Performances of small and medium scale enterprises (SMEs) in Nigeria: a case of financial management

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SMEs, Financial Management, business failure, poverty, credit, Tax, employment and economic development.

Abstract

This paper aimed at stressing the need for better performances of SMEs in Nigeria considering its contributions in some various factors that influence economic development such as Employment, Production of Consumer/Producer Products for market growth and Income to curb Poverty. However, the path of SMEs growth and fight against poverty and unemployment in the economy has some challenges which are classified into internal and external factors. I employed survey method to discover that the failure rate of SMEs is high, people in the sector has little or no knowledge of Financial Management, and that government contributes to the exit of so many failed SMEs due to lack of infrastructure, and that source of adequate capital also affects the existence or growth/expansion of the existing SMEs in Nigeria. I recommend that Government, Financial Institutions and other related bodies should create programs that would be educating the SMEs managers and owners on the basic principles of Financial Management. Higher Institution of learning should also create academic programs that would accommodate the SMEs owners/managers irrespective of their academic qualification but based on the area of their interest and business, Government to make soft tax policies that would encourage the SMEs in Nigeria and also Financial Institutions to create available soft credit programme for SMEs in Nigeria.

Introduction

Industrialization is seen widely as one of the most reliable means of raising a country's standard of living. There is an increasing awareness in the international community about the important role and potentials of small scale enterprises in fostering socio-economic development in both urban and rural settings. This explains why less developed countries (LDC's) pursue the goal of industrialization with determination and viguor. A critical observation of the history and structure of the Nigerian economy revealed that the future of the economy largely depends on the small scale enterprises (SSEs). This is in view of the relevance of the sub-sector in the production, distribution and consumption of commodities in the country.

Before 1970's the view was that large firms were the cornerstones of modern economic structure. The theory of economics of scale, which is predicated on the advantages of large scale operation was almost a doctrine and from this perspective small scale industries were seen as sign of technological backwardness. Until the 1960s it was common for economists to view the continued existence of small-scale industries in developing countries as a transition phase caused by capital inadequacy and weak administrative capacity. Many economists argued that with economic growth, these small scale enterprises would give way to modern large-scale organization capable of capturing economies of scale (Fadahunsi and Daodu, 1977).

A modern market sector and a dwindling traditional sector co-exist within the Nigerian economy. Most remained very relevant in the production, distribution and consumption of goods and services in the country. These small scale enterprises are dynamic entities. Government has designed programmes to enhance small scale industries. The government usually does this by using fiscal policies (Fiscal policy measures are macro-economic tools, which the government uses to manipulate the economy). This could be done through taxation i.e by granting tax holidays to local industries to encourage development, or imposition of tax rates on imports so as to discourage importation and encourage consumption of goods produced locally. This protects infant (Small scale) industries from competition. Government expenditure could also be used to encourage the promotion of small and medium scale industries. These mean that the government can play a major role in developing the industrial sector via small and medium scale industries.

Small and medium scale industries usually tend to develop and grow into medium and large scale industries. This form of growth yields to the development of the economy. It is also more logical than the path for industries to employ more workers and expand their output. This is a good example of development of small scale industries without any foreign intervention. On this basis, it could be said that Nigeria can achieve meaningful development of small and medium scale industries that can determine the height to which a country can aspire to, in its overall growth and development.

This paper tries to identify the factors that influence the growth and development of SMEs in Nigeria. In this context, it will analyze the impact of internal and external factors that most influence the development/performance of SMEs in Nigeria.

Literature review

The Small and Medium industries and Equity Investment Schemes (SMIES) defines small and medium enterprises (SME) as any enterprise with a maximum asset base of N200 million excluding land and working capital and with the number of staff employed not less than 10 or more than 300. Small and medium enterprises (SME) have been defined along a broad continuum of size and type. In terms of size, measures used to classify SMEs include employment, assets and revenue. (NigeriaBusinessInfo.com).

