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Financial Obligations of Commercial Banks on Entrepreneurial Development: Evidence from Smes in Lagos State Nigeria

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Abstract

Inadequate financial support and access to finance have been identified as some of the challenges faced by Small and Medium Enterprises (SMEs) and these have contributed to low entrepreneurial growth as well as achieving sustainable development in a developing economy such as Nigeria. SMEs usually rely on commercial banks to render financial assistance in order to meet the financial needs of their businesses. This paper seeks to find the level of financial obligations of commercial banks on entrepreneurial growth in Nigeria with the aims of assessing the capital base of commercial banks, the number of entrepreneurs that could assess the loan, interest paid on loans by those who benefitted from financial supports from commercial banks. Primary source of data was adopted for the collection of data through administration of structured questionnaires of a total sample size of one hundred and eighty five (185) of SMEs in Lagos Nigeria. Correlation coefficient was calculated to establish a relationship between the financial obligations of commercial banks and entrepreneurial growth. The result indicated a positive correlation of 0.702 between the independent and dependent variables. Regression analysis was also carried out with analysis of variance (ANOVA) to test the significant level of the hypotheses. There is a positive and relationship between entrepreneurial growth of SMEs and interest paid on loans, access to finance and number of beneficiaries from financial supports by commercial banks in Nigeria. Recommendations were made based on the findings emanated from the research.

Keywords: *Commercial banks, Entrepreneurial Growth, Sustainability, SMEs, Nigeria.*

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Background to the Study

Small and Medium Enterprises (SMEs) have been considered as the backbone of the economy of many countries and they play significant roles in the development and achieving sustainable economy(Aganga, 2014, Bunyasi, Bwisa & Namusonge, 2014; Durkin, McGowan & Babb, 2013; Asikhia, 2010; Needle, 2010; Lee, Peng & Barney 2007; Onugu 2005). The SMEs have also been recognised as catalyst in the socio- economic development of any country and as veritable vehicles for the achievement of microeconomic objectives in terms of employment generation at low cost and the development of entrepreneurial capabilities, indigenous technology, stemming rural-urban migration, local resources utilisation and poverty alleviation (Asikhia, 2010).

Despite the significant roles SMEs play in the economy, past statistics indicate that 60% to 70% of Small and Medium Enterprises fail in their first three years of starting operation in Nigeria (Akingbolu, 2010). This may be attributed to lack of adequate planning, excessive focus on products and services are part of some basic challenges arising against the growth of entrepreneurship in Nigeria. Other reasons for business failure has been attributed to limited access to finance, limited market access to information, technology, unfavourable policy and regulatory environment (Oyelana &Fiseha, 2014;Onugu, 2005).

Access to finance has been identified as one of the key challenges and determinants for business start-up, development and growth for SMEs (Buyansi, *et al.*, 2014; Onugu, 2005). In addition, Kerr and Nanda (2009) note that obtaining adequate access to finance is one of the biggest hurdles to starting and growing a new business while Askari and Krichene (2014) observe that in today's business world, a number of developing countries suffer from slow economic growth with unproductive industrial and manufacturing sectors. Asikhia (2009) confirms that in spite of the immense benefits derivable from SMEs, available statistics have revealed that the SMEs in Nigeria are not given the desired support particularly with respect to funding.

From the bank's perspective, as it becomes more knowledgeable about the small businesses and, importantly in the long term context about small businesses, the bank is aimed to improve its ability to retain the small businesses and make more informed and prudent lending decisions. On the other hand, it is viewed by Durkin, *et al.*, (2013) that if the small businesses can develop closer and stronger bonds with its bank, the SME is then assured of financial support in times of difficulty. SMEs are performing below expectation in their contributions towards economic growth in Nigeria and appear to be far away from realisation of poverty alleviation (Odunayo, 2014; Siyanbola, 2014).

Butler and Durkin (1995) establish that while banks saw themselves as procedural, systemic and prudent, entrepreneurs saw banks as obstructive, procrastinating and fearful. Conversely, small businesses saw themselves as risk-taking, entrepreneurial and innovative, banks saw them as reckless, foolhardy and immature (Durkin, *et al.*, 2013) and Ayedun & Oke (2015) assert that the need for proper risk assessment by any business venture in other operate effectively.

