EXAMINING A SUSTAINABLE FUNDING OPTIONS FOR SUSTAINABLE SMEs PERFORMANCE

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ABSTRACT

Studies have shown that formal SMEs contribute up to forty percent of national income (GDP) in developing economies. These numbers are considerably higher when informal SMEs are included. Therefore the role of this sector cannot be overstated. The aim of this study was to examine the funding options for sustainable performance of SMEs in Nigeria with reference to Oyo State SME operators. The research adopted the quantitative method where questionnaires were administered to the business owners. A sample size of 362 were drawn from a population of 6131 SME operators within Oyo State, however, a questionnaire collection rate of 147 was achieved and used for the analysis. The study found that informal source of funding and government funding were significant to SMEs Performance, while there was a negative and insignificant relationship between formal credit financing and SMEs Performance. In terms of contribution to the model, government funding contributed more than the informal source of funding. The study recommended how the government should formulate actions to assist SMEs in boosting their ability to access alternative funds from formal institutions.

Keywords - *Formal Credit Financing, Funding Options, Informal Financing, Nigeria, SME Performance*

I. INTRODUCTION

The importance of small and medium enterprises (SMEs) in any country is such that cannot be overlooked by the government of any nation especially in Nigeria. Consequently, it has been recognized that SMEs growth establishes one of the foundations of economic development in the country. Generally, SMEs are viewed as a tool of economic growth in developing countries [1] and industrialized countries [2]. Accordingly, SMEs form the driving force of industrial growth and development in the country. Therefore, it makes it a sector that should be focused on and be concerned for, supported by the government by making financial resources more accessible to them at a low interest rate as they need funds to flourish and survive.

Thus, in any business milieu, financing is usually a strategic component of attaining the aim of the business enterprise.

It is generally accepted by both the professionals and researchers that SMEs function as promoters of economic growth of the economy of any country. However, the SMEs are threatened by numerous challenges. A case in point is that, in Nigeria, one of the significant challenges faced by SMEs is that of financial resources to fund their operations [3]. Empirical evidence shows that finance contributes about 25% to the success of SMEs. [4]. Likewise, a World Bank report showed that 39% of small scale firms and 37% of medium scale firms in Nigeria are financially hindered. Many SMEs in Nigeria lack the financial resources to remain in business and they are forced to close shop because they are unable to access the required funds. What are therefore, the financing options of SMEs in Nigeria? Every enterprise is financed either through debt or equity or a combination of both. Both types of financing are usually sourced from either the informal finance sector (IFS) or the formal finance sector (FFS). The two basic financing concepts of SMEs, the formal and informal forms of financing, have been identified by earlier researchers, scholars and practitioners [5;6]. The researchers identified commercial banks and development banks in the formal sector as the most popular source of finance for enterprises. The informal sector which consists of borrowing from friends, relatives and cooperatives are also important source of financing SMEs. Another source of enterprise financing is through personal savings. The informal finance sector consists of informal finance institutions like money lenders, landlords, friends, relations, credit and savings associations (co-operative societies), among others [7]. The formal financing sector is made up of formal finance institutions such as commercial banks, microfinance banks, international development agencies etc. [8].

1.2 Problem Statement

The positive part of SMEs have been discussed in several SMEs studies, however, the challenges confronting SMEs in terms of funding have been studied haphazardly. There exist numerous studies on contributing factor of SME and aspects influencing financial profitability of SMEs. The obtaining of credit for SMEs has always been problematic and widely considered with a growing predisposition towards the limitations the SMEs encounter in obtaining funding from commercial banks and other lending institutions. Conversely, barely any of these studies has addressed the constraints that the SMEs face in accessing financing from different other sources and how this is related to their performance.

This study will therefore look at the best financing option for SMEs in Oyo State.

1.3   Objectives of the Study

1.   To examine the effect of informal financing sources on SMEs performance in Oyo State

2.   To assess the impact of formal credit financing on SMEs performance in Oyo State

3.   To determine the influence of government funding on SMEs performance in Oyo State

1.4 Research Questions

1. What is the effect of informal financing impact sources on SMEs Performance in Oyo State?
2. Does formal credit financing have any impact on SMEs Performance in Oyo State?
3. Does government funding have any influence on SMEs Performance in Oyo State?

