SOURCES OF INVOLUNTARY FINANCIAL EXCLUSION AMONG SMES: PERCEPTUAL EVIDENCE FROM KWARA STATE, NIGERIA

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ABSTRACT

The contribution of Small and Medium-sized Enterprises (SMEs) to economic growth and development, job creation and income generation has made it a cynosure worldwide. However, most SMEs are financially excluded thereby undermining their potentials in most developing economies of the world. This study investigated the sources of involuntary financial exclusion among SMEs in Kwara State, Nigeria. Data were drawn from primary sources using questionnaire to elicit responses from sampled SME owners and managers. The study used both descriptive and one sample t- test statistical techniques to analyze the data gathered through the questionnaire. The results revealed that SMEs encountered various sources of involuntary financial exclusion which include lack of capital market access, prohibitive loan cost, non availability of collateral, lack of business financial records, lenders' risk averse behaviour, information asymmetry and high interest charged. The study, therefore, recommended that fund providers including financial institutions on their part, should de-emphasize enterprise profile and develop a personalized banking relationship with SMEs and open more micro credit windows, relaxing some of their seemingly stringent formalities specifically for SMEs and making documentation less rigorous. In addition, efforts should be made to integrate the SME subsector into the Nigerian capital market for improved financial inclusion.

Key Words: *SMEs, Financial Exclusion, Firm Profile, Pecking Order*

1.0 INTRODUCTION

The fact that Small and Medium Scale Enterprises (SMEs) are veritable drivers of sustainable development across the globe is seemingly incontestable given their transformational activities in some of the national economies. SMEs constitute the largest proportion of the businesses world over. History has it that private enterprises, mostly SMEs have been controlling the European economy prior to 19th century (Akogu, 2003). SMEs are no doubt imperative catalysts for employment generation, poverty reduction and economic growth and development. SMEs are lifeblood of most economies. On the average, the subsector constitute over 90% of the enterprises and account for 50 to 60% of employment in most African countries (Ahiawodzi and Adade, 2012). It is also on record that 80% of the Nigerian labour force is employed by SMEs (Adelaja, 2007). In corroboration of this position, Odubanjo (2001) and Usman (2001) cited in Lawal and Ijaiya (2007) also documented that 70% of the industrial sector employment and 60% of the agricultural sector employment are products of the SMEs. SMEs have been described as efficient prolific job creator, the seed of big businesses and the fuel of national economic engine. As a matter of fact, there is a battery of empirical evidence that SMEs occupy a place of pride and their contributory role in the economic growth and development cannot be down played.

Nigerian government at all levels and the concerned private sector have lent credence to the economy-driven potential of SMEs through implementation of various policies, schemes and regulations aimed at building formidable capacity for the sub sector. These include establishment of Small and Medium Enterprises Development Agency (SMEDAN), the defunct Small and Medium Scale Industries Equity Investment Scheme (SMIEIS) Initiative, National Economic Reconstruction Fund (NERFUND), The Nigerian Bank of Industry (BOI), The Bank of Agriculture (BOA), The Agricultural Credit Guarantee Scheme Fund (ACGSF), Microfinance Banks (MFBs), You With Innovation in Nigeria (YOUWIN), the recent disbursement of 220 billion Naira for private entrepreneurship via the Central Bank of Nigeria Entrepreneurship Development Centres in the six geo-political zones to mention just a few. In spite of these policy measures and schemes, the bulk of which are aimed at stemming the finance related problems among SMEs, plethora of literatures still hold that Nigeria SMEs are financially excluded (see Ekpenyong & Nyong 1992; Adewale, 2011; Koko, 2011; Onwukwe & Ifeanacho, 2011; Koko, 2013; Tijani, Oke, Musa & Abdulsalam, 2014). While quantum of SMEs exclude themselves voluntarily, many a number of them are involuntarily excluded. Inability of the SMEs to access finance to pursue new businesses and/or finance expansion could result in their exodus thereby spelling doom on the national economy, viz, undermining their quota contribution to national Gross Domestic Product (GDP). Kwara State is one of the SMEs-clustered States in Nigeria and the state government has been making frantic supportive efforts to build the subsector's capacity by implementing several policies and programmes in that direction (see www.kwara.gov.ng). These policies and programmes include the Grow Enterprise Scheme (GES), the KWSG-MFB partnership, the 250 million Micro-credit Intervention Scheme (MIS), the Kwara Youth Empowerment (KYE), The Kwara Bridge Empowerment Scheme (KWABES), The QUICKWIN Small business scheme among others. One would expect a transformed SME subsector with the governmental policy measures in place, yet the susector's performance and growth are inhibited due to financial exclusion. The thrust of this study is therefore to investigate the sources of involuntary financial exclusion among SMEs in Kwara State of Nigeria that has been adjudged

