

VENTURE CAPITAL FINANCING AND GROWTH OF SMES IN RIVERS STATE

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ABSTRACT

The study examined the nexus between venture capital financing and growth of SMEs in River State. The correlational design within a quantitative method was adopted; the population comprised of 2,596 SMEs in Port Harcourt, Rivers State. A sample size of 310 was drawn from the population using Krejcie and Morgan (1970) table. The simple random sampling was adopted and the data were gathered using copies of questionnaire which were personally administered to respondents. The reliability test was tested using the Cronbach Alpha method with the aid of Statistical Package for Social Sciences (SPSS) version 23, and it was 0.78, which is higher than the benchmark of 0.7. 5 items were used in measuring each of the variables and the item were given on a 5-point likert scale ranging from strongly disagree, disagree, agree, neutral and strongly agree. The Spearman Rank Order Correlation was used in testing the stated hypotheses. From the foregoing analysis, it is evident that venture capital financing showed a significant relationship with growth of SMEs in River State. The empirical results of this study confirmed this as a positive and significant relationship was found between debt financing and market share growth of SMEs in River State; equity financing and market share growth of SMEs in River State. It was concluded that venture capital financing is a significant predictor of growth of SMEs in River State via equity financing and debt financing. In line with the analysis and conclusion, the study recommends that: Given that the role of equity financing is key to the growth and survival of any firm; venture capitalist should make available equity financing for SMEs and venture fund managers should periodically assess SMEs under their control to determine the state of debt management ability. This will enhance profitability and performance of small and medium scale enterprises.

Keywords: venture capital financing, debt financing, equity financing and growth of SMEs.

INTRODUCTION

The performance of SMEs is very important to the growth of any nation, Venture capital though a new concept in Nigeria has been existing in developed countries for years now, it has been known to add great value to the economic growth. It enhances the growth of SMEs by providing the needed capital and taking part in the management of the business. Venture capital (VC), according to Gompers and Lerner (as cited in CVCA, 2009), is an independently managed, dedicated pool of capital that focus on equity or equity-linked investments in privately held, high-growth companies. It is designed to provide medium to long term investment funds to small businesses. Venture capital is particularly necessary as an alternative finance to help SMEs set up and expand their operations, develop new products, invest in new stuff or production facilities and mobilize resources for more productive use including acquisition of technology and fixed assets, and meeting working capital requirements (OECD, 2006). In the developed economies, like the United States of America, United Kingdom, Canada, Australia and Japan, venture capital has been an important contribution in economic development. Thousands of companies in the Information and Communication Technology (ICT) sector like Apple Computers, Microsoft, Intel, Cisco, Genentech, Google, Yahoo and Netscape as well as a number of successful service companies such as eBay, Starbucks and Staples exist today because of the support provided by venture capital (Elsiefy, 2013; Timmons & Spinelli, 2009).

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Result from European Venture Capital Association (2001), reveals that SMEs that are financed by venture capital added up to 46 jobs to the Nigeria economy. However, in River State, the funding and utilization of venture capital is relatively low and its impact is greatly unnoticed. This research therefore, is an attempt at investigating the nexus between venture capital financing and growth of SMEs in River State.

Statement of the Problem

Financial capital problem is one of the major issue facing SMEs in Rivers State. This has caused stagnation to their growth and development. Nearly 80% of Small and medium enterprises are restrained as a result of poor financing and other associated problems. The problem of financing SMEs start from the accessibility of funds. There are certain factors recognized as responsible in preventing accessibility of funds that are severe conditions set by financial institutions, lack of adequate collateral and credit information and cost of accessing funds. Studies consider that the capital shortage difficulty related to the small firm sector is partly one, which stems for the uneconomic deployment of available resources by the owner-managers. In line with the aforementioned problem, this study was birthed to examine the nexus between venture capital financing and growth of SMEs in River State.

Aim and Objectives of the Study

The main aim of this study is to assess of venture capital financing and growth of SMEs in River State. The specific objectives are as follows:

- i. examine the relationship between equity financing and market share growth of SMEs in River State.
- ii. ascertain the relationship between debt financing and market share growth of SMEs in River State.

