European Journal of Business and Management www.iiste.org
ISSN 2222-1905 (Paper) ISSN 2222-2839 (Online)
Vol.8, No.6, 2016

Financing Practices of Entrepreneurs in Small and Medium Enterprises in Southwestern Nigeria

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Abstract
The study examined the financing practices engaged by entrepreneurs in Small and Medium Enterprises (SMEs) in Southwestern Nigeria and also determined the extent of their dependence on internal and external financing practices to operate their businesses. Specifically, the study is designed to determine the extent that the financing practices of small and medium enterprises are dependent on internal and external financing. Primary data obtained through questionnaire and in-depth interviews were analysed with the aids of descriptive statistical tools, to describe financing practices of SMEs, while logistic regression was employed to determine the relationship between dependent variable (SMEs) and independent variable (internal and /or external sources of finance). Findings revealed that owner-managers of SMEs employ both internal and external financing practices, and the study concludes policy makers need to ensure official discriminations between the small and medium enterprises, by treating them separately. The policy interventions should make access to financing easier for small enterprises, this will not only fast track their growth into medium and large enterprises but will also increase their capacities, in production and provision of employment opportunities to massive number of youths that are presently unemployed.
Keywords: entrepreneurship; small and medium enterprises; internal financing; external financing.

This study was funded by TetFund (Nigeria) Institutional based Research grant

Introduction

The SMEs sector in Nigeria is much smaller compared to other developing countries of the same level of development and economic activities, such as, Brazil, Indonesia and South Africa, due to poor financing access among other reasons (World Bank, 2009). When SME sector is combined with the micro enterprises, it accounts for 50 per cent of GDP compared to 80 percent for many developing countries (World Bank 2009). The Sector is hampered by an environment that presents considerable challenges like, poor infrastructure, low skills and weak governance (World Bank 2009).

The difficulty experienced by Nigeria SMEs, where 59 percent of small firms report such, is only similar to Brazil but far worse when compared with India, China, South Africa and Indonesia (figure 2.1). Most of the SMES in Nigeria are in need of finance and 80 per cent do not border to apply for one, because of the obstacles they will have to overcome. These obstacles are short loan maturities; inaccessible collateral requirements, high interest rate, can be as high as 50% and cumbersome application procedures (figure 2.1). The cost of finance however is similar to Brazil again but worst compared to others like South Africa and India at less than 20 per cent. This is especially worrisome in the sense that SMEs account for a large portion of the labor force, a large portion of enterprises and also a large portion of national income.

Moreover, a sizeable portion of the population already earn their living in micro or small and medium enterprises, often earning poor wages, most especially in low income developing countries (OECD 2006). Ayyagari, Beck and Demirguc-Kunt (2003) reported that SMES and informal enterprises in low income countries, account for over 60 per cent of Gross Domestic Product (GDP) and 70 per cent of total employment. In Nigeria, SMEs when combined with micro enterprises contributed 46.54 percent to GDP in Nominal terms. A total of 32, 414, 884 persons were employed by the micro enterprises sector as at December 2010. While a total of 39,478 persons were employed in small and medium enterprises, representing 22,139 males (56.08%) and 17,339 females (43.92%) (SMEDAN/NBS, 2012).

In the case of Nigeria, studies (OECD, 2006 and World Bank, 2009) have shown that if environmental challenges are addressed, the SME sector could be made more robust, thereby contributing to poverty alleviation, employment generation and economic growth. Other studies have also suggested that the SMEs in Nigeria are the catalysts for economic growth and development as well as the backbone of the Nation (Ihua, 2009). This notwithstanding, a World Bank study (2009) has shown that low access to financing is the next most important constraint, for Nigeria SMEs after electricity shortage. Thus, a crucial element in the efforts to reduce poverty and generate employment opportunities in the country rests on the capacity of SMEs to have unhindered access to external finance.

In recognition of the role of SMEs in economic growth and development, coupled with the importance of finance to stimulate the sector, the succeeding governments in Nigeria over the years have come up with the intervention programs leading to, the establishment of several micro credit institutions (SMEDAN/NBS, 2012).

Such micro credit institutions include the Nigeria Bank of Commerce and Industry (NBCI), Nigeria Economic Reconstruction Fund (NERFUND), People's Bank of Nigeria (PBN), Community Bank (CB), Nigerian Export and Import Bank (NEXIM) and Micro-finance Bank (SMEDAN/NBS, 2012) . In addition to the establishment of the finance institutions, the government also liberalized the banking sector (Mambula, 2002). However, some of these institutions were not sustained because they were products of political regimes and went into extinction as soon as the regimes were out of power, as a result of fund starvation and neglects, hence effective development of SME sector became constrained.

Small and Medium Enterprises Development Agency (SMEDAN) was established as an apex institution to arrest these shortcomings. As an agency it was saddled with the statutory responsibility of facilitating the creation, resuscitation and stimulation of the growth and development of the Micro, Small and Medium Enterprises (MSMEs) sector of the Nigerian economy. The government, despite the failure of past efforts to stimulate the SMEs sectors, came up with intervention programs, which made access to finance easy (SMEDAN/NBS, 2012). Some of the intervention programs and their policy targets (SMEDAN/NBS, 2012) are as follows:

(a) The microfinance policy, regulatory and supervisory framework for Nigeria – This framework provides for establishment of microfinance banks and conversion of former community banks into microfinance banks. The goal is to create sustainable and credible microfinance banks that will mobilize and channel funds to MSMEs.