Capital inadequacy has led to a crisis of loss of confidence in Nigeria commercial banks to the extent that the original functions which is to support the volume, type character of a bank's business, to provide for the possibilities of losses that may arise and to enable the bank to meet a reasonable credit needs of businesses and community have eroded (Ikpefan, 2012). According to Asikhia and Shokefun (2013), capital adequacy is the percentage ratio of financial institutions primary capital to its assets (loans and investment), is expected to be used as a measure of its financial strength and stability in meeting the needs of its customers. The problem arises with the SMEs inability to access loans from commercial banks as a result of inadequate capital to meet the financial request of the entrepreneurs.

Commercial bank lending rates in Nigeria are between 25-30% for SMEs, due to the supposed high risk of the sector, which is unaffordable for the start-up and growth of entrepreneurial business ventures (National Enterprise Development Programme (NEDEP), 2014). As a result the 2012 access to finance survey revealed that less than 1% of SMEs have accessed bank finance in the last three years. However, millions of SMEs that per chance have access to finance from commercial bank go bankrupt every year as a result of high interest rate charged on loans which has in turn led to the stagnation in growth of the SMEs. This buttress the general assertion that even though, commercial banks are willing to give financial support to SMEs, the high interest rate still remains a challenge to the SMEs owners. The Federal government Nigeria also express her concern about high interest rate on loans to SMEs sector, as part of measures in solving this problem; the Central Bank of Nigeria has directed all commercial banks in Nigeria as a matter of policy to put the lending rate to SMEs sector at 15% (Aganga, 2014).

The entrepreneurs are also concerned with problems of matching of information required by the banks, due diligence, loan administration processes, timing and understanding of their businesses (Deakins, Whittam & Wuper, 2010).

Objectives of the Study

The aim of this study is to ascertain the impact of financial obligations of commercial banks in meeting the financial needs towards entrepreneurial growth, while the specific objectives to enhance the achievement of the major aim are to:

i. Determine the relationship between capital adequacy of commercial banks on the growth of entrepreneur.
ii. Ascertain the effect of interbank interest rates on the interest paid on loans by entrepreneurs.
iii. Explore the relationship between credit administration processes and number of entrepreneurs that ultimately access the loans.

Hypotheses

Ho_1: There is no significant relationship between Commercial banks' capital adequacy and entrepreneurial growth.

Ho_2: Interbank interest rates of commercial banks has no significant effect on the interest paid on loans by entrepreneurs.

Ho_3: There is no significant relationship between Loan administration period of commercial banks and the number of entrepreneurs that access the bank loans.

Literature Review

Finance and Entrepreneurship are inevitable dependent for the fact that entrepreneurial ventures require both material and non-material resources. The acquisition of these resources depends on the capacity to finance them (Jean, *et.al*, 2009). Entrepreneurship has been defined by several authors such as, Wale-Awe(2011);Schildt, Zahra, and Sillanpaa (2006) by its paradigm such as: business opportunity, the creation of an organisation, value creation, innovation and entrepreneurial risk.Entrepreneurship holds a veritable position in economic development and its sustainability of any nation (Wale-Awe, 2011).

According to Aremu and Adeyemi (2011), the development of entrepreneurial business ventures is a major driver and indices for the actualisation of industrialisation, urbanisation, gainful and meaningful employment for all those who are able and willing to work, income per capital, equitable distribution of income, and the welfare and quality of life enjoyed by the citizenry. The growth of SMEs sector in developed nations is generating new sources of employment and has contributed significantly to a country's Gross National Product (Chaston, 2010).

In Nigeria, the Small and Medium Scale Enterprises (SMEs) is the driving force and establish an important mainstay of the Nigerian economy. A few years ago SME represent about 90 percent of the industrial sector in terms of the number of enterprises. This sectoreconomically, holds the key to sustainable development of the country and its importance can be put in proper aspect in relation to the structure of the Nigerian economy with many performance contributions as the source of technology innovation and new products. In spite of the exploitation of petroleum oil, SMEs provide gainful employment for about 70% of the Nigerian population, available reports suggest that the agricultural sector accounts for close to 35% to 40% of the nation's gross domestic product (GDP).

