



RESEARCH ARTICLE

EFFECT OF BUSINESS CREDIT AVAILABILITY ON PROFITABILITY OF SMALL AND MEDIUM ENTERPRISES IN SOUTH-WEST, NIGERIA

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Abstract

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Introduction:-

Small and medium enterprises (SMEs) are vital tools to most economies across the world and it has been identified as important catalysts of economic growth owing to its important roles in the global economy (Kamrul, 2019) which is why the governments around the globe are increasingly promoting and supporting it for evidence of its good performance contribution to the growth of nations (Tahir & Inuwa, 2019). Robust economies like United States of America and the United Kingdom trace their development from growth and development of their SMEs (Olubiye, 2019). The estimation illustrates the importance of SMEs in shaping emerging economies. SMEs accounts for 52% of the private work force and 51% to United States GDP (Muriithi, 2017) while in the United Kingdom they are associated with 62% of total employment. Like USA and UK, SMEs contribute to 79% of Italian employment, 63% of France and Germany employment respectively (Iyad, & Sa'dun, 2019). Japan has the highest proportion of SMEs among the industrialized countries, accounting for more than 99% of total enterprises (Economist Intelligence Unit, 2010). India, according to its Ministry of Micro, Small and Medium Enterprises, had 13 million SMEs in 2008, equivalent to 80% of all the country's businesses (Ghatak, 2015). In Vietnam, SMEs account for up to 98% of the total number of enterprises. They contribute about 48% to the country's GDP, 20% to export value and provide jobs for 77% of the country's labour force. However, majority of the SMEs are micro enterprises with very limited access to resources such as advanced technology and formal credit, etc.

In South Africa, SMEs contribute not only to the economy, but also, together with co-operatives, towards defeating the scourges of unemployment, poverty and inequality and also 91% of the formal business entities (Small Enterprise Finance Agency (SEFA), 2016). During 2017, one billion Rand was injected in the South African economy to assist 43,000 SMMEs and co-operatives. This amount, in turn, helped create and maintain close to 56,000 jobs (SEFA, 2017). In Nigeria, SMEs represent about 90 per cent of firms in the industrial sector on numerical basis, and account for about 70 per cent of aggregate employment per annum in the face of a roll-a-coaster nature in the last 59 years of nationhood partly due to her existence on the periphery of the global economy (Ekpo, 2017).

Despite these immense contributions of SMEs, small and medium scale businesses have been beleaguered with incessant poor performance. In Nigeria, despite these immense contributions and projections of SMEs, its performance has been hampered by many obstacles, (Ndiaye, Abdul Razak, Nagayev & Ng, 2018) such as declining profitability, poor output, low market share, stunted revenue growth, and low sales. SMEs are vulnerable and very few manage to survive most especially due to the problems of credit availability (Kamrul, 2019). The average life of

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small businesses has been measured as being less than five years (Muriithi, 2017). The study of Aremu and Adeyemi (2011) cited in Iloh and Chioke (2015) indicated that most SMEs particularly in Nigeria die within their first five years of existence. It was also revealed that smaller percentage goes into extinction between the sixth and tenth year while only about five to ten percent of young companies survive, thrive and grow to maturity. In congruence, Egwakhe and Odumesi (2019) highlighted that in Nigeria, despite the important roles of the SMEs to the nations of the world, its performance suffers due to lack of business credit availability. The situation is seem to be persistent to date and when some SMEs meet the requirements of accessing fund from deposit money banks, attached terms and conditions may not be affordable for the SMEs owners, yet they are not supported as deposit money bank prefer large firms to small enterprises. Insufficient capital has also been identified as the major factor for the premature death of the SMEs (Iloh & Chioke, 2015). The Vision (2020, 2009) have added that the level of finance for entrepreneurship in Nigeria is one of the lowest in the world.

Several factors have been identified in literature as the causes of credit availability challenges of SMEs. Some of the identified factors include corporate issues, banks points of restriction, and credit establishments (Imoughele & Ismaila, 2014), lack of collateral security (Abosede, Hassan, & Oko-Oza, 2017), inconsistency in government policies, high monetary policy rate, loan diversion, exchange rate depreciation, infrastructural decay and tenor of loans (Ubesie, Onuaguluchi, & Mbah, 2017), informational barriers, lack of management expertise, high default rate, monitoring (Alhassan & Sakara, 2014; Bondinuba, 2012) and so on. Bondinuba (2012) found that the main challenges that make it difficult for SMEs to access finance include policy regulation, inadequate financial infrastructure, stringent collateral security requirements, and a lack of institutional capacity of the SMEs sector. An empirical study by Adebisi, Alaneme, and Ofuani (2015) on challenges of finance and performance of SMEs in Southwest of Nigeria revealed that high collateral requirements by banks, high interest rates charged by deposit money banks, as well as difficulty in the process of accessing the funds were major constraints to lending to SMEs. Stringent collateral requirements of banks often rule out a large number of SMEs. Eniola and Ektebang (2015) also assert that access to formal finance by SMEs in Southwest Nigeria is poor because of the high interest rate.

Furthermore, the use of collateral and other personal guarantees, the variations in interest rates, how they relate to the characteristics of loan performance, and the relationship between SMEs and deposit money banks in Southwest Nigeria has remained unclear as empirical research is yet to be carried out in this direction. This study therefore sought to bridge the gap by assessing the effect of business credit availability (information asymmetry, bank density, and credit rationing) on the profitability of small and medium enterprises in Southwest, Nigeria.

Statement of the Problem:

SMEs in Nigeria have not been able to play significant roles in the economy given the quantum of challenges they face which include inadequate capital, as they are not able to have access to finance from banks, poor operating environments as typified by poor state of infrastructure, low entrepreneurial skills and inconsistent government policies. Even, where they have plenty access like the current opportunity to access various government schemes and intervention funds, credit affordability remains a serious challenge to SMEs. Olatunji and Ibukun-Falayi (2018) stated that most Nigerian SMEs have found banks credits unattractive due to prohibitive interest rate, high loan administration costs, stringent credit terms and other cost of credits. According to Aguwamba and Ekienabor (2017), deposit money banks' in Nigeria knack to lend out loans are influenced by a lot of reasons such as the existing interest rate, loan administration, the volume of deposits, the level of their domestic and foreign investment, banks liquidity ratio, reputation and public recognition and other factors. Ogujiuba, Ohuche, and Adenuga (2004) also have long attributed the reluctance on the part of financial institution to fund SMEs to the insufficient capital base of banks and information asymmetry that often exists between SMEs and lending institution. The information asymmetry between banks and SMEs continue to persist, since the skills needed to set up a business is not the same as those needed to run a business (Edoko, Ngige, & Okoli, 2017). Balogun, Agumba, and Ansary (2018) pointed that there was information gap between the deficit unit (SMEs owners) and deposit money banks and that poor credit rationing by the banks to SMEs industry had negatively drop-down SMEs profitability. This caused SMEs businesses to collapsed and unable to contribute to economic activities and create employment.