1.5 Research Hypotheses

1. Informal financing sources have significant effect with SMEs Performance in Oyo State
2. Formal credit financing is statistically correlated to SMEs Performance in Oyo State
3. Government funding is significantly related to SMEs Performance in Oyo State.

II. LITERATURE REVIEW

2.1 Informal Financing

The swift proliferation of informal financial institutions in several developing countries like Nigeria is the lack of ability of formal financial sector to fill wide gaps created in making available financial assistance to individuals and small business owners. The motives for their existence comprise, lack of access to bank loan; collateral free loan and free, low or single digit interest rates as case may be. The informal finance sector (IFS) offered more than seventy per cent of the resources required by SMEs [8].

One of the uniqueness of informal financial institutions is the adaptation to the needs of its members than formal financial sector or institutions such as banks [9]. CBN, (2005)[10] reported that in Nigeria, formal financial system offered services to about 35% of the economically active population and the remaining 65% is served by informal financial sector). [11] found out that moneylender enterprises have been made legitimate in certain parts of the globe and suitably, formally instituted policies have been put in place to regulate the operations of theirs and consequently are normal in the semi urbanized locations. It calls for the provision of third party or maybe security as to stay away from defaults in repayment. [12] observed that the borrower is usually necessary to create a guarantor, pledge the land of theirs or possibly both to perform as collateral before the extension of the loan facilities. Recognition from these loan shark is generally the costliest credit accessible; therefore the demand for this generally comes from persons not having another alternative.

2.2. Formal Credit Financing

[13] pointed out that despite the importance of SMEs to economies, banks and other financial institutions are reluctant to provide credit to the SME sector because of the risky nature of early start-ups ventures with insufficient assets.

Access to finance is essential to any enterprise development; the reason being that investment and innovation are difficult without suitable financing. Challenges of obtaining sufficient finance is named among the leading barrier to the growth of many small and medium sized enterprises (SMEs). Access to finance is still a key problem to numerous SMEs and a comparison of the different enterprises has discovered [14].

Formal finance is borrowing from financial institutions such as banks and credit unions, and other non-bank financial institutions. Both informal and formal finance have their strengths and weaknesses, implying that a borrower may benefit by simultaneously obtaining both of them. In addition, the major categories of financial institutions include central banks, retail and commercial banks, internet banks, credit unions, savings, and loans associations, investment banks, investment companies, brokerage firms, insurance companies, and mortgage companies.

2.3   Government Funding

The successive government in Nigeria, over the years, set up numerous financing institutions, designed to make available support to SMEs to assist in the development and growth of the SME sector [15; 16]. The institutions included the Nigerian Industrial Development Bank (NIDB), the Nigerian Bank of Commerce and Industry (NBCI), National Economic Reconstruction Fund (NERFUND), Nigerian Export-Import Bank (NEXIM), and the Peoples Bank of Nigeria [15; 16]. Other institutions included National Directorate of Employment (NDE), Industrial Development Coordinating Centre (IDCC), Community Banks, Family Economic Advancement Program (FEAP), and State Ministries of Industry SME schemes, the Nigerian Agricultural, and Cooperative Development Bank (NACDB), and Bank of Industry (BOI).

[13] remarked that regardless of the prominence of SMEs to economies, banks and other financial organizations are indisposed to offer credit to the SME segment for the reason of the precarious nature of early start-ups ventures with inadequate capitals. The establishment of specialized development banks for SME, loan offerings for SMEs could be part of the government policies to help alleviate the SMEs' financial constraints [13].

However, financial assistance or grants tends to be set aside for non-profit organizations, social services, educational endeavours and specified research. When seeking government grants for small business, it is vital to recognize the requirements to qualify for government assistance. The support from government including financial and non-financial assistance is another critical strategy for entrepreneurs in nascent venture increased their survival rates.

2.4. SMEs Performance

In the field of strategic management and management research at large, the term performance has come under different descriptions, such as performance management, performance measurement, performance assessment, or performance evaluation are used in various field of management science [17]. Most of these studies concentrated on examining causes of SMEs performance, in which several variables were recognized as the factors influencing SMEs performance [17].

