EFFECT OF VENTURE CAPITAL FINANCING ON THE FINANCIAL PERFORMANCE OF SMEs IN CROSS RIVER STATE

EGU USANG INAH Ph.D, ACA; OLOFU MATHIAS AJOR; MANNAH ELIZABETH JACOB; UWALAKA BENEDICTA CHISOBEM; IBAYE THERESA MBONG
DEPARTMENT OF ACCOUNTING, FACULTY OF MANAGEMENT SCIENCES, UNIVERSITY OF CALABAR, CALABAR

KEYWORDS

ABSTRACT

This study examined the effect of venture capital financing on the financial performance of small and medium scale enterprises (SMEs) in Cross River state, Nigeria. Specifically, the study sought to determine the effect of venture capital financing on the Net sales, net profit and Return On Assets of SMEs in cross river state. The study anchored significantly on pecking order theory. Descriptive survey research design was used for the study. The population of study comprised all the SMEs in Cross River State that registered with Corporate Affairs Commission and have used venture capital. The sampling technique adopted was a two-staged sampling technique which are purposive and simple random sampling technique. Primary data were collected from respondents through structured questionnaires. Data collected were analysed using descriptive statistics of mean and standard deviation. Correlation test and analysis of variance (ANOVA) were also used. The findings therefore revealed that there was significant difference in net sales, net profit and return on assets after using venture capital financing. Hence, it was concluded that venture capital financing has significant effect on the financial performance of SMEs. Based on the finding and conclusion, it was recommended among others that fund managers should intensify the advisory role to ensure that businesses take advantage of increase their turnovers.

Introduction

In recent times, there has been an increase in attention towards Startup enterprises within developing economies as they are deemed as key drivers of economic growth and an avenue for foreign direct investments (Mogiro, 2012). venture capital (VC) financing has subjugated debates on global financial markets for the perceived momentous influence to inspire small- and medium-sized enterprises' (SMEs) performance. Empirical evidence, essentially from developed countries such as the United States of America, Canada, Europe and China, recognises VC as a viable financing model with

the proficiency to escalate access to finance for SMEs' growth (Agyeman 2010; Gomper& Learner 2004; Muriithi 2017; OECD 2018; Shanthi& Schneider 2018). Similarly, the growth of small and medium-sized enterprises (SME) has an effect on the global economy and contributes to wealth generation (Arouri, 2018).

However, majority of SMEs face financing challenges because most financial institutions and specifically banks perceive SMEs as borrowers having inherent risk given that majority of them are first timers in business (Vita, Mari &Pogessi; 2014). These financing challenges seem to have continuously persisted and constrained the growth of SMEs despite accessing venture capital financing. Similarly, Muniech and Mondi (2017), submits that SMEs are a very important segment in most economies, particularly in developing countries and thus SMEs growth accounts for the majority of global businesses and are important contributors to job creation and global economic development.

Thus, according to the World Bank (2017) report, SMEs represent about 90% of businesses and more than 50% of employment worldwide. Formal SMEs contribute up to 40% of national income- Gross Domestic Product (GDP). These numbers, however, are significantly higher when informal SMEs are included. According to World Bank estimates, 600 million jobs will be needed by 2030 to absorb the growing global workforce and this makes SME development and growth a high priority development item for many governments globally (Beck, Dermiguc-Kunt& Levine, 2015).

The Inter-American Development Bank (IADB) defines SMEs as having a maximum of 100 employees and less than $3 million turn over in revenue while in Europe, they are defined as having manpower fewer than 250 employees and United States define SMEs as firms with employees less than 500 (Natarajan&Wyrick, 2011). The World Bank (2018) defines SMEs as those enterprises with a maximum of 300 employees, $15 million in annual revenue, and $15 million in assets. The same variations with regards to SME definition has been realized in Kenya as well and are yet to be consolidated. For example, a national baseline survey of MSEs carried out in 1999 defines a small enterprise as one which employs between 6-10 people while a medium one is expected to have between 11-100 employees (CBS et al., 1999).