Oshagbemi (1983) observed that small and medium scale business covers business whose scale of operation is less than the average for the industry. By 1993, the Apex bank found it necessary to revise its definition of the small scale business to mean; an enterprise with total cost of land including working capital above N1million but not exceeding N10million.

The Contingency theory which measures the performance and effectiveness of an organization claims that there is no optimum method to systematize a firm and the organization structure of the company (Fiedler, 1964). In other words, contingency theory argued that the most appropriate structure for an organization is the one that best fits a given operating contingency, such as technology (Woodward, 1965) or environment (Burns & Stalker, 1961). Every business faces its own set of challenges which are either internal or external constraints because every company has different organizational culture and different perspective towards risk.

According to Morrison (2006), enterprises which are affected by external macroeconomic factors; political environment, economic, social, technological, environmental and legal factors, are not controllable. These factors are rarely affected by management decisions because they are external factors and beyond the control of SMEs. Others are access to finance, corruption, competition, government policies etc.

Internal factors on the other hand, are those constraints that affect the businesses of SME owner/ manger's ability to operate efficiently, despite any inmate potential in the owner/manager (Baloyi 2010). According to Stokes and Wilson (2006) internal factors are the personal attributes, skills and competencies of the individual owner/manager which are crucial to how well the business faces up to the inevitable crises that arise. An important thing to note about these constraints is the fact that they are controllable by the owner/manager.

Internal and external factors affecting the development of SMEs

In SMEs, the position of individuals matter a lot as they are supposed to be generalist (Drew, 2003) in performing their functions. Most SME personnel are either in key managerial positions or are classified in a unit or function that performs a certain task or numerous tasks. Most SMEs are run by a manager who is usually the owner of the organisation (Demirbas, Hussain, & Matlay, 2011).

Internal factors

Manager characteristics

The competence of SME manager is the ultimate determinant of survival or failure. The root cause of either SME failure or poor performance is almost invariably a lack of management attention to strategic issues such as human resources management, forecasting and overall planning of the business. Moreover, the early founder of the SMEs' personal competence in selecting the right business and running it will be crucial, as the firm is likely to be indistinguishable from the owner. Therefore, as the business develops, growth can be rapidly partially due to unwillingness or inability to draw others to help with the management of the SME (Pasanen 2006). In addition, the management of people (human resources management) is particularly important as it includes not only the personnel issues of dealing with employees, but also of managing people outside of the organisation who are also critical to its success, such as key customers, suppliers, banks and investors (Stokes and Wilson 2006).

Level of knowledge of financial management

It is also necessary that the owner/manager and other key personnel in SMEs attain an acceptable level of education on financial management in order to drive SMEs activities. Research studies have found that one of the criteria for successful SMEs is the level of education on financial management (Thong, 1999; Sarosa & Zowghi, 2003). A basic level of education such as General Certificate of Education (GCE) or its international equivalent is also critical as it allows easy communication and appreciation of business terms in global business. Most SME owner/managers, especially in developing countries, are unable to communicate in international languages that give access to global markets. It is also patinent to consider the owners/manager to have reasonable knowledge of financial management wich can not be actualized without a general acceptable level of education which is high school ordinary level certification, although higher business qualifications are better.

Another individual factor in relation to education is the level of ICT knowledge. It is expected that an acceptable level of ICT knowledge of the owner or key manager, and other key decision making personnel can assist the SME to adopt appropriate activities in their business (Teo & Ranganathan, 2004; Meso, Musa & Mbarika, 2005; Looi, 2005). Wilson et al., (2008) found that skilled ICT personnel were crucial for the progression in the UK SMEs. They further argued that this factor is more important than financial ability.

