THE ATTITUDE OF SMALL AND MEDIUM INDUSTRIALISTS TO VENTURE CAPITAL FINANCING IN NIGERIA

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ABSTRACT

The principal objective of this paper is to ascertain the extent to which Myers' Pecking Order Theory (POT) of business financing explains the financial structure of Small and Medium Manufacturing Enterprises (SMEs) in Nigeria. The goal is to examine their attitude with regard to the venture capital financing known as Small and Medium Enterprises Equity Investment Scheme (SMEEIS) introduced by the government in 1999. The data employed were from the database of the survey of manufacturing SME's in Nigeria. The findings provide evidence suggesting Pecking Order financing behavior is prevalent among manufacturing SMEs in Nigeria. A small proportion of SMEs that consider equity financing for both business start-up and expansion is found. Hence, equity financing through venture capital has not become as popular as other financing alternative in Nigeria. Debt financing appears to dominate their preference, apart from their personal saving and retained earning. Consequently, the paper suggests policy formulation that will address the mindset of the people and encourage greater commitment of banks to actually undertake promotional activities. Among such activities suggested are the identification, development and packaging of viable industries with enterprising customers, and readiness to provide the complementary services to ensure their success.

INTRODUCTION

In response to limited access to capital by Small and Medium Enterprises (SMEs) in Nigeria, the Central Bank of Nigeria (CBN) adopted an innovative method of financing SMEs through equity financing (that is, venture capital). This action was taken in response to a finding that debt financing was not able to appropriately bear the huge risks that are associated with start-up of SMEs in Nigeria (especially those in the manufacturing sector). Empirical studies have even shown that the incidence of extra outlays required to compensate for deficiencies in the supply of basic utilities (especially in developing countries like Nigeria) is relatively heavier on SME's than large enterprises (Udechukwu, 2003). While such extra investments account for about 10 per cent of the total cost of machinery and equipment of large enterprises, it represents about 20 per cent of that of manufacturing SMEs because of the absence of economies of scale. Moreover, unlike buying and selling, manufacturing SMEs have a long gestation period, which may extend into several years. Therefore, there was a need for more accessible financing for manufacturing SMEs, especially long-term funding, to avoid a fatal mismatch between project gestation and loan maturity.

Consequently, the Bankers' Committee, comprising of all the banks' Chief Executives and CBN, adopted the new initiative in 1999, called the Small and Medium Industries Equity Investment Scheme (SMIEIS), later changed to Small and Medium Enterprises Equity Investment Scheme (SMEEIS). This requires all commercial banks in Nigeria, which make a profit in any financial year, to set aside 10 per cent of their profit before tax (PBT) for equity investment and promotion of SMEs. This funding, to be provided in the form of equity investment in any SMEs that meet guidelines set out by the Committee, will reduce the burden of interest and other financial charges expected under normal bank lending, as well as provide financial, advisory, technical and managerial support from the banking industries (CBN, 2002).

Equity financing of SMEs (through venture capital) is a relatively new tool in economic development, and is largely a response for the failure of many SME lending programs intended to meet the full needs of SMEs' start-up and growth. Most importantly, in an economically depressed environment such as Nigeria, SMEs need more than capital. They also need highly focused, on-going assistance, particularly in a variety of areas including marketing, equipment sourcing and financial controls. But given the absolute limitations of interest rate-based returns, traditional bank lending generally cannot afford, and are not suited to provide such assistance. Therefore, by contrast, an equity investor, as an intimate partner with any investing business, can work with the entrepreneur to address problems and opportunities in the above crucial business areas.

Inspite of this innovative and world-wide financing option, the attitude of Nigerian small and medium scale industrialists to the fund, vis-a-vis foot-dragging by Nigerian banks to invest in SMEs, left much to be desired. This could be seen in the amount of money in the fund which had been invested in the SMEs since its commencement in 2000. Out of a total amount of ₦38.34 billion set aside by eighty two (82) banks as of September 2005, only about ₦10.54 billion (representing about 27.5 per cent of the total amount set aside) was reported invested by fifty six (56) banks in 173 SMEs projects (CBN, 2006).

