generally which potentially could affect the efficiency of the market for lending. Information asymmetry is a situation where business owners or managers know more about the prospects for, and risks facing, their business than do lenders. Where information

asymmetries exist, bank lending theory predicts that lenders may respond by increasing lending margins to levels in excess of that which the inherent risks would require.

Bank lending theory also suggests that banks may also curtail the extent of lending – credit rationing – even when SMEs 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. Information asymmetry is more acute in case of SMEs because their relative size makes them economically unattractive to banks since they are unable to accurately gauge the level of risk involved in lending to SMEs (Ohanga, 2005).

Pecking order theory/hypothesis of lending

Hanger (2005) asserts that, from the borrower's perspective, if faced with a cost of lending that is above the true risk-adjusted cost, the borrower will have incentives to seek out alternative sources of funding. Bank lending theory suggests that, where information asymmetry and moral hazard are prevalent, firms are likely to fund themselves firstly from retained earnings and then from bank debt rather than issuing equity. This is referred to as the pecking order theory/hypothesis. The theory further suggests that the mix of debt and equity should be the cumulative result of hierarchical financing decisions over time. Evidence around the world indicates that small scale enterprises provide an effective means of stimulating indigenous entrepreneurship, enhancing greater employment opportunities per unit of capital invested and aiding the development of local technology (Sule, 1986: World Bank, 1995). Through their wide dispersal, they provide an effective means of mitigating rural-urban migration and resource utilization.

Furthermore, by producing intermediate products for use in large scale enterprises, SMEs contribute to the strengthening of industrial linkages. These explain the increased interest which developing countries have shown in the promotion SMEs since the 1970s (Ekpenyong and Nyong, 1992). Akabueze (2002) asserts that the significance of finance in the drive for economic growth is fairly well established and generally accepted. For instance, the take-off and efficient performance of any industrial enterprises, be it small or large, will require the provision of funds for its capitalization, working capital and rehabilitation needs, as well as for the creation of new investments. Apart from entrepreneurship, funds are required to bring together the other factors of production– land, labour and capital – before production can take place. Provision of funds to the industrial sector, particularly, for the SMEs has, therefore, been of prime interest to policy-makers in both the public and private sectors. Aladekomo (2003) notes that successive governments in Nigeria have, since the last three decades, shown great interest in financing of SMEs, by establishing specialized banks and other credit agencies/schemes to provide customized funding to the sub-sector to enhance growth and stability. In addition to these, programmes like the Nigerian directorate of employment (NDE), better Life for rural women, family support programme, child care trust, people's bank, national poverty eradication programme (NAPEP), to mention a few, have been introduced. Most of these institutional arrangements have, however, performed below expectations over the years owing to operational bottlenecks.

The impact of all existing credit schemes to SMEs, in terms of providing funds for meaningful and sustained development among the SMEs, had hardly been noticeable. These credit schemes either have a direct or indirect link with banks. The banks by their nature and position in the economy, therefore, remain the known formal source of finance for enterprises (Agumagu, 2006). It is disheartening to know that a 2001 world bank survey on Nigerian firms showed that although 85% of the firms had relationships with banks, most of them had no access to their credit. This explains why SMEs in Nigeria represent about 90% of firms in the Nigerian industrial sector on numerical basis but regrettably contribute as low as one percent to GDP in contrast to countries like Indonesia, Thailand and India where SMEs contribute almost 40% to GDP (HPACI, 2002). The failure of most of the schemes and the need for a sustainable source of financing SMEs, therefore, necessitated the recent central bank of Nigeria (CBN) inspired banker's committee initiative which is aimed at committing the banking industry to the provision of finance and other ancillary support to the sub-sector via an equity participation scheme.

Bank lending and SMEs development in Nigeria

SMEs are crucial catalysts for economic development (Aruwa, 2006). Banks provide a nation with a function of pooling scattered resources from surplus to deficit units so as to promote investment innovation, productivity and consequently growth and development. The banking industry in Nigeria dominates the financial system (Agusto, 2000). Berger et al. (2001) maintains that a well functioning financial system contributes to investment and economic growth. Every enterprise at its onset, before standing firm on its feet, needs borrowing. The first place that they need to go and borrow at those times

is the banks. According to elementary corporate finance theory, an investment project should be undertaken whenever its net present value is positive. This assumes that the capital outlay is not exhaustive. Firms do any volume of investment, and so where the firms do not have adequate capital to embark on any level of investment, there is need for capital borrowing (Mainoma, 2005). This shows that even if an enterprise is strong and firmly rooted, it still does not stop borrowing, because it can embark on a very large scale investment more than it currently does, if it can get the required capital. In an economy where the interest rate is high, small and medium scale enterprises find it difficult to borrow and repay when in fact they constitute the real sector of the economy.

