FORMAL FINANCING OPTIONS AND SMALL AND MEDIUM SCALE ENTERPRISES PERFORMANCE. THE CASE OF OTA, OGUN STATE NIGERIA

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Abstract: *Many efforts have been made in recent years to increase small and medium-sized performance in the Nigerian economy. Despite the efforts and investments, SME's are still on the chase towards improved growth level. It is important to address this because Micro, Small and Medium Enterprises (MSME's) employ approximately 84.02% of the total workforce, constitute 96% of businesses in Nigeria and contribute 48% to the Gross Domestic Product (GDP) of the nation. Financial resources are scarce for small SME's. As a result, many governments, and donors prioritize interventions that increase small and medium-sized enterprise (SME) access to capital. The study has explored the effect of formal financing options on small and medium-sized businesses in the Ado-Odo Ota, Local Government Area (LGA) of Ogun-State Nigeria. The study has utilized survey methodology via questionnaire and analyzed using the Statistical Package for Social Sciences (SPSS). The Analysis of Variance (ANOVA) and regression results were applied to test the study's hypothesis. The study discovers that formal financing options have significant impact on SME performance in Ado-Odo, Ota, Nigeria at 5% significance level. The finding further showed that a one percent increase in formal financing options would lead to a 1.36 percent increase in SME performance. The study recommends that formal financial resources are considered significant factors influencing the growth and development of SME's in Ado-Odo, Ota, and Nigeria by implication. The study recommends that formal financing institutions which include commercial banks, business angels, venture capital, microfinance banks should be considered as significant sources of finance for SME's. On the other hand, formal financing institutions should assist SME's through friendly interest rates and flexible packages to ensure that SME's find them as attractive options for forcing sourcing for purposes, which include purchase of equipment and others that can enhance SMEs' growth and development.*

Key words: formal financing options, commercial banks loans, SME performance, growth and development.

JEL Classification Codes: L21, L25, M13, O16.

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1. Introduction

Access to finance can be considered from two different sources: internal and external sources. Internal finance source is expressed as that involving savings, retained profits, depreciation and the sale of assets which is key to the survival and development of any enterprise. To be a successful small and medium enterprise (SME), external finance sources are required, sources such as individual-investors, financial banks, venture-capital and crowdfunding. Lawal, Iyiola, and Adegbuyi (2018) noted that external sources are considered absolutely key for expansion and can decisively determine the faith in/of a business. Formal external sources of finance include merchant, commercial and development banks.

Businesses, no matter their size, have the main objective of buying and selling of goods and services for profit. Although some businesses are non-profit organizations with the aim of fulfilling a charitable purpose, most are enterprises trying to create utility for personal or private profit (Okafor, Onifade and Ogbechi, 2018). Small and Medium Enterprises (SME's) innovatively generate employment due to their labor-intensive processes, making them a crucial ingredient for economic integration, hence, unleashing domestic resources which are likely to create a more stable and sustainable pattern of growth (Nwandu, 2016). For example, in industrialized countries such as Taiwan, Malaysia and South Korea, SME's have been noted to significantly drive industrial development policies due to their large share in export earnings overtime (Ehinomen and Adeleke, 2012).

Investment decisions and policy formulation in developing economies like Nigeria, are also increasingly favoring SME's compared to large scale capital-intensive industrial projects due to the evolving knowledge that SME's create small resilient economies that can be a better solid base for development. This is evident as the majority of businesses or enterprises in the Nigerian economy are small and medium sized. However, Okafor, Onifade and Ogbechi (2018) noted that despite efforts by the government to use SME's as the wheel of progress to drive economic growth, most of these efforts have proven to be unfruitful. Issues faced by SME's include the absence of a suitable environment to thrive as well as the fact that SME's require the absence of the appropriate and considerate financial processes to help foster entrepreneurship (Lawal, Iyiola, and Adegbuyi, 2018). Notably, Nigerian SME's are faced with a major constraint such as gaining access to finance, usually resulting from the extreme risk profiling by commercial banks, information asymmetry, lack of collateral, poor record keeping, poor management and loan recovery uncertainty.