Several studies have investigated credit availability predictors among small and medium enterprises and performance of SMEs (Kwaning, Nyantaky & Kyereh, 2015; Mole & Namusonge, 2016; Balogun, Agumba, & Ansary, 2018) but few studies have critically employed information asymmetry, bank density and credit rationing as measure for bank credit availability and their effect on SMEs business profitability especially SMEs industry in Nigeria. Similarly, no studies especially in Nigeria that have examine how business credit affordability affects SMEs

business profitability. This deficiency of literature motivated the design of the current study which assessed the effect of business credit availability (information asymmetry, bank density, and credit rationing) on the profitability of selected small and medium enterprises in Southwest, Nigeria.

Literature Review:-

Business Credit Availability:

Credit availability refers to the amount of credit to which a borrower has access at a given time. Asad, Asad, Abdullah, and Khalid (2018) defined access to credit as the ability of a firm or households to obtain financial products and services at reasonable cost. On the other hand, firms and household that can't access financial products and services are termed as financially constrained. Harelimana (2017) described access to credit as the ability of individuals or enterprises to obtain financial services, including credit, deposit, payment, insurance, and other risk management services. Those who have only limited access to financial services are referred to as the unbanked or under banked, respectively. Abiola (2011) viewed access to credit as a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some later date. The financial services provided to SMEs include financial products and services such as savings, credit, insurance and payment systems (Nyakado & Okello, 2016).

Also, Osoro and Muturi (2013) viewed access to credit as the ability of individuals and enterprises to obtain external funding to enable them ease cash flow problems. Credit can be either short term or long term depending on the lender's assessment of the borrowers' ability to repay. Access to credit refers to a situation where a business or a person can obtain loan facility from lenders (Kimaiyo, 2016). Lack or limited access to credit refers to obtaining less or no loan facility at all due to some reasons. The definition described access to credit as SMEs ability to obtain external financial products and services to enable them to ease their funding problems. According to Manasseh (2004), external financing or credit facility is a kind of finance provided by person(s) other than the actual owner of the company who are the company creditors. Manasseh further added that credit can be in any of the following forms: overdrafts, trade creditors, lease financing, debentures, loans, among others. All these external sources depend on the enterprise's creditworthiness.

According to Eniola and Entebang (2015), credit determines access to all of the resources on which SMEs owners/manager depend on. Credit serves as a source of funds to SMEs that can be utilized in the production and sustaining of a firm's competitive advantage. (Eisenhardt & Martin, 2000). Three types of credits are usually required by small scale enterprises (Ayeni-Agbaje & Osho, 2015). They include: short term loan, which is used to finance yearly operation until the product or proceeds from the industry are sold and the amount which is involved is usually small; Medium term credit, which is type of loan that is for more than one year maturity period but not exceeding three to five years; and long term loan, which is a type of credit that is a necessary for acquisition of major industrial machines, improvement in industrial equipment, building and land, whose maturity period is for quite a longer duration.

Discussing the importance of bank credit to SMEs, Ogar, Enya, and Oka (2015) argued that it reactivates, expands and modernizes all types of enterprises which are considered economically feasible and desirable to the achievement of stated economic goals of self-sufficiency in production. Also, credits remove financial constraints faced by SMEs, as it provides incentives to adopt new technologies that would have otherwise been slowly accepted. Thus, credit enables SMEs to switch quickly to new technologies which enhance the achievement of a rapid productivity and growth. Beck and Demircuc-Kunt (2016) further argue that access to finance allows SMEs in developing economies to undertake productive investments to expand their businesses and to acquire the latest technologies, thus ensuring their competitiveness, and fostering innovation, macroeconomic resilience, and GDP growth. Kevane and Wydick (2016) also suggest that provision of credit to micro enterprises encourages economic growth in the informal sector through promoting increased capitalization of business, creating employment opportunities, and long-term income growth. This is supported by Aghion and Bolton (2017) who argue that more credit means more entrepreneurship, more firm formation, and economic growth.

Information Asymmetry:

Verrecchia (2001) refers to the information asymmetry as the difference in the cost of capital in the presence/absence of an adverse selection problem that arises from information asymmetry. Information asymmetry comprises of a situation where in a contract the two parties involved does not have the full information about the contract. According to Wu, Song and Zeng (2008) information asymmetry is a core reason commercial banks are

generally reluctant to provide loans to SMEs. In most instances, SMEs are unable to provide information on their creditworthiness. Taiwo, Falohun and Agwu (2016) observe that information asymmetry is a situation in which one party in a transaction has more or superior information compared to another. This often happens in transactions where the seller knows more than the buyer, although the reverse can happen as well. Potentially, this could be a harmful situation because one party can take advantage of the other party's lack of knowledge. Information asymmetries associated with lending to small scale borrowers have restricted the flow of finance to smaller enterprises. The main information asymmetries that constraints SME access to finance includes high cost of obtaining credit information on SME, inconsistent SME financial statements and audits and lack of access to third party information by providers in the marketplace (Ganbold, 2008). Due to lack of information on the creditworthiness of potential SMEs, banks perceive SMEs as high risk and thus charge higher interest rates (Mazanai & Fatoki, 2012). This in turn discourages low risk SME to seek financing and ultimately reduced the interest of banks to lend. Ganbold (2008) highlighted that SMEs also produce financial statements with large discrepancies and unreliable as they are not required to adopt international accounting standards. It is also reported that Banks also need to rely heavily on third party information especially from credit bureaus in order to get histories and credit profiles of SMEs.

Bank Density:

Bank density refers to the value of total assets of deposit money banks. Bank density could be term as capital ratio, which is measured using Tier 1 ratio, where the ratio of tier-1 capital to total risk- weighted assets (Odundo & Orwaru, 2018). Odundo and Orwaru (2018) further asserted that bank density is the asset value ratio represents the ownership of assets by banks and high asset ownership enables banks to offer more financial services at low cost. According to Muhindi and Ngaba (2018), bank density is a primary factor in determining the profitability of a bank and its loan extension to SMEs industry due to the concept of economies of scale in the neo classical view of the firm. They further showed that in today's global economy, bank density is very critical to performance due to the phenomenon of economies of scale. Essentially, it means larger deposit money banks can obtain cost leadership relative to smaller banks. Firms size is seen in the banking industry as a resource in obtaining sustainable competitive advantage in terms of profit and market share which determine credit extension to economic sectors. The number of financial institutions offering credit in an economy has an impact on the overall growth of an economy. As observed by Schoof (2006) an inadequate number of financial institutions offering credit services to SME's would constrain development of the industries. When there are many small-scale traders, whilst the financial institutions with the services customized to them are few (demand exceeds supply), the price of the loan will be high therefore not affordable and hence low uptake by SMEs. The issue of bank density is crucial to ensuring stability of financial sector to finance SMEs activities in an economy because, bank serves as the blood veins of the SMEs economy drive (Muhindi & Ngaba, 2018).