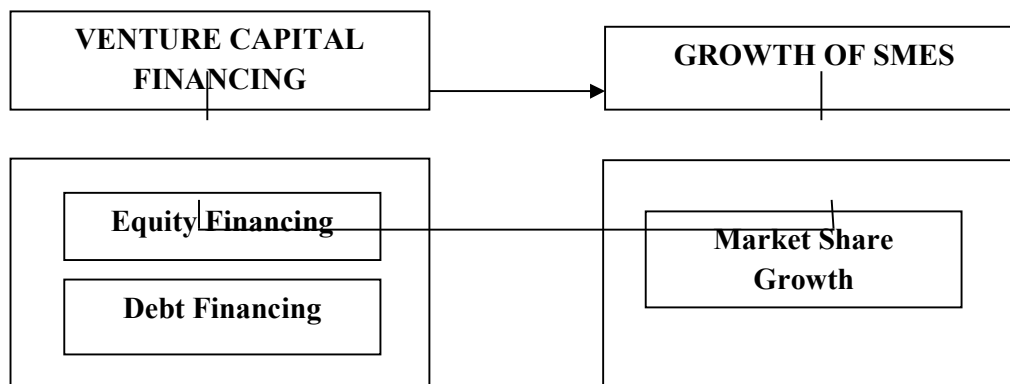


Fig.1.1: conceptual framework of venture capital financing and growth of SMEs.

Source:David et., al., (2020); Daibi&Walter (2009).

Research Questions

In order to address the objectives of the study, the following research questions were raised:

- i. To what extent does equity financing relate to market share growth of SMEs in River State?
- ii. To what extent does debt financing relate to market share growth of SMEs in River State?

Research Hypotheses

In order to address the objectives and research questions, the following hypotheses were formulated and tested:

Ho₁: There is no significant relationship between equity financing and market share growth of SMEs in River State.

Ho₂: There is no significant relationship between debt financing and market share growth of SMEs in River State.

Review of Related Literature

Concept of Venture Capital

According to Abereijo and Fayomi (2005), venture capital involves the provision of investment finance to private or medium companies in the form of equity or quasi-equity instrument not traded on recognized stock exchanges. They argued that it is a long-term risk finance where the primary return to the investor is derived from capital gain rather than capital income. Willam (2004) affirms that it is a funding institution that is quite different from the traditional way of financing. By this, he means that they can be viewed as follows, they are: investors who provide fund to new and promising enterprise; they provide fund for startup and emerging firms without demanding for collateral; it's an investment that requires a higher rate of output so that the business can stand within three to seven years period before public offer may be made etc.

Dagogo and Ollor (2009) opined that venture capital is a type of equity finance involving investments in unquoted companies with growth potentials. According to them, it is generally a medium to long term investment in exchange for a stake in a company. As a result, venture capitalist place emphasis on the support they offer start-ups and the controls they might be granted as well as the exit strategy available. However, Guillermo (2002) argued that venture capital is a form of financing in which investors do not purchase a stake in a going concern but support the creation and development of new companies through investments from the very early stages of business development through the launch of a company.

Equity Financing

Equity financing is thought to be a source of financing that corporation raise capital by trading the stocks to investors, and take over the ownership rights in the company. In line with Ou & Haynes, (2006) said that "equity capital is that capital licensed within the firm without a particular date of refund, where the provider of the fund is proficiently funding the enterprise" Meanwhile, equity finance could be considered as one of the best method suitable for funding small business enterprises especially those that have high portfolio risk and return, seeking long-term corporate investment for expansion, enduring innovation and worth creation. Equity financing is most popular over debt finance, as debt finance is expensive, not appropriate for short-term and troublesome to access.

Concept of SMEs' Growth

This refers to growth in SMEs in terms of changes or improvement in every aspect of its operations whether quantitative or qualitative. In academic literature, there are many definitions of growth. Perenyiet., al., (2008) stated that growth can be defined from two different angles: (i) as increase of size and other quantifiable measures, and (ii) as a process of changes or improvement. Robbins (as cited in Lu, 2006) also defined growth as improvement in the operation of an organization including more revenue, increase staffing and market share. This implies growth in sales or turnover, earning profits, growth in productivity, avoiding losses, being cost efficient, surviving in the market, or performing well compared to competitor (Woldieet., al., 2008).