Socio-cultural issues

Culture is another important factor that explains cross-country differences in SME development as entrepreneurs' decision-making is influenced by their cultural backgrounds. The term "culture", is defined as "the collective programming of the mind that distinguishes the members of one group or category of people from another" (Hofstede, 1991). Some empirical literatures have demonstrated the relationship between entrepreneurial activities and cultural dimensions, and have found similar results. In general, low power distance, individualism, low uncertainty avoidance, and long-term orientation are associated with entrepreneurial activities and innovation (Shane, 1993, 1995; Thomas and Mueller, 2000; and Jones and Davis, 2000). Collectivism can be a good support to subsequent implementation after invention (Nakata and Sivakumar, 1996). Masculine cultures emphasize the value of performance, competition and success, while feminine culture may be more successful in the service sector due to the strong focus on relationships (Luczak and Mohan-Neill, 2009).

Addressing cultural impacts on entrepreneurship, the interrelationships among culture, policy, and entrepreneurial development must first be considered. The objective is shaping culture is not to overtake it but to capitalize on the positive sides and to introduce the missing elements for entrepreneurship and innovation.

External factors

Access to finance

The first external factor is the financial constraints. Lack of capital or financial resources was a major barrier for SMEs and entrepreneurs who usually have to mobilize their own capital or their own resources to establish or expand their business (Harvie, 2005). In addition, SMEs in developing countries have difficulties in accessing bank loans as a consequence to the high risk for failing loans, low profitability and lack of collateral required by banks (Harvie, 2005).

For many SMEs in Nigeria, access to finance and capital appear to be difficult. This comes as a consequence of weak banking institutions, lack of capital market and inefficient legal framework regarding credit and collateral assessment. Financing of SMEs and access to finance plays a crucial role in the growth process and development of the enterprises (WB, 2011).

According to Fatoki and Garwe (2010), the lack of capital seems to be the primary reason for business failure and is considered to be the greatest problem facing small and micro business owners. This was supported by Shafeek (2009) who said that, from a business viewpoint without adequate financing, the business will be unable to maintain and acquire facilities, attract and retain capable staff, produce and market a product, or do any of the other things necessary to run a successful operation.

Stokes and Wilson (2006) also added on to say that financial difficulties of SMEs arise, either because of an inability to raise sufficient funds to properly capitalise the business, or a mismanagement of the funds that do exist or a combination of both. He explained that, access to external funds may be difficult to achieve for new or young, small and micro businesses with no track record, especially for owners without personal assets to offer as security. Stokes and Wilson (2006) go on to stress that many new owner managers, having received funds, misuse them; small businesses are notorious for their lack of proper financial controls and information.

Government policies

The importance of SMEs to the economy of a country indicates how important it is to have government policies that support SMEs, including regulations that enable them to operate efficiently and regulations that reduce their administrative costs (Harvie and Lee, 2005). Althoughthere have been initiatives by governments to promote and support SMEs in order to enhance their development and reduce poverty, there is still a lack of laws and genuine administrative procedures such as accessibility to assistance from the government agencies.

According to World Bank research, complex tax systems, low level of trust in the judicial system, and the need to pay bribes to access public services, represent major barriers, especiallyin South East Europe (WB, 2000).

Marketing

To have a good chance of survival, a small business firm needs to answer the basic strategic questions: "what markets are we targeting, with what products?" A common weakness in the SME owner/ managers lies in their failure to understand key marketing issues (Stokes and Wilson, 2006). Stokes and Wilson (2006) believed that product or service concepts and standards often reflect only the perceptions of the owner, which may not be mirrored in the market place. They further stated that, minor fluctuations in markets can topple a newly established small/micro business) firms, particularly where it is reliant on a small number of customers.

Application of information technology

Apulu and Latham (2011) found that the competitiveness of SMEs will be increased through adopting Information and Communication Technology. Subrahmanya, Mathirajan, and Krishnaswamy (2010) summed up that those SMEs which have technological innovation have a higher growth compared to the SMEs which are not creative in the sales turnover, investment and job.

Environmental factors

The external environment of the SME organisation also impacts some challenges to e-commerce adoption. It describes the realm of business engagement of the firm (Scupola, 2009). This describes factors such as government role; business partner affiliation and preferences; nature and characteristic of value chain; logistics and telecommunications infrastructure; economic and political instability; human-rights issues; business culture macro-economic policies; natural disasters and floods.