The concepts and definitions of SMEs are typically based on size or amount of investment in assets, annual turnover and number of employees. Thus, Olumide (2004) noted that the conceptualisation and definition of SMEs are dynamic in character and changes with time, and also varies among institutions and among countries. However, the basic definitional parameters are the same; namely, the number of employees, asset base, turnover and financial strength. According to United Nations Environmental Programme(UNEP, 2003), European Union submits that Micro firms are those which employ less than 10 employees and with an annual turnover of about 2million Euros, small firms employ less than 50 employees and with about 10 million Euros as their annual turnover while medium-sized firms employ less than 250 employees with an annual turnover of 43 million Euros. Henschel (2009) reports that an SME in the United Kingdom is a company that employs less than 250 workers, while in the United States of America the figure is less than 500 employees. There are various empirical studies describing inadequate financing as the primary cause of SMEs'failure (Coleman, 2000; El-Namiki, 1993). The capital structure of small firm differs significantly from larger firms because small firms rely more on informal financial market which limits the type of financing they can receive. The small firm's initial use of internal financing creates a unique situation in which capital structure decisions are made based on limited financing options.

A survey of small firms across the world from 1980 to 1990 revealed that on average, 50-60% of start-up failed within the first five years (El-Namiki, 1993). The main reason for failure would appear to be finance, including cash-flow problems, poor products and inadequate marketing and market research. However, small business owners and entrepreneurs are not always the best people to offer an objective analysis of the failure of their own business. It must be acknowledged that not all small firms' closures are the result of business failure. Other reasons have been attributed to death or retirement. Empirical studies have shown that SMEs contribute to over 55% of GDP and over 65% of total employment in high income countries .MSMEs and informal enterprises, account for over 60% of GDP and over 70% of total employment in low income countries, while they contribute about 70% of GDP and 95% of total employment in middle income countries. Recent research from International Finance Corporation (2011) generated important data about the market size of the SMEs sector and the financing needs of this sector a global scale, it is estimated that there are 365 to 445 million formal and informal micro, small and medium enterprises with a subset of 25 to 35 million formal SMEs in the developing economies. Out of these, 70% do not use external financing from financial institutions despite the fact that they are in need of it. Approximately 85% of these SMEs suffer from credit constraints (IFC 2011). This reveals that the latest market research studies are beginning to fill in the previously missing knowledge about the SME financing gap globally.

In Nigeria, Small and Medium Enterprises (SMEs) contribute to over 55% of Gross Domestic Products(GDP) and over 65% of total employment in high income countries and also, Micro, Small and Medium Enterprises (MSMEs) and informal enterprises, account for over 60% of GDP and over 70% of total employment in low income countries, while they contribute about 70% of GDP and 95% of total employment in middle income countries (Micro, Small and Medium Enterprises (MSMES) Reports 2012). According to Bunyasi, *et al.*, (2014), the question of financing entrepreneurial businesses for growth and the relationship of entrepreneurs with commercial banks is therefore of a great concern to the banks themselves, indeed SMEs owners also have a vested interest in improving their relationship with banks if they are to obtain appropriate financial support and better financial advice and services.

Inadequate access to entrepreneurial finance is one of the major factors hindering entrepreneurship development and affecting SMEs development in Nigeria, as it impedes the progress that comes from timeous application of resources (Rwigema & Venter, 2004; Foster & Gupta, 2003). Studies have shown that the majority of start-up funds for SMEs are obtained from personal savings and less than 5% of these funds are from banking institutions (Aganga, 2014). The Bank of Industry (BOI) recently signed a Memorandum of Understanding with ten (10) SMEs friendly commercial banks in Nigeria out of the licenced twenty five (25) commercial banks by Central Bank of Nigeria. The banks are; Access Bank Plc, Diamond Bank, Eco Bank International, Fidelity Bank Plc, First City Monument Bank (FCMB), First Bank Plc, Skye Bank Plc, United Bank for Africa (UBA) Plc and Stanbic IBTC to enhance and ensure access to finance by SMEs and other entrepreneurial business owners (Olaoluwa, 2015). On the other hand other commercial banks (Heritage Bank Plc, Guaranty Trust Bank, Wema Bank Plc, Key Stone Bank, and others are yet to join the MoU).

The choice made by an entrepreneur as to what type of finance that will be most appropriate for different kinds of small business has been shown to follow a Pecking Order Theory of financial hierarchy. If internal funds are inadequate, then external finance becomes necessary (Stokes &Wilson, 2010). In the first instance, the small business will prefer debt to equity since the former is less 'informationally sensitive' than the later. It has been noted that small businesses'differ in their capital structure but their intense reliance on pecking order is only one of the variables that make small businesses financing decision unique. This theory has been found to be relevant to the financing of SMEs.