The principal objective of this paper is to ascertain the extent to which the perceived attitude of the small and medium industrialists to this new financial structure financing in Nigeria, is explained by the Myers' Pecking Order Theory (POT) of financing amongst the manufacturing SMEs in Nigeria. Based on the foregoing objective, the paper seeks to address the following questions: 1. How valid is the Pecking Order Theory to the SMEs in Nigeria? 2. What is the general attitude of SME operators to venture capital financing? 3. What are the challenges of operationalizing the venture capital financing through SMEEIS in Nigeria? In effort to achieve this, the paper is divided into five sections. Section 1 is the introductory part, section 2 establishes the theoretical framework of equity financing in manufacturing SMEs and the prior research on the POT (as it applies to SMEs). The research method is outlined in section 3, thereafter; the findings of the research are presented in section 4, followed by a section containing some concluding comments.

THEORETICAL FRAMEWORK Of EQUITY FINANCING IN MANUFACTURING SMEs

A number of articles examine the extent to which theories of financing appear to explain the financial structure of business concerns. Pettit and Singer (1985) argued that business firms of all sizes select their financial structure in view of the cost, nature, and availability of available financial alternatives. They also posit that the level of debt and equity in a small firm likely a function of firm and manager. Levin and Travis (1987) provide support for this view, suggesting that in a private corporation, leverage theory does not always apply. Hence, the owners' attitude towards personal risk determines the amounts of debt and equity that are acceptable.

McMahon Holms Hutchison and Forsaith (1993) reasoned that given the initial failure of modern finance theory to provide normative and practicable guidance on making financial structure decisions in business generally, and particularly in small enterprises, a positive theory is necessary. The absence of a widely accepted normative theory of financial structure for business enterprises thus led to the theory of business financing provided by Myers (1984), which is known as Pecking Order Theory (POT). In summary, the theory states that businesses adhere to a hierarchy of financing sources and prefer internal financing when available. If external financing is required, debt is preferred over equity. POT has become one of the more popular theories of capital structure. Information asymmetries suggest that external financing is more expensive than internal financing. Financiers add a risk premium to cover their information disadvantage. Signaling theory supports a preference for debt over equity if external financing is sought. Agency problems also increase the cost of external financing as monitoring and bonding costs are incurred in the process of seeking external financing.

Scherr, Sugrue and Ward (1993) and Hall Hutchinsom and Michaelas (2000) apply the POT to the capital structure of SME's. They argue that the closed nature of SMEs makes information asymmetry and agency costs more onerous than for other firms. This accentuates the pecking order theory pattern for SME financing decisions. Suggesting that theoretically, small enterprises as a whole would prefer internal financing, as external financing is either more costly or more difficult to obtain due to the impacts of bankruptcy costs, monitoring or other agency costs and greater information asymmetries (Pettit and Singer, 1985).

The rationale for SMEs owners financing decisions may be somewhat different from those of larger enterprises, even if the pattern is consistent with the prescriptions of the pecking order theory. The strong desire for control on the part of most SME owners makes the preference for internal finance and the aversion to external equity finance, in particular, much stronger for SME financing decisions than for larger enterprises (Holmes and Kent, 1991). The application of the pecking order theory to SMEs is, therefore, somewhat constrained. Ang (1991) argued that in order of preference, new equity contributions from the owners of a small enterprises' rank just behind retained earnings and ahead of debt financing. SMEs may also prefer debt to equity when seeking external funding because they are more familiar with banks and other sources of debt financing (KPMG Consulting, 2002).

The stage of the firm's life-cycle on capital structure was examined by Scholten (1999) by applying the pecking order theory to SME financing. It was noted that younger firms, which are generally smaller firms, are less likely to generate sufficient retained earnings from internal sources to adequately finance an expansion of operations. This is because retained earnings are more readily available for more mature firms; hence capital structure will vary over the life cycle of the small enterprise (Ang 1991).

An additional factor impacting the financing structure of SMEs is the limited availability of certain sources of funding to SMEs. External equity finance in the form of venture capital is generally unavailable to SMEs without strong growth prospects. This includes both venture capital funds and wealthy individual investors known as business angels. Widespread access to external equity through public listing on a stock exchange is unavailable until the firm is relatively large and is able to meet the minimum size listing requirements. For most SMEs, the only feasible source of external equity funding is from relatives and friends. This further constrains the applicability of the pecking order theory to SMEs.