Economic and political instability

Economic and political instability prevents SMEs from freely trading in the country due to several uncertainties. Related to this is the human rights situation that may hinder SMEs growth and development in Nigeria.

3. Research Methodology

Study Area

Southeast Nigeria was the area of coverage. The states involved within the Southeast include Enugu, Abia and Anambra. This Three amongst the Five States are business oriented. Nevermind the researcher due to fund and time constraints could not get to all the states.

Population, sampling procedure and Size

The Population consists of all existing small and medium scale businesses in three states (Enugu, Abia and Anambra) The 1000 questionnaires was made available and administered randomly based on the number of SMEs existing in the local governments selected for the survey. Such SMEs in each local government were first identified and 50 percent of SMEs in each Local Government were sampled using systematic random sampling procedure.

Methods of Data Collection

The questionnaires collected data on the performances of small businesses and factors contributing to incessant business failures, low output and low income/profit margin of SMEs in Nigeria. The data collected are analysed using appropriate descriptivestatistics and inferential techniques. The sampling frames for the survey consists of SMEs which employ not more than 10 for micro, 50 people for small(SSEs) and 250 for medium(MEs) Since not all the SMEs are formally registered with government and even trade associations, the population size cannot be exactly pre-determined.

Variables Description

The questionnaires were used to collect data on some variables. The first set of data was on socioeconomic profile and characteristics of the SMEs. The second sets of variables were used to analyse the critical factors influencing the ability of Small Scale business to contribute to poverty reduction and income growth The critical factors identified include owner's sex, level of knowledge on financial management, motivation for starting their businesses, activities undertaken before establishing their current business, sources of initial capital, and technology being used.

The analysis of the constraints to capacity of SMEs to alleviate poverty was examined by estimating a Probit model. The model regresses the probability of whether SMEs is able to alleviate poverty on a set of both economic and non-economic factors. These model variables have been identified as growth determinants of firms (and thus determinants of employment growth). These include the characteristics of business owners such as ownership structure, Duration of business, level of literacy on Financial Management, activities undertaken before establishing their current business, motivation for starting businesses, sources of initial capital, and the types of technology used.

Probit regression was used to develop the predictive models for whether performance improves or not. The probit model is known to produce statistically sound results. The model is also known to produce results that can be easily interpreted and the method is simple to analyse in economics applications. Furthermore probit model is one of the most popular binary response model used in empirical analysis. The probit model for this study is specified as follows:

$y = \alpha_0 + \alpha_1 x_1 + \alpha_2 x_2 + \alpha_3 x_3 + \alpha_4 x_4 + \alpha_5 x_5 + \alpha_6 x_6 + \alpha_7 x_7 + \alpha_8 x_8 + \alpha_9 x_9 + e_1$…………1

In a more compact form, equation (1) can be rewritten as

$y_t = \sum_t^n \alpha_t x_t + et$ ………………………2

Where:

y_t = Poverty measures (profit, turn over owners satisfaction,). If the probability of making profit is high, 1 and otherwise, 0.

X_1 = Age (years); 1 for above 5 years and 0 for otherwise

X_2 = Gender; 1 for male and 0 for female

x_3 = level of knowledge on Financial management; 1 for post-secondary and 0 for otherwise

X4 = Source of startup capital (N); 1 for personal and 0 for otherwise

X_5 = Sources of raw material; 1 for local and 0 for imported

x_6= Business size; 1 for micro and 0 for otherwise

X_7 = Business Registration; 1 for registered and 0 for otherwise

X_8 = Nature of factor Intensity, 1 for Labour intensive, 0, otherwise

X_9 = Nature of Business, 1 for trading, 0, otherwise

α0= Constant (A);

α_t = Regression Coefficients;

e_t= Error term.