Methodology

This study employs descriptive survey research design through administration of structured questionnaires to 185 SMEs in Lagos State for the collection of primary data. A six-point rating scale was used to obtain the responses from the respondents. Secondary data were also obtained from past literatures, journal articles and on-line materials.Multiple sampling techniques involving stratified random sampling and simple random sampling were used in selecting the sampling size. Descriptive statistical data analysis as well as advanced statistical techniques such as, Multiple Regression Analysis and correlation coefficient for different aspects of the study in relation to the entrepreneurial development. The hypotheses were tested for empirical data analysis at the significant level of 0.05 (5%) and the degree of freedom of 95%. Cronbach's Alpha co-efficient reliability was calculated for the constructs using statistical package, the result indicated that all of the variables were acceptable as the Cronbach's Alpha was more than 0.70

X = Financial Obligation of Commercial Banks (FOCB)

Y = Entrepreneurial Growth (EG)

$Y = f(y_1, y_2, y_3)$

$X = f(x_1, x_2, x_3)$

Where:

x_1 = Capital Adequacy (CA)

x_2 = Interbank Rate (IR)

x_3 = Loan Administration Period (LAP)

Where also;

y_1 = Entrepreneurial Growth (EG)

y_2 = Interest Paid on Loans (IPL)

y_3 = Number of Entrepreneurs that Access Loans (NEAL)

Therefore,

$y_1 = f(x_1)$ --- (i)

$y_2 = f(x_2)$ --- (ii)

$y_3 = f(x_3)$ --- (iii)

Multiple Regression analysis was employed to determine the contribution other variables (x_1, x_2, x_3) of commercial banks to the growth and development of SME business owners. The multiple regression equation is given thus:

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

Findings and Discussion

Descriptive statistics analysis and inferential statistical analysis were carried out on entrepreneurial relationship with commercial banks for financial support and the result indicated that commercial banks' financial support had a positive influence on entrepreneurial growth. The mean and standard deviation indicated how the respondents strongly agreed, agreed, partially agreed, partially disagreed, disagreed and strongly disagreed according to the 6 point rating scale of 1-6 which is shown by the means and the dispersion of respondents as shown by the standard deviation. It was found that majority of the responses on the various aspects of financial support from commercial banks for business growth were of average of 3.0 and therefore, 'partially disagreed' that commercial banks had enough capital base to support entrepreneurial growth as shown in the figure below.

Table 1: Descriptive Statistics of Financial Support based on Capital Adequacy

	Mean	Std. Deviation	N
Commercial Banks and Capital Adequacy for Businesses	3.4914	2.01037	185
Financial Support from Banks For Business Growth	2.7496	1.80631	185

Source: Field Survey, 2015

Results from the correlation analysis revealed a positive correlation between the variables, r = 0.702, n = 185. The p value is less than 0.01 level of significance which implies that the variables financial support from commercial banks is very significant and greatly influences entrepreneurial development. This will allow Small and Medium Enterprises to undertake productive investments to expand their businesses, increase their asset base and profitability. The correlation analysis results are indicated in the table below.

Table 2: Correlation Analysis of Capital Adequacy and Financial Support

		Capital Adequacy of Commercial Banks	Financial Support from Banks for Business Growth
Capital Adequacy of Commercial Banks	Pearson Correlation	1	.702**
	Sig. (2-tailed)		.000
	N	185	185
Financial Support from Banks for BUSINESS GROWTH	Pearson Correlation	.702**	1
	Sig. (2-tailed)	.000	
	N	185	185

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

Source: Field Survey, 2015

The regression analysis revealed that financial support from commercial banks has a positive influence on entrepreneurial growth of Small and Medium Enterprises in Nigeria. The R = 0.509 and the R^2 value of 0.259 or 25.9% revealed that 25.9% of the variation in entrepreneurial growth of SMEs is explained by variation in financial support from commercial banks. This therefore means 74.1% of variation in the entrepreneurial growth is explained by other factors not in the model or by chance. Financial support by commercial banks in Nigeria is therefore a good predictor for entrepreneurial growth.

Ho_1: Commercial banks capital adequacy for financial support has no significant effect on the growth of entrepreneur.

Analysis of variance (ANOVA) was carried out to test the significance of commercial banks capital adequacy for financial support for entrepreneurial growth of SMEs. From the results below, it was showed that the p – value (0.000) is less than the level of significance (0.01) implying that the model is significant. In addition, the F- computed 55. 678 is greater than F – tabulated 3.12which implies that the model $Y = 1.418 + 0.438X_1$in table 4 below is significant and therefore good for prediction. This therefore implies that financial support by commercial banks based on their capital adequacy is a significant factor influencing entrepreneurial growth of SMEs in Nigeria. As a result of the above findings, we reject the null hypothesis that commercial banks capital adequacy for financial support has no significant effect on entrepreneurial development.