However, on the other hand, some authors suggest that, since the SMEs sector is mostly a heterogeneous sector, it may be difficult sometimes to generalise POT across all SMEs. Barton and Mathews (1989) emphasized that the management structure of the SMEs can affect the capital structure decision. Certain authors found that capital structure in some SMEs depends on the risk-taking propensity and objectives of the owner-managers and on the responses of potential funding providers to the special circumstances and requirements of the owner-managers (McMahon *et al*, 1993). Matthews Vasudevan Bartan and Apana (1994) argued that small enterprise owners have a range of different attitudes towards debt financing depending on their risk propensity, desire for control, experience and wealth.

Additional sources of finance availability to growing SMEs, coupled with the different objectives and aspirations of the owners of these enterprises, may lead them to make different financing decisions from the traditional SME which has, at most, capped growth objectives. In particular, growing SMEs may take no more external equity finance and may be less highly levered than many non-growth enterprises (Forsaith and McMahon, 2003).

The desire for growth, in some SMEs was also identified by some authors, explains capital structure. They find that many small enterprises forego growth when this would lead to loss of control (Hakim, 1989; Davidson, 1989). Cressy and Olofsson (1997b) found that aversion to new owners in incorporated firms in Sweden was stronger in manufacturing firms than in the services sector and was even present amongst growth aspirants. Cressy and Olofsson (1997a) also noted that firms with limited or no growth aspirations are unattractive to providers of equity capital as they would not offer the rates of return required by investors.

The foregoing arguments suggest that internal equity, through capital contribution and retained earnings, is expected to be the major source of SME funding. Meanwhile, external equity is relegated to a minor role. Non-growth SMEs avoid growth, and growth SMEs, comprising a small minority, may be unable to attract as much external equity as they might want, thereby limiting their growth potential.

Prior Research on Pecking Order Theory (POT) for Manufacturing SMEs

Initially, the POT sought primarily to explain the observed financing practices of large publicly traded corporations. However, in time researchers recognized that the theory is also applicable to the financing practices of non-publicly traded SMEs that might not have the additional financing alternative of issuing external equity finance. Scherr *et al*. (1993) considered the POT to be an appropriate description of SMEs' financing practices, because the Pecking order hypothesis suggests that debt is by far the largest source of external finance for small businesses. Holmes and Kent (1991) noted that in most SMEs, Managing Directors are usually the owners of the business; hence they do not normally want to dilute their ownership claim. Thus, the issue of external equity financing, and the consequential dilution of ownership interest, may be further down the pecking order. The theory's application to SMEs implies that external equity financing issues may be inappropriate. In relation to the owner-manager's control over operations and assets, if the POT holds, then internal equity finance will be preferred, because this form of finance does not surrender control. When external financing is required, obtaining debt rather than equity finance is favored, because this places fewer restrictions on the owner-manager.

Norton's support for the application of the POT to SMEs is evident in his assertion that "contrary to financial theory, factors dealing with bankruptcy costs, agency costs, and information asymmetries play little role in affecting capital structure policy. Rather, the financial officers seem to follow a 'pecking order' in financing their firm's needs" (Norton, 1991). Hall *et al*. (2000) argue that the information asymmetry and agency problems arising between owner-managers and outside investors providing external finance which give rise to the POT are 'more likely to arise in dealing with small enterprises because of their "close" nature, that is, being controlled by one person or a few, related people, and their having fewer disclosure requirements'.

Since the POT is pertinent to both SMEs and large enterprises, the theory may therefore explain the observed differences between SMEs and large enterprises' financial structures. Holmes and Kent (1991) explain that the application of the POT to SMEs is constrained by the following two factors:

(i) Small firms usually do not have the option of issuing additional equity to the public.
(ii) Owner-managers are strongly averse to any dilution of their ownership interest and control. This is in contrast to the managers of large firms who usually only have a limited degree of control and often have limited, if any, ownership interest, and are therefore prepared to recognize a broader range of funding options.

Fama and French (2000) however reason that there is possibility of modifying the financing pecking order for growing SMEs. This could arise because of owner-managers' attitudes to the option of raising external equity, and to any dilution of their control. Thus, the theory may explain the observed differences between SME's and growth SME's financial structures.

Venture Capital Financing in Developing Countries

In developing countries venture capital funds have become an important source of financing for SMEs, which often have difficulty raising long-term financing because of underdeveloped capital markets (Aylward, 1999). Experience over the years shows that developing countries pose special challenges for venture capital funds because of the weak institutions, and legal and regulatory frameworks which do not adequately support enforcement of contracts with the enterprises in which they invest (IFC, 1997). In addition, many entrepreneurs and smaller companies do not want to give up control and fear the consequences of venture capital investment but are willing to take that step to "grow" their company to the next level (World Resources Institute, 2006).