Credit Rationing:

According to Masambu, Antony and Malenya (2018), credit rationing is a situation in which the demand for credit exceeds the supply of credit at the prevailing interest rate. The bank's credit rationing behaviour may theoretically be influenced by a number of factors which include credit history, age and size of the firm, risk profile and collateral offered (Mole & Namusonge, 2016). Credit rationing or restrictions for SMEs arise from a higher default risk that is associated with SMEs. This association is often due to the fact that deposit money banks cannot generate sufficient information about the businesses which applies especially for start-ups, and that the business success is uncertain (Levenson & Willard, 2000). Under condition of imperfect credit markets, interest rates fail to play the market clearing role of equating demand and supply. But rather the banks adopt the strategy of credit rationing using the non-price mechanisms so as to maximize their expected profits.

Bank's credit rationing behaviour may theoretically be influenced by a number of factors which include the borrower's observable characteristics (age, gender, wealth, experience, credit history), firm characteristics (business experience, risk profile, earnings), and loan characteristics (amount demanded, loan maturity, collateral offered, interest rate). Diaz-Serrano and Sackey (2015) argued that the bank's credit rationing behavior against the firm's loan demand can be categorized into three stages: the screening stage, the evaluation stage, and the quantity rationing stage. At the screening stage, the bank manager interviews the potential borrower to determine their eligibility for credit (in terms of their creditworthiness, loan requirements and the terms desired). The manager then decides whether the applicant is sufficiently qualified to apply for a loan or not. At the evaluation stage, the loan officer undertakes a detailed analysis of the viability of proposed investment project (including detailed investigations of the credit history, the type and value of proposed collateral, management of the firm, probability of

repayment). Based on this information, the loan officer (and/or the loan committee) makes a decision as to whether it will be profitable for the bank to grant a loan or not (Mole & Namosonge, 2016).

Quantity rationing refers to a scenario where some borrowers are granted loan amounts that are less than what they had applied for. It is at quantity-rationing stage that the bank fine tunes the loan contract to reflect the bank's subjective evaluation of the riskiness of the loan and of the borrower and the impact of these risks on expected profit (Lapar & Graham, 1988) quoted in (Mole & Namosonge, 2016). The risk for the bank implies the default risk, being the risk that the firm can't fulfil its obligations to the bank. The degree of risk of the firm may be inferred from the credit history of the borrower, the expected returns of the project and business experience of the firm.

Profitability:

According to Hifza and Malik (2011), profitability is one of the most important objectives of financial management since one goal of financial management is to maximize the SMEs owner's wealth. Profitability is the state or condition by which a business enterprise exceeds its overall revenue from its total expenses. Guda, (2013) defines profitability as a financial benefit that is realized when the amount of revenue gained from a business activity exceeds the expenses, costs and taxes needed to sustain the activity. Profitability is the profit-making ability of an enterprise and is a measure of evaluating the overall efficiency of the business (Guda, 2013). Makau and Kosimbei (2014) view profitability as the organizations' ability to generate income and its inability to generate income is a loss. They further assert that if the income generated is greater than the input cost, that is simply profitability but if the incomes are less than the input cost, it reflects poor performance.

There are a number of criteria used in assessing the performance of SMEs and other organizations for long run survival in the event of globalization and competition. Profitability can be measured by relating output as a proportion of input or matching it with the results of other firms of the same industry or results attained in the different periods of operations. Profitability of a firm can be evaluated by comparing the amount of capital employed i.e. the input with income earned i.e. the output. This is known as return on investment or return on capital employed. Business is conducted primarily to earn profits. The amount of profit earned measures the efficiency of a business. The greater the volume of profit, the higher is the efficiency of the concern. The profit of a business may be measured and analyzed by studying the profitability of investments attained by the business. Thus, profitability may be regarded as a relative term measurable in terms of profit and its relationship with other elements that can directly influence the profit (Barad 2010).

Theoretical Review:

The concept of credit availability has been explained by a number of theories in the field of finance. This study will explore the loanable funds theory, information asymmetry theory and financial intermediation theory.

The loanable funds theory:

The loanable funds theory was proposed by Swedish economist Knut Wicksell (1851-1926). According to loanable funds theory, rate of interest is determined by the demand for loanable funds and supply of loanable funds. This theory could be divided into "Demand for Loanable Money and Supply of Loanable Funds. In this regard this theory is more realistic and broader than the classical theory of interest. Demand for Loanable Funds; loanable funds theory differs from the classical theory in the explanation of demand for loanable funds. According to this theory demand for loanable funds arises for the following three purposes viz.; Investment, hoarding and dissaving.

The theory assumes that interest rates are determined by supply of loanable funds and demand for credit and that there exists an inverse relationship between the loanable funds and the interest rates. If both the demand and Supply of loanable funds change, the resultant rate would depend on the magnitude of movement of the demand and supply of the loanable funds. In other words, the availability of these loanable funds depends on the interest rate that the lenders charge and whether the borrowers can afford the funds at the same interest rate.

The loanable funds theory has been criticized for combining monetary factors with real factors. It is not correct to combine real factors like saving and investment with monetary factors like bank credit and dishoarding without bringing in changes in the level of income. This makes the theory unrealistic. Also, Ross (1976) criticized the theory that it fails to address the reasons why people would prefer to save and invest without necessarily having to deposit money in the banks like the fear of unknown, wealth taxation, delay in accessing the banked money among other factors.

Despite the arguments against this theory, it is still found to be relevant to this study because by trying to adjust the interest rates, the pricing determinants of the commercial loans granted to SMEs is affected thus affecting the total cost of loanable funds. This development will in turn affect the loan uptake by the SMEs which will eventually affect the lending business of the Deposit money banks. The Loanable Funds theory is linked to credit access since accessibility to credit is related to the interest rate charged. Akingunola (2011), Azende (2011), Muritala, Awolaja, and Bako (2012) and Taiwo, Falohun and Agwu (2018) have validated loanable fund theory in their studies and established that loan to SMEs enhance their contribution to economic activities and overall performance.

Informational Asymmetry Theory:

The theory of Information Asymmetry was proposed by Akerlof (1970). The Information asymmetry arises when one group of participants has better or timelier information than other groups. Theories based on asymmetric information assume that firm managers and insiders possess private information about the firm's characteristics of return stream or investment opportunities that are rarely known by outsiders (Niu, 2008). The nature of the asymmetric information in the case of SMEs lending is that insiders (SME owners and managers) know more about the enterprises prospects, risks and values than commercial banks. Banks know the credit risk breakdown among their borrowers, but due to information asymmetry, they are not able to identify individual amounts of default costs for particular borrowers (Slazak, 2011). Robinson (2011) observed that this theory assumes that Banks can't effectively differentiate between high risk and low risk loan applicants. The theory further argues that mainstream financial institutions are unable to compete successfully with informal lenders because such lenders have access to better information about credit applicants than formal institutions have. The theory suggests that it would be difficult for banks to operate profitably in developing countries credit markets and to attain extensive outreach.

In relation to credit financing and SMEs performance, which is the thrust of this study, the theory view credit financing as having positive impact on performance. However, availing the credit is affected by information asymmetry which implies that there will be some proposals on which lending institutions will not have perfect information therefore limiting the access to credit facilities for such propositions. This includes new and technology-based propositions for which market intelligence would be limited.