The UNDP (2015) study report classifies and defines an SME into three categories: Micro enterprise is defined as any firm, trade, service, industry, or a business activity, formal or informal that has an annual turnover that does to exceed Ksh 500,000 and employing between one and twenty workers in a year. Small enterprises are those firms, trade, service, industry or business activities, formal or informal that post an annual turnover of more than Ksh 500,000 but less than Ksh 5 million and employing between twenty-one and fifty workers in a year. Medium enterprise as any firm, trade, service, industry or business activities, formal or informal employing between fifty-one and two hundred and fifty workers with an annual turnover of between Ksh 30 million to Ksh 150 million. This study has therefore adopted the UNDP (2015) definition. The prospect of the SMEs growth is premised upon the type of financing that various investors are willing to inject into the new venture. In growing economies, SMEs growth is essential not only as avenue of revenue generation but also successful SMEs offer employment to unskilled workers, who are overly plentiful in those developing countries (Ndesaulwa, Kikula& Chao, 2017).

For SMEs to grow, they require affordable financing models that would give them enough time to invest their capital in the production of competitive products with capability of meeting the requirements of consumer demand of various markets. According to Ongore and Kusa (2012), most financial institutions and intermediaries are hesitant to offer credit facilities to SMEs because majority of them lack collateral and most importantly they are considered as risky borrowers given that they are new start-ups in business whose products and services have not been test marketed. The usage of venture capital as a financing model targeting start-up entrepreneurs has been considered as a success determinant for the growth of SMEs (Savaneviciene, Venckuviene, Gidduaskiene, 2015). It bridges the financing gap experienced by budding entrepreneurs in the financial market since its operations is backed by legal and regulatory framework in most countries observes East Africa Venture Capital Association (EAVCA, 2016).

Therefore, venture capital financing is key in a background where both investors and

entrepreneurs encounter an information asymmetry such as moral hazard and uncertainty (Shoghi&Safieepoor, 2013). Venture capital bridges the gap of financing through provision of seed capital in the essential stages of early expansion and progress of many firms. They are useful for directing the flow of funds from savers to investors for investment projects that would yield the highest returns.

According to a survey done by Deloitte (2016), VC firms are increasingly showing interest generally on Africaowing to a vibrant private sector and ease of doing business deals. Despite increased efforts to secure VC financing, past statistics indicate that 40% of such startups fail by the second year with at least 60% shutting down by the 4th year (KNBS, 2017). This is because businesses in this part of the world suffer challenges that affect their growth beyond the inceptions stage while others go out of business prematurely. There is a high failure rate of startups range between 50% and 95% within the five years of operations primarily in emerging economies. The above indicates that the increasing venture capital investments have not resulted in better growth among startups hence examining how venture capitals influence growth of startups within Nigeria especially in Cross River State thus filling the knowledge gap.

Venture capital financing provides funds to young but promising entrepreneurs and it goes beyond provision of pure financial capital for small or startup firms (Ndesaulwa, Kikula& Chao, 2017). According to Sichie and Bohnstedt (2013), venture capital financing is characterized by complex and very secretive information exchange with standards, processes and logistics controlled by the venture capitalists. According to Dagogo and Ollor (2009), venture capital firms have some unique characteristics. Venture capital depends on their potential and capability to invest in businesses that yield profits in a competitive market (Gikomo, 2013).

Venture capital though relatively a small financial intermediary, promotes employments to a large number of working population globally through financing of promising entrepreneurs. From a hypothetical approach, many firms that start the operations as embryonic would hope to progress into large organizations. Practically, this is often an elusive dream to many entrepreneurs as more than 70% of newly started SMEs rarely see their firth birthdays (Kaplan & Lerner, 2012). To overcome this practical challenge, venture capital is a critical financial intermediary which needs to address the gaps exhibited by burgeoning SMEs with regards to varying levels of risk and uncertainty.

Statement of the Problem

Lack of finance is predominantly regarded as one of the major problems contributing to slow development and high mortality rates of small businesses in Africa (Muteti, 2005). The World Bank report (2003) states that SMEs do not experience greater difficulty that other emerging countries (surveyed by world bank) in obtaining finance and argues instead that in Nigeria, lack of adequate financial management support is the second biggest weakness in the national environment for entrepreneurial activity. The small and medium enterprises have been said to be one of the answers to Nigeria's economic problems given the proper funding support. Venture capital financing have remained one of the key managerial problem decisions that affects SMEs in Nigeria today even in business environment too. Currently, the SMEs have almost $7.4 billion with a complement of 2.8 million owners and employing 2.9 million people. Most of the SMEs experience difficulties in accessing capital financing across Nigeria government financial disposition. Tucker and Lean (2013) have documented those small businesses often have difficulties in obtaining funding from financial institutions to expand on their fixed assets and working capital.

