BANK LOANS AND SMALL MEDIUM ENTERPRISES’ (SMES) PERFORMANCE IN LAGOS, NIGERIA

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Abstract
The study examined the link between bank loan (measured by access to loan and debt financing) and Small and Medium Enterprise (SME) performance (measured by business expansion and output) in Lagos, Nigeria. The study adopted the survey research design. The population for this study consists of 11,663 SMEs in Lagos State, Nigeria. The Yamane sample size determination formula was employed, which gave a sample size of 372. The survey research design was adopted in carrying out the study, through the administration of structured questionnaire to selected chief executives of SMEs in Lagos. Two hypotheses were formulated and Pearson correlation analysis was employed to ascertain the association between bank loan and SMEs performance. The findings revealed that access to loan is positively associated with business expansion of SMEs in Nigeria ($r = 0.801$, $p$-value < 0.05); also, debt financing is positively associated with outputs of SMEs in Nigeria ($r = 0.894$, $p$-value < 0.05). It is therefore concluded that bank loan is strongly associated with SMEs performance, particularly SMEs business expansion and output. The researchers recommend that Government should ensure active operation of the SME Credit Guarantee Scheme to improve credit providers’ exposure to longer term debt issued to SMEs. SMEs should also utilise debt financing opportunities to enhance their outputs.

Keywords: Bank Loan, Access to Loan, Debt Financing, Output, Business Expansion

1. Introduction

Some scholars have observed that in Nigeria SMEs are major sources of employment generation as they contribute immensely to the nation’s Gross Domestic Product (GDP) and they constitute about 92% of businesses in Nigeria (Ifeakachukwu & Olasunkanni, 2013; Nwosu & Oseni, 2013). SMEs also play a crucial part in enhancing economic growth and sustaining livelihood in developing countries (Al-Abri, Rahim & Hassan, 2018; Hassan & Olaniran, 2011). Likewise, several researchers have argued in their studies that, if all stakeholders are to show serious commitment to the development of the SMEs sub-sector, the economy will necessarily witness meaningful transformation and prosperity.

SMEs are efficient prolific employment creators; they are also viewed as the seed of big businesses and the fuel of the national economic engine (Musah, et al., 2018; Adeyelure, et al., 2018; Abor and Quartey, 2010). In addition, SMEs have been identified as catalysts for the economic growth of a nation as they are major sources of income generation and job creation (Ahiawodzi & Adade, 2012; Oke & Aluko, 2015; Musah, 2017). Aside from SMEs being a tool for employment generation, it also assists to provide efficient means of restraining rural-urban migration and proper resource utilisation. Some major constraints working against the performance of SMEs in Nigeria can be summarised into four, namely lack of access to modern technology, hostile and turbulent business environment, poor managerial skills and lack of access to finance (FSS 2020, SME sector Report, 2007). Poor managerial skills and lack of access to modern technology could be as a result of inadequate finance for employment of skilled staff and
acquisition of relevant technology. This problem can be solved if the SMEs are given access to finance through granting of loans and trade credit. Supporting SMEs in Nigeria financially is therefore very important, if they are to survive, grow and play a developmental role in the nation’s economy.

Theoretically, the concept of SMEs is amorphous as it varies from country to country and even within the same country. It may vary from sector to sector, depending on the purpose for which the definition is sort. However, there are some common indexes of the definition such as: number of employees, value of assets and turnover. The problems facing the SMEs in Nigeria are numerous. In their study, Akingunola et al. (2018) note inadequate capital and inaccessible loan facilities as some of the problems. Long term development institutional credit was known not to be accessible to SMEs because they are mostly considered high loan risks by financial institutions. A major concern is that the deposit money banks (which should be the major financiers of SMEs) are not giving adequate assistance to new economic initiatives, particularly to the expansion of SMEs. Despite their dominance and significance in job creation, SMEs traditionally face difficulties in procuring formal equity and credit.

Therefore, this study is undertaken to examine the relationship between bank loan and the performance of small and medium enterprises in Nigeria. It also discusses the challenges of SMEs financing in Nigeria, the association between bank credit and SMEs sales volume and the role of money deposit banks in financing SMEs.

**Objectives of the Study**

The broad objective of this study is to examine the relationship between access to bank loan and the performance of SMEs in Nigeria. The specific objectives are:

i. to examine the association between access to loan and business expansion of SMEs in Nigeria;

ii. to examine the association between debt financing and outputs of SMEs in Nigeria.