SMEs performance can be seen as how the firm offers value to its stakeholders such as owners, customers, society and even government [17]. In other words, it indicates how successful the management manages the firm resources [18]. [19] defined firm performance as the procedures of

quantifying business firm actions of in terms of accomplishing its objectives. Firms attain their objective if they succeed in satisfying their stakeholders' needs more than their rivals. Firm performance can be measured either by looking at economic variables or non-economic variables [20]. In other words, it can be measured quantitatively or qualitatively [21]. Several studies on firm performance use various organizational resources to measure SMEs performance. Additionally, [22] reveal that access to finance is directly related to the performance of SMEs. Thus, the lack of finance adversely affects the full potential of SMEs as an economic driver. [23] state that access to finance allows firms to grow and develop.

2.3   Theoretical Framework

The theoretical framework introduces and describes the theory that explains why the research problem under study exists. This study is underpinned by two theories - Financial Intermediation Theory and Pecking Order Theory.

2.3.1   Financial Intermediation Theory

Financial intermediation theory builds on the notion that intermediaries serve to reduce transaction costs and informational asymmetries. The building blocks for a theory of financial intermediation is that which aims at understanding and explaining the existence and the behaviour of real-life financial intermediaries. Financial intermediation is the role played by financial institutions by creating specific monetary commodities when they discover they are in a position to market them for fees which are expected to be over the costs of the development of the commodities, both quick costs in addition to opportunity costs [24]. Monetary intermediaries are available due to business imperfections. Financial intermediation theory is based on transaction costs and asymmetric information. This theory indicates that the financial intermediaries play a critical role in coordinating surplus units with deficit units. In the present study, the purpose was to assess how financial performance of SMEs is affected by the following financing options; access government finance, formal sources, and informal sources. This theory was valuable especially in the assessment of the barriers and constraints the SMEs face in getting credit from diverse sources of surplus funds like Bank of Industry (BOI), Pension Funds, Commercial banks and Microfinance banks.

2.3.2   Pecking Order Theory

The pecking order theory states that managers are given a preference to fund investment opportunities using three sources: first through the company's retained earnings, followed by debt, and choosing equity financing as a last resort. According to this particular concept, firms favour internal funding much more than external funding. Merely, in case businesses call for outside financing, they will prefer equity less than debt as equity is actually used as a final measure. The firms adopt cautious approaches with respect to dividends and make use of borrowed funds to enhance the valuation of the business. The principles of the pecking order principle were supported by a selection of academics like [25; 26] which offered evidence of bad choice connected with equity

issues. While investigation by [27] provided associated evidence on experimental bases concerning firm's financing needs.

The theory was used to establish if the SMEs preferred the conservative sources mostly from personal sources or have ventured into liberal financing schemes and loans for SMEs. The effects on financial performance of SMEs by each financing option was also established.

For the purpose of this study, the financial intermediation theory was chosen as the overarching theory for the reason that the object of this study is to identify the exact financing options suitable for the study. This theory indicates that the financial intermediaries play a critical role in organizing surplus units with deficit units.

III. RESEARCH METHODOLOGY

3.1 Research Design

Research design refers to the over-all methodology that one may possibly select to combine the several components of the study logically and coherently. It gives a format for the selection of the desired population and methods of data collection that enables a researcher answer the precise research questions [28]. This is done to determine that the researcher properly confronts the aspect under investigation [29]. The study will employ a quantitative approach which will utilize a descriptive survey design technique to establish the association between financing options and financial performance of the small and medium enterprises. There are a number of research designs and they include: experimental designs, descriptive designs, and exploratory designs [30]. There are four types of descriptive research design; correlation, evaluative, survey and meta-analysis [31].

3.2 Research Population

[32] defines population as all the members of a real or hypothetical set of people, events or objects to which a researcher wishes to generalise the results of the study. The population represents the entire set of units of analysis or the total collection of elements on which inference is to be made [33]. In this case, the population consisted of 6,131 (6,039 Small + 92 Medium) SME owners/operators within Oyo State who are officially registered with SMEDAN as the study population.

3.4 Sampling Technique and Sample Size

A sample is a representation of the entire population whereby respondents are given questions to answer from a standardized questionnaire. The study used random sampling technique. The goal of simple random sampling was to achieve desired representation from various subgroups. That is, everybody has equal chance of being selected.