When funding becomes a major problem for such enterprises, nothing else works. This is because other problems which emerge later in an enterprise's lives that are being tackled as natural problems which come after its funding. This in turn hinders the growth and development of the economy. Njoku (2007) postulates 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. He continues that banks should plough back a 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. 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 a persistent cry against inadequate finance for the development of the SMEs in the country. The CBN (2008) shows that commercial and merchant banks loans and advances to SMEs have been decreasing over the years. The statistics show thus; commercial bank's loans to SMEs as a percentage of total credit decreased from 48.8% in 1992 to 22.22% in 1994. The trend increased marginally to 22.9 and to 25.5% in 1995 and 1996, respectively. There was a sharp reduction from 25 to 17% in 1997, and the decrease continued till it reached 0.2% in the year 2008. Similarly, merchant banks loans to SMEs as a percentage of total credits reduced from 31.2% in 1992 to 9.0% in 2000 (Akabueze, 2002). The continuous decrease in commercial and merchant bank's loans to small scale enterprises can be attributed to lack of collateral from the SMEs to secure the loans and the high lending rates from the banks.

Approaches of SMEs financing in other countries

Since 1961, the government of Canada has supported small businesses in Canada via a strategic partnership with financial institutions. This strategic partnership exists in the form of the small business loans act (SBLA), which allows financial institutions and the government to "share the risks inherent in extending credit" where they exist. In its 37 years of operation, the SBLA has facilitated the financing, creation and/or improvement of more than 500,000 businesses. During this time, financial institutions have been able to provide small and medium-sized enterprises with more than $20 billion in financing. Loans guaranteed during 1997 to 8 totaled $1.9 billion in Canada and more than $145 million in atlantic Canada (Canadian Bankers Association, 1997). While the Export Development Corporation (EDC) provides support to SMEs in the form of insurance services, loans are typically not issued directly to Canadian companies but rather are provided to foreign purchasers of Canadian exports. This financing is important, as it allows Canadian SMEs to successfully bid on and finance export sales opportunities (Canadian Bankers Association, 1997).

In EU countries, Gamser (1998) notes that SME financing can be broken down into three major categories:

(i) Credit guarantees;
(ii) Loans/equity investments; and
(iii) Grants.

All these instruments exist in EU and OECD countries. Credit guarantees enable SMEs with sound investment proposals to borrow from commercial banking institutions at reasonable rates. They encourage the private financial sector to act, to raise the profile of the SME market and to be flexible on security. However, the transaction costs are high and in the case of poor design, they may lead to adverse selection and be a distraction from other policy matters. Concerning loans and equity, governments may pass on the benefits of low borrowing rates to SMEs, they can promote business start-ups and focus on other key economic development objectives (like the environment, quality or technologies).

However, they can discourage the formal financial sector and can confuse the responsibilities and obligations of borrowers and the commercial financing

sector. Grants can promote start-ups, assist in new market development and are potentially complementary with unemployment benefits. However, they are unsustainable, politically difficult to share and difficult to coordinate. Gamser (1998) opines that successful financial intermediaries have to address three key issues:

(i) The financial service has to fit with the market;
(ii) New financial techniques should slash administrative costs; and
(iii) The new technique has to motivate repayment.

Starmans (1998) emphasizes that SME support is not just about giving away money. The lesson of the advanced market economies shows that an enabling legislative framework has to be created prior to giving loans to SMEs. It is a government task to increase the supply of credit facilities to the SME sector in order to provide funding for its economic expansion. Government support can be provided in the following forms:

(i) Promoting the granting of credit to SMEs through targeted guarantee schemes; and
(ii) Supporting merchant banks in a general sense (through tax incentives, legislation, subsidies, liquidity guarantees, etc).