(b) The Small and Medium Enterprises Equity Investment Scheme (SMEEIS) – the SMEEIS initiative was to provide adequate and cheaper funding to SMEs, with a view to aid government aggressive and radical transformation of the SME sector. Commercial banks operating in Nigeria were mandated to set aside 10% of their profit after tax (PAT) to acquire equity participation in SMEs. The cumulative sum set aside by the banks as at December, 2009 was ₦42 billion. The programme did not achieve the desired impact because the SMEs were not interested in equity participation for fear of dilution of control over their firms. Most of the SMEs because of their opaque operations, lack the required 60% they need to provide as a pre-condition to access the scheme. In addition, most SMEs lack clear marketing strategy, business plan and sound accounting practices, which are pre-conditions to access the scheme.

(c) The ₦200 billion small and medium Enterprises Guaranteed scheme – the scheme was set up in 2010 to aid quick transformation of the SME sector and to provide for increase access to finance by SMEs. The scheme was to provide guarantee to loans accessed by SMEs so that banks risks that limit financing to the sector can be absorbed. The SMEs that can access the scheme are those with an upper limit of ₦500 million in assets, with employees in the range of 11 to 300. The maximum amount that could be guaranteed is ₦100 million that could be in form of working capital, term loan for refurbishment or equipment upgrade or expansion and overdraft.

(d) The ₦200 billion SME Restructuring/Refinancing funds -The fund was established by the government through the Central Bank and it is managed by the bank of industry who disburses the fund to participating Banks. The objective of the fund was to improve the financial position of banks and thereby enhance the access to finance by SMEs.

(e) The ₦2 Billion NERFUND facility – The National Economic Recovery Fund (NERFUND) is being repositioned to aid the growth and development of MSME sector. The ₦2 Billion is meant for fund to be directly lent to MSME. The disbursement of funds involves all stakeholders and SMEDAN to direct bankable business plan from their clients to the fund for wider reach of SMEs in need of financing. This is made possible because SMEDAN and various stake holders signed MOU to ensure channeling of good business plan to the fund for financing.

(f) The ₦5 Billion Dangote fund for MSMEs - To stimulate the growth and development of the sector, the government entered into collaboration with the private sector to partner in transforming the MSMEs sector and an example of the partnership/collaboration is the Dangote fund. The Dangote fund in the terminology of the field is referred to as business angel financing. This is a fund provided by wealthy individual or group of individuals looking for diversification of their investment portfolio. So far it is the first case of business angel model of financing SMEs in Nigeria.

The antecedent of the intervention programs vis-à-vis the problem of access to finance in the SMEs sector of Nigeria economy justifies the need for detailed study in this area. One of such efforts is this study.

This study is further justified because its outcome can provide useful guides on how to enhance financing practices of SMEs. As a matter of fact, a research in this area is informed by the World Bank Study (2009) that revealed disturbing statistics on the Nigerian business and entrepreneurial climate. The study without any doubt supports the need for further research into areas which can enhance the growth and development of entrepreneurship environment in Nigeria. This is more so, in view of the fact that over the years succeeding governments in Nigeria, have come up with many intervention programs. Some of the programs are still in existence without any or much effectiveness when evaluated against the facts contained in the World Bank Study (2009). Some of the disturbing statistics revealed by the study include, amongst others the following:

- One in every five Nigerians is unemployed and the country is not maximizing its human potential for a country with over 150 million people.
- The demographic trend also shows that one in ten of the 6 million new entrants to the workforce find employment and that youth unemployment is estimated at about 60 percent.
- In finance, eighty percent of SMEs would like to have a loan but only 5% actually have one and at a prohibitive rate of interest as high as 28%.

SMEs are of critical economic importance, because they are the engines of growth and development for most developed, emerging and developing countries of the world. Lack of finance in the appropriate forms can constitute serious obstacles to growth and development in the sector and consequently, hampers their significant contributions to the economies of these countries (OECD, 2006, Beck and Demirguc-Kunt, 2006).

A survey (SMEDAN/NBS, 2012) conducted in 2010 shows that financing and financial assistance is considered by 24.7 per cent of the enterprises as the most needed areas of assistance. The same survey also shows that in diagnosing the major problem militating against enterprises' development in Nigeria, lack of access to finance ranks as the most severe (SMEDAN/NBS, 2012). Poor access to financing can stunt and be a major hindrance to the growth and development of the SME sector (World Bank, 2009). Small and medium enterprises, with the dominance in numbers among operating businesses in any economy and their importance in employment generation and poverty alleviation, have traditionally faced difficulty in accessing financing, particularly external financing in forms of formal credit or equity (Mambula, 2002; Storey and Greene, 2010).