Table 3: Analysis of Variance (ANOVA)

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	534.001	4	133.500	55.678	.000b
	Residual	1529.756	638	2.398		
	Total	2063.757	642			

Source: Field Survey, 2015

From the analysis of increase in employee base as a measure of entrepreneurial growth, the mean was found to be 3.9658 and a variance of 1.789. This indicated that it was partially agreed by the respondents that their employee base has increased over the years and it suggests that there is a reasonable level of entrepreneurial growth in Nigeria in terms of employee base. The mean of the assets base as a measure of entrepreneurial growth was 4.7 which also suggest that the respondents agreed that there had been an increase in the assets base. The coefficient table below indicates the standardised coefficients (Beta) and respective t- calculated for the variables. It was established that majority of the responses on the interest paid on loans from respondents were of average of 4.0 and therefore, 'partially agreed' that the interest charged on loans by commercial banks is relatively high and this affects the entrepreneurial growth as the profits made by entrepreneurs are being partially eroded as a result of high interest paid on loans as shown in the table below.

Table 4: Descriptive Statistics Analysis on Interest Paid on Loans

	Mean	Std. Deviation	N
Financial Support from Banks for Business Growth	2.7496	1.80631	185
Interest Paid on Loan Influence Entrepreneurial Growth	3.7061	1.72278	185

Source: Field Survey, 2015

There was a positive correlation of 0.273 between loan collected from commercial banks and interest paid on loans by entrepreneurs which implies that the variables interest paid on loans by entrepreneurs to commercial banks is very significant and greatly affects entrepreneurial growth. This may results in slow growth rate because most of the profits from entrepreneurial business will be used to service commercial banks loans and this had also resulted in high rate of default experienced by commercial banks.

Table 5: Relationship between Financial Support from Commercial Banks and Interest Paid on Loans

		Financial Support from Banks for Business Growth	Interest Paid on Loan Influence Entrepreneurial Growth
Financial Support from Banks for Business Growth	Pearson Correlation	1	.237**
	Sig. (2-tailed)		.000
	N	185	185
Interest Paid on Loan Influence Entrepreneurial Growth	Pearson Correlation	.237**	1
	Sig. (2-tailed)	.000	
	N	185	185

Correlation is significant at the 0.01 level (2-tailed).
Source: Field Survey, 2015

Table 6 : Descriptive Statistics Financial Support and Number of Beneficiaries

	Mean	Std. Deviation	N
Financial Support from Banks for Business Growth	2.7496	1.80631	185
Beneffitted From Commercial Banks Loans	2.8460	1.79292	185

Source: Field Survey, 2015

Ho_3: Loan administration processes of commercial banks do not have a significant effect On the number of entrepreneurs that access the bank loans.

The correlation coefficient therefore revealed that loan administration procedures of commercial banks have a significant effect on the number of entrepreneurs that access the bank loans for their business growth.

Conclusion

Financial obligation of commercial banks in Nigeria is a good predictor for entrepreneurial development since a positive correlation exists between the variables. This is in tandem with the findings of Buyansi et al., (2014) who found out that small business owners who have the opportunity of financial support from financial and non-financial institutions are likely to grow more than business that a lack of financial support. The findings are also supported by Wei and Baker (2012), who established that the success of SMEs is being determined by the ability of the entrepreneur to apply finances appropriately in order to achieve entrepreneurial growth and development. It could then be concluded that commercial banks have more financial capacity to support entrepreneurial development. Although, the risk involved in commercial banks' loans is relatively high which had resulted in high interest rate, many of the entrepreneurs are however ready to access the loans as long as commercial banks are willing to support their businesses financially.

Recommendation

Commercial banks and other financial institutions in Nigeria should endeavour to increase their capital base in order to improve on their commitments to SMEs growth and development in the country in terms of financial support. They need to ensure that SMEs have access to funding and financial advisory services that can enhance their business growth which will also enhance their contributions towards the socio-economic growth. . The interest rate regime needs to be reviewed downward probably to single digit by the financial regulatory authority and a policy that will ensure that commercial banks have special intervening funds to support SMEs' development. Further research topic might also address the nature of financing constraints faced by entrepreneurs should be examined for further research.

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