Anic and Paus (1998) identify major barriers to the development of SMEs as insufficient support by the government, low access to loans, lack of information on new technological developments, and insufficient investment in education. The Croatian Guarantee Agency (CGA) provides guarantees of up to 80% of the total amount of the loan. Guarantees are provided for (i) small businesses; (ii) business activities of SMEs in areas of special importance to the country; and (iii) start-ups. Small loans are available up to 50,000 Dutch Mark (DM) with an interest rate of between 1 to 9%. Start-ups may obtain up to DM 100,000 and existing businesses up to DM 300,000 at interest rates of between 7 and 12% with a repayment period of between 5 and 8 years (Anic and Paus, 1998).

In India the trend amongst financial institutions to promote environmentally and socially responsible lending has increased. The reserve bank of India (RBI) and government play a vital role in governance of banks, mainly by way of banks regulation and supervision (Samantray et al., 2008). To Bihari (2010), the RBI directed banks in December, 2007 to undertake corporate social responsibility (CSR) initiatives especially with respect to SMEs for sustainable development. The regulator bank also asked banks to begin non-financial reporting so that their activities relating to environmental, social and economic accounting will be unveiled and it is an open and transparent way of communicating with stakeholders. They directed banks to put in place a board-approved plan of action aimed at ensuring sustainable development. The Indian approach as above shows clearly that the regulator bank is active and responsive. The government also is in close partnership with the regulator bank to see that SMEs are successful.

Main sources of financing SMEs in Nigeria

The importance of finance to business organisation cannot be over-emphasised. Business finance is however, not easy to come by especially in respect of SMEs. Yet they require funds from every source available to meet their asset needs, working capital needs, and for expansion. According to Ekpenyong and Nyong (1992), there is wide consensus in Nigeria that government policies are skewed in favour of the formal sector to the detriment of the informal sector. This skewness is to the great disadvantage of SMEs in Nigeria since they are more disposed to the funds of the informal sector.

Formal sources of financing SMEs

The commercial banks, merchant banks, and development banks provide the formal sources of finance to SMEs. The financial system in Nigeria is not in short supply of liquidity, but banks have been very reluctant to grant loans to SMEs, which they regard as a high-risk sector. Most of the banks would rather pay the penalty imposed for not meeting the minimum exposure to preferred sectors of the economy than actually run the risk of being exposed to them. According to Ojo (1984), the sources of investment finance for SMEs include owner's savings and assistance from banks, government institutions, local authorities, co-operative societies, relatives and friends, and moneylenders. The study shows that almost all the funds came from personal savings (96.4%) with about 3% from the informal sector and 0.21% from the formal financial institutions. This trend is further established by a 1983/84 study by the Nigerian institute for social and economic research (NISER). NISER findings show that about 73% respondents obtained their funds from personal savings, while only about 2% obtained their funds from the formal financial institutions.

The small and medium industries equity investment scheme (SMIEIS) fund

In Nigeria, the formal financial institutions have been

organised to finance SMEs through venture capital financing in the form of a SMIEIS fund. This was in response to the federal government's desire to promote SMEs as vehicles for rapid industrialisation, sustainable economic development, poverty alleviation and employment generation. Venture capital financing supplements or 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). The Nigerian government's version of venture capital financing of SMEs -SMIEIS, requires all licensed banks in Nigeria to set aside 10% of their pre-tax profit for equity investment and to promotion of small and medium-scale enterprises. The goal is to reduce interest rate burden and other financial service charges imposed under normal bank lending.

However, SMIEIS's fund has been reported to have accumulated 20 billion Nigerian naira, but only 8 billion Nigerian naira has been disbursed. The reason for the inability of the SMEs to avail themselves of this fund is yet unconfirmed. The apparent lack of investment in the micro-enterprises sub-sector could be informed by the absence of approved guidelines which is still being finalized (Osagie, 2004). According to Sanusi (2004), a breakdown of the SMIEIS fund investment by sectoral distribution shows that 68.82% went to the real sector while service related investment accounted for 31.18%. This, he noted, is a sharp reversal from the initial trend recorded under the scheme. The bankers Committee have allocated the investment of banks with respect to the fund as 60, 30, and 10% of their fund in core/real sector, service-related and micro-enterprises respectively. Analyzing the geographical spread of the SMIEIS fund, Sanusi (2004) reported that Lagos-based investments have gulped 56.63% of the fund, and Abuja and 18 states received the balance 43.47%. Golis (1998) submits that venture capitalists do not seek enterprises on the start-up and survival stage but only in the stability and rapid growth stages did the venture capitalists appear.

