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Small Business Financing in Nigeria: An Investigation of the Angel Option

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Abstract

Small businesses are often faced with funding challenges in developing economies which constraints their growth and long term survival. This study examines the existence and role of business Angels as a source financial, human and social capital to overcome challenges of funding for small businesses in Nigeria. The research aims to strengthen the framework that seeks to provide detail understanding of the benefits that business angels can bring to small business in developing economies, considering the gap that exists in this regard. Data for the study were obtained using questionnaires and analyzed using Kolmogorov-Simirov (KS) test. The finding reveals, that Angel financing is a viable alternate source for financing small businesses in Nigeria. Recommendations proffered include the need for publicity on the activities of angels to support other government programmes on small business financing. There should also be an enabling environment for angel venture networks to participate in economic growth and development of small businesses in Nigeria.

Key words: Small business; Business angel; Funding challenges; Financing

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INTRODUCTION

Financing small business remains one of the most important factors determining the survival and growth of small businesses particularly in developing economies. Suffice it to stress that accessing capital for new entrepreneurial pursuit has not always been an easy task in Nigeria. Although many Nigerian entrepreneurs have recorded successes in the area of business but the obvious is that more entrepreneurial dreams are aborted at conception due to financing constraints. Small businesses have been widely acknowledged as the spring board for sustainable economic development. In Nigeria, since the 1970's there has been an increased interest in the promotion of small businesses due to the inability of government and mega organizations to employ the nation's teeming populace. This has strengthened individuals' self-sustaining and self-reliant perspective to the recognition that dynamic and growing small businesses can contribute substantially to a wide range of national developmental objectives. Therefore, strengthening the debate that one way to alleviate poverty could be to increase the productivity of those engaged in small scale production (Aftab & Rahim 1989). The small business community in Nigeria has assumed universal recognition and relevance based on its potentials for creating self-employment, balanced development of regional utilization of available localized resources. They play active role in generating and providing employment opportunities at lower capital cost

Entrepreneurs for small business in developing countries often cite lack of capital as a major constraint to entrepreneurial development, a notion often referred to as "capital illusion". This lack of access is often associated with financial policies and bank practice that make it hard for banks to cover the high costs and risks involved in lending to small business. By their nature, small and medium scale business require long term capital for investment, because they have long gestation periods. So any capital mismatch by these enterprises in terms of loans can have serious consequences, especially in an unstable economic environment (Osisioma 2004). Financing has also been identified in many small business surveys as one of the most important factors that determine the survival and growth of small enterprises (Moses, 2010). Mambula (2002) acknowledging this affirms that small businesses in Nigeria suffer from the dearth of funding as top most amidst other constraints.

Access to finance allows small business to undertake productive investment to expand their business and to acquire the latest technologies, thus ensuring their competitiveness and that of the nation as a whole. This limitation affirms that not many opportunities are available to small starters. As predominantly informal system operators and not possessing sufficient knowledge of how to access formal financing most Nigerian businesses find it challenging to fund their entrepreneurial strides. Since Angel investors are likely to become the next generation funding option for business start-ups; because they attempt to fill some of the gaps other financing options cannot provide, based on the formality and accessibility. It is necessary to understand their existence and modus operandi in Nigeria. Shane (2008) supporting this assertion posits that many observers consider angel investments to be one of the key drivers behind the startup and the growth of new businesses, despite a paucity of information to confirm whether or not this is true. This is so because even in developed economies where angels exist not much is known about them. He further affirms that very few academic studies have examined angels, in part because data on angel investment is still difficult to obtain. This study therefore attempts to investigate whether angel funding is available in Nigeria and whether angel investors can be developed as additional option of financing small business in Nigeria.

1. BRIEF LITERATURE REVIEW

Small businesses face financial difficulties which can constrain their growth. Business angels as gap fillers in start-up financing can provide sources of financial, human and social capital to overcome these gaps (Macht & Robinson, 2009). A business angel is an investor who has passion and enjoys helping early stage businesses with limited or no fund (Preston, 2007). Angels are significant suppliers of equity capital at the early stage of a small business life. These category of informal investors are predominantly affluent, self-made, with a good level of formal education, and they tend to invest in the industry in which they familiar with.