As pointed out by Blanton and Dorman (2014), SMEs are often undercapitalized. In other words, requirements for loans approval for SMEs are not met, and even when SMEs do receive loans, usually they are short-term. Hence, SMEs have no alternative but to depend on credit from friends as well as family members to finance their long-term requirements, for example, the procurement of new equipment (Riding and Short, 2017). Despite all this, a lot of studies have shown that there is no inconsistency in most of their findings such as Mansa, (2011); Mbhele (2011); Njoroge (2011) and Dagogo and Ollor (2019) also did a study on the effect of venture capital financing on the economic value added profile of Nigerian SMEs.

Theoretical Framework

The study anchored significantly on pecking order theory. According to Pecking Order Theory of financing, firms and individuals will use personal funds before acquiring external debt and equity. Pecking order theory (POT) was originally devised to examine the financing of large corporations, but it has also been applied to small and medium-sized businesses. It is a framework for examining firm financing that states that firms attempt to reduce information asymmetries and maintain ownership by first using internal financing, followed by external debt and equity (Myers, 1984; Berger &Udell, 2003).

Purpose of the Study

The main purpose of the study was to determine the effects of venture capital financing on the financial performance of SMEs in cross river state. Specifically, the study sought to:

1. Determine the effect venture capital financing on the Net sales of SMEs in cross River state.
2. Determine the effectsVenture Capital Financing on the net profit of SMEs in Cross River State.
3. Ascertain the effect of Venture Capital Financing on the Return on Assets of SMES in Cross River State.

Research Questions

The research questions for this study are:

1. How does venture capital financing affects the Net sales of SMEs in cross River state?
2. How does Venture Capital Financing affect the net profit of SMEs in cross river state?
3. How does Venture Capital Financing affect the return on assets of SMEs in cross river state?

Hypotheses

The following are the hypotheses for this study:

HO1: venture capital financing does not have significant effect on the Net sales of SMEs in cross River state

HO2: Venture Capital Financing does not have significant effect on the net profit of SMEs in cross river state

HO3: Venture Capital Financing does not have significant effect on the return on assets of SMEs in cross river state

Literature Review

The literature review is based on conceptual and empirical review of some critical factors regarding the variables of the study.

Conceptual Review

Venture capital

Venture capital is defined as "as capital provided by firms who invest alongside management in young companies that are not quoted on the stock market. The objective is a high return on the investment. Venture capital is one of the least understood forms of financing as some think it is meant for early stage financing of small rapidly growing technology companies. Panday (2003) argues that venture capital is a significant innovation of the twentieth century. It is generally considered as a synonym of high risk capital. It is a commitment of capital, or shareholding for the formation and setting up of smallscale enterprises. The focus of the venture capitalist is to see small businesses growing in to larger ones. Hisrich and Peters (2002) view venture capital finance as a professionally managed pool of equity capital. Frequently the equity pool is formed from resources of wealthy limited partners. Mucherjee (1999) also define venture capital as funding mainly for development of existing businesses with sound management and high growth potential but with especially attractive start-ups. In terms of definition, Wright and Robbie (1997) state that venture capital can be defined broadly as the investment by professional investors of long-term, risk equity finance where the primary

reward is the eventual gain, rather than interest income or dividend yield.

In another definition, Lerner (2000) defines venture capital as equity or equity-linked investments in young privately held companies, where the investor is a financial intermediary who is typically active as a director, advisor, or even a manager of the firm. A similar definition, according to Cumming and MacIntosh (2001), is that venture capital investors are financial intermediaries (in essence a kind of specialized mutual fund) which receive capital contributions from institutional investors or high net worth individuals across the economic spectrum, and invest the pooled deposits in small, private and mainly high technology businesses or entrepreneurial firms with potentially high growth.