Yet the method of financing remains a critical success factor for SMEs. To be eligible for equity funding under the scheme, a prospective beneficiary shall:

i) Register as a limited liability company with the corporate affairs commission and comply with all relevant regulations of the companies and allied matters act (1990) such as filling of annual returns, including audited financial statements;
ii) Comply with all applicable tax laws and regulations and render regular returns to the appropriate authorities (Bankers Committee Revised, 2005).

Aruwa (2005) laments that given the developmental stage of Nigeria's dominant SMEs; it is difficult for them to meet any of these requirements. Consequently, SMEs in Nigeria do not have the capacity to access funds from SMEEIS.

METHODOLOGY

This study is designed to look at the lending habit of conventional banks and how it affects to SMEs from 1992 to 2008. To achieve this purpose, the survey research design and an empirical method making use of the T-test and correlation was used. The T-test is used to measure the significance of loans to SMEs by banks who contribute to the SMEEIS funds. The questionnaire is used to obtain the views of the owners of SMEs on the operations and impact of SMEEIS. The population of this study is made up of 700 SMEs with a minimum of five year life span operating within Benue and Nasarawa States. The study's sample size is 88 SMEs made up of 43 from Nassarawa state divided into 30 small-scale enterprises and 13 medium-scale enterprises. Similarly, 45 SMEs were drawn from Benue State divided into 34 small-scale enterprises and 11 medium-scale enterprises. Unfortunately only 40 completed questionnaires were returned from Nasarawa made up of 28 small-scale enterprises and 12 medium-scale enterprises.

Similarly, only 44 questionnaires were returned from Benue State made up of 33 small-scale enterprises and 11 medium-scale enterprises. The sample size was, therefore, limited to 84 SMEs. The research sample was computed using the following formula, allowing 10% tolerable sample error. Sample formula (n) = $N/1 + N(e)^2$, where n is the required sample size, N is the research population, and e is the tolerable error in judging the population. Primary data were obtained using questionnaire designed for SMEs and financing institutions separately and structured interview instruments. The questionnaire employs likert-scale measures, a fifteen likert-like scale having four response categories labeled or weighted as strongly agree (4), agree (3) disagree (2) and strongly disagree (1).

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

Analysis and Interpretation of responses on formal financing

The responses from the questionnaire administered in respect of formal financing sources available to SMEs in Nigeria are presented and analyzed as follows: in the analysis presented in Table 1, none of the formal financing variables meet the cut-off mean of 2.5 for individual item. Respondents perceived that the utilization rate of formal financing sources among the SMEs sampled was low. The overall perception of formal

Table 1. Mean scores on formal financing sources.

Variable	Sample size	Mean	Standard deviation	Minimum score	Maximum score
Formal finance as main source of capital	84	1.34	0.71	4.00	1.00
Bank loan	84	1.33	0.69	4.00	1.00
Second-tier Security market (SSM)	84	1.00	1.18	0.00	0.00
SMEEIS	84	1.20	0.57	4.00	1.00
Others	84	1.19	0.50	3.00	1.00
Combined Mean/SD score	84	6.06	3.65	6.06 < 12.5	

Source: Field data computation (November, 2009).

Table 2. Mean scores on informal financing sources.

Variable	Sample size	Mean	Standard deviation	Minimum score	Maximum score
Informal finance as main source of capital	84	3.86	0.48	1.00	4.00
Personal Savings	84	3.60	0.82	1.00	4.00
Cooperative credits	84	3.91	3.39	1.00	4.00
Loans from friends/relatives	84	1.96	1.28	2.00	1.00
Ploughed-back profits	84	1.35	0.87	2.00	4.00
Combined mean/SD score	84	14.68	6.84	14.68 > 12.5	

Source: Field data computation (November, 2009).

Table 3. Mean score on financing problems.

Variable	Sample size	Formal sources	Informal sources
Cost	84	2.02	1.03
Accessibility	84	1.31	3.71
Collateral	84	3.71	1.62
Awareness	84	3.38	2.10
Risk (others)	84	2.57	1.36
Combined Mean Scores		13.99 > 12.5	9.82 < 12.5

Source: Field data computation (November, 2009).

financing sources that emerge from this analysis, therefore, is that there is low utilization rate of formal financing sources by SMEs in Nigeria given that the computed overall mean score of the variables (6.06) is less than the sections cut-off mean of 12.5. The standard deviation (3.65) shows that there is no much disparity in the respondents' perception as evidenced in the mean scores. Table 2 depicts a favorable perception on utilization of informal financing sources than the data presented in Table 1. The cooperative credit has the highest mean score of 3.91. What is significant in the table is that the SMEs' mean score of 14.68 on informal sources of finance is higher than the section's cut-off mean of 12.5. The disparity in perception as indicated by the standard deviation is low. Comparatively, the mean scores recorded for formal sources of finance in Table 1 recorded for informal sources of finance (Table 2). This is interpreted that informal sources of finance are more available and more utilized by SMEs in Nigeria than the formal sources.