**Research Hypotheses**

The following hypotheses will be tested in the study:

- **H_01:** There is no association between access to loan and business expansion of SMEs in Nigeria.
- **H_02:** There is no association between debt financing and outputs of SMEs in Nigeria.

2. **Literature Review**

2.1 **Concept of Small and Medium Enterprises**

A business might be depicted as small, medium or large in size. However, what is small, depending on individual perspective, might be viewed as a large venture from someone else's perspective. For example, most observers would contend that an automobile manufacturing venture is a large enterprise, depending on their own judicious judgment. These and numerous different issues brought up the debate on what ought to be used in determining what is to be depicted as large, medium or small businesses. Most of the time, the quantity of workers on the company's payroll may be the most broadly used criterion. Other criteria that draw a line of
division among large, medium and small business are assets, investment, turnover and paid-up capital (SMEDAN, 2007).

Ayegusi (2004) characterises small venture as a business which has an investment capital that is up to one hundred and fifty thousand naira and hires not more than fifty workers. From another perspective, small business are those ventures with total assets in capital, plant, equipment and working capital that do not surpass two hundred and fifty thousand naira, which hires not more than thirty workers (Okpara and Wynn, 2007). These definitions do not visibly differentiate large, medium and small. They only characterize ventures as small, if workers are between 30-50 and investment capital is N150,000-N250,000. The Small and Medium Enterprise Development agency of Nigeria (SMEDAN, 2007) provided a suitable definition by drawing a line of demarcation between small, medium and large businesses.

Table 1: Demarcation among Small, Medium and Large Enterprises

<table>
<thead>
<tr>
<th>S/N</th>
<th>Size Category</th>
<th>Employment</th>
<th>Assets (Nm excluding land and buildings)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Micro Enterprises</td>
<td>Less than 10</td>
<td>Less than 5</td>
</tr>
<tr>
<td>2</td>
<td>Small Enterprises</td>
<td>10-49</td>
<td>5 less than 50</td>
</tr>
<tr>
<td>3</td>
<td>Medium Enterprises</td>
<td>50-199</td>
<td>50- less than 500</td>
</tr>
</tbody>
</table>

Source: SMEDAN, 2007. This classification was adopted by National Policy on Micro, Small and Medium Enterprises (MSMEs).

There is no universally accepted definition of SMEs because several researchers hold divergent views about the concept. Charles (2012) posits that the definitions of SMEs vary between countries and continents. The major criteria used in the definitions could comprise various combinations of the following: financial strength, relative size, initial capital outlay, sales value, number of employees and type of industry. Some also base the definition on criteria such as number of employee’s capital investment, sales volume (turnover) motive, power and total assets (Akingunola et al., 2018; Akingunola, 2011).

It is imperative to know that the definition of small-scale industries is relative, indicating that there is no clear-cut conventional definition of SMEs. Industries that are considered as small in the developed nations might be large in developing nations. Hence, each nation or country has tried to define medium and small-scale industries to suit its own environment and purpose, considering the level of industrial development in the country, and the design to meet the administrative and other needs of the country.

Small scale industries in Indonesia are defined as all businesses either cottage or household, hiring less than ten full-time employees and not utilising motive power or machinery, while medium scale industries are characterised as ventures or businesses that provide work for between ten to fifty employees (Afolabi, 2013; Ayanda, & Laraba, 2011). The Centre for Management Sciences, Delf University, Netherlands identifies small industries as organisations that hire ten to ninety-nine workers and medium scale industries as those that hire from a hundred to two hundred and forty-nine workers. This Centre also postulates that small businesses are industries where the manager personally accomplishes or does all functions of management without taking real part in production (Chidi & Shadare, 2011).
It is clear from the foregoing that there exists no agreement among scholars and policy makers concerning the time when a business firm is considered to be medium or small. In fact, there is no generally or nationally acceptable standard definition except that the scale of venture needs to be defined for a particular reason. They are likewise difficult to quantify independently or measure individually, hence statistics on the number, geographical distribution and activities of venture, size, and the SMEs’ sub-sectors are highly and partially un dependable (USAID, 2004).

The United Nations Industrial Development Organisation offers fifty definitions of small-scale enterprises in seventy-five unique nations, dependent on parameters such as employment, type of country or other criteria, installed capacity utilisation, capital and output which have more significance to the industrial policies of the particular nation. Nevertheless, it has been suggested that the SMEs sub-sector may encompass about eighty-seven percent of all organisations operating in Nigeria, barring informal businesses (Ayegbusi, 2004).