The phenomenal lack of financial resources' pass-through to SME's has led to entrepreneurs being forced to find funding sources with high interest rates which have detrimental implications (Bello, Adamu, and Ahmed, 2018). Nigerian Bureau of Statistics (NBS) (2019) has documented that small enterprises only grew by 4.6% between 2013 and 2017 whilst the number of medium sized enterprises decreased significantly from 4,760 in 2013 to 1,793 in 2017, having a 61% drop. NBS (2019) has also revealed that for 55.6% of SME's rely on personal savings as their source of capital, with 11.7% depending on families and only 17.5% making use of loans. This shows that there seems to be a wide gap between the aims of the different financial agencies supporting SME's and their actual success levels.

This is necessary as SME's are regarded as the lifeblood of the economy and their development generally tends to transmit to the development of a nation. However, SME's in Nigeria have been experiencing challenges leading to non-significant performance. Ogun State was ranked as one of the states in Nigeria with the largest SME's, nevertheless, the question of whether formal financing options successfully affects SME performance exists. This study examines the impact of formal financing options on SME's' performance in Ota, Ogun State, Nigeria and to what extent Commercial bank loans' affect SME's' performance.

2. Brief Review of Literature

Several studies have been conducted to assess the influence of SME lending on Nigeria's economic development. Rao et al. (2021) have performed a thorough review of 280 publications from 1986 to 2020 and have discovered that SME finance research includes a wide range of subjects, including publishing patterns, theoretical framework, methodological design, and themes. Bakhtiari et al. (2020) have examined SME's' financial constraints and performance and have discovered that financial constraints have had a substantial influence on employment, productivity, and remuneration. Gherghina et al. (2020) have discovered that investments and innovation boosted the territorial economic growth of active Romanian enterprises, especially SME's. According to Bello, Adamu, and Ahmed (2018), SME's have a favorable influence on Nigeria's economic development. Finance contributes 25% to SME performance, according to Gbandi and Amissah (2014), yet SME's only contribute 1% to Nigeria's GDP, compared to industrialized nations where the contribution is larger.

Adegbuyi et al. (2016) have discovered that financial support has a considerable influence on SME's, although it is insufficient. Ogbuabor (2018) has discovered that cash reserve ratios had no influence on SME's' performance, but short-term and long-term lending-interest rates do. Due to rigorous collateral requirements and high-interest rates, Ugwu-Oju et al. (2019) have discovered that commercial banks are unsympathetic to SME loan requests. According to Lawal et al. (2018), funding constraints are more widespread in industrialized countries, and financial capital is one of the most important elements influencing SME's development and output.

Ilori and Ilori (2015) have discovered that despite initiatives designed to help SME's, little progress has been made, and SME's contribute just approximately 1% of GDP. Githaigo and Kabiru (2015) have resolved that long term as well as short term loans diminish financial performance of SME's. Meanwhile, Kaya and Masetti (2019) have proven that a rise in securitization issuance lessens the likelihood that SME's would experience credit limitations and lowers the cost of bank financing for companies that are not experiencing such constraints. Our findings show that different types and qualities of securitization have different impacts on the availability of credit to SME's.

Kersten et al (2017) have discovered that SME financing has a statistically significant beneficial influence on capital investment, firm performance, and employment inside the supported business, while having no effect on overall profitability or salaries. In conclusion, it is not apparent to what degree SME financing aids in economic growth and poverty alleviation.

2.1. Theoretical Framework

This study's argument hinges on the pecking order and financial growth theories. The pecking order theory popularized by Myers and Majluf (1984), states that there is a hierarchical order by which companies prioritize funding resources to meet the financing needs of firms. The theory posits that funding begins with internal sources and as requirement increases, the company moves on to external sources, usually first in the form of debt and then finally external equity (Akpan and Nneji, 2015). It also theorizes a negative relationship between profitability and external borrowing. The theory suggests that the final mixture of debt and equity is something that only occurs after a period. External equity is something that is seen as a last resort whilst debt financing is also something that is carefully considered in regard to the cost of lending. By extension, Holmes and Kent (1991) have stated that a glance at the debt-equity mix of a firm can indicate a quick understanding of the health of that organization. On average, older firms are expected to have more retained earnings that they can use to finance themselves and therefore should have less need for loans. The lack of access to finance and the preference manifested by such enterprises (SME's) for internal funds leaves small businesses in a unique position (Akpan and Nneji, 2015).

