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Entrepreneur-firm characteristics and financing sources

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Abstract

The point of this study is to review the effect of entrepreneur-firm characteristics on the financing sources of small and medium enterprises (SME) in Nigeria. To review the effect of entrepreneur characteristics on financing decisions regarding debt and equity. In addition, the overview will extend the acknowledgment and the acumen of entrepreneur-firm managers. They can have an effect on via precious information to assist them in their preference manner with appreciate to their business enterprise's capital structure amid a period when entrepreneur financing bothers are progressively inspired in the Nigeria ambience.

Keywords: SME; entrepreneur; financing; Nigeria; firm

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1. Introduction

By far most of the organizations all-inclusive are SMEs and capacities a tract for entrepreneur-firm and an antecedent of determination to adapt to the innovation in technology and uplifting in social status issue in every single expending work and have a prodigious capacity for tenable development (Eniola & Entebang, 2014, 2015b). Entrepreneur-firm performance is sine qua non to the performance of the country (Eniola & Entebang, 2015c). This implies entrepreneur-firm fills in as an underlying wellspring of inspiration for economic power. This assertion is further clearly noted by Eniola and Entebang (2014, 2017), that the backbone of the Nigeria economy is SMEs which is about 98 per cent of the enterprises in the country. The authors further stated that the 98 per cent of all businesses in the manufacturing sector were entrepreneur-firm operating in Nigeria, providing 76 per cent of the workforce and 48 per cent of all industrial output in terms of value added. Since entrepreneur-firm vary from large firms in a few regards alternatives and methods (Uyar & Guzelyurt, 2015), thus, the entrepreneur-firm performance has a strong impact, in a competitive global business, on the economies of numerous countries through their adeptness to innovate new products and process (Eniola & Entebang, 2016). Likewise, entrepreneur-firm differs from big firms in a variety of ways, like firm size, lack of access to the capital market, business age, ownership structure, location and limited financing sources. In any case, remembering the true objective to begin or create business venture, the fund is fundamental. Consequently, company's manageability and achievement rely on upon a selection of financing choices (Eniola & Entebang, 2015c). For the requirements of this review, it will thus be basic to get a handle on; be that as it may, these decisions direct the organizations which were examined.

This study presents the review conducted by the Nigeria entrepreneur-firm regarding their decisions towards sources of financing. Prior studies on this research have been mainly found in advanced nations (Benkraiem & Gurau, 2013; Uyar & Guzelyurt, 2015), and have applied firm-level data and is not applicable to developing countries. Moreover, just like the case in practically every developed and developing country, entrepreneur-firm speaks to an extensive extent of organizations in the Nigeria economy. Therefore, the study review will focus on a developing nation and the subject needs to be analyzed in Nigeria context due to the importance of entrepreneur-firm in that economy by review the effect of firm-specific characteristics like firm size, age, and location on the choice of sources of financing. This is considered vital as robust and applicable investment policies like entrenching financing for small and medium business can boost local economic development thereby reducing poverty, unemployment and increase wealth. In like manner, using the review approach as a part of an investigation of capital structure decision might help SME owners-managers, practitioners, and policymakers in designing and delivering suitable financing and backings at applicable stages in an exceeding firms advancement.

2. Literature Review

2.1 Conceptual Issue

The dynamic resource-based theory aggress the building, advancement and development of capabilities and in this manner passes on that the competitive advantages and impediments in understandings of resources and capabilities advance after some time in foremost approaches (Hasan, Hossain, Cheung, & Habib, 2015). Established on *The Theory of the Growth of the Firm* (Penrose, 1959), which is about dynamic resource-based theory, proposes that the growth of the firm relies on the economy and the effective correlation of the firm's resources and management; consequently, the evolution of the firm's competitiveness. According to Anderson (2015), entrepreneurship is concerned first and foremost with a process of change, emergence and creation: the creation of new value; but also, and at the same time, change and creation for the individual. SMEs is the development of innovative technology, economic growth, poverty reduction, an increase in employment creation, and uplifting in social status and standard where the importance is determined by the size of the firm, ownership, innovation activities, and technological change (Gërguri-Rashiti, Ramadani, Abazi-Alili, Dana, & Ratten, 2017; Storey, 2011). SMEs is the dominant form of business organization in both developed and developing economies (Harvie, Narjoko, & Oum, 2010; OECD, 2013), and they play a major role in economic development. The importance of the SME as a sector is getting a vital factor for economic growth. As such, it has gained a high importance in the research field. While some analysts suggested that the successful outcome of enterprises is a function of both external and internal factors (Beck & Demirguc-Kunt, 2006; Benzing & Chu, 2009; Cook & Nixson, 2000; Fatoki, 2014). Other authors argued that the dynamics of the small and medium business successful outcome and performance remain a black box (Deakins, Logan, & Steele, 2001; Ligthelm, 2013).