Sample size is the number of values of each sample [34]. [35] defines a sample as a part of the entire population selected for study to obtain information on the whole set of human respondents from the population. The sample

size was calculated using the Raosoft sample size calculator [36]. According to the calculator, the sample size for this study is 339 respondents. Therefore, in this study, the sample size was 339 participants.

IV. DATA PRESENTATION AND ANALYSIS

4.1   Response Rate

In survey research, response rate, also known as completion rate or return rate, is the number of people who answered the survey divided by the number of people in the sample. It is usually expressed in the form of a percentage. A total of three hundred and sixty-two (362) questionnaires were administered and one hundred and forty-seven were returned duly completed, representing 40.6% response rate.

Table 4.1: Questionnaire Return Rate

Response Rate	Frequency	Percentage
Response	147	40.6
Non-Response	215	59.4
Total	**362**	**100.0**

According to [37], response rate of 30% and above was regarded as being acceptable. With the response rate of 40.6% from the 362 randomly sampled firms, it is considered good for the course of this study.

4.3   Reliability Statistic

Reliability refers to the extent to which a measure is free from random measurement errors [38]. If measures have low reliability, they will limit the statistical power to predict relationships. Since this research uses a multi-item scale, internal consistency between the items is important to ensure that there is little random measurement error. Cronbach's alpha is a widely used technique to test and establish reliability of the research instrument. Alpha coefficients were calculated using the average correlation between the items [39]. This study accepts an alpha score >0.7 as an acceptable indicator of reliability as suggested by [40].

As the estimate of reliability increases, the fraction of a test score that is attributable to error will decrease. Cronbach's alpha coefficient greater than 0.7 suggests that the data are reliable [41], so, with the value of 0.710, the data accordingly are reliable and fit for the analysis as shown in Table 4.2 below.

Table 4.2: Reliability Statistics

Cronbach's Alpha	N of Items
.710	4

4.4 Assumptions of Multiple Linear Regression

Key assumptions for multiple regression exist. For multiple regression, the dependent or independent variables have to be an interval or scale level variable which is normally distributed in the population from which it is drawn. Figure 4.1 confirmed to the normally distributed feature. That is the error, or residual, is normally distributed
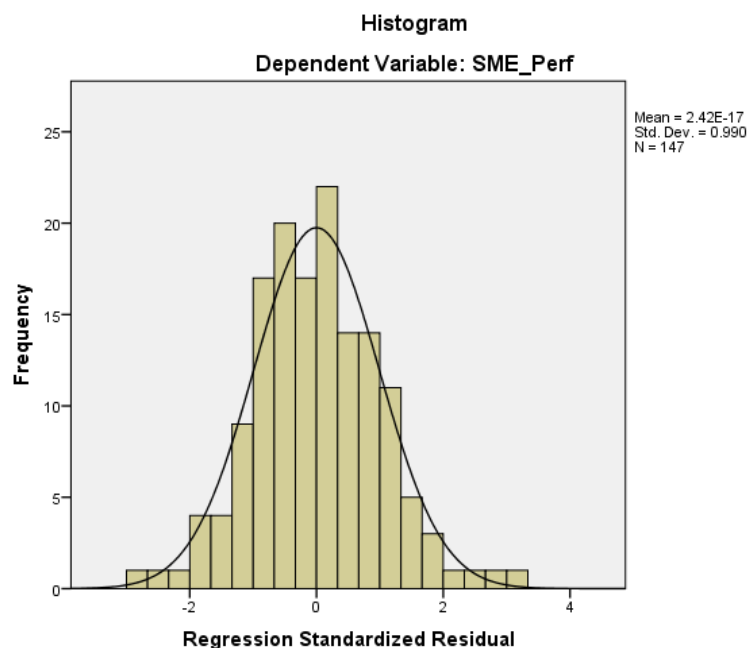

Figure 4.1: Normality Histogram

Another assumption to take care of, prior to the consideration of the analysis proper is the linearity assumption [42]. From the Linearity probability plot (Figure 4.2) below, the variables are clustered very closely along the regression line; indicating that the data are well suited for this study and analysis.
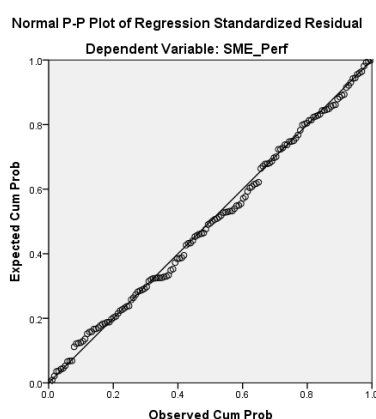