Venture capital finance is also viewed as early stage financing of new and young ventures seeking to grow rapidly (Ross and Wester, 1990). It is actually an alternative form of equity financing for small and medium term business. William (2002) also looks at venture capital as a process by which investors fund early stage, more risk-oriented ventures. Kibiriti et al. (2000) view venture capital as basic risk capital of an enterprise. Unlike investment in secured debt which tend to be risk averse, venture capital seek significant returns to compensate the high risk of loss of entire equity investment. It involves building and financing self-sustaining companies from scratch and also assist revive their enterprises by merger and reconstruction. These definitions imply that venture capital involves the provision of equity finance to ventures that are typically small in size. Thus the working definition of venture capital in this study is early stage financing of small and medium term business seeking to grow.

William (2004) argues that venture capital differs substantially from 'traditional' financing in the following ways: One, funding provided to new or existing firms with potential of above-average growth. Two, often provided to start-up and 31 other emerging enterprises because they lack the collateral, track record or earnings required getting a loan. Three, the investment, typically requiring a high potential of return, is structured so that it can be liquidated within a three to seven-year period, then an initial public offering may take place, or the business merges or is sold, or other sources of capital are found. Four, the entrepreneur typically relinquishes some level of ownership and control of the business. Five, venture capitalists typically expect a 20-50% annual return on their investment at the time they are bought out. Six, typical investments range from $500,000 to $5 million and management experience is a major consideration in evaluating financing prospects. Panday (2003) also notes that conventional financiers generally support proven technologies with established markets, however high technology is not a necessary condition for venture financing.

Venture Capital Investment Process

The venture capitalists follow a clearly defined procedure (Tyebjee& Bruno, 1981) in investing their funds in SMEs as given below and also illustrated in figure 2. a) Deal origination: venture capitalists require a flow of deal, which may originate in various ways like referral system, active search and intermediaries. b) Screening: initial screening of all projects on the basis of some broad criteria is carried out. Venture capitalists obviously seek to attract desirable propositions yet many unwanted proposals are received; these have to be weeded out as quickly as possible. There is broad agreement that proposals are assessed first in relation o the quality of their business plans and the basic concept of the project and personality and track record of the entrepreneur and/or management team is vital, however venture capitalists are more concerned with market acceptance. c) Due diligence: ones a proposal has gone through initial screening; it is subjected to detailed evaluation or due diligence process. The aim of this part of the investment cycle is to minimize investment risk by conducting a thorough investigation of the information presented in the business plan, with special attention usually paid to the qualities of the entrepreneur or management team. The quality of an entrepreneur is evaluated before appraising the characteristics of the product, market or technology. Most venture capitalists ask for business plan to make an assessment of the possible risk and return on the venture. The final decision is taken in terms of the expected risk-return trade-off. d) Deal structuring: once the venture has been evaluated as viable, the terms of the deal are negotiated, in terms of amount, form and price of the investment. The agreements also include the protective covenants, and earn-out arrangements. Venture capitalists generally negotiate deals to ensure protection of their investment. e) Post

investment activities: ones the deal has been structured and agreement finalized, the venture capitalists assumes the role of a partner and collaborator. The capitalist gets involved in shaping the direction of the venture. f) Exit: venture capitalists aim at making medium to long-term capital gain within a period of five to ten years and then exit. A venture may exit in any of the following ways; initial public offering, acquisition by another company, purchase of the venture capitalists' shares by promoter and purchase of 39 venture capitalists' shares by outsider.

Small and Medium Enterprises (SMEs)

There is no globally recognized definition of SMEs but the definition varies from country to country, region to region and sector to sector (Report on Business Advisory group of 2004; Storey, 1994; Bolton Committee Report, 1971; EU Report, 2003). In the Business Advisory Report of 2002, SMEs are defined as businesses with fewer than 20 employees. Copper et al (2005)'s study on textile and clothing manufacturing SMEs in the United Kingdom defined SMEs sector as those that employ less than 250 people and with a turnover of not more than £22.8 million.