Results And Discussion
Analysis of Socio–Demographic Characteristics of Respondents

The age structure of the respondents was classified into six groups The findings showed that only (0.4%) of the respondents are above 60 years of age and less than ten percent (8%) is less than 20 years of age. (32%) were between the ages of 20 to 30 while (28%) of the SMEs owners were between 30 and 40 years of age. 22% of the respondents were not older than 50 years but above 40 years. This suggests that the bulk (82%) of the SMEs owners were in their middle ages (20 to 50years) with only (10%) of the respondents between 50 and 60 years of age. The age structure reflects the fact that most of the respondents are mature and they are the people whose economic reality and the survival instinct must have driven into the establishment of the businesses.

The level poor knowledge of financial management is very high among the SMEs the Micro business owners in the southeast, Nigeria. At least 94% of the micro business owners areignorant of financial management. The remaining 6% are SMEs that has reasonable knowledge of financial management. According toWord Bank SMEs with less than 10 workers are regarded as microenterprises, those with not more than 50 workers are the small scale enterprises and the SMEs with above 50 workers but below 250 are called the medium enterprises.

The distribution of respondents by the ownership structure shows that the bulk of the enterprise (73%) is one- man business. Twelve percent of the SMEs businesses were family joint business while (11%) are owned by different people who are not from the same family. Four percent ofthe respondents claimed that their businesses were owned by friends. The ownership structure alsoconforms to earlier observation that most of the businesses are microenterprises of less than ten workers with little start-up capital. It is a generally held view in the literature that most SMEs collapse within five years of establishment. Twenty-two percent of the SMEs were established within the last ten years while only 15% had been in operation for more than 10 years. Though, it could be said that the proportion of business that fall below five years are higher, the fact that a sizeable number of the businesses are older than five years implies that the survival rate of the SMEs business in the South-eastern part of Nigeria is growing but not in encouraging rate.

Assessment of Income and Employment generating capacity of SMEs
Income Generation

The assessment commenced by looking at the position of small businesses occupied as a source of disposable income. 77% of the respondents ranked small businesses as their top income source. Micro enterprises owners sourced their income mainly from their business and 85% of small scale enterprises (SSEs) while 67% of the medium scale enterprise owners sourced their income from their business. The importance of income from the businesses is further emphasized by the fact that majority of respondents was not engaged in other occupations, implying that these small businesses were their sole source of income To determine if income derived from small businesses was poverty reducing, respondents' perceptions of their standard of living were examined for those who ranked small businesses as the number one source of income. Majority of respondents (55%), who ranked income from small businesses as their number one source, indicated an improvement in their standard of living, while 27% experienced a declining standard of living, and 18% reported no change.

Employment Creation

Small businesses in developing countries have been long recognized to play a dynamic role through which employment growth can be achieved. This study also assessed the ability of small businesses to generate employment opportunities. The Micro enterprise has more potential to growth than the other two types of SMES. It grew by about 133% while SSE and ME grew by 75% and 45% respectively.

Socio-Economic Factors Influencing the Contribution of Small Scale Businesses to Poverty Alleviation

The contribution of small businesses in term of profit margin can be influenced by a number of critical factors. Some of such factors influencing profit margin were identified. The factors identified and examined in the study include the business owner's sex, level of knowledge of financial management, motivations for starting their businesses, sources of initial capital and technology used.

Socio-Economic Factors influencing Employment Creation

This section looks at a number of issues that have been identified as growth determinants of firms (and thus determinants of employment growth). These include the characteristics of business owners such as ownership structure, level of knowledge of financial management, experiences of former business, motivation for starting businesses, sources of initial capital, and the types of technology in use.

Regression Analysis of Socio-Economic Factors Influencing SMEs Capacity in Poverty Alleviation

In this section, probit regression model was specified to analyze the possible factors that may influence SME's potential to alleviate poverty. The results for both Income and employment generation are presented in Table 1 below. The variables used were as earlier defined.