Many studies (Beck, Demirguc-Kunt, and Maksimovic, 2004; Berger and Udell, 2006 and OECD 2006) have established the sources of financing available to SMEs but few studies have been conducted in the actual financing practices they engage in, particularly in developing countries such as Nigeria. But it is the knowledge of the actual financing practices the SMEs engage in that can help the entrepreneurs in the sector, given that the knowledge will guide policy interventions in such a way that will assist the sector to reach its potential. Thus this study is designed to describe the prevailing financing practices of entrepreneurs in small and medium enterprises, and specifically, to determine the extent that the financing practices of small and medium enterprises are dependent on internal and external financing.

Sources of Finance to SMEs

Berger and Udell (2006) identify two broad categories of financing sources available to small enterprises and they are, the external and internal sources of finance while the small enterprises rely on internal sources of financing, such as, retained profits and personal savings, the large enterprises rely on external sources like, private placement of equity and commercial papers. Zoppa and McMahon (2003) buttress the view that SMEs tend to embrace internal financing practices more than external financing. The results of their study (Zoppa and McMahon, 2003) amongst a panel of 871 manufacturing SMEs taken from Australia government's business longitudinal survey provide further empirical evidence, suggesting pecking order financing practices among SMEs, though modified to reflect special circumstances and peculiarities of SMES financing.

Financing practices of SMES in Nigeria based on SMEDAN/NBS (2012) survey that was conducted in 36 states of the federation including Federal Capital Territory, Abuja, and 300 Micro enterprises per state were surveyed, while 4000 SMES across 12 sectors of the economy were also covered. The findings of the survey show most SMES are operated by personal savings, which represents 84.6 percent of their financing. Family source represents 29.8 percent of financing practices. While loan and cooperative/Esusu were other major sources of financing representing, 9.2 percent and 8.0 percent respectively. The financing practices as showing from the survey findings still support the notion that external financing is very negligible for SMES.

SMES financing practices are mainly internal sources, with very limited external financing sources as shown by Winborg and Landstroom's (2001) study of 900 small businesses in Sweden. The study provided further evidence, of SMEs not only relied on internal financing but that they also fashioned other creative methods in their financing practices, called bootstrapping. Six Clusters of boots trappers were identified such as: (1) Delaying boots trappers; (2) Relationship-oriented boots trappers; (3) Subsidy-oriented boots trappers; (4) Minimizing bootstrapers; (5) Non-bootstrappers; and (6) Private owner-financed bootstrappers. The evidence provided by Winborg and Landstrom (2001) is also similar to Zoppa and McMahon (2003) except that the Bootstrapping techniques do not involve institutional commitments or market obligations.

In a study conducted by Gatner (2009) of financing choices of 1,214 nascent entrepreneurs, using data from Panel study of entrepreneurial dynamics 11 (PSED11), the financing sources are divided into two broad categories: personal and external. The study categorizes the financing resources that are used by nascent entrepreneurs and the amount based on the hypotheses developed, about the influence of the kind of firm and nascent entrepreneur characteristics. The results of the study provide further empirical evidence that majority of financing (57% of all financing) comes from personal contributions of its founders for emerging ventures. This result therefore reinforces the notion that entrepreneurs in established ventures such as SMEs also experience the heavy reliance on personal resources or internal resources. The results also showed that enterprises created by entrepreneurs with higher level of education, duly incorporated, legally registered and that were projected to have higher level of revenue, were more likely to use external financing.

In an empirical study conducted by Morrish (2009) on effectuation approach of portfolio entrepreneurs to venture development, there is evidence that the portfolio entrepreneurs made use of effectuation reasoning. The study shows that effectuation reasoning is employed during preliminary and early stages of venture and portfolio development; while the portfolio entrepreneurs employed causation logic as venture and portfolio mature (Morrish, 2009). The findings of Morrish (2009) study further support the position of Read and Sarasvathy (2005) that both causation and effectuation approaches can complement each other. The study however is limited in scope in the sense that only 15 successful participating entrepreneurs were involved in the case method approach used in the study. A further empirical study using statistical survey method is required for the findings to be generalizable.

Storey and Greene (2010), comprehensively treat sources of financing available for businesses, whether categorized as internal or external and regardless of the size of the enterprise. The two scholars identified twelve main sources of finance available to enterprises and these are listed below with brief descriptions.

(i) Overdrafts, is a facility provided by a bank, with a flexibility to borrow up to an agreed limit whenever needed. The borrower only pays interest when the facility is used and not on the availability of overdraft. It is used mainly to fund working capital and to even out cash flow fluctuations.

(ii) Grants or subsidized loans, is generally non-repayable payment that is usually provided by a public organization. Subsidized loans are repayable unlike grants, but at an interest rate below the commercial rate. These two forms are typically funded from public money to encourage a particular sector or to stimulate development in a particular geographic area.

(iii) Term loans, are provided by banks and other financial institutions repayable with a given period of time, normally at an agreed intervals for both interest and principal not exceeding three years. The loans are usually used to purchase ‘fixed assets’ such as plant and machinery.