The theory is important to the study because it look at the needs of the SMEs to be externally financed since it may not be adequate to finance a business internally. For the appropriate consideration, the SMEs owners are supposed to be honest in their dealings and utmost disclosure so that they are granted the bank loans they sought which promotes the SMEs operations and performance.

Financial Intermediation Theory:

The theory of financial intermediation was developed in 1960 by Gurley and Shaw. This theory is founded on the agency theory and the informational asymmetry theory. They argued that, the existence of financial intermediaries is explained by the existence of the following categories of factors: high cost of transaction, lack of complete information in useful time; and the method of regulation. The theory describes the process where surplus units (savers) give funds, that is, through deposits, to intermediaries who include financial institutions such as banks, credit unions, mutual funds and insurance companies) who in return channel out the funds to deficit units (spenders or borrowers or SMEs).

The theory emphasizes resource allocation based on perfect markets and thus the transaction costs and asymmetric information are important in understanding financial intermediation. They observed Financial intermediaries bring together the depositors and the borrowers matching their transactional needs and providing other services and as a result reduce the transaction costs and eliminate information costs. Depositors entrust their funds with these intermediaries who in turn invest them through loans and other investment projects, with the depositors able to liquidate (through withdrawals) their savings at any given time. SMEs engagement with the financial institutions can therefore be summarized from the roles played by the financial institutions as financial intermediaries. SMEs can both be depositors and or borrowers and are bound to receive, from the financial institutions, such services including transactions services, provision of liquidity, financial consultancy, analysis and evaluation of assets, issuance of financial assets, loan granting, monitoring services, risk management, insurance services, and other services (Allen & Santomero, 1998; Andries, 2009; Diamond & Dybvig, 1986).

Financial intermediaries bring together the depositors and the borrowers matching their transaction needs and providing other services and as a result reduce the transaction costs and eliminate information costs. Financial

intermediaries also act as delegated monitors (on behalf of the depositors) and therefore help lower monitoring costs hence eliminating would be agency costs, lower liquidity costs, and lower price risks. Depositors entrust their funds with these intermediaries who in turn invest them through loans and other investment projects, with the depositors able to liquidate (through withdrawals) their savings at any given time (Andries, 2009). The diagram below shows the link between deficit units (SMEs owners), deposit money banks (Financial intermediators) and surplus units (Saver). See figure 1.

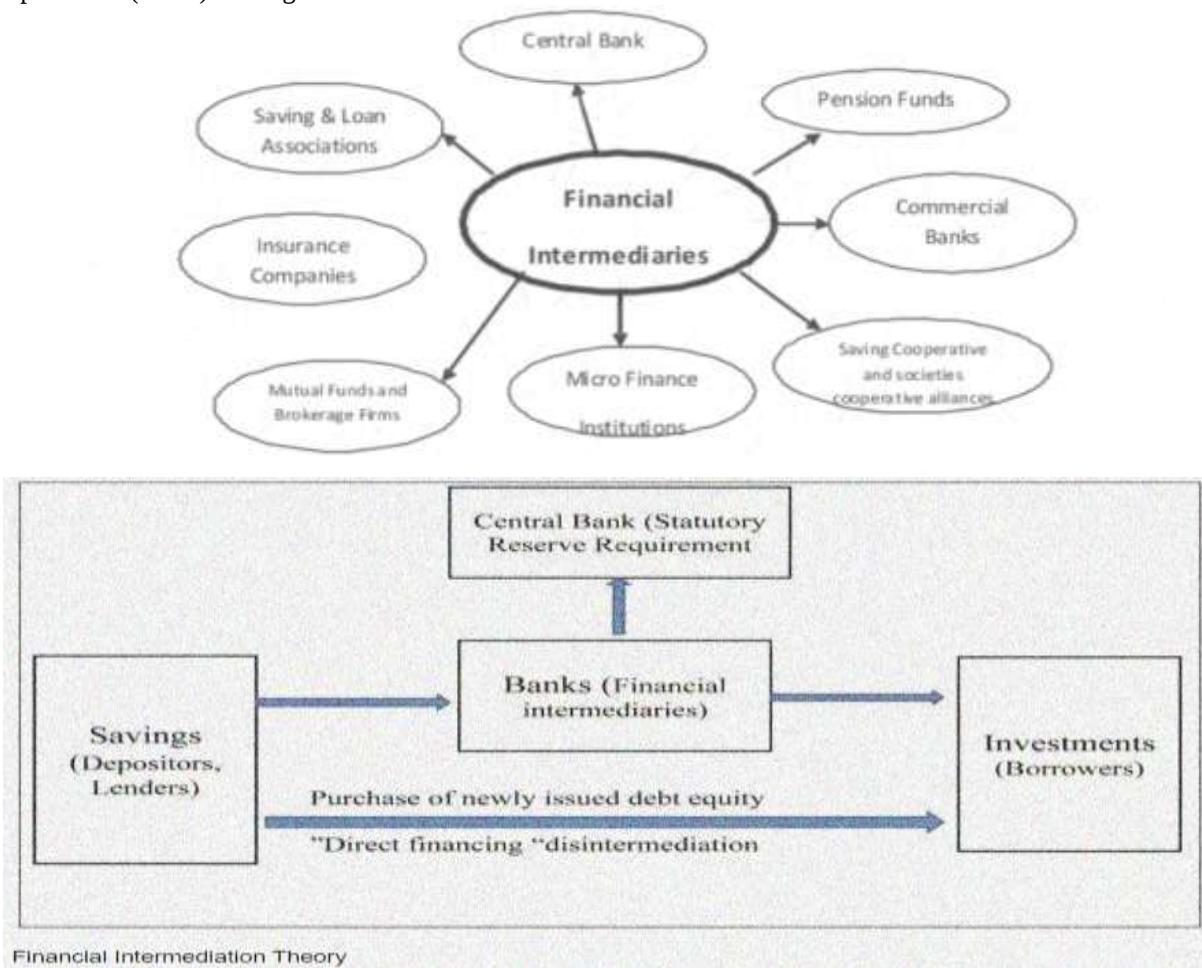


Figure 1:-

Through intermediation, banks are able to create and supply specialized financial products to meet the needs of all types of customers. This happens whenever banks establish that they can supply the financial products for higher returns which cover all costs. In addition, banks as financial intermediaries find the reason for existence from market imperfections. Therefore, given a perfect market position, where transaction and information costs are missing, banks would not exist. SMEs have traditionally encountered problems when approaching providers of finance for funds to support fixed capital investment and to provide working capital for the firm's operations (Lean & Tucker, 2001). Thus, there exist a finance gaps for SMEs due to their disadvantaged position in the market for bank finance and the incomplete financial intermediation process between financial institutions and SMEs. The current financial intermediation theory builds on the notion that intermediaries serve to reduce transaction costs and informational asymmetries.

Several researchers such as Tobin (1969), Akerlof (1970), Pyle (1971), Leland and Pyle (1977), Fama (1980), Campbell and Kracaw (1980), Stiglitz and Weiss (1981), Diamond and Dybvig (1983), Diamond (1984) and Boot (2000) contributed to the financial intermediation theory, focuses on the role of banks as lenders. In that capacity, the theory builds on the notion that banks develop close relationships with borrowers over time and such

proximity facilitates monitoring and screening and overcome problems of asymmetric information. Based on this predication, banks as intermediaries serve to reduce transaction costs and informational asymmetries.