In spite of the above however, the volume of venture capital finance in developing countries has followed a steeply rising trend in recent years, with longer a history in Asia (Aylward, 1999). The distribution of investment is usually toward expansion and mezzanine financing. Compared to venture capital funds in industrialized countries, venture funds in developing countries are invested, to a greater extent, in private debt securities of portfolio companies**.** According to the study by the International Finance Corporation, the two largest sources of formal venture capital in developing countries are non-financial corporations and banks (IFC, 1997). Also, the consumer goods and industrial products industries are the biggest recipients, and most venture capital investment is in form of ordinary equity.

One challenge, noted by World Resources Institute (2006), is the presence of a strong stock exchange. A strong stock exchange is required for the development of venture capital financing in developing countries The developed stock exchange provides and important exit for a venture capital fund to "realize" their investment gains. Other exit options such as strategic purchases or management buybacks are difficult to structure, detailed and time consuming.

Model of Central Bank of Nigeria Venture Capital

The SMEEIS, which is a development venture fund, is a voluntary initiative of the Nigerian Bankers' Committee. The fund, set aside by participating banks, is to be invested in the form of equity, either in form of fresh cash injection and/or conversion of existing debts owed to participating investment. However, an upper limit of 40 per cent equity funding by banks applies. In addition investment is subject to a maximum amount of ₦200 million in any enterprises. Also, **c**o-investment by different banks is allowed subject to the maximum limit of 40 per cent. The banks may operate the scheme directly through their wholly owned subsidiary venture capital companies or through venture capital companies floated by consortia of banks.

For the purpose of the scheme, a small and medium enterprise is defined as any enterprise with a maximum asset base of ₦500 million (excluding land and working capital), and with no lower or upper limit of staff (however subject to review). To be eligible for equity funding under the Scheme, a prospective beneficiary (SMEs) must be a registered limited liability company, comply with all applicable tax laws and regulations; and engage or propose to engage in any legal business activity, however with the exception of trading/merchandising and financial Services.

RESEARCH METHODOLOGY

The data for this paper were drawn from the baseline economic survey of the manufacturing SMEs conducted in 2004 by the Centre for Industrial Research and Development, Obafemi Awolowo University, Ile-Ife and other universities in different zones in Nigeria. The survey, which was conducted on behalf of Central Bank of Nigeria (CBN), concentrated on the existing manufacturing SMEs in Nigeria. The enterprises were stratified into small and medium scale based on the number of persons employed. That is, enterprises employing between 10 and 50 persons were regarded as small scale, while those engaging between 51 and 300 persons were considered as medium scale.

The survey employed a purposive sampling of the SMEs engaging in manufacturing activities. Thus, the Manufacturers Association of Nigeria (MAN) classification of manufacturing activities was adopted with some modifications. These include Food, Beverages and Tobacco, Textiles, Wearing Apparel and Leather products, Wood and Wood Products, Pulp, Paper and Paper Products; Chemical and Pharmaceutical Products, Non-Metallic Mineral Products, Electrical and Electronics, Basic Metal, Iron and Steel and Fabricated Metal Products, Motor vehicle and Miscellaneous Assembly, Plastic and Rubber Products, Information and Communication Technology and Solid Minerals/Processing.

Data were collected through self-administered, structured questionnaires containing essentially closed-ended questions designed to cover issues such as the characteristics of SMEs, production inputs and technology, infrastructure, capital and investment, production capacity, cost structure, growth potential and marketing activities, organization and management, and government policy environment. A sampling frame was compiled for each state in each of the zones covered through documents collected from the Commissioners in charge of Chamber of Commerce and Industry, State branches of MAN, Chambers of Commerce, Industry, Mines and Agriculture, and the National Association of Small Scale Industries.

RESEARCH FINDINGS

A total of 6,344 questionnaires were administered to operators of these manufacturing SMEs in the entire country. Out of these numbers, 4,462 completed questionnaires, representing 70.3 per cent, were retrieved. The relevant results to this paper are discussed below. The data analysis employed was mainly descriptive, that is, percentages and cross tabulations.