Schumpeter (1911) has advocated for the financial growth theory, which posits that development occurs when the right financial resources are provided to entrepreneurs who have the best and highest probability of success. What this basically means is that the more developed the financial sector of an economy, the better its chances of providing the right resources and gaining correct information. This in turn is seen as key to generating economic growth. The supply-leading response school of thought supports this view and argues for the importance of growth in gaining economic development (Adusei, 2012).

3. Methodology

3.1. Model Specification

The study proposes a model of this research work which expresses small and medium enterprises' performance as a function of formal financing options. The formal financing options utilized by this study include commercial bank loans, business angels, venture capital, microfinance loans and crowdfunding. The implicit model is specified thus:

$$SMEP_i = f(ffp_i) \quad (1)$$

Where: SMEP represents small and medium-scale enterprise performance; 'ffp' represents formal financing options. The explicit model is displayed thus:

$$SMEP = \beta_0 + \beta_1 ffp + u_t \quad (2)$$

Where β_0 represents the intercept of the model; and β_1 represents the coefficients of the estimated parameter.

3.2. Data and Analytical procedure

The study has adopted the descriptive survey research design following the pattern of Igbinoba, Soola, Omojola, Odukoya, Adekeye and Salau (2020). The study's data was sourced based on variables of interest for further analysis. The data was amassed by administering well-structured questionnaires with the aim of garnering a representative population. The study population consisted of 100 small and medium scale enterprise (SME's) owners, partners and employee managers in the Ado-Odo Ota area, Ogun state.
Notably, due to data constraints, there are no clear estimates for the number of SME's residing in this area. This non-availability made it impossible to utilize other types of sampling techniques, hence the use of the purposive sampling technique. This analytical selection comprises of non-probability sampling method where researchers rely on their judgment when selecting members of the population, based on the researcher's understanding of the study to be conducted and prior knowledge of the Local Government Area (LGA). This selected sampling method enabled selections that fit the profile of those that match the purpose of the study to be conducted. The researcher however aimed for a maximum variation of responses across the population to make sure that the SME's in Ota are well represented across the board. The survey questionnaire was carefully prepared to ensure completeness, consistency and accuracy. The collection process was also carefully managed to reduce errors. The analysis utilized to achieve this study's objective includes binary logistic and descriptive statistics.

4. Results

4.1. Demographics

Based on the unit analysis of the study, the demographic information considered necessary were gender, marital status, age range, role in business, the highest level of education and

years in the business of the respondents in the organization. An observation of Table 1 showed that the respondents who participated in the study had a gender distribution of 56.7% of the participants as male respondents and 43.3% of the participants as female respondents. By implication, the gender distribution of the respondents was almost evenly balanced. Notably, from the demographic information shown in Table 1, 58.9% of the respondents are married, 40% are within the age range of 36-45, with about 40% of the respondents being the owners of SME businesses. Also notable is the fact that out of the 100 questionnaires administered to the small and medium-scale enterprises in Ado Odo Ota LGA, Ogun State 90 questionnaires were retrieved by the respondents and 10 questionnaires were not retrieved.

Table 1: Socio-demographic features of respondents

Socio-Demographic Characteristics	**Frequency**	**Percent**
Gender		
Male.	59	56.7
Female	31	43.3
Total	90	100
Marital Status		
Single	31	34.4
Married	53	58.9
Divorced	4	4.4
Widow/Widower	2	2.2
Total	90	100
Age Range		
Below 25	18	20.0
26-35 Years	21	23.3
36-45 Years	36	40.0
46 Years and Above	15	16.7
Total	90	100
Role in Business		
Owner	36	40.0
Partner	30	33.3
Employee	24	26.7
Total	90	100
Highest Educational Qualification		
Primary Leaving Certificate/W.A.E.C	16	17.8
NCE/ND	27	30.0
HND/BSc.	44	48.9
M.Sc.	3	3.3
Total	90	100
Years in Business		
(1-5) years	18	20.0
(6-10) years	24	26.7
(11-15) years	22	24.4
16 years and above	26	28.9
Total	90	100