Despite its definitional problem, there is a high level of consensus on the significance of SMEs to economic growth and development. Okpara and Wynn (2007) have found out that the significance of SMEs differs with sectors and with the developmental phase or stage of a nation. They also discovered that developing features such as management size and arrangement, the level of capital allocation requirements, as well as limited market access make SMEs less acquiescent to the unsatisfactory results of development approaches. These approaches emphasise large, capital intensive and high import dependent industrial plants as well as failed public ventures. This study adopts SMEDAN (2007) definition of SMEs.

2.2 Challenges of SMEs Financing in Nigeria

The problem of lack of access to finance has hindered SMEs’ impact and contribution to economic growth and development as it has affected their productivity and ancillary functions. In this regard, Eriki and Inegbenebor (2009) note that the commonly adduced reasons for the inability of SMEs to meet the expectations of government in accelerating job creation, increasing the production of goods and services, facilitating technology transfer, creating more opportunities for entrepreneurs and, particularly, intensifying the local content element of the giant multinational firms in Nigeria is due to lack of access to credit facilities.

In a related study, Abereijo and Fayomi (2005) note that paucity of capital for SMEs, especially their inability to raise external funding, is due to the fact that they are regarded by investors and creditors as high-risk debtors due to inadequate assets and low capitalisation, vulnerability to market fluctuations and high mortality rates. The existence of data asymmetry rising from SMEs’ lack of accounting records, inadequate business plans or financial statements makes it hard for investors and creditors to assess the credit merit of potential SMEs’ proposal. Other points are high administrative or transaction costs of lending or investing small amount. They asserted that the collective effects of these factors make SMEs financing an unsuccessful and unprofitable enterprise.

In another study, Okpara and Pamela (2007) did not substantiate some of the claims above but also classify SMEs. They attribute small enterprise failures in Nigeria to inappropriate book and record keeping, lack of infrastructure, corruption, lack of management experience, inadequate training and insufficient financial support. Other factors recorded include: low demand for products or services, withdrawing too much cash for personal use and lack of market research.

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2.3 Bank Loan and SMEs Sales Volume

There is a strong relationship between bank loan and the performance of SMEs. The lack of access to credit and capital is a major barrier to the development of SMEs. It prevents them from acquiring the new technology that would make them more productive and more competitive (Devi, 2013). Micro finance credit assists SMEs in the area of accounting, financial management and entrepreneurship that comply with national accounting standards, requirements and best practices. This will improve the performance of SMEs (UNCTAD 2002). Okpara and Wynn (2007) argue that only firms with the potential to graduate from micro to small and medium enterprise can be considered as entrepreneurial and businesses that are merely surviving to sustain a family and are not able to demonstrate any growth are not entrepreneurial. Kuzilwa (2005) clearly established the relationship between credit and expansion of business, thereby supporting the need for credit for entrepreneurial activity. Small enterprises often operate on short term cycle and that is why there is need for short-term loan in small amounts for them. In order to run their businesses, they require sufficient amount of capital constantly and on time.

Devi (2013) states that one of the foremost problems of any entrepreneur is finance. Availability of adequate finance at reasonable costs at the required time is the need and expectation of any entrepreneur, including the owners of small-scale industries. In the same vein, Adams and Von-Pischke (1992) argue that lack of fund is always perceived as the most important problem for the micro entrepreneurs rather than product price, modern input costs, low yield, etc. because it is easier for donors and government to give credit than provide other forms of support. This is the dominant reason behind the launch of so many micro-credit programmes. They also believe that reliable access to small and short-term loans is more important for poor small entrepreneurs than large and long-term loans. They emphasized the role of expanding services to savings for formal financial institutions by two ways:

1. Developing financial institutions which can deal in small transactions efficiently;
2. Innovating means to assist more poor people to become credit worthy and to have long term relationship with formal financial institutions.

In conclusion, money deposit banks are seen as powerful tools for the growth of small-scale industries since they can make people self-sufficient through the empowerment of their economic activities, which undoubtedly have long term socio-economic benefits.