Characteristics of the Responding SMEs

The survey indicated that most of the responding firms were in business from 1 to 30 years, with mean value of 5 years. Therefore, on the average the responding firms are relatively new. From Table 1, a total number of 4,185 firms were in the small scale category, while 277 were in the medium scale category. Thus, the bulk of the responding firms (93.8 per cent) in all the zones in Nigeria were small scale firms.

Table 1: Distribution of Responding Firms by Major Line of Business and Size

Sector	**Small Firms**		**Medium Firms**		**Both Firms**	
	No	**Percent (%)**	**No**	**Percent (%)**	**No**	**Percent (%)**
Food Beverages & Tobacco	1271	30.4	65	23.5	1336	29.9
Textile, Wearing Apparels etc	567	13.5	12	4.3	579	13.0
Wood & Wood Products	815	19.5	34	12.3	849	19.0
Pulp, Paper & Paper Products	107	2.6	20	7.2	127	2.8
Chemical & Pharmaceutical Products	91	2.2	34	12.3	125	2.8
Non-Metallic Mineral Products	55	1.3	4	1.4	59	1.3
Plastic & Rubber Products	54	1.3	32	11.6	86	1.9
Electrical and Electronics.	24	0.6	4	1.4	28	0.6
Basic Metal, Iron & Steel & Fabricated Metals	738	17.6	32	11.6	770	17.3
Motor Vehicle & Miscellaneous Assembly	32	0.8	5	1.8	37	0.8
Information & Communication Technology	45	1.1	4	1.4	49	1.1
Solid Mineral, Mining (Processing)	65	1.6	13	4.7	78	1.7
Other (Specify)	321	7.7	18	6.5	339	7.6
Total	4,185	100.0	277	100.0	4462	100.0

Source: Field Survey, 2004

Table 2 indicates that, in all the zones, the small and medium scale firms were owned mostly by Nigerians (the proportion of Nigerian ownership ranged from 73.8% in North-West Zone to over 95.0 % in other Zones). Table 3 shows that over 40 per cent of the responding manufacturing SMEs were sole proprietorships (family business), while about 30 per cent were limited liability companies, 12 per cent were partnerships and 7 per cent were cooperatives.

Table 2: Analysis of Ownership Structure

Zone	Percentage Ownership (%)	
	Nigerian	Foreign
North-West	73.8	26.2
North-east	99.4	0.6
North-Central	99.4	0.6
South-West	97.6	2.4
Lagos	95.3	4.7
South-south	98.8	1.2
South-East	66.2	33.8

Source: Field Survey, 2004

Table 3: Percentage Distribution of Responding Firms by Legal Status and Major Line of Business in Nigeria

Major Line of Business	Sole Proprietorship	Partnership	Cooperative	Limited Liability	Others
Food Beverages and Tobacco	52.1	10.3	3.8	31.5	2.3
Textile, Weaving Apparels, etc.	49.8	13.9	4.3	29.7	2.3
Wood & Wood Products	47.7	15.7	4.9	29.8	1.9
Pulp, Paper and Paper Products	46.3	5.8	5.3	33.3	9.3
Chemical & Pharmaceuticals	46.4	12.8	4.0	36.8	-
Non-Metallic Mineral Products	36.8	9.1	17.9	29.1	7.1
Plastic & Rubber Products	25.6	8.1	-	58.1	8.2
Electrical & Electronics	41.8	14.0	16.7	27.5	-
Basic Metal, Iron & Steel & Fabricated Metals	45.0	9.1	7.0	30.0	8.9
Motor Vehicles & Miscellaneous Assembly	57.1	17.1	-	25.8	-
Information & Communication Technology	36.3	15.0	3.6	45.1	-
Solid Minerals, Mining (Processing)	40.1	13.6	7.7	38.6	-
Others (specify)	58.6	6.7	4.3	28.6	1.8
Total (Average)	44.9	11.6	7.2	31.1	5.2

Source: Field Survey, 2005

Preference of the Responding SMEs for Start-up Capital

The distribution of the manufacturing SMEs by sources of investment or start-up capital is shown in Table 4. Examination of this table indicates that very small proportion of the proprietors ever gave consideration to equity financing (SMEEIS). Only a small percentage of the small scale industrialists (between 1 and 2 per cent) indicated willingness to source the start-up capital from the SMEEIS fund, while none of the medium scale industrialists ever considered the fund. The exceptions, among the medium scale industrialists, were those from Lagos/Ogun zone. In this zone, 8.5 per cent of the industrialists indicated willingness to use SMEEIS fund. The reason for this could be explained by the industrialists' high awareness of the importance of equity financing. This may be because the zone has the highest concentration of industries in Nigeria and the SMEs associations in this zone are very active in mobilizing and educating their members about the fund.