Theoretical Review

This study is anchored on Agency Theory

This theory refers to the fulfillment of the main objective of financial management, namely maximizing shareholder wealth. Shareholders as owners of the company are called principals. Maximization of principal wealth will be handed over to parties who are considered professional to manage the company. The professional party in the company is referred to as management, which in agency theory is referred to as an agent (Jensen &Meckling, 1976).

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Agency theory is grouped into two, namely positive agent research and principal-agent research. Positive agent research focuses on identifying situations where the agent and principal have conflicting goals and limited control mechanisms only maintain the behavior of self-serving agents. Exclusively, this group only pays attention to the conflict of objectives between the owner (stockholder) and the manager. On the other hand, principal-agent research focuses on the optimal contract between behavior and outcomes, emphasizing the relationship between principal and agent. Agency conflicts between managers and shareholders will result in agency costs. Therefore, it is necessary to have parties who can carry out the process of monitoring or monitoring the activities carried out by these parties.

Relevance of the Theory

This theory is relevant in the sense that the theory sees SMEs owners as agent and Shareholders as financiers of the firm. The Shareholders are the ones that act as venture capitalist by providing the necessary resources to run the firm.

Empirical Review

Mboto et., al., (2018) carried out a study on venture capital financing and the growth of small and medium scale enterprises in CalabarMetropolis, Cross River State, Nigeria. The exploratory research design was utilized. In the study, a non-probability sampling method (purposive) was used. Using the Yamane formula, a sample of forty (40) SMEs from among the SMEs in Calabar metropolis was selected. The manager, accountant or account officer and secretary were purposively selected and included in the sample. Information were gathered with the utilization of organized solid and approved polls. An aggregate of 120 polls were directed, however 80 recovered. The information was examined with the utilization of various relapse investigation introduced in tables. The discoveries of this examination uncovered that there was a critical effect of investment back on the general development of SMEs in terms of record keeping, volume of business, access to other sources of funding, sales value, and net Assets. etc. Accordingly, the study recommended that awareness be created among SMEs on the existence and operations of venture capital as this could be one of the potent ways of boosting sustainable growth and stability of SMEs in particular and socio economic growth and development of the economy in general.

Daibi and Walter (2009) carried out a study onventure capital (VC) financing for small and medium-scale enterprise (SME) development in Nigeria by comparing the economic value added (EVA) of venture capital-backed SMEs and those of non-venture capital-backed SMEs. Three independent variables were specified namely: Equity finance, management support, and technical support, and the following tests were conducted: paired t-tests for significance of the differences in dependent and independent means, f-test for significance of R² and t-test for significance of individual regression coefficients. 120 sets of questionnaire were administered, 60 for each category of SMEs, and a stepwise procedure followed the first response in order to maintain balanced responses between venture capital and non-venture capital-backed SMEs. Each set of questionnaire retrieved was checked for adequacy and completeness and if not, fresh questionnaires were sent out, ensuring that the objective criteria set out were met. It was found that VC financed SMEs clearly outperformed non-VC-financed SMEs, and that the distinctive performance is the effect of management support by venture capitalists in their portfolio SMEs.

David et., al., (2020) studied venture capital (VC) and the growth of SMEs in Lagos, Nigeria. It specifically investigates whetherthere is significant relationship between: (i) VC and Innovation, (ii) VC and management practice, and (iii) VC and financial management in SMEs. The study adopted the correlational research design with a sample size of 316 based on SMEs population of 1516 that have benefited from venture capital using the prescribed formula of Yamene (1967). A Cross sectional data from primary sources covering a period of 2006 – 2018 were used to answer the research questions while the instrument for data collection was the questionnaire. Tests of validity and reliability were conducted to confirm the suitability of the instrument. The data collected were analysed with SPSS AMOS version 22.0 using the Structural Equation Modeling (SEM) approach. The results showed that VC has a significant positive effect on SMEs growth. The findings

specifically suggest that there is significant positive relationship between VC and innovation as well as financial management in SMEs.