Sohl (2003) affirms that in relation to formal venture capitalists in the United States angels invest in approximately 20 times the number of new ventures. In the category of the youngest "seed-stage" investment in the U.S, angels invested over 56 million in 2004, compared to only $346m from venture capitalists. In addition to their financial role in new venture development, angels also play a significant role in the strategic decision making of these ventures' their influence stems both from the authority associated with formal participation on the firm's board of directors as well as from their knowledge and expertise. Angels typically have substantial business experience of their own and act as a "sounding board" for the entrepreneur's managing the venture day to day (Amis and Stevenson, 2001). This reaffirms the fact that angel investors play a leading role in financing entrepreneurs beyond their own resources.

1.1 Conceptualizing Business Angels

The term "angel" which is used to imply 'business angel' or an 'informal investor' was first adopted from the United States Broadway during the 1900s where it was used to describe wealthy individuals who provided money for theatrical productions (Benjamin & Margulis, 2000: 5; Mason 2008). Even though angels' activities across the globe may have a very long history, its significance became obvious between 1950s to 1960s when a lot of the pioneering garage start-ups in Silicon Valley obtained their initial funding from this informal source (Sohl, 2003). One of the most difficult components in starting and growing a new enterprise is acquiring capital and other resources. The lack of funding can lead to cash flow problems, missed opportunities, and shut down of the fledgling enterprise (Auken, 2002). Globally, angels are responsible for a growing number of investments, even though this is relatively unidentified in both developing and developed economies (Shane, 2008).

All though scholars have put forth several conceptual perspectives of business angels, with each attempting to extend in a slightly different way the general view. They all however hold a level of commonality. In their simplest form angels are affluent individual who provide capital for a business startup.

According to Mason and Harrison (2008)

"a business angel is defined as an individual acting alone or in a formal or informal syndicate who invests their own money directly in an unquoted business in which there is no family connection".

Shane (2008) posits that an angel investor is

"*a person who provides capital, in the form of debt or equity, from his own funds to a private business owned and operated by someone else who is neither a friend nor a family member"*.

Mason (2006) defines angels as

"*high net worth individuals who invest their own money, along with their time and expertise, directly in unquoted companies in which they have no family connection, in the hope of financial gain"*.

He extends this definition by logically explaining the following components of the definition: High net worth, Investing their own money, Direct, Time and expertise, unquoted companies and financial gain. In the views of Mason (2006)

High Net Worth

This implies *h*aving wealth as a pre-requisite for becoming a business angel. This according to him is because angels invest in the excess of £10,000 and typically have a portfolio of two to five investments running within the same time period.

Investing Their Own Money

This is what separates angels from other institutional venture capital funds whose investment funds come from sources such as pension funds, banks and foundations and, as a result have a legal duty of care for how they invest such funds. This further minimizes the conditions tied to angel investments patterns and offers them more flexible investment criteria.

Direct

This affirms that business angels make their own investment decisions as opposed to investing in some form of pooled investment vehicle in which the investment decisions are made by fund managers. This implies that those people who become business angels have both the personal networks that will provide a flow of investment opportunities and the competence to undertake the appraisal of new and young entrepreneurial companies.

Time and Expertise

This explains the "Capital and Consulting" features business angels. The investment approach of business angels involves supporting their investees through a variety of roles, including mentoring, the provision of strategic advice, networking and in some cases direct involvement in a specific functional capacity.

Unquoted Companies

Here angels invest in companies that are publicly traded as opposed to companies that are listed on a stock market. Their typical investment is in a new or recently started business. The key point here is that business angels want to be active investors in the companies in which they invest, helping them to grow.

Financial Gain

Like any rational investor angels invest in the hope of achieving a financial return, typically in the form of a capital gain.

Angels make their investments in businesses that are owned by strangers as well as those owned by acquaintances. This condition distinguishes them from the typical (family, founders, and friends) investors who basically seek to invest in businesses where they have personal ties attached. This perhaps makes an angel financing the appropriate option for poor entrepreneurs seeking financing. Gaston (1989) attests to this fact as business angels constitute the largest pool of equity capital available for both start-up and emerging companies in advanced economies.