Source: Authors' own computations (2023)

4.2. Research Hypothesis

H_0: Formal Financing Options have no significant impact on SME's performance in Ado-Odo, Ota, Ogun State

As observed in Table 2, the description of the model where the model's modified coefficient of determination (R2) is .95 with adjusted R2 =.96. It means that about 95.9% of the variance in the performance of SME could be explained by the variation in the structured financial options and the remaining 4.1% of the overall variation was explained by other variables not included in the model. Furthermore, the correlation result, shown in Table 2 (R = 0.98) indicates that there is a strong association between the SME's performance and formal finance options. The findings of the correlation and coefficient of determination, thus, imply that there is thus a linear relationship between the formal alternatives for funding and the success of SME's.

The overall significance of the model is presented by the F-test in Table 3. Given that the F-statistics has a value of 3351.70 and a corresponding P value of 0.00, it is evident that the null hypothesis that "there is no significant relationship between Formal finance options and SME's performance" could not be accepted. We assume that a linear association occurs between formal-finance alternatives and SME results by dismissing the (H0) null hypothesis as well as supporting the alternative hypothesis. The regression results in Table 4 further confirm the ANOVA output in Table 3. The t-statistics being greater than 5 confirms that formal financing options impact SME's' performance at a 5% level of significance. The direction of the relationship is further confirmed as positive implying that an increase in formal financing options influences SME's' performance positively. With regard to the magnitude of the impact, the regression result in Table 4 shows that a one-per cent increase in formal financing options influences SME's' performance by 1%.

Table 2: Model Summary for Formal Financing Options - SME's performance Hypothesis

Model	R	R-Square	Adjusted R-Square	Standard Error
1	0.98	0.96	0.95	1.05

Source: Authors' own computations (2023)

Table 2 above shows the model for the study clearly revealing the adjusted R-squared which includes the R value (0.98), R-squared value (0.96), adjusted R-squared value (0.95), and standard error (1.05). This means that formal financing alternatives may explain 96% of the difference in SME performance.

Table 3: ANOVA Output for Formal Financing Options - SME's **performance Hypothesis**

Model	Sum of Squares	Df	Mean Square	F	P-Value
Regression	2348.08	1	2358.08	2091.21	0.00
Residual	98.80	88	1.12		
Total	2446.89	89			

Source: Authors' own computations *(2023)*

Table 3 shows the hypothesis's ANOVA (Analysis of Variance) results, including the sum of squares for the regression (2348.08), residual (98.80), and total (2446.89). The F-value (2091.21) and p-value (0.00) suggest that the hypothesis is statistically significant, implying that formal funding alternatives and SME performance are related.

Table 4: Regression Result for Formal Financing Options-SME's performance Hypothesis

Model	β	Standard Error	Standardized Coefficients	t-Statistics	P-value Significance
Constant	-3.67	0.40		-9.08	0.00
Coefficient (β)	1.36	0.30	0.980	5.73	0.00

Source: Authors' own computations *(2023)*
Note: Dependent variable: SME Performance; Predictor: Formal Financing options.

The tables above provide the findings of a regression study on the association between formal funding choices and SME's' performance. The model is summarized in Table 2, which includes the R value (0.98), R-squared value (0.96), adjusted R-squared value (0.95), and standard error (1.05). This means that formal financing alternatives may explain 96% of the difference in SME performance. The regression findings for the hypothesis are shown in Table 4, containing the constant value (-3.67), the coefficient for formal financing alternatives (1.36), the standard error (0.30), standardized coefficients (0.980), t-statistics (5.73), and the p-value (0.00). A unit increase in formal financing choices is connected with a 1.36 unit improvement in SME performance, according to the positive coefficient of 1.36. This link is statistically significant, according to the t-statistics (5.73) and p-value (0.00). Finally, these statistics indicate that formal financing choices have a considerable and favorable influence on the performance of SME's.
The positive and significant finding of this study extends with the study by Lawal (2018), who posited that financial resources can be considered to be one of the major factors influencing the growth and development of SME's. These results corroborate those of previous research by Babu (2017) and Nikaido, Pais, and Sarma (2015), which identified collateral and lending conditions as major obstacles to formal funding. The other major factors can be said to also be highly influenced by the number of financial resources available. A venture's financial management as it moves into the entrepreneurship operation also plays a key role in its development (Lawal, Iyiola, and Adegbuyi, 2018).