one of the six poverty ridden states and of course the poorest state in the North Central region of the country (see Gannicott, 2008; Kale, 2014; Ikengawo, 2014).

2.0 LITERATURE REVIEW

2.1 Conceptualization of Small and Medium Scale Enterprises (SMEs)

SMEs constitute the very foundation upon which the large businesses were built (Onakoya, Fasanya and Abdulrahman, 2013). However, SMEs have not enjoyed a universally acceptable definition owing to the fact that the concepts "small and medium" have been identified differently by various individuals and organization such that an enterprise that is considered small and medium in one place is seen differently in another. Even within a country, the definition differs among institutions and often undergoes review and changes over time. In this study, the definition of SMEs contained in the National Policy on MSMEs issued by SMEDAN in the year 2007 has been adopted. The currency of the definition to reflect the current economic condition in the country informed its choice.

Micro Small and Medium Scale Enterprise (MSME) policy by Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) in 2007 has defined Micro Enterprise as one whose total assets (excluding land and buiding) is less than 5 million naira with less than 10 employees, while Small Enterprise has its total assets (excluding land and buiding) to be more than 5 million naira but less than 50 million naira with more than 10 employees but less than 50. Medium scale firms are those having more than 50 employees but not exceeding 200 with total assets (excluding land and buiding) of more than 50 million but not exceeding 500 million.

Table 1: Classification of Micro, Small and Medium Enterprises in Nigeria

Size	Employment	Assets (N Million) (Excluding land and Building)
Micro Enterprise	Less than 10 employees	Less than 5 million
Small Enterprise	10 -49 employees	5 million but less than 50 million
Medium Enterprise	50 -199 employees	50 million but less than 500 million

Source: Small and Medium Enterprises Development Agency of Nigeria (SMEDAN), (2007)

2.2 Involuntary Financial Exclusion: Meaning and Sources

Finance accessibility as essential as it is, has also been suggested as a tool for achieving the different Millennium Development Goals (Claessens and Feijen, 2007). According to Ahiawodzi and Adade (2012:p.44), access to finance has been defined "as the availability of credits from formal sector like financial institutions and also availability of credit from the informal sector like personal savings and family assistance". Based on this definition, access to finance is limited to credit availability and is construed as ability of an enterprise to access it from formal and informal institutions for the acquisition of productive assets that translate to firm performance through efficient utilization. In a broader and more lucid terms, Beck and Demurguc, (2006: p.23) saw access to finance as: "..... the possibility that individuals or enterprises access financial services, including credit, capital market, insurance, and other risk management services" .

Based on this definition, financial access is viewed as transcending trade credit and money market access to include capital market access and various other means of accessing finance including insurance.

However, the moment an individual or enterprise cannot access and use basic financial services in a manner that is reasonably convenient, reliable and flexible then such an individual or enterprise is said to be financially excluded (Adewale, 2011). Financial exclusion as thus been viewed as the existence of price and non-price barriers in the use of financial services (Demirguc-Kunt & Levine, 2008). Financial exclusion may thus be voluntary and involuntary. Elucidating voluntary exclusion, Corr (2006) noted that some self-exclusion barriers exist due to personal, cultural and religious inclinations. These self-induced factors culminate into voluntary financial exclusion of individuals or enterprises. However, Owuallah (2002) and Beck and De la Torre (2006) cited in Adewale (2011: p.2) observed that "when micro-entrepreneurs do not voluntarily exclude themselves financially, other factors relating to financial illiteracy, eligibility and affordability barriers still impede their access to requisite financial resources for micro-entrepreneurial development". These sources of involuntary financial exclusion has further been broken down in the literature to include lack of capital market access, prohibitive loan cost, collateral demand, inadequate business financial records, Risk averse nature of fund providers, information asymmetry, High interest charged among others (Kira & He, 2012; Musamali & Tarus, 2013; Koko, 2013).