(iv) Asset finance is an alternative to term loans for acquisition of assets. Using asset finance, the firm can engage in hire purchase or leasing. The only difference between the two forms of finance is that ownership of assets always remains with the (owner) lessor rather than the business lessee for leasing.

(v) Credit cards provide access to cash to purchase assets or for working capital. It attracts no interest if repaid within time otherwise the interest rate are prohibition.

(vi) Equity finance is a stake or share of the ownership of a business. This often happens when an owner cede part of their business to others in return for cash. There is no interest payment. The disadvantage of this form of financing is that full control will be diluted. There are two sources of equity finance; it can be formal or informal. The formal source is usually from venture capitalists and their funds often provided by pension funds or other financial institutions. The informal source of equity comes from the business angels and their funds come from wealthy individual or groups of individuals looking for diversification of their wealth portfolio. Both forms of equity are in it for future capital gains.

(vii) Personal savings, these are cash and other assets of the owner.

(viii) Mortgage on home, provides borrowed funds based on the collateral value of property. This is usually the owner’s own house.

(ix) Gifts from friends and family, these are normally assumed to be non-payable.

(x) Loans from family and friends, these are assumed to be repayable. If it incurs interest rate at all, they are often minimal or zero.

(xi) Asset-based finance, involves either factoring of invoices to a third party for a proportion of the yet unpaid invoices or stock finance which raises finance against the stock a business holds. These two forms of asset-based finance can make valuable contribution to working capital.

(xii) Trade credit, the owner may be able to acquire use of an asset without having to pay for it until some point in the future. Soft information and mutual trusts play a role in trade credit.

Lending Technologies

Many of current studies on SMEs access to finance concentrate on transaction lending versus relationship lending (Berger and Udell, 2006). The transaction technologies are based on ‘hard’ quantitative data that can be assessed, garnered and verified at about the time of start of credit origination, like certified audited financial statements; credit scores assembled from data on the payments histories of the SME and its owner provided by the credit bureau (Berger and Udell, 2006). The relationship lending in contrast, is based significantly on ‘soft’ qualitative information gathered through contact over time with the SME and often with its owner and member of its community by the loan officer. The soft information may include the character and reliability of SME owner (Berger and Udell, 2006).

Berger and Udell (2006) framework also takes the position that current study, that makes a fine divide, in which transactions lending is generally viewed as being focused on informational transparent borrowers, while relationship lending is seen as meant for opaque borrowers as flawed. The framework sees the characterization of these lending technologies as flawed in the sense that apart from financial statement lending that focused on transparent borrowers other lending technologies are also targeted at opaque borrowers.

The transactions lending technologies were treated as homogeneous group in the literature, hence they were considered to be suited to transparent firms and not opaque SMEs (Berger and Udell, 2006). The recognition, that transaction-based lending technologies are heterogeneous, which additional studies in this area suggest, brought the realization, that it may well be suited for many opaque SMEs (Berger and Udell, 2006; Berger and Black 2007 and Uchinda, Udell, and Yamori, 2007). Udell (2009) suggests that transactions lending which is based on hard information may come in many forms including, financial statement lending; small business credit scoring; factoring; asset-based lending; equipment lending; real estate lending; and leasing. These transactions lending technologies can be used by informational opaque SMEs because the focus is not on the quality of the firms but on the quality of specific assets that are pledged as collateral, which can be valued invariably using hard information e.g. accounts receivable (factoring), accounts receivable and inventory (asset-based lending), and equipment (equipment lending) (Berger and Udell, 2006; Berger and Black, 2007 and Uchinda et al. 2007).

DeYoung, Hunter and Udell (2004) argue that because relationship lending is labor intensive, it is likely to be more costly than any of the transaction-based lending technologies, especially financial statement lending, credit scoring, equipment lending, real estate-based lending and leasing. Spatial dimension is another distinction drawn between relationship lending and transaction-based lending, with the consequent effect on costs (Hauswald and Marquez, 2006). Relationship lending rests on the hypothesis that lenders must be in close proximity of the borrowers, so as to ensure contacts at lower costs and to gather quality information about the firms and its owners, coming from good understanding of being in close proximity of the community (Hauswald, and Marquez, 2006). Transactions lending in contrast is not limited by distance because generation, storage and transmission of information is not dependent on distance, given the state of technology innovation and its application in banking operations, with the potential costs reduction that can be achieved (Hauswald and Marquez, 2006 and Udell, 2009).

Access and Obstacles to Finance

The access to finance difficulties experienced by SMEs stem from several sources: the domestic financial market may contain an incomplete range of financial products and services; the lack of appropriate financial mechanism in itself may be a function of, regulatory rigidities or gaps in the legal framework; monitoring difficulties such as principal/agent problems and asymmetric information (OECD 2006). Therefore, suppliers of finance may rationally choose to offers range of financial services that leaves significant number of borrowers without access to finance. The group that is mostly going to be affected by this rational offer will be the SMEs because of their operational opacity. The access to finance difficulty will even be made more worst if the business environment lacks transparency, weak legal system, reluctance to fund start-ups, young firms that lack collateral and firms with risky activities (OECD, 2006).