The study investigated what could be the likely financing problem that brought about deviation in the use of both formal and informal financing sources. Table 3 provides the analysis along five variables on Likert scale measures. The formal sources of finance combined mean score (13.99) on the cost, accessibility to source of finance, collateral security requirement, awareness of existence of sources of finance and the risk inherent in

Table 4. Correlation coefficient of financing problem variables.

Variable	Mean	
	Formal sources	Informal sources
Cost	2.02	1.03
Accessibility	1.31	3.71
Collateral security	3.71	1.62
Awareness	3.38	2.10
Risk (others)	2.57	1.36
Correlation coefficient (r)	-0.5000	

Source: Field data computation (November, 2009).

use is higher than the cut-off mean whereas the cut-off mean on informal sources, which is within acceptable mean score (9.82 < 12.5). However, the informal source was 1.34. This is less than the mean score of 3.86 of finance mean score on awareness is lower than that of the formal sources. This could mean that the existence of formal sources of finance like SMEEIS is not to the knowledge of most SMEs. A further test of correlation between the mean scores of formal and informal sources of finance shows negatively- correlated relationship of -0.5000 on the variables of financing problems. This is shown in Table 4 further: it is no doubt that there is a relationship between formal and informal sources of finance as far as SME financing is concerned. The calculation of correlation coefficient (r) revealed an average negative relationship between these variables. This could be explained that accessibility may be a problem more of the formal sources than of the informal sources. Similarly, the level at which collateral is demanded in formal sources is not the same as in an informal source. A positive correlation coefficient would on the other hand mean, the more collateral is needed in formal source, the more it is needed also in an informal source. The negative correlation therefore, shows that the variables move on average in the opposite direction.

Test of hypothesis 1

There is no significant difference in the loans granted by banks to SMEs in Nigeria before and after the introduction of SMEEIs. Before 1996, commercial banks were operating under a stipulated guideline that their total credit allocation to SMEs should not fall below 20% of their overall total credit. This was in respect of SMEs wholly owned by Nigerians. This was, however, abolished on 1st October, 1996 (Aruwa, 2004). From Table 5 it is clear that before the abolition, commercial banks were adhering to these guidelines as none of their total credit percent fell below 20%. Immediately after the abolition (from 1997), the total credit percent drastically fell from 25% in 1996 to 17% in 1997. Since then it has been on a steady decline till date. A paired sample t-test is used to test this hypothesis. The data with respect to commercial bank loans to SMEs as a percentage of total credit from 1993 to 2008 is used in calculating the paired sampled t-test before the introduction of SMEEIS there was a decline in loans to SMEs by banks especially immediately after the abolition of the 20% mandatory credit to SMEs in October 1996. With the introduction of SMEEIS in 2001 to save this situation one would expect a significant turnaround with regards to loans to SMEs by banks. This would have been so if the values of ***d*** in Table 6 were predominantly if not all negative. The ***t*** in the end would have been a negative figure greater than the critical. Computed value of t = 8.29 and the critical is 2.365 value at 0.05 significance level and degree of freedom df = 7. What our calculation as above gives us is a positive value of computed t which shows there was no significant improvement in loans to SMEs even after SMEEIS was introduced. The result of insignificance could be explained that the SMEEIS did not create a significant impact on the financing of SMEs. We therefore accept the null hypothesis that there is no significant difference in the loans to SMEs before and after SMEEIS by banks. This could also be as a result of the fact that even though the SMEEIS was in place, it lacked standard guidelines for its funds disbursement as asserted by Aruwa (2005). Table 7 depicts the percentage of the formal and informal component sources of financing in the capital structure of the SMEs. The results in the table show that the SMEs benefited more from informal sources than the formal sources of finance. The informal source of finance makes up 68% of small enterprise's capital and 70% of medium enterprise's capital respectively. None of the enterprises secured capital from the second-tier security market (SSM). Cooperative credits constituted the highest contribution to the capital of these enterprises accounting for 31 and 33% in the small and medium enterprises respectively.