2.3 SMEs and the Constraint of Involuntary Financial Exclusion

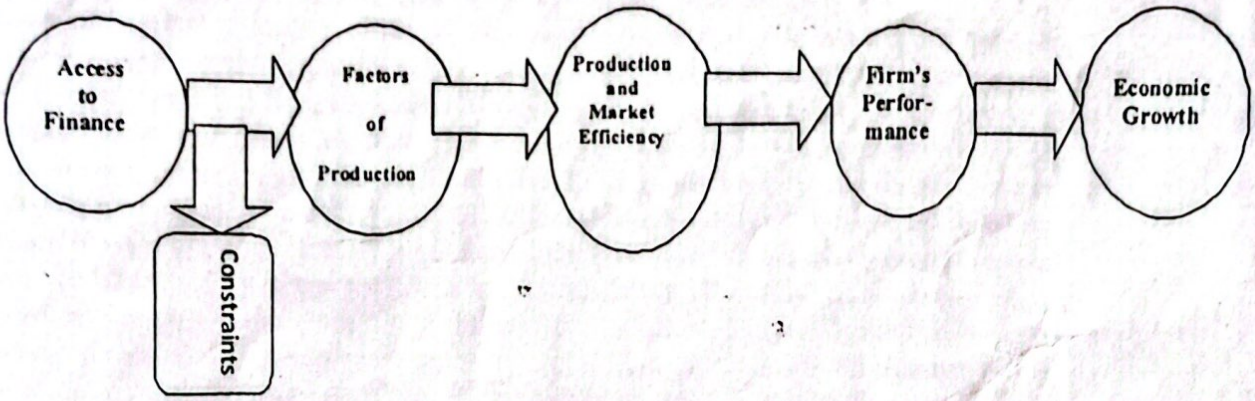
As earlier mentioned, a major constraints bedeviling SMEs world over is in fact, poor or inadequate access to finance. Most of the small enterprises have limited access to capital to pursue new businesses and even expand their already established operations. This major barrier to rapid development of the SME sector is evident in the financial exclusion in terms of their limited access to financing (Evbuomwan, Ikpi, Okoruwa and Akinyosoye, 2013). Accessing finance has been identified as an essential precondition for SMEs to succeed in their drive to build productive capacity, to compete, to create jobs and to contribute to poverty alleviation in developing economies like Nigeria. SMEs especially in Africa hardly meet the conditions set by financial institutions, which adjudged them as risky outlets due to their poor guarantees, inaedquate collateral and lack of information about their ability to repay loans (Koko, 2013). To further reiterate significance of access to finance to SMEs performance, UNCTAD, (2002: p.34) posits that:"Without finance, SMEs cannot acquire or absorb new technologies nor can they expand to compete in global markets or even strike business linkages with larger firms".

A number of factors could be attributed to the refusal of loans and equity fund to SMEs by formal financial institutions including banks. According to Cook and Nisxon (2000), poor management and accounting practices constitute a challenge to smaller enterprises to raise finance. This is coupled with the fact that small businesses are mostly owned by individuals whose personal lifestyle may exert significant influence on the operations and sustainability of such businesses. Consequently, considering their ownership structure, some of these businesses are unstable and may not guarantee returns in the long run. In addition, fixed costs associated with loan appraisal, supervision, and collection is prohibitive to lenders. The implication of this is that lenders prefer to provide larger amounts of credit to large enterprises than small amounts of credit to many smaller enterprises. Another factor that constitutes financial constraint to SMEs

is the inability to raise equity financing from capital market due to their relative si. (Evbuomwan et'al, 2013). According to Kauffmann (2005), access to formal finance is poor because of the high risk of default among SMEs and due to inadequate financial facilities including collaterals, hence, the risk aversed attitude of the banks.