Hadjimanolis (2000) opined that small firms lack resources and bargaining power, which hinders their ability to be innovative and successful. He established that the size of the firm did impact on the availability of resources. Fairlie and Robb (2009); Robb and Wolken (2002) confirmed that firm size, age, and the type of ownership may determine the firms' financing decisions. Likewise, Dana (2010) carried out a study in Ghana and Togo, West-Africa. It was revealed that many businesses are not efficient because of financial restriction and the ability to reach outside the world are finite due to the absence of credit capital and sometimes, entrepreneurial capital cannot finance new ventures to turn sawdust to charcoal. Moreover, the researcher noted that there is a multitude of micro-businesses with the lack of entrepreneurship venture. The implication is that those businesses as results of their sizes, location and ownership structure are suffering from less leveraged and more susceptible to failure.

Furthermore, Islam, Khan, Obaidullah, and Alam (2011) affirmed that the firm characteristics in terms of the origin of enterprise, operation period, the size of the enterprise, and capital source are found not to be a significant factor in the business success of SMEs in Bangladesh. Rossi, Lombardi, Siggia, and Oliva (2016) conceptualized the impact of corporate characteristics on the financial decisions of companies: evidence of funding decisions by Italian SMEs and found that there is a correlation between business size and financial decision. Moreover, it was revealed that managerial skills and experiential learning, access to, and accumulation of financial resources also increases over time with firm age. Solomon and Tomczyk (2008) revealed that age has an effect on entrepreneurs' views on training needs which could be in terms of financial decision making and experiential learning.

Accordingly, Sherifat (2013) conducted a study in Nigeria and revealed that factors that affect men owned businesses are significantly different from women-owned businesses in gaining access financing. The study showed that women perceived marital status, family, age, business location, customers, and business development services as factors that influence women entrepreneur successful outcome. However, factors such as friends, government support, adequate training, innovativeness, risk-taking, re-training, business premises, and access to information as important factors influencing men entrepreneur business performance. Though, access to sources of financing and family members were significantly considered by men and women entrepreneur in Nigeria as part of the factors influencing a successful outcome. Akande, Adewoye, Oladejo, and Ademola (2011), in a study conducted on the performance analysis of the strategic effect of age, size and sources of funds on micro enterprises in Nigeria, using regression analysis. It was revealed that age, size and sources of funds effect on MSMEs in Nigeria. Empirical studies have shown that both age and size have a significant effect on the SME (Beck & Cull, 2014; Kangasharju, 1999; Mac an Bhaird & Lucey, 2010).

Accordingly, Hisrich, Petković, Ramadani, and Dana (2016) noticed that SMEs in transition countries are facing difficulties in accessing external sources of financing. Research evidence shows that with the favorable business environment, venture capital is one source of funding for new ventures. According to Ramadani (2014), Venture capital often invests in small enterprises which deal with mathematical reviews and use of present-day innovation, in which investments are characterized by a high risk. If they realize a successful penetration in the market, then they will achieve a high level of profitability, in comparing with other enterprises. Venture capital can be formal or informal. The formal venture capital is equity, usually in a minority position while the informal venture capital is a debt which is converted to equity or debt of a risk-capital nature that is medium to long-term and granted more on the basis of the profit prospects of a project or firmer than its security.