Table 5. Ratio of loans to SMEs by commercial banks and merchant banks to their total credit.

Year	Commercial banks loans to small scale enterprises as percentage to total credit	Merchant banks loans to Small scale enterprises as percentage to total credit
1993	32.2	19.5
1994	22.2	18.2
1995	22.9	29.9
1996	25.0	13.6
1997	17.0	13.1
1998	15.5	12.9
1999	13.3	12.9
2000	8.7	10.2
2001	6.6	-
2002	8.6	-
2003	7.5	-
2004	3.6	-
2005	2.7	-
2006	1.0	-
2007	0.9	-
2008	0.2	-

source: Central Bank of Nigeria statistical bulletin, golden Jubilee edition (December, 2008).

Table 6. Computation of paired sample t-test.

Year	X	Y	d(x-y)	d^2
1993/2001	32.2	6.6	25.6	655.36
1994/2002	22.2	8.6	13.6	184.96
1995/2003	22.9	7.5	15.4	237.16
1996/2004	25.0	3.6	21.4	457.96
1997/2005	17.0	2.7	14.3	204.49
1998/2006	15.5	1.0	14.5	210.25
1999/2007	13.3	0.9	12.4	153.76
2000/2008	8.7	0.2	8.5	72.25
Total			125.7	2176.19

Source: Secondary data computation (November, 2009).

Test of hypothesis 2

HO_2: Conditions for accessing SMEEIS funds are beyond the reach of most SMEs in Nigeria.Chi-square was used to test this hypothesis. The data used for the testing are the responses obtained from the research questionnaire. The summary of the responses are presented in the table. Table 8 shows that a total of 56 owners of small-scale enterprises from Nassarawa and Benue states lamented that stiff conditions are responsible for their inability to access SMEEIS funds, while five owners of small-scale enterprises from the two states did not attribute their inability to access the funds to tough conditions. In the same vein, a total of 20 owners of medium-scale enterprises said they could not access the funds because of the stringent conditions given by SMEEIS, while three owners of medium-scale enterprises gave other reasons, outside stiff conditions, as being responsible for their inability to access the funds.

On the whole, 76 owners of SMEs from the two states stated that SMEEIS funds were beyond their reach because of the tough conditions given to access the

Table 7. Sampled SME financing mix.

Source of finance	Small enterprise (percentage of total capital)	Medium enterprise (percentage of total capital)
Formal Sources	32	30
Bank loans	04	24
NDE/NACRDB	25	00
SMIEIS	03	05
SSM	00	00
Equipment Leasing	00	01
Informal Sources	68	70
Personal Savings	20	23
Cooperative Loans	31	33
Loan from friends/ Relatives	15	12
Others	02	02

Source: Interview questionnaire responses (November, 2009).

Table 8. Responses from question 17 of the questionnaire.

Respondents	Responses		Total
	Stiff conditions	Other reasons	
Small-scale enterprises	56	5	61
Medium-scale enterprises	20	3	23
Total	76	8	84

funds, while eight owners of SMEs from both states encountered other factors that hampered their ability to access the funds. If the calculated chi-square (X^2) is greater than the table value (critical value), the difference is significant, and so the null hypothesis is rejected. But if X^2 is less than the table value, the difference is insignificant, and so the null hypothesis is accepted. The critical value of X^2 at 0.05 1df is 3.841. The calculated value in this case 0.73 which is less than the critical value. Therefore the difference is insignificant and so the null hypothesis, which states that conditions for accessing SMEEIS funds are beyond the reach of most SMEs, is accepted.

DISCUSSION OF FINDINGS

Table 7 shows that bank lending to small-scale enterprises in Nigeria was just four percent of the total finance of the sector during the period under review. This is at variance with the pecking order theory or hypothesis which implies that banks should lend to SMEs where they have exhausted their retained earnings to finance their investment. SMEs by their nature cannot raise substantial internal finance. It, therefore, becomes necessary for them to seek bank lending to bridge the gap between their retained earnings and their potential investment outlay. Table 7 also shows that bank lending to medium-scale enterprises was 24% of the total finance of the sector, which is relatively higher than the figure for small-scale enterprises. This is also at variance with the pecking order theory. Going by the theory, it is to be expected that small-scale enterprises should get more bank loans than medium-scale enterprises since they can raise more internal finance than small-scale enterprises. It could, therefore, be inferred from the above that banks in Nigeria only lend to enterprises that have high potentials to repay loans. With this type of philosophy, they can hardly support small-scale enterprises.