The financial institution and other external sources of finance are reluctant to finance SMEs in Nigeria because they are perceived as High risk borrowers, due to insufficient assets, vulnerability to market fluctuations and high failure rate; information asymmetries due to lack of good financial book-keeping or business plans to assess the viability of their proposals; and high administrative/transaction costs of lending or investing small amounts making SME financing unprofitable (Abereijo and Fayemi, 2005). Mambula (2002) study, lists two other reasons, not included in Abereijo and Fayemi (2005) and these are: judicial system is inefficient, contracts cannot be easily enforced; and the business environment is generally uncertain and risk prone. Therefore, when banks lend to SMEs, they charge more and apply tougher requirements that make it difficult to access external finance (Abereijo and Fayemi, 2005).

The difficulty in accessing finance for SMEs, a very low share of credit (external finance) where available and the situation where majority are often denied any access to formal markets is worrisome because of two reasons:

1. The financial and institutional deficiencies might prevent SMEs from growing to their Optimal size and thus explain the lack of an empirical causal link between SMEs and economic development (Beck & Demirguc-Kunt 2006);
2. This might also be related to the development of phenomenon of "informality in emerging markets in which many enterprises operate outside the formal system" (OECD, 2006).

Ayyagari, Demirguc-kunt and Maksimovic (2010) buttress the phenomenon of informal financing with their study. Their study suggests that in fast growing economy like China, SMEs substitute the informal financing for the formal system because the latter can only take care of small fastest growing SMEs. However, there are three factors in favor of this culture of informal financial system and these are:

1. established financial institutions are not interested in dealing with SMEs and hence there is no incentives for them to operate transparently;
2. entrepreneurs in SMEs seek to avoid regulations and taxations associated with the formal sector; and
3. Lack of administrative capacity on the part of government to enforce laws and regulation and this particular factor is more germane to most developing and poor countries (OECD, 2006).

The more specific obstacles to access to finance for SMEs from the financial sector, for better understanding of the nature of the difficulties are: (a) Collateral requirements of banks and financial institutions; (b) Bank paperwork and bureaucracy; (c) High interest rates; (d) Need for special connection with banks and financial institutions; (e) Bank lack of money to lend; (f) Access to foreign banks: (g) Access to non-bank equity; (h) Access to financing from leasing equipment; (i) Inadequate credit and financial information on customer; (j) Access to long term loans; (k) Whether corruption of Bank officials creates a problem Beck, Demirguc-Kunt and Maksimovic 2004).

These identified problems posed by the financial sector to finance access by SMEs are by no means uniform to all SMEs in different economies and regions of the world. Beck, Demirguc-kunt and Maksimovic (2004) study and OECD (2006) report indicate that SMEs in countries with higher levels of, financial intermediary development, stock market development, legal system efficiency, GDP per capital, and institutional development, resort lower financing obstacles.

Methodology

The statistical survey approach was adopted for the study. Primary data were collected through the instrumentality of structured questionnaire administered on a total of 748 small and medium enterprises from six states in the Southwestern Nigeria that constitute the study sample. Data obtained were analyzed with the aids of descriptive statistical tools, to describe financing practices of SMEs, while logistic regression was employed to determine the relationship between dependent variable (SMEs) and independent variable (internal and /or external sources of finance). Effectuation logics were also employed to determine the extent to which effectuation framework can be used to explain the financing practices of SMEs in the study area.

Results and Discussion

This study described the financing practices opened to small and medium enterprises with a view to determine the prevalent practices among them in southwestern Nigeria. Specifically, it attempts to determine the extent that the financing practices of small and medium enterprises are dependent on internal and external financing, while exploring the extent to which effectuation framework can be used to explain the financing practices of SMEs.

The results (Table 2) indicate the extent to which SMEs depend on the use of internal finance with a correlation p-value distributed between 0.17 and 0.565 (Table). This shows a moderate positive correlation as attested to by Frankfort – Nachmias and Nachmias (2007) that when correlation values ranges between 0.3 and 0.6, they are positive. The result was affirmed by a logistic regression p-value of 0.0000, indicating that all independent variables are jointly statistically significant to the dependent variable (internal financing). The result was further affirmed by a two-tail p-values of RE – 0.000; BFF – 0.038; PS – 0.040; and SLGFF – 0.000. It should however be noted that while RE and SLGFF have the strongest relationship with the dependent variable, followed by BFF and PS, MH with two-tail p-value of 0.479 is not statistically significant to the dependent variable-internal financing (Table 2). This result is in consonance with earlier studies in developed economies (Berger and Udell, 2006; Storey and Greene, 2009) that SMEs depend to a large extent on internal financing for their businesses.