The major preference of the industrialists (among the small and medium scale) for start-up capital was personal saving (40 – 70 per cent), loans from relatives/friends (12 – 25 per cent), and loans from banks (10 – 20 per cent).

Table 4: Percentage Distribution of SMIs by Sources of Invested Capital Across the Zones

Zone	Source of Invested Capital													
	Small Scale Industry (%)							Medium Scale Industry (%)						
	Personal savings	Loans- friends	Loans-Bank	Loans -Govt. Agency	Funds- SMEEIS	Equipment Leasing	Loans- Cooperative	Personal savings	Loans- friends	Loans-Bank	Loans from Govt. Agency	Funds- SMEEIS	Equipment Leasing	Loans- Cooperative
North Central Zone	70.4	12.9	9.2	2.1	0.6	1.1	4.4	48.7	11.5	5.3	3.8	0.0	0.0	0.0
North West Zone	54.3	7.2	20.8	5.8	1.1	3.0	4.3	34.1	0.0	6.4	15.4	0.0	0.0	0.0
North East Zone	74.6	11.0	6.0	10.7	0.0	0.6	1.3	NA	NA	NA	NA	NA	NA	NA
South West Zone	88.7	2.7	5.4	0.6	0.6	0.6	2.5	51.2	0.0	29.1	3.8	0.0	0.4	0.0
South East Zone	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
South South Zone	57.9	28.3	6.1	2.1	2.2	3.2	4.4	48.1	29.0	44.8	0.0	0.0	9.1	0.0
Lagos/Ogun Zone	48.1	25.4	12.6	0.4	0.3	3.2	7.9	23.3	9.8	33.0	9.8	8.5	4.5	3.9

Source: Field Survey, 2004

Preference of Responding SMEs for New Investible Funds for Expansion

Table 5 shows the percentage distribution of respondents by the sources of investible funds for expansion. The situation was not quite different from their preference for start-up capital. However, within the small scale category, about 24.2, 22.6 and 15.1 per cent of the industrialists from North Central, Lagos/Ogun, and South East zones respectively indicated their preference for SMEEIS fund for expansion. The reason for higher percentages could also be explained by the level of industrialization in these zones. The zones are the most industrialized parts of Nigeria with highly enlightened industrialists and well organized associations. But generally, larger percentages of these industrialists still preferred retained earnings (26 – 72 per cent), followed by loans from banks (11 – 50 per cent) and friends/relatives (5 – 30 per cent).

Enterprise Size and Equity Financing

Taking the two tables together, the data indicated that there is not much difference in the preference of the industrialists, both in the small-sized and medium-sized categories. The finding holds for both start-up and for expansion projects. That is, the majority of small-sized industrialists indicated personal saving as their source of financing for start-up and retained earnings as the source of investible fund for expansion. The same situation applied to the medium-sized industrialists. However, there were a few exception industrialists in the industrialized parts of Nigeria.

Table 5: Percentages Distribution of SMIs by Sources of Investible Funds for Expansion

Zone	Source of Invested Capital													
	Small Scale Industry (%)							Medium Scale Industry (%)						
	Retained Earning	Loan from Friends/Relative	Loans-Bank	Loans -Govt. Agency	Funds- SMEEIS	Equipment Leasing	Loans-Cooperative	Retained Earning	Loan from Friends/Relative	Loans-Bank	Loans -Govt. Agency	Funds- SMEEIS	Equipment Leasing	Loans-Cooperative
North Central Zone	72.4	30.7	50.0	21.4	24.2	21.5	39.8	21.1	1.8	0.0	0.0	1.5	7.7	0.0
North West Zone	16.4	4.4	3.9	0.8	1.6	2.2	1.2	11.3	0.3	2.6	2.6	0.0	0.0	0.0
North East Zone	12.1	6.5	1.5	4.8	0.4	0.4	0.7	NA	NA	NA	NA	NA	NA	NA
South West Zone	79.8	13.6	20.0	4.7	5.4	8.2	24.6	57.8	2.5	4.6	0.1	2.0	8.2	15.0
South East Zone	78.0	25.9	48.1	33.4	15.1	20.0	23.5	10.8	20.7	16.2	36.3	31.1	38.2	38.8
South South Zone	26.5	13.0	11.3	7.6	5.3	0.3	2.6	NA	NA	NA	NA	NA	NA	NA
Lagos/Ogun Zone	39.0	5.7	17.5	0.0	22.6	2.4	3.8	NA	NA	NA	NA	NA	NA	NA