2.4 The Role of Money Deposit Banks in Financing Small and Medium Enterprise (SMEs)

The most economical source of borrowed capital available to SMEs is money deposit banks (Nwoye, 2008). It is not arguable that the money deposit banks form the largest source of funding for small SMEs. Due to the nature of funds accessible to them, money deposit banks specialise in short-term loans and working capital funds in form of overdraft. Before a loan could be granted, the bank demands a well-prepared business proposal to satisfy them as to financial requirements of the business and how the loans can be serviced and paid back if approved and granted. The objective of the loan request determines the type of loan that will be granted. If the loan request is a credit risk, or if the amount of fund being applied for surpasses the amount that the bank manager considers reasonable on unsecured basis, then security will be required. Money deposit banks specialise in giving out short-term loans. This is because most money deposit banks’ deposit are subject to withdrawal on demand by the customers and therefore could be risky to loan out for long term or permanent financing.
Most money deposit banks’ interests on loans depend upon the level of interest rate in the economy, usually determined by the Central Bank. However, in 2007, the Central Bank’s controls on interest rate were removed by the federal government in line with emphasis on deregulation of the economy (CBN Annual Report, 2007). It is clear that commercial loans, equipment financing and leasing are the most common. They are also for short-term seasonal needs. They mature between 90 and 180 days and they may not be backed with collateral. Term loans are usually paid within five years and are secured. The principal amount is paid in instalments and the business must abide by certain specified conditions entered in the loan agreement. With equipment financing and leasing, banks give loans, using equipment as collateral and can arrange for a small business to lease equipment for negotiated periods of time. Bank loans can be for short, medium and long terms.

Banks use the following criteria in evaluating requests for loans: character, capacity, capital, condition and collateral. Character is associated with reputation which is a sum of personal attributes revealed indirectly. A borrower’s reputation is really the opinion held by others about him. His business conduct, for example, brief instalments of commitments and speculative tendencies are altogether showed by his character. To banks, character implies the capacity of a borrower to evaluate the advantages of his business and to guarantee brief reimbursement of his loans. Character is accordingly essential in the assessment of the credit value of business and people.

Narrowly, capacity implies the capability of a borrower to pay his financial commitments when they are due. The borrower, notwithstanding being skilled, should likewise be eager to balance his/her liabilities. The client’s total assets (in the business) guarantee the bank that the borrower will probably meet his commitments. Borrowers ought to have solid capital base. Banks want to recover their advances from foreseen salary or benefit as opposed the returns of liquidities swore security. A few factors which the representative has no control over may restrain the bank from giving bank credits to him. Occasional characters of the business, long run business exercises are a portion of the restraining factors. New entrepreneurs must give security to bank advances. Old timers with high credit standing do not really secure loans. Property, extra security approach and attractive securities are among the collateral required. There is a greater risk in expanding businesses; hence long-term loans have to be protected by directly pledging assets. Lipsey (2003) observes that money deposit banks in Nigeria could not meaningfully contribute to the development of small ventures because of the low rate of returns of entrepreneurial development. The cash holdings of the money deposit banks are mostly made up of demand deposits. These deposits are liabilities to the banks and are payable on demand. Thus, short term loans, cash and advances are the major consumers of money deposit bank funds in Nigeria. Many projects, which include enterprises such as footwear, printing and publishing, soap, oils and detergents and flour milling and bakeries, are financed by money deposit banks.

Nigerian banks barely finance projects requiring medium-loans and long-term loans because current deposits constitute their major source of funds. This is confirmed in the study carried out by Manufacturers’ Association of Nigeria (MAN) in a survey aimed at determining funding requirement of the manufacturing sector as well as existing constraints in accessing bank credits. It revealed that the nature of banks operating in Nigeria favors short-term credit financing as against medium to long-term financing (SMEDAN, 2007).
3. Methodology

The study adopts the survey research design which is cross-sectional in nature. This type of research design is adopted because the information about the variables represents what is going on at only one point in time. The paper obtained primary data from the population of the study, using self-administered questionnaire. The population of the study consists of 11663 SMEs in Lagos, Nigeria (NBS, 2016). A sample size of 372 was obtained from the population, using Yamane sample size determination formula at 95% confidence level and margin of error of 5. Due to the likelihood of some level of non-response, additional 30% was added to the sample size. This increased the sample size to 483. The chief executives of SMEs were used as the key respondents because they are the major decision makers. Purposive sampling technique was adopted in selecting 483 SMEs in Alaba International Market and Trade Fair Complex in Ojo and Amuwo-Odofin Local Governments in Lagos, Nigeria. The questionnaire was grouped into two sections: Section ‘A’ was designed to obtain the demographic data of the respondents, while section ‘B’ was designed to obtain data for the dependent and independent variables. A well-structured questionnaire was designed on a five-point Likert scale, ranging from 1(strongly disagree), 2 (disagree), 3 (undecided), 4 (agree), to 5 (strongly agree).