Since SMEEIS comprise banks, this behavior of banks can be rightly said to represent the behavior of SMEEIS. The abolition of mandatory bank's credit allocations of 20% of its total credit to SMEs wholly owned by Nigerians took effect from October 1, 1996. This was the genesis of the most remarkable dwindling effect of the banking sector overall credit to SMEs in Nigeria. The formal financing sector is still averse to funding SMEs in Nigeria. What is evident from this study is that without mandatory

regulation, the banking sector will not take active part in funding the SME sector. Moral suasion has been ineffective. The key reason for this behavior has been the risky nature of the SMEs investment activities. The SMEEIS initiative has not been popular with SMEs. Even those who know about the scheme have not been able to benefit from it. The result of the test of hypothesis two is that conditions for accessing SMEEIS funds were too stringent for owners of SMEs. Even from the definition of SMEs by the scheme it can be reasonably inferred that the predominant SMEs in the country were not captured or considered.

It becomes worrisome that the SMEs in Nigeria are not recognized and so the scheme cannot reach out to them. The factors that have favored informal financing of SMEs in Nigeria over the formal financing were cost of finance, steady decline in the ratio of loans to SMEs to total banks' credit. The most remarkable decline was from 1996 when the abolition of 20 percent mandatory credit to SMEs took effect.

It is therefore, obvious that a legal framework plays an important role in the decline of financing to SMEs by banks. SMEEIS has been unable to make any significant positive impact on the financing of SMEs in Nigeria, and therefore of the growth of SMEs for them to make any significant impact to the economic growth and development of the country. The financing mix of SMEs is predominantly from informal sources of finance. This is shown by the use of this option more than the formal sources by the SMEs. cooperative credit ranks highest inthis category while the second-tier security market (SSM) is left un-patronized. 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. Stringent conditions of SMEEIS prevent SMEs from accessing the funds under the scheme. The following recommendations are hereby made in response to the aforementioned findings. The operational guidelines of SMEEIS should redefine SMEs in the country to take into account their predominant nature so that they can be more disposed toease of accessibility, nature of collateral security and risk mitigation capacity. It is evident from the study that it costs SMEs less interest charges on borrowings from informal sources than prevailing rates in the formal sources. Whereas accessibility to informal sources of finance was less a problem, it was still difficult for SMEs to access funds from the formal sources because of stringent collateral security requirement and inadequate risk mitigation schemes for the formal sources of finance. In the informal sources, individual's reputation and community acceptance or cooperative society membership were sufficient to access the funds for business purposes.

CONCLUSIONS AND RECOMMENDATIONS

It is obvious that a dynamic SME sub-sector is needed for Nigeria to attain industrialization and sustainable economic development and for its vision 20-20-20 to be achieved. This subsector is, therefore, vital and imperative for the actualization of Nigeria's vision. The observed weak performance of notable formal financing options, like SMEEIS, occasioned by lingering constraints should, however, be seen as a big challenge for policy makers in the country. This study hereby reveals the following major findings: From 1993 to 2008, there is a accessing SMEEIS funds. The SMEs should be sensitized by the SMEEIS operators for them to be part of the Scheme, benefit from it and contribute more towards attaining the Vision 20-20-20 target of the country. Banks, by their nature and in line with their objective, do try to minimize risk; while SMEs, on the other hand, are inherently risky.

Consequently, the government and the banks should mutually agree on a credit guarantee scheme that will incorporate a risk-sharing arrangement as a way of encouraging banks to channel funds to SMEs. Government should reintroduce the 20% mandatory loans by banks to SMEs as a way of improving their finances. The problems that amounted to the withdrawal of the policy should be mitigated by the government in any way possible. Capacity building and sensitization programmes for SMEs should be put in place by government to empower them with ideas and information needed to grow the enterprises to the highest level possible for the benefit of the Nigerian economy as a whole. Diversification of financial support for start-ups, growing and successfully operating SMEs will significantly contribute to the creation and development of SMEs. Start-ups, growing and successful SMEs should get 50, 30 and 20% respectively of whatever financial support are available for SMEs.

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