A Study by Liedholm and Mead (1987) covering developing countries reveals that SMEs are privately owned, in sole proprietorship and in terms of employment, but of this proportion family workers generally form the largest component. According to the statement by United States Committee for Economic Development (1997), a small business has two or more of the following characteristics: i) Management: the business is managed and operated by the owner(s). The entrepreneur or founder of the business acts as both manager and worker who does decision making. ii) Resources: A small business often has limited resources. This is especially true for new starts-up due to a lack of track record on the business to convince potential investors and bankers. Thus, it is highly dependent on the ability of the owner to generate resources. iii) Organizational Structure: For a small business, the structure is often flat and informal. The owner has to do almost everything and the workers are normally expected to be able to function as generalists since there is no clear demarcation of tasks. iv) Flexibility of Change: The business has more flexibility to adapt to changes in the environment due to its size and informal structure. It is also vulnerable to develop in the business environment. For instance, any changes in technology or government policy might have a great impact on the business because immediate changes normally require additional capital or resources.

This might become a constraint to the business to compete and sustain itself in the market. In Japan small and medium-scale enterprises are defined as: those in manufacturing with 100-million-yen paid-up capital and 300 employees, and those in the retail and services sector with 10-million-yen paid-up capital and 50 employees (Grey et al., 1996).

As a result of this heterogeneity in the definition of SMEs in different sectors or regions, it is often necessary to modify the various offerings in definition according to particular sectoral, geographic or other contexts in which the businesses in the sector are examined. The implication for research is that researchers are likely to have to continue using their own definitions of small-to-medium enterprises which are appropriate to their particular 'target' group (Storey, 1994).

Whilst this research is not in one way or the other focused on the 'grounded' definitions of SMEs as presented in the Bolton Committee Report (1971) and EU Report (2003), the study however, acknowledges the different characteristics represented in these reports and sets its target group of businesses in the SMEs sector as those that employ six to fifty people and 24 with a turnover of not more than Kshs 50 million. This definition has been used by studies ((Grey et al., 1996)) on SMEs in Kenya and this study will adopt it as a working definition. SMEs have become more important in the economic matrixes as seen in recent years across the globe through increased deliberate government policies and legislation aimed at nurturing SMEs as engines of economic growth and employment creation. It is also estimated that SMEs constitute over 90 percent of total enterprises in most economies with a high rate of employment growth. They are also a vehicle for increased industrial production and exports (Copper et al 2005). . However, there are challenges that they face.

A recent study by Wanjohi (2005) reveal that most people in Kenya work in the agricultural sector with majority practicing subsistence farming while a very small number practice large-scale farming. Some people work

as wage labourers in coffee farms or tea plantations where they are paid small wages and life become rather unbearable at times. There are all sorts of small businesses related to Agricultural sector and finance is said to be the major challenge in whichever business one undertakes.

Performance Measurement

Performance refers to a degree of accomplishing a task that make up a specific job. It reflects the degree of fulfilling the requirement of a job and it is measured in terms of results (Joubert, 2002). The word performance is an evasive concept and may be interpreted differently by different people. Performance can be defined as ability to perform or capacity to achieve desired results (Langdon, 2000). Performance then needs to be measured during a time period in line with an expectation, promise or target. Measurement has been recognized as a crucial element to improve business performance (Sharma et al., 2005) particularly focusing performance from a financial perspective to a non-financial perspective.

Kaplan & Norton, (1992) devised the balanced scorecard as a measurement framework for strategic, operational and financial measures. Although extensive 28 research has been carried out to investigate the needs and characteristics of performance measurement in large organizations, there is a distinct lack of published research on issues related to SMEs (Hudson et al., 2000). Fitzgerald (2007), examined the performance measurement in for-profit services, and concluded that performance measures fell within two broad categories: end results and means or determinants. Results were further subdivided into competitiveness and financial measures while means or determinants were subdivided into four broad categories namely quality of service, flexibility, resource utilization and innovation. The discussion above then implies that performance measurement can be looked at from many dimensions and this study considered financial and management governance measures among others.

To measure the success of an enterprise and to guide executives through the benefits realization process, an appropriate performance measurement model is needed. It is common practice to measure the performance of any business on a financial scale. Return on Investment (ROI) and Return on Capital Employed (ROCE) sales, profitability among others are the most common ways of measuring the financial success of a business (Kaplan and Norton, 2000; Kaplan and Norton, 1996; Kaplan and Norton, 1992).