The instrument (questionnaire) was validated by three evaluators using Content Validity Index (CVI), that assess the instrument on a two-scale (relevant and not relevant) measure. Using the CVI formula: n/N

Where; n= number of questions rated as relevant
N= total number of the questions

a CVI of 0.813 was obtained, which indicated that the instrument is valid.

The reliability of the instrument was tested, using test-retest method. A pilot study was conducted, whereby the instrument was administered twice to thirty-eight chief executives of SMEs in Computer Village, Ikeja, Ikeja Local Government Area of Lagos State, Nigeria, within an interval of two weeks. The result of the first pilot study was correlated with that of the second, which gave the values of 0.719, 0.822, 0.771, and 0.894 for access to loan, debt financing, business expansion and output, respectively. This result, according to Nunally (1978), ascertains the reliability of the instrument. The data was analysed using Pearson’s Correlation coefficient with the aid of SPSS version 23 at 5% level of significance.

4. Results and Discussion of Findings

Out of the 483 copies of the questionnaire distributed, 405 copies were returned. Out of the 405 copies, 13 had some missing values and one was an unengaged response, thus they were all deleted. However, 392 were valid and useful for analysis. In the process of checking, no missing value was found.

Test of Hypothesis

Hypothesis One

H0: There is no association between access to loan and business expansion of SMEs in Nigeria.
**Correlations**

<table>
<thead>
<tr>
<th></th>
<th>Access to Loan</th>
<th>Business Expansion</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Access to Loan</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>1</td>
<td>.801**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>392</td>
<td>392</td>
</tr>
<tr>
<td><strong>Business Expansion</strong></td>
<td></td>
<td></td>
</tr>
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<td>Pearson Correlation</td>
<td>.801**</td>
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</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>392</td>
<td>392</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.05 level (2-tailed).

**Decision Rule**

If the P-value is less than 5% (P<0.05), then the null hypothesis is rejected. Otherwise it is accepted.

**Interpretation of Result**

The result above illustrates the Pearson’s Correlation r = 0.801 computed for relationship between access to loans and business expansions with p-value<0.05. This hypothesis is therefore rejected and this confirms that there is a significant relationship between access to loans and business expansions of SMEs in Nigeria.

**Hypothesis Two**

H₂: There is no association between debt financing and outputs of SMEs in Nigeria.

**Correlations**

<table>
<thead>
<tr>
<th></th>
<th>Debt Financing</th>
<th>Outputs of SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Debt Financing</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>1</td>
<td>.894**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>392</td>
<td>392</td>
</tr>
<tr>
<td><strong>Outputs of SMEs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pearson Correlation</td>
<td>.894**</td>
<td>1</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>392</td>
<td>392</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).

**Decision Rule**

If the P-value is less than 5% (P<0.05), then the null hypothesis is rejected. Otherwise it is accepted.

**Interpretation of Result**

The result above illustrates the Pearson’s Correlation r = 0.894 computed for a relationship between debt financing and output of SMEs with p-value<0.05. This hypothesis is therefore rejected and this confirms that there is a significant relationship between debt financing and outputs of SMEs in Nigeria.
Bank Loans and Small Medium Enterprises’ (SMES) Performance in Lagos, Nigeria

Discussion of Findings

It is evident from the findings that there is a strong positive association between access to loans and business expansions of SMEs in Nigeria. This implies that an improved access to loan tends to enhance SMEs’ expansion which might be in the form of establishment of an additional outlet or expansion of an existing outlet. It could equally lead to the establishment of additional factories or the expansion of existing factories for manufacturing in SMEs. Furthermore, the existence of strong positive association was equally established between debt financing and SMEs outputs in Nigeria. This implies that an enhanced debt financing package tends to lead to increased outputs.

5. Conclusion and Recommendations

The study examines the link between bank loans (measured by access to loans and debt financing) and small and medium enterprises’ performance (measured by business expansions and outputs) in Lagos, Nigeria. The survey research design was employed and the findings revealed that access to loans is positively related to business expansions of SMEs in Nigeria. Also, debt financing is positively related to outputs of SMEs in Nigeria. This is consistent with the studies by Musah, et al., 2018; Adeyelure, et al., 2018; and Abor and Quartey, 2010. It is therefore concluded that bank loans are strongly associated with SMEs’ performance, particularly SMEs’ business expansions and outputs. The study recommends that government should ensure active operation of the SME Credit Guarantee Scheme to improve credit providers’ exposure to longer term debt issued to SMEs and the SMEs should utilise debt financing opportunities to enhance their outputs.

References