However, Cressy and Olofsson (1997) summarize constraints facing SMEs into two: demand-based (SMEs) and supply-based (formal banks) financial constraints. Supply-side finance constraint, according to them, is regarded as a capital market imperfection that leads to a socially incorrect supply of funds to projects, or the incorrect interest rate charged on funds. Whereas a demand-side financial constraint is construed as a capital market imperfection in which performance of a firm is adversely affected by a factor internal to the firm.

Figure 1: Diagrammatic Model Representation on How Access to Finance Impact Firm's Performance and The Economy



Source: Adapted from Kira & He (2012) with modification.

The diagram illustrates how access to finance enables the SMEs to acquire productive assets (otherwise known as factors of production) that can be used to increase productivity while at the same time reducing the unit cost of production resulting to economies of scale. And *Ceteris paribus*, decrease in unit cost of production tends to generate an increase in profit. As a consequence, performance of SMEs informs economic growth. Olutunla and Obamuyi (2008) cited in Kira and He (2012: p.111) opined that the improved firm's performance ensures higher earnings, increment in sales volume, creation of employment and wealth maximization. However, firm performances can be unattainable if SMEs fail to access debt financing to support their investment opportunities.

2.4 Theoretical Underpinning: The Pecking Order Theory

The concept of optimal capital structure has been expressed based on the notion of asymmetric information (Myers, 1984; Myers and Majluf, 1984). The existence of information asymmetries between the firm and finance providers causes the relative costs of finance to vary among different sources of finance. For example, an internal source of finance where the funds provider is the firm, it will have more information about the firm than new equity holders, thus due to asymmetric information, these new equity holders will expect a higher rate of return on their

investments. This means that cost of issue of fresh equity share for the firm is more expensive than the internal funds. Also in a similar way, this argument could be provided between internal finance and new debt-holders. The conclusion drawn from the asymmetric information theories is that there is a certain pecking order or hierarchy of firm preferences with respect to the financing of their investments (Myers and Majluf, 1984). The pecking order theory states that in the presence of asymmetries of information among the stakeholders; most firms utilize optimal internal sources available to finance their investments before opting to use debt and equity (Myers & Majluf, 1984; Myers, 1984). The theory is suggesting that the firm will initially rely on internally generated funds including retained earnings and personal contribution, in the absence of information asymmetry; they will turn to debt for additional funds, and finally they will issue equity to cover any remaining capital requirements. The relative costs of various financing options are reflected in the order of preferences. According to Myers and Majluf (1984), firms constrained by the presence of asymmetric information, would prefer internal finance sources to costly external finance. Lenders consider the repayment ability of a borrowers by considering the credit worthiness of such firms which is usually linked to their size, age, business forms, industry types etc. However, SMEs are usually perceived to be risky ventures with limited portfolio management skills (Amidu, 2007) and as such are offered less debt capital than larger firms. The size of SMEs usually predisposes them to the problem of adverse selection in consideration for financing by fund providers who often proxy size in inverse proportion to the probability of bankruptcy (Honhyan, 2009; Musamalli & Tarus, 2013). Hence, their belief that SMEs are majorly small-sized may send a wrong signal about their ability to manage debts. The multiplier effect of this is inadequate access to finance or total financial exclusion of the SMEs who are forcefully restricted to insufficient internal financing.

3.0 METHODOLOGY

The study adopts the positivist approach with the use of a survey design. Survey design is "a research technique in which information is gathered from a sample people using a questionnaire" (Tariq, 2009 p.37). In this study, however, the researcher's interest is in studying the perception of respondents - SME owners or managers through the distribution of self-administered copies of questionnaire (involving closed structured questions) on a cross-sectional basis to the selected samples in order to harness information for the purpose of analysis and making useful deduction therefrom. The adoption of questionnaire was informed for the fact that it is acclaimed to be a popular means for primary data collection in both quantitative and qualitative research because of its encouragement on the respondents to give detailed answer within the domain of the questions (Cresswell, 2008). The questionnaire was designed and administered on each of the sampled 170 SME owners or managers out of the total 260 SMEs who are members of Kwara Chamber of commerce, Industry, Mines and Agriculture (KWACCIMA) as at 31st December, 2013. A sample size that ranges between 160 and 170 is considered approximately adequate for a population of 260 (see Krejcie and Morgan, 1970). Stratified sampling method was adopted due to relative homogeneity of SMEs characteristics and the industrial structure of the enterprise under study. In order to enhance a high response rate, respondents' absolute anonymity was guaranteed.