Source: Field Survey, 2004

The findings on the use of venture capital for start-up and/or expansion corroborate the findings of Berger and Udell (1998) for USA and Cressy and Olofisson (1997b) for Sweden. Berger and Udell (ibid) found that angel financing (3.6%) and venture capital (1.85%) were minor providers of funding to U.S.A. enterprises. Also, Cressy and Olofisson (ibid) found that formal venture capital funds were not favored as equity partners by Swedish manufacturing firms. These firms felt that the time horizons of the funds were too short and that their demands were unreasonable. Equally important to this study is the findings of Forsaith and McMahon (2003) on the longitudinal survey conducted on manufacturing SMEs in Australia. The conclusion of the study was that only a small proportion of SMEs ever undertake new equity financing, suggesting that this is not a popular financing alternative. Also, most SMEs are predominantly closely-held concerns with controlling interests in the hands of working owners, and any new equity financing is been undertaken in a manner that maintains this situation.

SUMMARY, CONCLUSION AND POLICY RECOMMENDATION

This paper examines capital structure of Small and Medium Sized Manufacturing Enterprises in Nigeria. The key findings of this research, as revealed in this survey, are summarized as follows: 1) A majority of the responding manufacturing SMEs are relatively new and small sized, 2) Ownership is primarily Nigerian and ownership is primarily as a sole proprietorship and 3) Debt financing appears to dominate their preference, apart from their personal saving and retained earning.

There is an evidence broadly suggesting Pecking Order financing behavior among manufacturing SMEs in all the zones in Nigeria. This is shown from the small proportion of these firms that considered equity financing through venture capital, either as start-up capital or for expansion. Moreover, the size and legal structure of the responding firms could equally explain the reason for this behavior. The majority of these firms are small and sole proprietorship (or family business), hence they might be unwilling to dilute the ownership of the business so that they can maintain control over operations and assets.

However, it is worth noting here, that equity financing, through venture capital, is relatively new in Nigeria, hence there is possibility that the industrialists had not been well enlightened about the benefits of this form of financing. Inspite of the newness of the scheme, however, the preference of the industrialists, after four years of its implementation, suggested that the capital structure decisions of SMEs in Nigeria follows the Pecking Order Theory. That is, they prefer internal financing, and if external financing is required, debt is preferred over equity.

There is no doubt that venture capital financing, through SMEEIS, is an innovative way of financing the real sector of the economy in Nigeria, hence care should be taken to insure that success is not be undermined by faulty implementation. Therefore, the policy of the government should be directed at re-orientation of the mindset of both the SMEs promoters and the bank officials.

There should be more and constant enlightenment programs directed at educating program participants about the concepts and benefits of venture capital for business financing, especially for the SMEs. The orientation of both the industrialists and banks needs to be changed to have the right motivation, and demonstrate what can be gained if they nurture their projects to success. Doing so will create wealth for the benefit of national economy and succeeding generations of Nigerians who will depend on the project for their living. This can be conveniently achieved when they are ready to "become small fish in the large water rather than being a large fish in very small water".

Finally, it should be noted that equity investment by banks can only form a part of the financial package of manufacturing SMEs. Consequently, the scheme cannot succeed in its objective if SMEs promoters do not provide additional equity contribution. It is therefore suggested that the Bank of Industry (BOI) should be instructed to provide long-term loans to the SMEs promoters, once the project ideas had been thoroughly appraised and viability ensured. This will give the opportunity to the promoters of manufacturing SMEs to meet their equity contribution and maintain higher ownership control.

As expected in the guidelines for the Scheme, in addition to providing financing, the banks are also expected to undertake promotional activities, which include the identification, development and packaging of viable industries with enterprising customers. Therefore, a policy should be implemented to encourage the bank to willingly accept these responsibilities.

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