Ramadani (2009) opined that financing could be an essential point for the survival and improvement of small and medium-sized enterprises. He noted that Informal venture capital known as business angels assumes a key part in financing these enterprises, particularly innovative ones with high growth potential. Informal venture capital fills the crevice between originators, family, and companions on one aspect, and institutional venture capital funds on the opposite aspect, as a financing source. They supply more than cash. They are active investors and contribute their abilities, skill, information, and contacts in the organizations they put resources into. They are affluent people with the extraordinary business expertise, ready to contribute and supply their riches and information to the proprietors and to business people to begin or build up their organizations. Nevertheless, venture capital has its shortcoming. The venture capitalists are selective and invest only a small number after analyzing a large number of projects presented via determinants. They are attracted to a specific type of new venture with high growth potential and significant cash out. Subsequently, SMEs have a tendency to depend intensely on the equity and debt provided by the entrepreneurs, companions, relatives and the private sponsor, debt from the capitalist institutions, particularly from banks and trade credit. Therefore, venture capital is not suitable for the vast majority of new ventures or SMEs (Hisrich et al., 2016).

2.2 SMEs in Nigeria

Nigeria today has the biggest economy in Africa and SMEs make up 99 per cent of all companies in Nigeria (Eniola & Entebang, 2015a; Eniola, Entebang, & Sakariyau, 2015). SMEs has performed an unparalleled role in coming to the Nigeria economic growth and assist as a training ground for entrepreneurs and a provider of solutions to address the challenges of unemployment in all consuming labors and promoting marketing growth. An opportunity for the wholesome advancement of SMEs in Nigeria was in connection to the sea change and growth policy as a consequence of the rapid advancement of the global economic system. Despite this, they face some challenges (Eniola & Entebang, 2015b).

However, the study acknowledges that the impact of SMEs has been rather insignificant to the performance growth and development of Nigerians and it is worrisome to note that Nigeria has not experienced massive industrial development via SMEs, despite, the policy initiatives and all manners of support and program successive Government has pursued to ensure that SMEs perform. Financing problems keep reoccurring. The significance is that SMEs does not receive or have enough financing to meet the needs at different degrees of the development. A good SME borrower may not apply for a loan to a bank because they believe they will be rejected (Xiang, Worthington, & Higgs, 2011).

In evidence, Isern et al. (2009) estimated that only 5 per cent of SME in the country have access to credit, despite the fact that 80 per cent of SMEs seek financing; in fact, about 59 per cent have been discouraged from applying because of expected denial, despite, the fact that financial systems in Nigeria are not in short supply of liquidity, but lending institutions have been very reluctant to make loans to SMEs, which they regard as a high-risk sector. Thus, perceived financial constraints in the SME also affect the demand for finance by SMEs (Xiang et al., 2011). In view of this, an important question is raised regarding the factors influencing SME choice of financing.

There is no clear-cut definition of SMEs in Nigeria, but it varies over time from organization to organization. Various organizations or institutions in Nigeria have at specific times, defined SMEs in different ways, but the definitions have as common measures fixed assets, gross output, and the number of employees (Eniola, 2014). This study adopted the definition of SMEDAN/NBS (2010) with enterprises which employ fewer than two hundred people and have either an assets value (excluding land and buildings) or an annual turnover total is not exceeded N500 million are defined as SMEs. These enterprises are classified as micro, small, and medium enterprises as follows: Micro enterprises are defined as enterprises which employ fewer than ten people and with assets value (excluding land and buildings) of less than N5 million or total annual turnover total which does not exceed N10 million; Small enterprises are defined as enterprises which employ fewer than fifty people and with assets value (excluding land and buildings) of less than N50 million or total annual turnover total which does not exceed N100 million; and Medium enterprises are defined as enterprises which employ fewer than two hundred people and with assets value (excluding land and buildings) of less than N500 million or total annual turnover total which does not exceed N 500 million.

Size - Balakrishnan and Fox (1993) concluded that firm-specific characteristics are more important than structural characteristics of the industry. While empirical evidence from previous SME studies suggests that firm size is an important antecedent in the cost of making decisions concerning choices of firm financing, particularly the level of gearing (Mac an Bhaird, 2010; Mac an Bhaird & Lucey, 2011; Prahalad & Hamel, 2006). Benkraiem and Gurau (2013); Michaelas, Chittenden, and Poutziouris (1998, 1999) with empirical findings, assumed a positive relationship between size and long-term debt, and a negative one between size and short-term debt. Mac an Bhaird (2010); Mac an Bhaird and Lucey (2010, 2011) showed that in attaining a sustainable, there must be a strong correlation between firm size and the scope for external financing. Fazzari, Hubbard, and Petersen (1996) investigated the link between SME firm size and financing and argue that in times of tight credit, small and medium-sized firms are often denied funds, in favor of better quality borrowers. With economies of scale, large firms can produce a larger quantity of outputs by spreading fixed costs. Large firms also benefit from the improved capacity to access critical resources such as business finance (Penrose, 1959), particularly with regard to low-cost capital (Goerzen, 2007). Larger firms are not restricted in their debt financing while smaller firms rely on intermediary finance. Hence, smaller firms find it difficult in achieving a better outcome.