The estimates in the Table 1 showed that Age of the business has negative and insignificant effect on the capacity of the SMEs to generate income. The drive to success is higher in new entrepreneur and they are ready to do everything possible to promote the business than market pricing, aggressive marketing, after sales services and many others. The urge to create their own set of customers and to also be a big player in the market makes them to want to achieve greater performance. As they also become contented with their new status and business owners and they have moved from poor to relatively rich, the urge slows down and the ability to drive the business reduces and profit and income fall to an average level. However, the results of estimation of employment generation show that age of the business is positive and significant. This is in line with a prior theoretical expectation. The result shows that the older the age of the business the higher the number of jobs and employment it will generate. The results of Business registration are interesting and counter intuitive. The coefficients on the Business registration are negative and significant. One major reason for this counter intuitive result might strongly be due to the lack of adequate information about the importance of business registration. Also, the experience of some of those business owners who had attempted to register was bad. In many instances, the process of registration is cumbersome and relatively expensive The result of the business size corroborates the results on age of business. The coefficient on size is negative and significant. This implies that smaller SMEs experienced higher growth in income and employment generation. Nature of business and factor intensity were also negative and significant. The sources of raw material whether local or foreign had positive sign and significant effect on employment which also implies that locally sourcing of raw materials tend to alleviate poverty. The sources of finance and capital equipment had negative effects and also might hinder the capacity of SMEs to generate income and reduce poverty by the SMEs.

Table 1: Summary of Results for the Probit Regression

Variables Income Model Employment model

Variables	Income Level			Employment Level		
	Coef	Z-stat	P-value	Coef	Z-stat	P-value
Duration of Biz (DOB)	-0.08	-0.67	0.50	0.51	4.54	0.00***
Business size(BS)	-052	-3.93	0.00***	0.47	-3.90	0.00***
Nature of Biz (NOB)	-0.48	-4.42	0.00***	0.67	4.87	0.00***
Education Level of owners (EDU)	0.17	1.61	0.11	0.45	2.99	0.00***
Sources of raw materials (RM)	0.06	0.50	0.62	0.75	6.63	0.00***
Sources of capital	-0.53	-4.87	0.00***	-0.06	-0.55	0.58
Staff Strength (STS)	0.51	4.39	0.00***	0.09	0.80	0.42
Constant (C)	1.06	5.37	0.00	-2.25	-8.87	0.00***
McFadden R-squared	0.07			0.19		
S.D. dependent var	0.50			0.48		
Akaike info criterion	1.31			1.08		
Schwarz criterion	1.38			1.15		
Hannan-Quinn criter.	1.34			1.11		
Restr. Deviance	962.80			902.60		
LR statistic	72.19			169.95		
Prob(LR statistic)	0.00			0.00		

*** Significant at 1% level

Note:

In income model, the dependent variable is the income generation capacity (in terms of profit margin and disposableincome) of firms, whilst in employment model, the dependent variable is the employment creation capacity of the firms.

Conclusions

The four variables that were significant in the microenterprise were Age of the business, level of knowledge of financial management, Income of business owner and location of the firm. The variables had positive coefficient and conformed to theoretical expectations. The three variables that were significant, in the case of the Small scale enterprise are; quality of product, cost of labour and, initial capital.

The poverty model for the medium scale enterprise performed fairly low. Only two variables were significant and these variables are Level of knowledge of financial management and Income/profit level.

The poverty model for the pooled data had seven significant variables, these are:
Loan acquired, Business size, capital invested, location of the firms, income, Poverty dummy and staff strength. Only capital invested and location were negative and did not conform to theoretical expectation. In general, business registration, business size, nature of business, Sources of capital are significant factors determining both income generation and employment generation potential of the SMEs. However, age of business, level of knowledge of financial management and sources of raw material were only significant in influencing the capacity of SME to generate employment, on the other hand, sources of finance and staff strengths were only significant in income generation capacity of the SMEs. Therefore factors influencing SMEs

contribution to poverty reduction differ across the different components of Poverty reduction measures. The analysis showed that income from small businesses contributed to poverty alleviation, employment creation and market growth hence removing the obstacles that limit the performances of the SMEs in Nigeria would be of immense important in the bid for economic growth and development.

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