5. Conclusion

Policy measures are vital. OECD (2019) demonstrates that SME's still struggle to receive financing. The trend suggests that more small enterprises are financially limited and failing to thrive. From the findings, it could be deduced that formal financing options have a significant impact on the performance of SME's. In conclusion, financial resources are considered to be major factors influencing the growth and development of SME's. Therefore, policies should be tailored to foster financial support for SME's in order to contribute positively to the Gross Domestic Product (GDP).
Blancher et al. (2019) have suggested increasing the financial technology (FinTech) sector minimize bank dependence, exchanging credit information, and modernizing bankruptcy legislation and the legal system to promote SME's. FinTech can provide several services to small firms in emerging and developed nations. FinTechs may help SME's by streamlining the application process and providing financial services to rural places where internet connection opens up new entrepreneurship opportunities (Nanda, 2018).
The results of this research provide insight into the declining rate of capital creation and the high lending rate banks impose on small and medium-sized enterprises (SME's) in search of financing. Our estimated model emphasizes the paramount significance of stable financing to the long-term success of Nigeria's small and medium-sized businesses. SME's should have access to the massive deposit liabilities of banks by having the government guarantee the commercial banks' loans to them and by having the government subsidize the interest rate on such loans.

The research urged stakeholders and the government to take action to help small and medium-sized enterprises (SME's) increase their access to alternative funding from formal institutions and other options including government affirmative grants. Also, Incentives for traditional banking institutions that create dedicated SME-focused facilities and improve the effectiveness of SME-focused positive funds should be considered by the government. Financing options for SME's (small and medium-sized firms) are critical to their performance and development, particularly in developing nations. Policymakers must acknowledge the role of SME's in driving economic growth and provide an environment in which small businesses may get sufficient funding. Policymakers should promote financial literacy and entrepreneurship, support alternative financing sources such as microfinance institutions, crowdfunding, and peer-to-peer lending, and encourage the establishment of a strong banking sector that meets the requirements of SME's. Governments may also give tax breaks and subsidies to SME's, as well as guarantee programs to encourage banks to lend to small businesses. Furthermore, policymakers may collaborate with development finance institutions and donor organizations to give SME's technical support and training to help them access capital and expand their enterprises. Policymakers may boost SME's' access to funding by adopting these guidelines, which can improve their performance and contribute to overall economic development in developing nations.

Furthermore, based on the findings, banks could assist small and medium-scale enterprises through the provision of an overdraft, soft loans, advisory services, purchase of equipment, and other support that can enhance their growth and development. Small and medium-scale enterprises should seek private investors/business angels to invest their business skills and capital in the business enterprises to achieve economic objectives. Further studies should explore the comparative role of formal and informal financing options on SME's in Nigeria. This suggestion will give a comparative insight as to the most promising way for SME's to source funds.

Finally, governments may indirectly help SME's get financing. Few studies have indicated that government subsidies and grants to small and emerging enterprises boost their chances of market loans and investment. Takalo and Tanayama (2010) have demonstrated in a theoretical environment that government R&D subsidies to small enterprises cut capital costs and transmit a quality signal that makes it simpler for them to get finance. Meuleman and De Maeseneir (2012) found that Belgian R&D tax subsidies improved small enterprises' loan finance. Bakhtiari (2019) shows that Australian government aid increases the likelihood of enterprises securing external financing.

5.1. Limitation of the study and future research focus

SME heterogeneity and policy implications are two major unanswered problems. Is supporting SME's a good strategy to boost innovation and employment? Also, SME support is minor compared to macroeconomic variations and trends, making this difficult to assess. SME aid on economic aggregates is unclear. Can we meaningfully aggregate micro-, small-, and medium-sized businesses to meet policy goals? Are the "average" SME programs and policies suitable for micro-firms? Do SME's need distinct policies?

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