There have been a number of critiques on this theory leading to a paradigm shift in the theory. According to Allen (2001), intermediation theory has failed to provide the rationale for the existence of banks and the role they play in the modern economy. Following the study of Porter (1985), in their study, Allen and Santomero (1996) and Scholtens and Wensveer (2003) suggest that the theory of intermediation needs to reflect and account for the fact that financial systems in many countries have changed substantially over the years due to expansion and existence of new financial markets; fallen transaction costs and cheaper and more available information that should have ordinarily made banks to lose their relevance going by the traditional theory, but instead make them more important.

However, the theory is very relevant to this study because the SMEs are affected by financial intermediation, in that the laws that regulate the financial institutions who are the financial intermediaries to the SMEs and the economy as a whole also affect the availability of capital for the SMEs. The financial intermediary theory is linked to how bank manage the deficit and surplus units. Akingunola (2011), Azende (2011), Muritala, Awolaja, and Bako (2012) and Taiwo, Falohun and Agwu (2018) have validated financial intermediary theory in their studies and established that intermediary function between SMEs owners and surplus units, thus enhance SMEs contribution to economic activities and overall performance. This theory was useful particularly in the evaluation of the barriers and constraints the SMEs face in getting credit from diverse source surplus funds like deposit money banks. The theory guided the establishment of how asymmetry, bargaining power and transactional costs and other market imperfections affect the ability SMEs to source for funds and how that influences their performance.

Empirical Review and Hypothesis:

Access to finance is seen as necessary condition for SMEs success in their drive to build productive capacity, to compete and to contribute to poverty alleviation in developing countries. Findings of Amoako-Adu and Eshun (2018) and Idowu (2010) revealed a positive relationship between business collateral and profitability of small and medium scale enterprises. These findings indicated that without finance, SMEs can neither absorb new technologies nor can they expand to compete in global markets or even strike business linkages with larger firms. Furthermore, Rahman, Belas, Kliestik and Tyll (2017) revealed that loans with a longer maturity are more likely to be collateralized than short-term loans and bank-borrower proximity can alleviate the incidence of collateral whereas bank concentration may increase collateral requirements, thus bank collateral increase SMEs increase profitability. Shikumo and Mwangi (2017) established that bank size and liquidity significantly influences lending to SMEs by deposit money banks while credit risk and interest rates have no significant influence on lending to SMEs by deposit money banks.

Hwarire (2012), Barasa (2013) and Amsi, Ngare, Imo and Gachie (2014) also examined credit management and loan repayment of Small, micro and medium enterprises. These studies found that loan repayments by small, micro and medium enterprises were not made on time, while actually defaulted. In addition, the study established that gender, race and negative bank balance were found to be statistically significant in relation to default in credit management and loan repayment. A study by Nguyen (2014) investigated the use of hard and soft information for deposit money banks' lending decisions to SMEs in Vietnam. The study findings revealed that although collateral based lending was the most used method and could substitute for other lending technologies, usually a combination of lending information types was used in their decision-making process. Abdesamed and Wahab (2014) examined the financing of SMEs and the factors that influence SMEs to apply for a commercial bank loan. The study found that business experience of business owners has no significant relation with the business's tendency to apply for a deposit money bank loan. However, the study found that the educational background of the business owner, business size, collateral and loans with interest were negatively related to business tendency to apply for commercial bank loans. Oleka, Maduagwu, and Igwenagu (2014) argue that the loan size positively influences the growth of SMEs. It was also argued that the business that receive adequate amount of loan frequently perform better than the ones that do not (Wanambisi, 2013) also argues that appropriate loan sizes for clients, matching SMEs needs influence the business sustainability.

However, the studies of Garikai (2011), Oketch (2000), Bowen, Morara, and Mureithi (2009), Mwangi et al. (2013) in Kenya, found a negative significant effect between collateral requirement and profitability of SMEs. In the same vein, Amoako-Adu and Eshun (2018) found that collateral requirement negatively affects the profitability of SMEs. Further, Nyagah (2013) studied the non-financial constraints hindering growth of SMEs in Nairobi County and found that lack of collateral to access credit was a main challenge hindering the profitability of SMEs among other

non-financial challenges. In studies conducted in sub-Saharan Africa, Bass and Schrooten (2005) and Sacerdoti (2005) found that the inability of SMEs in SSA to provide adequate financial statements and quality collateral reduce their chances of accessing finance from formal financial institutions which overall affected the profitability of SMEs. Also, the absence of credible credit reference bureaus in most countries in SSA and its attendant effect of interest rates undermine the chances of SMEs gaining access to finance.

Nkuah and Gaeten (2013) found a negative relationship between collateral and SME profitability. The study showed that lack of collateral, inadequacy of managerial competence and lack of a clear repayment plan were some of the reasons for which most entrepreneurs in the Wa Municipality could not access bank credits for their businesses which ultimately affected their profitability. Similarly, Quartey, Turkson, Abor, and Iddrisu (2017) and Wang (2016) found that 'collateral requirement is the most significant obstacle that hinders growth and profitability of firms, particularly for high growth firms. Also, Gbandi and Amisshah (2014) found that collateral requirement negatively affected SME profitability of SMEs in Nigeria. These findings is as a result of the fact that SMEs typically rely on credit more than large firms, tightening of credit policies is expected to adversely affect SMEs more than larger firms which have access to national and even international credit markets.

Milanzi (2012) revealed that lack of collateral led to limited access to finance which significantly affected the export behaviour of Tanzanian SMEs to improve their profit. Likewise, Bellone et al. (2010) found that SMEs with collateral had better access to finance which enable these SMEs to venture into international markets and increase their revenue as opposed to those who had no or tangible collateral which denied them access to credit and however, led to poor financial health. These findings is also in congruence with other authors such as Campa and Shaver (2002); Ganesh-Kumar, Sen and Vaidya (2001); Greenaway, Guariglia and Kneller (2007); and Love and Roper (2015).

Thus, it can be concluded from these findings that the high borrowing rate charged by lenders reflects the persistent high inflation rate and other credit risk factors of SMEs, such as high risk of business failure. To mitigate the high credit risk of the borrower, the lending institutions tend to ask for collateral to back the loans. In the absence of acceptable collateral, the loans are normally denied which affects SMEs ability to conduct business and improve their revenue in terms of profitability. Thus, the literature shows no uniformity concerning the trend of the association between business credit availability and profitability of SMEs. Therefore, it is hypothesized that:

H₀: Business credit availability sub-variables (information asymmetry, bank density, and credit rationing) have no significant effect on the profitability of selected small and medium enterprises in Southwest, Nigeria.