Figure 4.2: Linearity P-P Plot

Next in line is the multicollinearity issue, which is a condition that can be extremely problematic. Multicollinearity occurs when two or more independent variables contain much of the same information. The Durbin-Watson (DW) was used to test for the existence of Multicollinearity. Table 4.3, shows a DW of 2.266 which lies between 1.5 and 2.5. Therefore, Multicollinearity issue was not violated.

4.5   Hypotheses Testing

Table 4.3: Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.747[a]	.558	.548	2.297	2.266

a. Predictors: (Constant), Formal_Funding, Informal_Financing, Govt_Funding

b. Dependent Variable: SME_Perf

Table 4.3 which is the Model summary, examines the strength of the prediction equation. A measure of the strength of the computed equation is the R^2 or coefficient of Determination. R^2 represents the proportion of variance accounted for in the dependent variable "SME Performance" by the independent variables (informal, formal and government funding).

Accordingly, for this study, the independent variables of informal, formal and government funding have explained 55.8 percent of the variance in the dependent variable "SME_Perf" as shown in Table 4.3. [39], put forward that the acceptable level of R^2 value depends on the research context, however, [43] recommend an R^2 value of 0.10 as a minimum acceptable level. Meanwhile, [44] recommends that the R^2 values of 0.67, 0.33, and 0.19 can be considered as substantial, moderate, and weak, respectively. Table 4.3 shows the R^2 values of the dependent variable (SME_Perf) to be 55.8%, which is considered as "Moderate".

Table 4.4: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	951.019	3	317.006	60.101	.000[b]
	Residual	754.260	143	5.275		
	Total	1705.279	146			

a. Dependent Variable: SME_Perf

b. Predictors: (Constant), Formal_Funding, Informal_Financing, Govt_Funding

On examining the hypotheses, it was found from Table 4.4 (ANOVA) above, that Formal funding, Informal_Financing and government funding are significantly related to SME Performance with p-value 0.000. This suggests that any of the three independent variables can explain the model.

Table 4.5: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
		B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1	(Constant)	8.497	1.974		4.305	.000		
	Informal_Financing	.201	.055	.224	3.678	.000	.836	1.197
	Govt_Funding	.491	.049	.634	10.021	.000	.772	1.295
	Formal_Funding	-.033	.078	-.024	-.418	.676	.915	1.093

a. Dependent Variable: SME_Perf

On further analysis, Table 4.5 (Coefficients) showed the significance of both informal financing and government funding to SME Performance. Actual contribution of the two significant independent variables to the SME_Perf was established. In terms of individual contribution, it was established that Informal_Financing contributed .201 or 20.1 percent to SME_Perf, while Government_Funding contributed .491 or 49.1 percent to SME_Perf. These actual contributions led to the construction of the actual model, derived from the assumed model as shown in Table 4.5 (Coefficient). The model is presented thus;

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + €$

Y is the dependent variable (SMEs Performance)

β_0 = Constant

β_1 = Coefficient of Informal Financing Source

β_2 = Coefficient of Formal credit Financing

β_3 = Coefficient of Government Funding

X_1 = Informal Financing Source

X_2 = Formal Credit Financing

X_3 = Government Funding

$€$ = Error term

SME_Perf = 8.497 + .201Informal_Financing + .491Govt_Funding

4.7   Discussion on Findings

The coefficient for informal financing (0.201) is statistically significant and different from zero. This is because its p value is 0.000 which is below the 5% degree of significance. Thus, a unit increase in informal financing for the SMEs will result in a 0.201 improvement in SME performance. Thus, the null hypothesis was rejected, and a

finding made that informal financing has a statistically significant impact on SME performance. The outcomes agree with prior studies like [11], [12], as well as [45] that established that financial performance is affected by informal financing. Similarly, the study results also agree with findings by [46] that SMEs rely largely on individual savings of owners, and quite often company earnings, in case there are any for their monetary requirements. This is because they have little or perhaps no access to formal outside credit.