On SMEs dependence on external financing, the study revealed, through logistic regression p – value of 0.0000, that all the independent variables are jointly statistically significant to the dependent variable (external financing). The results also reveal (Table 3) that BOFI, TL, BFML, NBFI and FFSB are all individually statistically significant to dependent variable (external financing), based on two-tail p-values of BOFI– 0.000, FFSB – 0.000 these two variables have the strongest relationship with the dependent variable, followed by TL – 0.009 BFML – 0.020 and NBFI – 0.020. While FEVC – 0.114, ABF – 0.287, OF - 0.490, AF – 0.537 and FEBA – 0.703 are not statistically significant to the dependent variable-external financing. The results as shown in Table 3 show that variables BOFI, FEBA, FEVC, TL, ABF, BFML and NBFI all have positive coefficient signs while OF, AF and FFSB have negative coefficient signs. A positive sign shows that an increase in the associated variable increases the probability of dependency on external financing. On the other hand a negative sign decreases the probability of SMEs dependency on external financing.

Thus the study affirms that financing practices of owner-managers of small and medium enterprises are dependent on external financing. This conclusion dovetails with results of other studies, that show that small and medium enterprises are also engaged in external financing practices (Berger and Udell, 2006; Storey and Green, 2009). Udell (2009) also provides evidence that SMEs also use external financing practices that are transaction-based lending technologies such as asset-based financing, asset financing, leasing and real estate lending. Berger and Udell (2006) framework also takes the position that the characterization that internal financing is meant for informational opaque SMEs while external financing is meant for informational transparent borrower such as large businesses as flawed.

On the whole, above results confirm the position that SMEs employ an admixture of internal and external financing practices for their businesses. The extent of dependence on either option notwithstanding, these findings are further affirmed by the analysis of data obtained through survey method as given below

Findings from table 1 (Appendix 1) show that a whopping 78.08% agree/strongly agree to the use of retained earnings for financing. On the other hand 14.57% disagree/strongly disagree to the use of this source as a means of financing. This result showing an overwhelming 78.08 percent admitting using this means for financing is consistent with various studies stating that SMEs rely mainly on own means for financing (OECD, 2006; World Bank 2009; Fraser, 2009). The result is also in agreement with one of the theories that provides bearing for this study such as the pecking order hypothesis as modified by Winborg and Landstroom (2001). This result, it must be pointed out, is not far off with the World Bank (2009) result of 70 percent of SMEs using retained earnings as a means of finance

The result on borrowing from friends and family also shows on table 1, that 40.51% of the small and medium enterprises surveyed agree/strongly agree to the use of this method for financing of their enterprises. However, 45.72% disagree/strongly disagree to the use of this method from financing their enterprises. This result shows that, this financing practice while used among the enterprises, it is not as popular as that of retained earnings. The result compares better than the World Bank (2009) result that shows 4 percent of small and medium enterprises using this method for financing. However, the better result from this study should be expected because borrowing from family and friends falls under internal financing, which most small and medium enterprises rely heavily on.

The results from table 1 also show that 75.53% of the small and medium enterprises surveyed agree/strongly agree to the use of personal savings for financing. On the other hand 19.65% of the owner-managers surveyed disagree/strongly disagree to the use of this method for financing. This result is also in consonant with the SMEDAN/NBS (2012) study that shows that small and medium enterprises are operated by personal savings which represents 84.6% of their financing. The result from this study of 75.53% of small and medium enterprises coming from personal savings is also supported by other studies such as Gartner (2009) in USA. Gartner (2009) study shows 57% of financing comes from personal contributions of its founders for emerging ventures.

Also, the results from table 1 show that, 40.64% agree/strongly agree while 51.47% disagree/strongly disagree to the use of taking mortgage on homes for financing. This result clearly shows that while some owner-managers of these small and medium enterprises favor this approach the majority are clearly in disfavor. It must be pointed out however, that the result from this study actually contradicts findings from other study showing a dismal 1% of small and medium enterprises using this approach for financing (World Bank, 2009).

Another finding from this study, as shown by table 1, provides data indicating that 44.25% of the small and medium enterprises surveyed agree/strongly agree while 43.85% disagree/strongly disagree to using soft loans and gifts from family and friends for financing. The result from this study therefore shows that almost equal percentage agree or disagree to the use of this approach to financing. The data in the table 1, with 44.25% agree/strongly agree to this method of financing is in support of the view from literature that, small and medium enterprises rely on internal financing of which soft loans and gifts from family and friends are an integral part (Storey and Greene, 2010). This study however, provides a far stronger evidence than World Bank study (2009) results that show 4% of small and medium enterprises engaged in this financing practice.

The results from table 1 show that 57.49% of the small and medium enterprises surveyed, agree/strongly agree while 36.50% disagree/strongly disagree to the use of banks and other financial institutions for financing. This result is contrary to some theories and empirical studies that show small and medium enterprises all over the world relying on internal financing practices as opposed to external financing (Winborg and Landstroom, 2001; Zoppa and Mcmahon, 2003; Berger and Udell, 2006; Gartner, 2009; World bank study, 2009; SMEDAN/NBS, 2012). The World Bank (2009) study actually portrayed a dismal picture of 1% of all financing of small and medium enterprises come from banks and other financial institutions.