Conceptual Framework:

The researchers have developed a conceptual framework for this study based on the review of literature and the research variables namely: information asymmetry, bank density, credit rationing and profitability. Ghulam and Iyofor (2017) pointed out that a SME that has a financial and audited financial statement is more likely to be extended credit by deposit money banks than SME that does not. The audited financial statement, being the significant predictor of credit availability, supports the theory that firms with an audited financial statement possesses less risk to potential lenders. The authors also indicate that medium sized firms are likely to get loan banks than small firms. Furthermore, better firm performance increases the likelihood or probability of obtaining a loan. This fact was confirmed by the study of Cole (1998), using profitability as proxy for firm performance, found a positive significant relationship between profitability and credit availability. The conceptual model for this study is presented in Figure I and it shows how the independent variables (information asymmetry, bank density, and credit rationing) relate to the dependent variable (profitability).

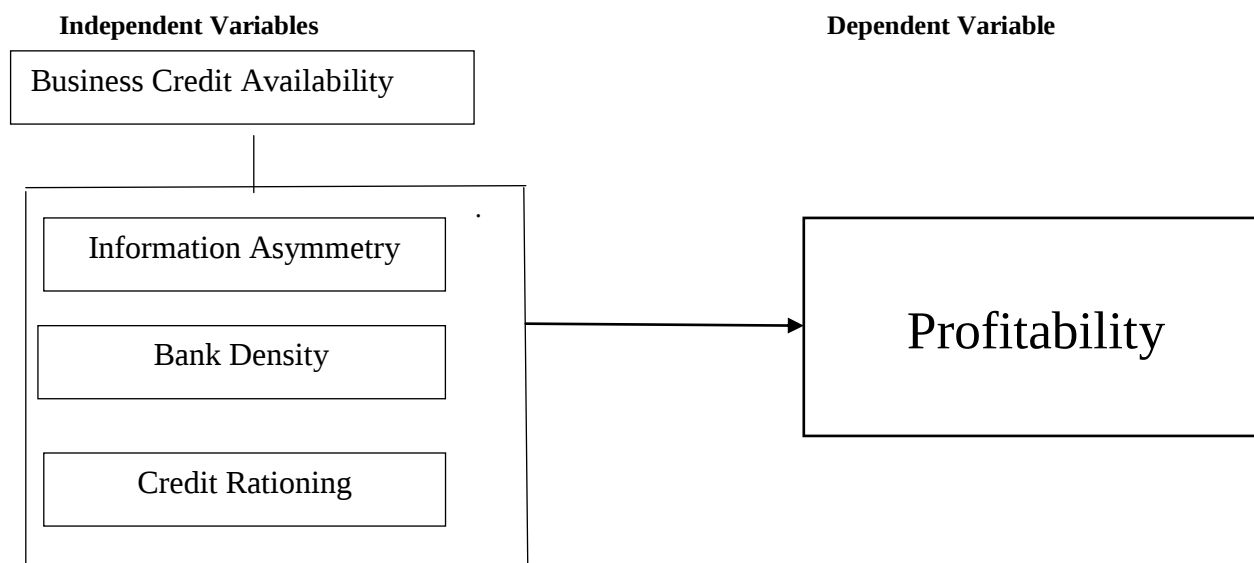


Figure 2:- The conceptual model for the research variables and their relationships.

Source: Developed by the Researchers (2019).

Methodology:-

The study adopted cross-sectional survey research design. The design was appropriate for this study because the study sought information from the respondents relative to their attitudes, beliefs, feelings and behaviours (Owenbiugie & Igbiniedion, 2015). The research design also enables the authors to compare many different variables at the same time because it affords the opportunity to collect different kind of data in a relatively short period of time. The research design has also been employed by authors who have carried out similar studies on this phenomenon (Atkins, Dou, & Jeffrey, 2015; Durrah, Rahman, Jamil & Ghafeer, 2016; Obokoh & Goldman, 2016).

The target population consisted of 26,744 registered Small and Medium Scale Enterprises operating in Southwest, Nigeria (SMEDAN Reports, 2013). The unit of analysis was the SME owners in South-West of Nigeria, one from each SME in cases where there are more than one owner. The justification for selection is the belief by the researcher that the owner-managers have the authority to provide information on the main variables and sub-variables of this study.

A sample size of 649 was initially determined based on Cochran's sample size formula (1977). However, 30% (194) of the sample size was added to it to increase the sample base as suggested by (Israel, 2009). This brought the sample size to 843. This was included to compensate for non-response probability. The formula used to calculate sample size is:

$$n = \frac{NZ^2pq}{d^2(N-1) + Z^2pq}$$

Where:

n = Sample size

N = Population size

Z = Value for the selected alpha level e.g. 2.58 for (0.25 each tail) a 99.5% desired confidence level.

P = Degree of variability (0.5)

q = 1-p

d = Degree of accuracy (0.05)

α = level of significance (5%)

Table 3.2:- Distribution of Questionnaire per State (Proportionate Sampling).

No.	States	Registered Small and Medium Enterprises in South-West Nigeria	No. of Questionnaire
1	Ekiti	1029	32

2	Lagos	11663	368
3	Ogun	1794	57
4	Ondo	1999	63
5	Osun	2272	72
6	Oyo	7987	251
	Total	26744	843

Source: Researcher's Computation (2019)

To get appropriate information from the respondents by States, the researchers used multi-stage sampling technique. The first stage involved the use stratified sampling technique. In this stage, the total population of SMEs in South-West Nigeria was identified and grouped according to the States where they operate. The six States are Lagos, Ogun, Oyo, Osun, Ondo and Ekiti. Thereafter the study employed simple random sampling method to select sample size in proportion to the total number of registered SMEs from each State which arrived at a total sample size of 843.

Data for the research was collected using a self-developed, closed-ended questionnaire. Closed-ended questionnaire was used due to ease of the administration and analysis of responses (Adimo, 2018). Furthermore, the cost and time required were low compared to other sources of data collection (Mundia & Iravo, 2014). The questionnaire instrument contained information on business credit availability (information asymmetry, interest rate, bank density, and credit rationing) and business profitability. A six points modified Likert scale type was used to elicit responses from every question in the questionnaire and this covered; Very High (VH) = 6; High (H) = 5; Moderately High (MH) = 4; Moderately Low (ML) = 3; Low (L) = 2; Very Low (VL) = 1. This modified scale was intended to increase the reliability of the responses and also gain more effective result from the respondents.

The data were analyzed using Partial Least Square Structural Equation Modeling (PLS-SEM) through Smart PLS 3.2.8. Smart PLS was utilized because of its completeness (Balarabe, Lily, & Shamsul, 2017). PLS-SEM is viewed as an alternative model to covariance-based SEM which uses OLS multiple regressions to explain and predict variations of dependent variables as a result of the independent variables (Chin, 1998). Reinartz, Haenlein, and Henseler (2009) contend that PLS-SEM is a powerful statistical technique that provides robust model estimations for both normal and abnormal data distributions. The analysis consists of two stages. The first stage is the assessment of the reliability and validity of the measurement model and the second stage is the assessment of the structural model to test the hypothesis understudy. PLS techniques such as bootstrapping and blindfolding were used to evaluate the model predictive capability (Hair, Hult, Ringle, & Sarstedt, 2014; Obonyo, Okeyo, & Kambona, 2017).