Furthermore, the coefficient for government financing (0.491) is statistically drastically distinct from zero. Since its p-value of 0.000 is under 5 % or maybe 0.05 degree of significance. As a result, a device increase of usage of government financing would result in a 0.491 device increase in financial performance of SMEs. The null hypothesis was thus rejected, along with a conclusion made that government financing has performance enhancing impact on financial performance of SMEs. The outcomes agree with previous outcomes by [47], [48], [49] and [50] that stated how government funding enhances efficiency. The regression model was developed as follows;

SME_Perf = 8.497 + .201Informal_Financing + .491Govt_Funding

V. SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

5.1.1 Objective One

Objective 1 of the study was to assess the impact of informal financing sources on SMEs performance in Abuja. Correlation analysis showed that informal financing sources was positively and significantly associated with SMEs performance. Regression coefficient revealed that there was a positive and significant relationship between informal financing and SMEs performance in Abuja ($\beta = 0.201$, p = 0.000). This was supported by a calculated t-statistic of 3.678 that is greater than the critical t-statistic of 1.96. This means that a unitary improvement in informal financing leads to an improvement in SMEs Performance by 0.201 units holding other factors constant. Accordingly, the study adopted the alternative hypothesis that informal financing has a significant effect on SMEs Performance in Oyo State, Nigeria.

5.1.2 Objective Two

Objective 2 of the study was to evaluate the impact of government funding on SMEs performance. Correlation analysis revealed that formal credit financing was negatively and insignificantly related to SMEs Performance. Regression coefficient showed that there was a negative and insignificant relationship between formal credit financing and SMEs Performance ($\beta = - 0.033$, p = 0.676). This was supported by a calculated t-statistic of - 0.418 that is less than the critical t-statistic of 1.96. The implication is that for the purpose of this study, formal credit financing is not a good predictor of SMEs Performance.

5.1.3   Objective Three

Objective 3 of the study was to evaluate the impact of government funding. Correlation analysis showed that government funding was positively and significantly associated with SMEs performance. Regression coefficient revealed that there was a positive and significant relationship between government funding and SMEs performance in Abuja ($\beta = 0.491$, p = 0.000). This was supported by a calculated t-statistic of 10.021 that is greater than the critical t-statistic of 1.96. This means that a unitary improvement in government funding leads to an improvement in SMEs Performance by 0.491 units holding other factors constant. Accordingly, the study adopted the alternative hypothesis that government funding has a significant effect on SMEs Performance in Oyo State, Nigeria.

5.2   Conclusion

The study concluded that informal sources of finance were the key source of SMEs' finance. A conclusion was further made that utilisation of informal finance serves to greatly enhance the financial performance of SMEs. The study further concluded that personal financing was a very significant facility in financing SMEs' operations. A further conclusion was made that personal financing strongly drives the financial performance of SMEs.

Furthermore, the study concluded that government funding influences the financial performance of SMEs.

Concerning formal financing, the study established that formal financing facilities did not the financial raise the performance of SMEs. Though SMEs had low access to these sources of financing, the conclusion was that SMEs could perform better financially if access to formal financing is enhanced. However, due to the stringent measures meted on SMEs by banks and other financial institutions, business owners will be reluctant to go to banks for financial assistance, rather, they will prefer their personal savings, friends and family as well as government financial intervention.

5.3   Recommendation

SMEs are encouraged to appraise their financing options to guarantee ideal financing blend to enhance liquidity and profitability. Secondly, the stakeholders and particularly the government should formulate actions to assist SMEs boost their ability to access alternative funds from formal institutions.

Thirdly, the formal finance institutions should be stimulated by government to set SMEs friendly lending conditions to enhance accessibility of credit to SMEs. To this end, the government should consider incentives to formal financial players who establish special facilities targeting SMEs. The government should also consider measures towards improving the visibility and relevance of affirmative funds in boosting SMEs' activities due to their significance to the economy.

5.3.1 Recommendation for Further Studies

As this study's context is Oyo State, further study targeting a wider population should therefore be conducted to give more evidence and increase generalization. Furthermore, as the independent variables were able to explain 55.8 percent of the model, future studies need to examine other factors other than the financing options.

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