Age - Profit generation is typically a function of scale, as firms possessing a larger asset base or generating greater sales revenue commonly earn larger absolute profits than smaller firms. Empirical studies show that the age of the firm is an important factor influencing the firm in sourcing for the choice of financing. Gregory, Rutherford, Oswald, and Gardiner (2005); Mac an Bhaird and Lucey (2010, 2011) argued that age together with experience and transparency play positive role in gaining access to public equity or long-term debt financing. They also assert that when lending to small firms, financial institutions require owners to pledge personal assets to guarantee payback of the loan. This factor might also force small firms to short-term debt financing. This is clearly indicated by higher bankruptcy rates in younger firms, they are more prone to failure than older ones (Cressy, 1996; Keasey & Watson, 1994; Mac an Bhaird, 2010). Similar to the development of managerial skills and experiential learning, access to, and accumulation of financial resources also increases over time with firm age. Robb and Wolken (2002) found that bigger, mature firms were more likely to have arrearage than smaller firms. Gregory et al. (2005) found that younger firms are more likely to use long-term debt. In Nigeria, SMEs is constrained in obtaining external from lenders, and they are generally required to pledge assets of the business or owners.

Location - The location is a requisite antecedent that shapes and determines the outcomes of entrepreneurial development and business decision. The firm that is geographically located to his customers and lenders is capable of utilizing soft available qualitative information advantage to establish the credibility for debt financing. Sridhar and Wan (2010) indicated that the sustainability advantage of the firm is induced by the location of the business, also, imply an outcome. Previous researchers suggest that the SME financing decision in accessing funds will depend on whether the geographical location has a role to play (Berger & Udell, 2002; Storey, 1994). There is some evidence to indicate that some SMEs in rural environments may face extra difficulties (Keeble, 1997; Storey, 1994) due to lower awareness and use of external funding and business advice have been reported by firms located in rural fields. However, Rand (2007) with a different opinion, stated that the probability of accessing credit is higher in rural than in urban areas. Contrary to Fatoki and Asah (2011) that SMEs located in urban are successful in access to debt financing compared to those located in rural areas.

3. Conclusion

This study presents the review of a study on Nigeria entrepreneur concerning the choice of financing. Entrepreneurs make up a large proportion of companies in the Nigeria economy and are different from large companies in a variety of ways, such as the capital size and structure, operations complexity, and so on. Thus, there is a need for empirical analysis conducted, especially, on SMEs in developing environment. Likewise, the application of the appropriate theory would be of approach benefit. It will consolidate changes in the handiness of information and collateral over time thoroughly as capital composition shifts with firm age. The review of the study generates some significant results. The majority of the firms in Nigeria, as reviewed, appear to have stagnated in the success stage after the period of survival. Most of the owner-manager cannot advance beyond this as cash gets a manageable factor again; hence, they preserve the present profit with the existing state of affairs by counting on internally generated funds for investment. They break to shift in the personal and financial resources, skills required of entrepreneurs as the business develops away from their functional capacities apropos their strategic management abilities in terms of getting to the correct conclusions about sources of financing. As firms advance along the continuum, they need the proper step, in addition, access to increase sources of debt and equity capital for success.

The original contribution of this paper addresses a gap in the existing literature regarding the financing choices of Nigeria SMEs, and the antecedents of the choice of financing using the definition established by the SMEDAN. The best possible understanding of the factors that decide the financial policy of Nigeria SMEs can broaden the potential of managers to take better decisions involving the financial decisions of their organizations. Consequently, it is valuable for firm owners-managers and policymakers in planning and providing for sufficient financing and backings at significant stages in a firm's development.

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