The Table 1 also shows the results on raising fresh equity from business angel as a financing practice. The analysis from table 1 shows 35.03% agree/strongly agree to use this approach to financing among the owner-managers of the small and medium enterprises involved in this study. However 50.27% disagree/strongly disagree to this method of financing. A further probe into the data provided in this table shows that actually 9.76% of the respondents of this survey strongly agree to this method, which means it is not popular or prevalent practice, even in developed countries and emerging markets it is not favoured method by small and medium enterprises (Zoppa and McMahon, 2003). In a study done by SMEDAN/NBS (2012) which was focused on Nigeria, the practice of using business angel financing did not even feature.

As shown in table 1, data on fresh equity from venture capitalists also shows that 33.16% of respondents involved in this survey agree/strongly agree while 50.14% disagree/strongly disagree to this financing practice.

This result also contradicts existing theories and empirical studies that show small and medium enterprises relying on internal financing practices (Zoppa and McMahon, 2003). Also, just like in the use of fresh equity from business angle as a financing practice, fresh equity from venture capitalists did not also feature in study that had local focus on Nigeria such as SMEDAN/NBS (2012) study.

The results as shown in Table 1 provide data on overdraft facility from banks. The analysis from the table shows that, 45.32% agree/strongly agree while 42.78% disagree/strongly disagree to the practice of overdraft facility for financing. This outcome is contrary to existing theories and empirical studies, that provided evidence in support of internal financing and a dismal 1% financing coming from banks and other financial institutions in form of overdraft facility (World Bank, 2009) SMEDAN/NBS (2012) survey of Nigeria small and medium enterprises financing results contradict this study results. SMEDAN/NBS (2012) result categorical shows that 84.6% of all small and medium enterprises financing are operated by personal financing. However as pointed out earlier, the high percentage involved in this financing practice may be a result of Government and Banks renewed interest in stimulating growth and development of the SMEs sector.

Table 1 also shows the data on term loans as a financing practice. The analysis from the data provided in table 4.20, shows that 51.47% of all respondents in this survey agree/strongly agree to this practice, while 36.23% disagree/strongly disagree to this practice.

This result of 51.47% of small and medium enterprises engaging in this practice is a strong indication of tendency to using of external financing practice in which a term loan is a vital integral part. The outcome of this study on term loan as a financing practice contradicts existing theories and empirical studies on small and medium enterprises financing practices (World Bank, 2009; SMEDAN/NBS, 2012). The extant knowledge shows that external financing practices are dismal compared to their reliance on internal financing practices (World Bank, 2009; SMEDAN/NBS, 2012).

The Table 1 shows responses with regards to asset-based financing. The results from the analysis of the data in this table show that 33.82% agree/strongly agree to this financing practice while 51.60% disagree/strongly disagree to this financing practice. Though, this financing practice which is external financing form is not as strong as other internal financing forms. The result actually contradicts evidence from theories and literature on asset-based financing as aspect of external financing (World Bank, 2009; SMEDAN/NBS, 2012). This result, which is better than the evidence from literature, may be preferred form of external financing because it is not based on the quality of the entrepreneurs but on the quality of the asset under consideration.

The results from table 1 show the data on asset financing. A fair percentage of the respondents involved in this survey with 34.76% agree/strongly agree while 49.60% disagree/strongly disagree to this financing practice. Again, the results from this study with a strong showing for asset financing should not come as a surprise, for small and medium enterprises that supposedly relied on internal financing. Though this study outcome contradicts the results from other studies that show a dismal 1% of small and medium enterprises are engaged in this method of financing (World Bank, 2009) because the financing comes from banks and other financing institutions. However, Berger and Udell (2006) and Udell (2009) suggest that transaction lending, which is based on hard information, can also be used, among the informational opaque SMEs because the focus is not on the quality of the enterprises, but on the quality of specific assets pledged as collateral.

The results from table 1 show that 38.10% agree/strong agree while 51.07% disagree/strongly disagree to this practice. Therefore, these results show that the majority of the small and medium enterprises are not engaged in the practice of using informal sources of financing such as money lenders. However, this result showing 38.10% agree/strongly agree to this practice also contradicts the results from other studies that show financing practices of small and medium enterprises relying almost solely on internal financing practices such as, retained earnings (World Bank, 2009; SMEDAN/NBS, 2012). Specifically, the 38.10% agree/strongly agree to financing practices based on informal sources contradict the SMEDAN/NBS (2012) survey that show 9.2% and 8.0% respectively for cooperative/Esusu loans. Nigeria entrepreneurs may be interested in this practice because there are no interest on funds and little or no legal requirements in informal financing practices.

The analysis as shown from table 1 shows that financing practices, based on non-bank financing sources, 49.06% agree/strongly agree while 44.78% disagree/strongly disagree to this practice. This result shows that the owner-managers of these small and medium enterprises patronize these non-bank financial institutions such as Micro-finance, Credit Cooperative and Finance Company. This study outcome also contradicts existing studies that show that a dismal 1% of these small and medium enterprises owner-managers engage in this practice and that they rely on internal financing sources (Berger and Udell, 2006; World Bank, 2009; SMEDAN/NBS, 2012).