Angel investors are often retired entrepreneurs or executive who may be interested in investing for reasons that go beyond pure monetary return, these include wanting to keep abreast of current developments in a particular business arena, mentoring another generation of entrepreneurs and making use of their experience and networks on a less than full time basis (Stathis, 2004; Feld, 2006). Thus, in addition to funds angels investors can often provide valuable management advice and important contracts because, there are no public exchanges listing their securities, private companies meet angel investors in several ways, including referrals from the investors trusted source and other business contacts.

1.2 Small Business Defined

There is no generally accepted definition of a small business due to several classifications of businesses-that is subjective across countries of the world. While some prefer to define small business in terms of annual turnover, others consider the number of employees, as the best yardstick. In Nigeria, there is no one single definition that distinguishes a purely small-scale enterprise form a medium-scale enterprise. The Central Bank of Nigeria, defines small-scale enterprises as having an annual turnover not exceeding ₦500, 000 five hundred thousand Naira (CBN, 2003). Section 376(2) of the companies and Allied matters decree of 1990 defines a small company as one with:

An annual turnover of not more than two million Naira, and

Net asset value of not more than one million Naira.

Small scale business is described by Moses (2010) as an owner-owned venture managed and operated by the owner personally or through the assistance of a few personnel who are informally engaged. This type of business is normally the natural habitat of entrepreneurs as it provides the ideal environment for entrepreneurs to test their talents.

Small businesses therefore is a business that does not dominate in its field, engages local workers, working at a single location, its produced units are relatively small in size, and often organized by the owner or his family members. The ease of starting a small business generally makes it attractive to low income and less opportune persons. However as a major constraint to their start-up and growth is financing and technical skills.

1.3 Trends of Business Angel's Investment

Angel capital fills the gab in start-up financing between other informal sources. However in addition to funds, angel investors offer valuable management advice and important contacts. They provide financial backing for small start-up entrepreneurs. Usually they are the bridge from the self-funded stage of the business to the point that the business needs a higher level of funding. The money they provide can be a one-time injection of seed capital or ongoing support to carry the company through difficult times. Where one angel cannot effectively finance a business proposal, other angel investors are often called up in a syndicate deal, which means they join together to invest on the same terms. These categories of investors give more favourable terms than other normal lenders, as they usually invest in persons rather than the businesses. They are focused on helping the business persons succeed, rather than reaping a huge profit from their investment.

2. METHODOLOGY

The study is a descriptive survey. The researchers administered one hundred and twenty (120) questionnaires which were completed and returned. The data collected were analyzed using simple percentage for descriptive result which considers the proportion of the respondents for each option and Kolgomorov-Smirnov (K-S) was used to test the stated assumption for empirical result. The business category examined by the researchers is the typical informal sector of the Nigerian economy.

2.1 Descriptive Results

The descriptive results of the study are put forth below.

2.1.1 Gender of Small Business Owners

The survey carried reveals that 71.7% of the small business owners examined were male while only 28.3% of the respondents were females. The simple percentage method of analysis was employed in this computation. This perhaps explains the level of female engagement in business ownership in Nigeria and the implication for policy makers.

2.1.2 Knowledge of Business Angels

The result of the respondents with knowledge of business angles show that only 25% of the respondents have any knowledge of business angels while the greater 75% do not have any knowledge or what so ever of business angels at all. This explains the low level activities of business angels in this area.

2.1.3 Businesses Financed by Business Angels

As to be expected the result of the respondents show that only 26.7% of businesses are financed by business angels while 73.3% have other sources as means for the financing of their business. This perhaps further buttresses their ignorance level of this financing option. In terms of its availability and accessibility to willing entrepreneurs in Nigeria

Table 1
Financing as A Challenge to Small Business

	Frequency	Percentage (%)
Strongly agree	77	64.2
Agree	16	13.3
Do not agree	27	22.5
TOTAL	**120**	**100**

Source: field survey 2012

The above table shows that 64.1% of the respondents strongly agree and 13.3% agrees that financing is the biggest problem to small businesses while 22.5% do not consider financing as a problem of small businesses. The overall cumulative result confirms that 77.5% of the respondents have financing as the main issue to small business startup.