The questionnaire has only three sections. Section 'A' covers demographic information of the respondents ranging from gender, age to higher educational qualification. Section 'B' covers the

Firm specific characteristics where questions involving business forms, industry type, age of the business, business staff strength, asset size and major financing source were raised. In each of the sections 'A' and 'B', nominal and ordinal scales of measurement were used as appropriate. Section 'C' contains questions on sources of financial exclusion among SMEs measured on five-point likert scale ranging from strongly disagree to strongly agree. The normality of the research data informed the choice of One-sample-t parametric statistical test. To ascertain if the instrument used in gathering data was reliable, a Cronbach's Alpha test was conducted. A value of 0.7 to 0.8 was considered an acceptable reliability value for Cronbach's Alpha, values substantially lower indicate an unreliable scale (Field, 2006). Analysis was carried out with the aid of Statistical Package for Social Sciences (SPSS) 16 version.

4.0 RESULTS AND DISCUSSIONS

4.1 Data Presentation

Table 1 presents how the 170 copies of the questionnaire were distributed among the identified classes of SME owners or managers across different industries. 170 copies of the questionnaire had been distributed on the basis of the proportion each industry occupies in the total population using stratified sampling technique. 150 of these, representing 88.2 percent were returned usable while the remaining 18, 10.6 percent were withheld by the respondents. Two (2) copies of the questionnaire (that is 1.2 percent) out of the returned questionnaires were found to be unusable for the analysis due to errors made by respondents in completing them. The response rate of 150 questionnaires was therefore adequate to constitute the sample size for the entire population of 260 SMEs.

Table 1: Presentation of Distributed Questionnaire

Industry	Total distributed	Total returned usable	Total withheld	Total unsuable	Returned usable as percent of total (%)
Agric,Agro-allied& Manufacturing	51	45	5	1	88.2
Trading	82	73	8	1	89.0
Service	33	29	4	-	87.9
Others	4	3	1	-	75.0
Total	170	150	18	2	88.2

Source: Authors' Survey, 2014

4.2 Demographic Characteristics of the Respondents

The socio-demographic characteristics and classification of the 150 respondents in relation to their gender, ages and highest educational qualifications are presented in Table 2. 97 percents of the respondents were male while 53 percent of the respondents were female whose ages range fall majorly within the age group of 41-50 years, a very active and matured group. The percentage distribution of the respondents' educational status shows that majority of them representing 30.7 percent and 29.3 percent hold Secondary School Certificates and B. Sc./ HND certificates, respectively.

Table 2: Respondents' Characteristics

Description	Characteristics	Frequency	Percentage(%)
Gender of Respondents	Male	97	64.7
	Female	53	35.3
	TOTAL	150	100
Age of Respondents	21-30	14	9.3
	31-40	40	26.7
	41-50	78	52.0
	51-60	18	12.0
	TOTAL	150	100
Highest qualification	Primary	7	4.7
	Secondary/Technical	46	30.7
	OND/NCE	21	14.0
	BSC/HND	44	29.3
	M. Sc./MBA	25	16.7
	Others	7	4.6
	TOTAL	150	100

Source: Authors' Survey, 2014

4.3 Firms' Characteristics

Table 3 presents the characteristics of the sampled SMEs in relation to their business form, industry categorization, business age, staff strength, asset size and sources of finance. Analysis of form of business operation reveals that majority of the SME businesses in Kwara State representing 56 percent are being operated as sole proprietorship, 24 percent of the sample businesses are being run as private limited company while 20 percent of the businesses are operated as partnership. Majority of the sampled firms representing 48.7 percent of the entire sampling frame belong to trading industry while 30 percent of the firms are operating in the agric, agro allied, manufacturing and food processing industry. Also, 19.3 percent and 2 percent of the firms belong to service industry and other category respectively. In terms of percentage distribution of SME firms with respect to their years in the business, the survey conducted shows that 20 percent and 44 percent of them have their length of years in business to range between 1-5 years and 6-10 years respectively. Cumulatively, 64 percent of the firms has been in operation between 1 and 10 years which is confirmation that majority of the SMEs commenced their operations not quite long. More so, with respect to staff strength and assets' size, the survey reveals that most of the sampled SME businesses (that is 52 percent) have number of staff that ranges between 10-49 while almost half of them have assets' size that ranges between 5-50 million naira. In addition, the survey indicates that 70 percent of the SMEs rely on informal source of finance (that is, private savings, borrowings from family and friends and retained earnings) while 30 percent of the SMEs had access to formal source of finance (Bank, Insurance, capital market and so on). Overall, the business form, Industry categorization, age of the firms, assets' size and major source of finance actually reflect the characteristics and business operations peculiar to small scale industries as reported by Ekpenyong and Nyong (1992).