The results from the analysis of data in table 1 relates to the use of financing from state owned bank and/or government agency. It shows 48.00% agree/strongly agree while 41.71% disagree/strongly disagree to this financing form. This result shows a good percentage favouring this financing practice that comes from government banks such as Bank of Industry, Bank of Agriculture and government agency such as Ministry of Trade and Commerce. This result also contradicts the results from other studies which show overwhelming support for internal financing practices as against external financing practices as exemplified by reliance on government banks and agency. The high percentage of entrepreneurs using this financing practice is a result of Government determination to grow the sector and use it as a platform to generate employment opportunities and create wealth.

Conclusion

This study has shown, from the findings that small and medium enterprises in South Western Nigeria, engage in the following financing practices: Internal financing; external financing; and their derivatives, such as retained earnings, personal savings, term loans, financing from state owned bank and agency, overdraft facility, soft loans and gifts from family and friends, mortgage on homes, loans from family and friends, fresh equity from business angles, assets financing, asset based financing and fresh equity from venture capitalists. This study has therefore established contrary to published studies, that financing practices of SMEs are not limited mainly to internal financing practices. This study has shown that they make use of a broad range of external financing practices also, such as; term loans, overdraft facility, asset-based financing, asset financing and fresh equity from business angles and venture capitalists. While the financing practices emerging from this study are in agreement with previous studies on internal and external financing practices (OECD, 2006; World Bank, 2009; Fraser, 2009), in the particular practices of suppliers' credit, prepayments from customers, term loans, overdraft facility, asset financing and asset-based financing, the indications from this study are stronger than Work Bank results (2009).

This study has shown that small and medium enterprises owner-managers financing practices are dependent on internal and external financing. The financing practices associated with both internal and external financing have strong statistical relationship with both internal and external financing. Therefore, this study has established that small and medium enterprises financing is not only dependent on internal financing but also on external financing.

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APPENDIX

Table 1: Sampled Respondents Responses in Percentages (%)

Particulars	Strongly Disagree	Disagree	Undecided	Agree	Strongly Agree
Retained earnings	6.95	7.62	7.35	48.53	29.55
Borrowings from family and friends	20.19	25.53	13.77	26.68	10.83
Personal savings	9.89	9.76	4.81	36.63	38.90
Mortgage on homes	29.89	21.66	7.89	27.27	13.37
Soft loans/gifts from family and	20.45	23.40	11.90	28.34	15.91
friends	20.59	15.91	6.02	36.90	20.59
Banks and other financial	23.13	27.14	14.71	25.27	9.76
institutions	27.41	22.73	16.71	25.27	7.89
Fresh equity from business Angels	22.33	20.45	11.90	33.29	12.03
Fresh equity from Venture	17.78	18.45	12.30	41.04	10.43
Capitalists	29.81	21.79	14.57	25.80	8.02
Overdraft from banks	25.80	25.27	10.83	26.34	11.76
Term loans	20.72	24.06	6.15	30.48	18.58
Asset-based finance	27.94	13.77	10.29	32.09	15.91
Borrowing from informal sources					
Non-bank financial institutions					
State-owned bank and Govt.					
Agency					

Source: field survey, 2014

Logistic regression

Number of obs = 748
LR chi2(5) = 106.39
Prob > chi2 = 0.0000
Log likelihood = -279.49829 Pseudo R2 = 0.1599

Table 2: Logistic Regression Results of dependency on internal financing

Variable	Co-eff.	Std. Err.	Z	P>|z|	[95% Conf. Interval]	
RE	.6376994	.0996836	6.40	0.000	.4423232	.8330757
BFF	.2389179	.1151029	2.08	0.038	.0133203	.4645156
PS	.1963086	.0956052	2.05	0.040	.008926	.3836913
MH	.0624687	.088228	0.71	0.479	-.1104551	.2353924
SLGFF	-.3563985	.1002859	-3.55	0.000	-.5529553	-.1598417
_cons	-1.081701	.3656272	-2.96	0.003	-1.798317	-.3650844

Source: Field Survey, 2014.

Logistic regression Number of obs = 748
LR chi2(10) = 224.22
Prob > chi2 = 0.0000
Log likelihood = -404.82504 Pseudo R2 = 0.2169

Table 3: Logistic Regression Results of the Dependency on External Financing

Variable	Co-eff.	Std. Err.	Z	P>|z|	[95% Conf. Interval]	
BOFI	.4482086	.086845	5.16	0.000	.2779956	.6184216
FEBA	.0469607	.1231644	0.38	0.703	-.1944371	.2883586
FEVC	.1801329	.1140082	1.58	0.114	-.043319	.4035848
OF	-.0627124	.0908046	-0.69	0.490	-.2406862	.1152615
TL	.2339149	.0900497	2.60	0.009	.0574206	.4104091
ABF	.1018102	.0956778	1.06	0.287	-.0857148	.2893352
AF	-.0638342	.10349	-0.62	0.537	-.2666708	.1390024
BFML	.1984396	.0852514	2.33	0.020	.0313499	.3655293
NBFI	.198055	.0851618	2.33	0.020	.031141	.3649691
FFSOB	-.2932568	.078274	-3.75	0.000	-.4466711	-.1398425
_cons	-3.164197	.3102589	-10.20	0.000	-3.772294	-2.556101

Source: Field Survey, 2014.