Data Analysis and Results:-

To ascertain the reliability and validity of the instrument used for data collection, the measurement model was calculated using PLS-SEM path modelling. The reliability is evaluated using Composite Reliability (CR) while validity is evaluated using Average Variance Extracted (AVE) and discriminant validity. Figure 1 and Table 1 represents the reliability and validity of latent variables of the study.

Figure 1:- Measurement Model.

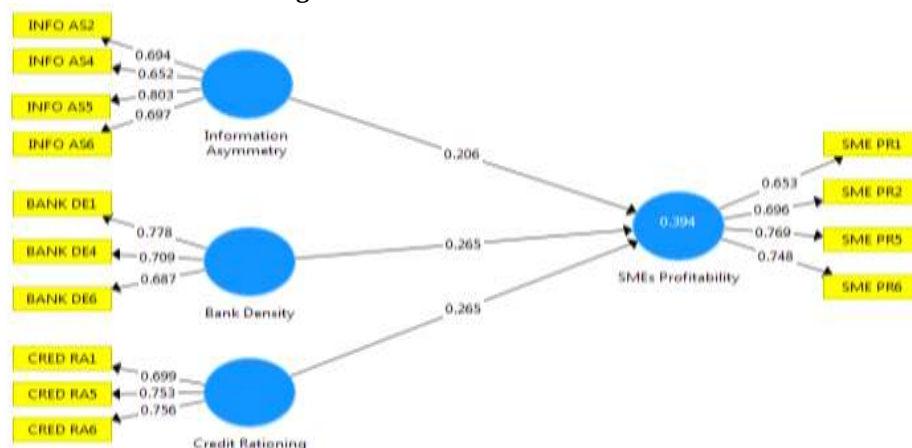


Figure 1 shows the value of cross loadings. Two items (INFO AS 1 and INFO AS3) were deleted from Information Asymmetry. Three items (BANK DE2, CRED RA3 and CRED RA4) were deleted from bank density. Three items (CRED RA2; CRED RA3; and CRED RA4) were deleted from credit rationing. While two items (SME PR3 and SME PR4) were also deleted SMEs Profitability. Thus, all these items were deleted because of their insufficient loadings (i.e. AVE is less than 0.5 and CR is less than 0.7). By the rule of thumb, AVE should be greater than 0.5 and CR is expected to be greater than 0.7 (Garson, 2016; Hammel & Abdul-Aziz, 2017). Item loadings should be above 0.5. The basis for these deletions is to increase the AVE and CR to the expected standard.

Table 1:- Construct Reliability and Convergent Validity (Measurement Model) n= 843.

Constructs	items	Loadings	Ave	Cr
Bank density	Bank de1	0.778	0.527	0.769
	Bank de4	0.709		
	Bank de6	0.687		
Credit rationing	Cred ra1	0.699	0.543	0.780
	Cred ra5	0.753		
	Cred ra6	0.756		
Information asymmetry	Info as2	0.694	0.509	0.805
	Info as4	0.652		
	Info as5	0.803		
	Info as6	0.697		
Smes profitability	Sme pr1	0.653	0.515	0.809
	Sme pr2	0.696		
	Sme pr5	0.769		
	Sme pr6	0.748		

Source: Smart PLS 3.2.8. Output (2020). Note: AVE represents Average Variance Extracted; CR represents Composite Reliability. INFO AS3; BANK DE2 & DE3; CRED RA3; SME PR3; INFO AS1; BANK DE5; CRED RA4; SME PR4; CRED RA2

Table 1 shows the reliability and validity of constructs of the study. Construct reliability and convergent validity of constructs were tested using composite reliability and Average Variance Extracted (AVE) as suggested by Garson (2016). As shown in Table 1, all of the items met the minimum benchmark for items loading (i.e., 0.5), composite reliability (i.e., 0.7) and AVE (i.e., 0.5). Hence, it is presumed that the items on Table 1 exhibited satisfactory level of reliability and good convergent validity. To test how the indicators are related to its construct other than the others, the data were subjected to discriminant validity using Fornell-Larcker criterion. According to the Fornell and Larcker criterion, the square root of each construct's AVE should be greater than its highest correlation with any other construct (Obonyo, Okeyo, & Kambona, 2017). Table 2 summarized the results.

Table 2:- Discriminant Validity using Fornell-Larcker Criterion (n= 843).

Constructs	Bank Density	Credit Rationing	Information Asymmetry	SMEs Profitability
Bank Density	0.726			
Credit Rationing	0.599	0.737		
Information Asymmetry	0.584	0.582	0.714	
SMEs Profitability	0.544	0.543	0.515	0.718

Source: Smart PLS 3.2.8. Output (2020). Note: The bolded numbers (diagonals) represents the square root of the AVE of each latent construct.

On Table 2, the bolded numbers represent the square root of the AVE of each latent variable. The square roots of all the AVE are higher than correlations with other latent construct. Going by the Fornell-Larcker criterion, the data demonstrated discriminant validity. The study next tested the hypothesis of the study by calculating the structural model, bootstrapping the samples 5, 000 times.

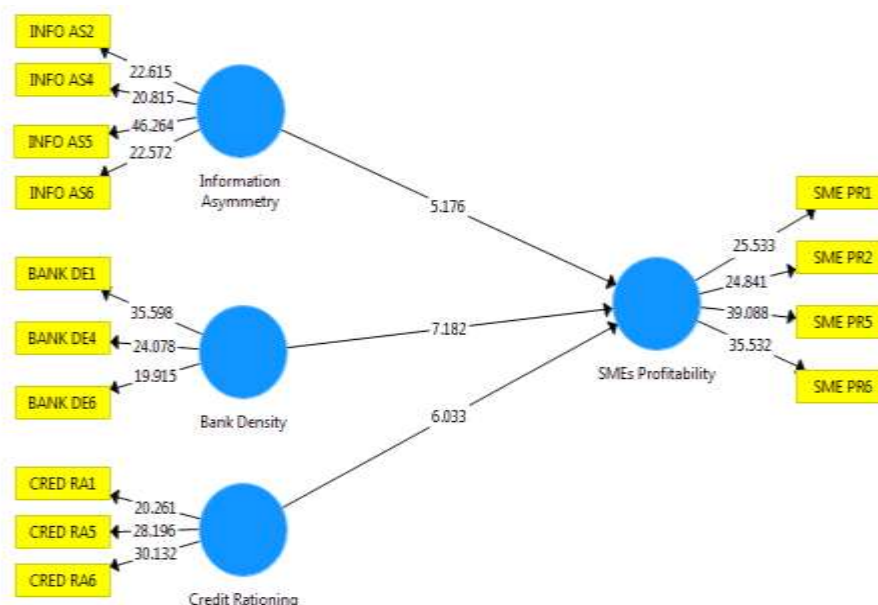


Figure 2:- Structural Models Direct Effect.

Table 3:- Summary of findings and hypothesis testing.