METHODOLOGY

The study adopted the correlational design within a quantitative method; the population comprised of 2,596 SMEs in Port Harcourt, Rivers State. A sample size of 310 was drawn from the population using Krejcie and Morgan (1970)table. The simple random sampling was adopted and the data were gathered using copies ofquestionnaire which were personally administered to respondents. The reliability test was tested using the Cronbach Alpha methodwith the aid of Statistical Package for Social Sciences (SPSS) version 23, and it was 0.78, which is higher than the benchmark of 0.7. 5 items were used in measuring each of the variables and the item were given on a 5-point likert scare ranging from strongly disagree, disagree, agree, neutral and strongly agree. The Spearman Rank Order Correlation was used in testing the stated hypotheses.

Data Presentation and Analysis

Quest. Issued	Quest. Retrieved	Useful
310	280	276

Source: Survey Data, 2023.

This revealed that out of the 310 copies of questionnaire issued, 280 copies were retrieved and 276 copies were useful after proper examination of the filed copies.

Test of Hypothesis One (1)

Ho₁: There is no significant relationship between equity financing and market sharegrowth of SMEs in River State.

		Correlations		
		equity financing	market share growth	
Spearman's rho	equity financing	Correlation Coefficient	1.000	
		Sig. (2-tailed)	.037	
			N	276
	market share growth	Correlation Coefficient	.738*	1.000
		Sig. (2-tailed)	.037	
		N	276	

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

Source: Survey Data, 2023.

The output analyzed the extent to which equity financing relate withmarket sharegrowth of SMEs in River State.Spearman’s correlation co-efficient indicates a strong association between the two variables (Rs=0.738).The test of significance indicates that with P < 0.05 we reject the null hypothesis which states that there is no significant relationship betweenequity financing andmarket sharegrowth. Thus, we can say that higher levels of equity financing were associated with higher levels ofmarket sharegrowth of SMEs in River State.

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Test of Hypothesis Two (2)

Ho₂: There is no significant relationship between debt financing and market sharegrowth of SMEs in River State.

		Correlations	
		debt financing	market sharegrowth
Spearman's rho	debt financing	Correlation Coefficient	1.000
		Sig. (2-tailed)	.857**
	N	276	276
	market sharegrowth	Correlation Coefficient	.857**
Sig. (2-tailed)		.007	.
N		276	276

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

Source: Survey Data, 2023.

The output analyzed the extent to which debt financing relate with market sharegrowth of SMEs in River State. Spearman's correlation co-efficient indicates a very strong association between the two variables (Rs=0.857).The test of significance indicates that with $P.007 < 0.01$ we reject the null hypothesis which states that there is no significant relationship between debt financing andmarket sharegrowth. Thus, we can say that higher levels of debt financing were associated with higher levels ofand market sharegrowth of SMEs in River State.

Summary of Findings

- i. There is a significant relationship between equity financing and market share growth of SMEs in River State.
- ii. There is a significant relationship between debt financing and market share growth of SMEs in River State.

Discussion of Findings

The analysis revealed a significant relationship between equity financing and market share growth of SMEs in River State. This finding is in line with the study of Kumar (2009) who affirmed "that venture capital financing tool is a suitable option to supply both the financing and non-financing requirement of SMEs as they practice a participating management approach and exercise due diligence technique in disbursement of credit".

Again, the analysis also revealed is a significant relationship between debt financing and market share growth of SMEs in River State.This finding is in line with the study ofDavid et., al., (2020) studied venture capital (VC) and the growth of SMEs in Lagos, Nigeria. The results showed that VC has a significant positive effect on SMEs growth. The findings specifically suggest that there is significant positive relationship between VC and innovation as well as financial management in SMEs.

CONCLUSION

From the foregoing analysis, it is evident that venture capital financing showed a significant relationship with growth of SMEs in River State. The empirical results of this study confirmed this as a positive and significant relationship was found between debt financing and market share growth of SMEs in River State; equity financing and market share growth of SMEs in River State. It was concluded that venture capital financing is a significant predictor of growth of SMEs in River State via equity financing and debt financing.

RECOMMENDATIONS

In line with the analysis and conclusion, the study recommends that:

- i. Given that the role of equity financing is key to the growth and survival of any firm; venture capitalist should make available equity financing for SMEs.
- ii. Venture fund managers should periodically assess SMEs under their control to determine the state of debt management ability. This will enhance profitability and performance of small and medium scale enterprises.

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