Table 3: Firm Characteristics

Description	Characteristics	Frequency	Percentage(%)
Business Form	Sole proprietorship	84	56.0
	Partnership	30	20.0
	Private Limited Company	36	24.0
	TOTAL	**150**	**100**
Industry	Agro-allied /Manufacturing/food	45	30.0
	Trading	73	48.7
	Service	29	19.3
	Others	3	2.0
	TOTAL	**150**	**100**
Age of Firm	1-5 years	30	20.0
	6-10 years	66	44.0
	11-15 years	40	26.7
	16-20 years	13	8.7
	21 and above	1	0.6
	TOTAL	**150**	**100**
Staff Strength	Less than 10	45	30.0
	10-49	78	52.0
	50-199	27	18.0
	TOTAL	**150**	**100**
Asset Size (N'm)	Less than 5	38	25.3
	5-50	74	49.3
	51-200	26	17.4
	200-500	12	8.0
	TOTAL	**150**	**100**
Major Finance Source	Informal	105	70.0
	Formal	35	30.0
	TOTAL	**150**	**100**

Source: Authors' Survey, 2014

4.4 Sources of Involuntary Financial Exclusion among SMEs

Under this subsection, the researchers investigated the sources of involuntary financial exclusion via subjecting the data gathered to a parametric statistical analysis in a way that the hypothesis raised is tested and the research question answered accordingly.

Ho: SMEs encounter no challenges in accessing financial resources for their businesses in Kwara State.

In an attempt to test the above stated hypothesis and answer the research question raised accordingly, a one sample t- test with test value of 3.0 (that is, the cut-off point of the five-point likert scale from strongly disagree to strongly agree) was carried out on all the identified sources of financial exclusion usually encountered by SMEs with the null hypothesis that the population mean is less than or equal to 3.0, and the alternative hypothesis that the population mean greater than 3.0. The p- value that is less than 0.01 indicates that it is highly significant for the population mean of the item to be greater than 3.0 at the 1% level of significant. As shown in Table 4, seven items were identified as major sources of involuntary financial exclusion faced by SMEs, having a mean response ranging from 4.15 to 3.61. The sources which include lack of

5.0 CONCLUSIONS AND RECOMMENDATIONS

The success or otherwise of any business concern depends fervently on its ability to gener finance. Access to finance may make or mar the success of SMEs, hence, the deterrence of th role in the economy at large. This serves as the backdrop against which this research w conducted. Drawn from the research findings, the study concluded that SMEs in Kwara St often encounter poor and/or non access to finance which is occasioned by a number of identifi factors including denial of capital market entry, formal documentation requirements in terms financial records, lenders' collateral request, risk averse nature of fund providers, asymmetr information and prohibitive interest charged on loan. These factors, therefore, culminate in involuntary financial exclusion to the SME operators who are forced to resort to pecking ord financing. The study therefore recommended that fund providers including financial institutio on their part, should de-emphasize enterprise profile and develop a personalized bankir relationship with SMEs via studying the prospect of the SMEs businesses and open more mic credit windows, relaxing some of their seemingly stringent formalities specifically for SMEs an making documentation less rigorous. In addition, efforts should be made to integrate the SM subsector into the Nigerian capital market as this will go a long way in enhancing financi inclusion among the operators. Furthermore, Government should not relent in her interventio role through formulation and implementation of various capacity building and funding policie aimed at empowering and transforming SMEs financially for economic growth and developmen

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