Table 2
Degree of Angel Financing in Nigeria

	Frequency	Percentage (%)
High	60	50
Moderate	38	31.7
Undecided	22	18.3
TOTAL	**120**	**100**

Source: field survey 2012

From the above table, 50% of businesses examined consider business angel as high source of financing 31.7% of the respondent only consider them as useful line of sourcing finance while 18.3% do not have a clear sense of where angels fit in.

Table 3
Conditions for Angel Finance

	Frequency	Percentage (%)
Comprehensive feasibility	78	65
Collateral security	26	21.7
Business plan	16	13.3
TOTAL	120	100

Source: field survey 2012

The above table shows that the major condition to be fulfilled when seeking for business angels is the preparation of a comprehensive feasibility studies; respondents affirm that 65% of business meet this comprehensive feasibility test, 21.7% show evidence of collateral and 13.3% avail angels with business plan need to access financing.

Table 4
Ratio of Small Business with Access to Financial Institution

	Frequency	Percentage (%)
YES	5	9.3
NO	115	91.7
TOTAL	**120**	**100**

The above table reveals that 91.7 % of businesses do not have access to financial institutions.

3. SPECIFICATION OF ANALYSIS INSTRUMENT

The empirical results of the finding is put forth here

$$\frac{\text{totalnumberofesponsesreceived (fororagainst)}}{\text{totalnumberofpeopleobserved}} \# \frac{100}{1}$$

The Kolmogrov–Simirnov (K – S) test method was used to test the hypothesis. The formula is stated below:

$$D = \frac{1 - 36}{\sqrt{N}}$$

For sample size above 35 the formula is given as D = 1.63 for P = 0.01.

3.1 Test of Hypothesis

The null hypothesis was tested based on the descriptive data presented above.

H_o: Angel financing is not a source of financing small business.

Responses	Very encouraging	Encouraging	Undecided	Not encouraging	Nil	Total(%)
No. of Population	60	38	-	22		120
Expected No. of Population	24	24	24	24	24	120
Cumulative population to the total population	60/120	98/120	-	120/120	-	100
Cumulative no. of expected in proportion to the population	15/120	30/120	45/120	60/120	120/120	100
Difference between cumulative expected and observed variable	30/120	43/120	-12/120	15/120	-	100
Division of a difference	0.25	0.358	- 0.1	0.125	-	

Source: field survey 2012

Using the calculated highest computation D = 0.358; the formula was applied thus:

D = 1.63

Estimated error for P = 0.01

$$D = \frac{1.63}{\sqrt{N}}$$

D = 0.1882

Since the calculated value D is higher then the critical value from the table. The null hypothesis was rejected.

The analysis carried out from the hypothesis reveals that at a level of significance of 0.01 and thus critical value D = 0.1882 since the calculated value of D represents = 0.358 is greater than the critical value and (K–S) test is said to be significant therefore the alternative hypothesis is accepted affirming that "angel financing is a source of financing small business in Nigeria". This finding aligns with the literature reviewed from other studies which agree that angels are major informal funders of small business in developed economies of the world.

CONCLUSION

The study explores the presence of business angels in financing of small businesses in Nigeria using a state pilot to elicit opinion and views of experts. The involvement of angel is evident in the Nigerian economy but with little or limited knowledge of both the angles and fund seekers. While other developed economies have established system for accessing this informal funding the reverse is the case in Nigeria. Small business accounts for over half of the annual employment of the country, which makes it the top job provider for the economy. However, financing coupled with managerial experiences have led to the early death of most ventures at their early stage. The involvement of business angles in the financing of small business will surely increase their survival and profitability. This is majorly from the finding of the research which reaffirms angel investors as entrepreneurs or one time entrepreneurs themselves whose interest goes beyond pure monetary reasons alone as they also provide technical support to their benefactor.

RECOMMENDATIONS

Based on the objectives set and the subsequent findings the below recommendations are made:

i. There is need for awareness of angel financing. This should be both for the teeming small business finance seekers and the few would-be business angels looking for avenues to invest their funds and technical know-how;
ii. The establishment of business angles network in Nigeria is needed and will go a long way to popularize and indeed formalize the activities of these business investors;
iii. Building ties with other developed economies to understudy the workings of business angles is critical to its success in the country.
iv. Government should as a policy matter seek avenues to encourage and popularize business angel using fiscal policies such as tax incentives and other fiscal motivational mechanisms.

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