Relationship	Beta Coefficient	Standard Error	T Statistics	P Values	Decision
Bank Density -> SMEs Profitability	0.265	0.037	7.182	0.001	Rejected
Credit Rationing -> SMEs Profitability	0.265	0.044	6.033	0.001	Rejected
Information Asymmetry -> SMEs Profitability	0.206	0.040	5.176	0.001	Rejected
R square	0.394				

Source: Smart PLS 3.2.8. Output (2020)

Table 3 presents the results of the hypothesis of this study. The R^2 value is 0.394, indicated that 39.4% of the variance in SMEs profitability can be explained by all the study variables of bank density, credit rationing, and information asymmetry. Therefore, the null hypothesis which stated that business credit availability (information asymmetry, bank density, and credit rationing) have no significant effect on the profitability of selected small and medium enterprises in Southwest, Nigeria is hereby rejected.

Results also revealed that bank density has effect on SMEs profitability, significant at less than 1% ($\beta = 0.265$, $p < 0.01$). This implies that a unit increase in bank density, will lead to a 26.5 unit increase in SMEs profitability. Credit Rationing has significant effect on SMEs profitability also at less than 1% ($\beta = 0.265$, $p < 0.01$). Finally, information asymmetry has positive and significant effect on SMEs profitability ($\beta = 0.206$, $p < 0.01$). It can be said from this analysis that Bank density, Credit rationing and Information asymmetry are major factors that influences SMEs profitability which leads to increase in overall performance. Further, both Bank density and Credit rationing had stronger effect on SMEs profitability than Information asymmetry, suggesting that the variables determine business credit availability to SMEs to increase performance than any other factors in the model.

Table 4:- Effect Size of Exogenous Variables.

Construct	f^2	Effect Size
Bank Density	0.065	Small
Credit Rationing	0.065	Small
Information Asymmetry	0.040	Small

Source: Smart PLS 3.2.8. Output (2020)

The study further tested for the effect size of the exogenous variables on the endogenous variable of this study using f^2 . According to Cohen (1988), f^2 values of 0.02, 0.15, and 0.35, represents small, medium, and large effects respectively. Table 4 show the effect size of each of the exogenous variables in the present study. The effect size of Bank density, Credit rationing and Information asymmetry on SMEs profitability were 0.065, 0.065, and 0.040 respectively. The values indicated that the effect size is small according to the Cohen (1988) criterion. This implies that Bank density, Credit rationing and Information asymmetry have small effects on SMEs profitability. Hence, these variables should be frequently reviewed by banks and CBN in order to increase availability of business credit and subsequently improve profitability of SMEs in South-West of Nigeria.

Table 5:- Construct Cross Validated Redundancy.

	SSO	SSE	Q ² (=1-SSE/SSO)
Bank Density	2,457.00	2,457.00	
Credit Rationing	2,457.00	2,457.00	
Information Asymmetry	3,276.00	3,276.00	
SMEs Profitability	3,276.00	2,630.43	0.197

Source: Smart PLS 3.2.8. Output (2020).

Table 5 shows the construct cross validated redundancy. The cross validated redundancy assesses the capability of the model to predict the endogenous variable and thus demonstrates the quality of the model (Abdullahi & Haim, 2017). In this paper, the Stone-Gleisser Q² value was utilized to determine the predictive relevance of the model. Cohen (1988) has suggested the range for using the Q². According to Cohen (1988), a Q² value of 0.02 represents a small predictive relevance, 0.15 represents a medium predictive relevance, and 0.35 represents a large predictive relevance. The result in Table 5 reveals that the Q² value of SMEs profitability is 0.197, this implies that the exogenous variables (Bank density, Credit rationing and Information asymmetry) has a medium degree of predictive relevance with regards to SMEs profitability. For this reason, the model has sufficient prediction quality.

Discussion of Findings:-

The effect of availability to credit financing on the profitability of SMEs is not clear and has been a source of discussion with some authors arguing that availability to credit financing enhances profitability while others argue the cost of financing nets off the benefits thereof. Further, studies especially in Nigeria that have ignored how business credit availability measured by information asymmetry, bank density, and credit rationing, affect SMEs business profitability. Consequently, to fill this knowledge gap, this study empirically examined the effect of business credit availability (information asymmetry, bank density, and credit rationing) on SMEs business profitability. The effects of information asymmetry, bank density, and credit rationing on SMEs business profitability are estimated separately. Based on the result, it is revealed that information asymmetry, bank density, and credit rationing have positive and significant effect on SMEs business profitability in Southwest, Nigeria. The result implies that if bank increase their density, reduce information asymmetry and credit rationing, SMEs profitability will also increase. These findings, supports the economic theory that expanding credit financing access holds the promise of increasing profitability by spurring investment in under-funded enterprise, following the logic of Gurley and Shaw (1955) and McKinnon (1973). Also, the finding is in line with the results of Olutunla and Obamuyi (2008) which showed interdependence between bank loans and the profitability of the SMEs, and a significant relationship between profitability and size of business. Somoye (2013) evaluates the impact of finance on entrepreneurship growth in Nigeria using endogenous growth framework, the results show that the finance, interest rate, real gross domestic product, unemployment and industrial productivity are significant to entrepreneurship in Nigeria. The results also show a uni-directional Granger causal relationship and suggest that access to finance by entrepreneurship has significant relationship with profitability of SMEs in Nigeria. Similar finding was found by Saqib, Azhar and Rao (2017) who asserted that fixed assets, set up and current asset financing of SMEs have positive relation with the profitability growth of SMEs.

Conclusion and Recommendations:-

From the review of extant literature, empirical and documentary results of the study, discussion presented in the preceding section and also from summary of the findings, the following conclusion emanated. It was evident that SMEs were confronted with a lot of challenges in Nigeria, especially the South-West, which had continued to hamper the growth and performance of the enterprises. Credit availability from deposit money banks has been identified as a major constraint to the growth, survival and profitability of the enterprises. Given the above

observation, it is concluded from the study that bank density, information asymmetry and credit rationing are seen to be major constraints to the profitability of SMEs, most especially from the South-West, Nigeria. This discovery of knowledge is very critical to policy makers, in establishing long-term initiatives necessary for reducing financial hiccup hindering the profitability of SMEs in the country.

Small and Medium Scales Enterprises have been described as catalyst for economic growth in any Country. It is therefore imperative to appreciate finance as a major constraint to the realization of the growth and potential of SMEs in South- West Nigeria. All stakeholders, the entrepreneurs, deposit money banks, government agencies, regulatory authorities among others should strike a balance in maintaining the financial needs of SMEs for both capital investment and working capital requirements and such needs should be provided promptly and adequately if the full impact of the SMEs is to be realized on both short and long term basis.

There is availability of funds that are budgeted for SMEs by all deposit money banks, but from this study it is evident that bank density, information asymmetry and credit rationing are major determinants and eventual potential of the SMEs sector. There should be Central Bank of Nigeria (CBN) credit policies that should be tailored towards branch expansion by the deposit money banks that could be accessible to SMEs. In addition, lending requirements that can be met by the SMEs should be developed in consideration of evident concept that would be attractive to deposit money banks. When this is moderately addressed, the issue of credit rationing will be eventually resolved. CBN could also take the bull by the horn and de-risk all lending to SMEs by deposit money banks to a certain ratio that would be attractive to these banks to support SMEs especially in South-West and in Nigeria as a whole.

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