Empirical Review

In this subsection, a brief summary of previous empirical works on the impact of venture capital on the performance of small and medium scale enterprises is provided. Biney (2018) investigated the impact of venture capital financing on small and medium enterprises' growth and development in Ghana. The study applied both propensity score matching and difference-indifference estimation techniques to determine the effects of venture capital financing on SMEs' growth and development in Ghana. The result showed a positive and significant correlation between venture capital financing and SMEs' growth in the context of employment and sales in Ghana. Achugbu, T.U. (2017) investigated the impact of venture capital (VC) financing on the growth of innovative start-up companies in Nigeria. Qualitative data were analysed using content analysis method. A sample of 30 start-ups from a total population of 120 start-ups in Onitsha, Awka, Nnewi and Abuja was randomly drawn using systematic sampling technique. It was found that venture capital financing had an impact on the growth of innovative start-ups. The use of VC financing increased profitability, spurs employment growth, boosted asset base, and improved the quality of management for VC-backed startups.

Similarly, Dalić, Terzić & Novarlić (2017) examined the role of venture capital in the development of the sme sector in the Republic of Srpska. The result showed that the companies (83.96% of the ample) regularly introduced new technology which is a good sign of the willingness to keep pace with the economy trends. Also, the research showed that they were willing to fund their ventures through venture capitals (77.36% of the sample). Half of the companies (51.89% of the sample) focused more of their attention on venture capital funds. The research concluded that newly-established companies that funded their early-stage business ventures through venture capital investments had greater chances of success. Manyani (2014) investigated effect of venture financing on small and medium scale enterprises in Bindura Urban,

Zimbabwe. The research focused on SMEs operating in Bindura town under Mashonaland Central Province. A target population of 356 registered SMEs operating different types of industries in Bindura was used in this study. Data were analyzed by content analysis and the results indicated that the majority of SMEs in Bindura used their own savings, family and friends to finance their businesses. The results also indicated that the financing options available to Bindura SMEs are impracticable to support the capital required for their operation because of stringent requirements and lack of collateral security. The study also concluded that SMEs do not only need financial support from government but also need support in research, quality assurance, marketing, financial management and technology.

Gikomo (2013) investigated the effect of venture capital financing on the growth of SMEs in Kenya. The study adopted descriptive cross sectional research design. The target population was the top 100 mediumsized companies in Kenya. Stratified sampling was adopted where a 30% sample was chosen to give a sample size of30 SMEs. The SMEs were chosen though purposive sampling whereby firms were chosen on the basis that they had received venture capital financing. The study collected secondary data from 2008 to 2012. The data was analyzed through a regression model to establish the form of relationship between the dependent and the independent variables. The study found out that there was a positive and significant relationship between growth in SMEs and venture capital financing. The study concluded that increased venture capital financing improved SMEs credit rating, marketing and distribution networks, technical expertise and management skills which in turn enhanced growth in these firms.

Memba, Gakure&Karanja (2012), studied the impact of venture capital on growth of Small and Medium Enterprises (SME) in Kenya. A descriptive statistical analysis was carried out on annual profit figures. The findings revealed that venture capital had an impact on growth of SME they financed and that use of venture capital can be profitable in Kenya even in an inauspicious political and economic climate. The study concluded that SMEs that use venture capital experience improved growth. The economic impact of venture capital was realized by SME in sales growth, profit, asset and improvement in management of finance and other resources.

Dalberg Global Development Advisors (2012) assessed the impact of Multilateral Investment Fund's Venture Capital Program in Latin America. Time-series analysis using t-test statistical tool was used to isolate the impact of Venture Capital on companies' revenue and job growth. The analysis compared the growth of companies, after they received VC funding with companies' counterfactual growth had they not received Venture Capital backing. The study concluded that Venture Capital-backed firms in the sample under analysis typically outperformed their national peers in economic, social and environmental terms. On the average, revenue increased by 23% annually among venture capital-backed companies during the average investing timeframe of 5.2 years. On average, full-time employment increased by 13% annually among Venture Capital-backed companies during the average investing timeframe.

Afua (2011) studied the impact of venture capital financing on SMEs in the Tema Metropolis in Ghana.50 copies of questionnaire were administered to Managers/SME owners operating within the Tema Metropolis with focus on Elsa Foods Ltd using convenience sampling techniques. The researcher adopted frequency counts and percentages as main statistical techniques for the interpretation of data. It was generally observed that SME‟s prefers self-financing and occasionally received support from financial institutions. The findings further showed that SMEs continue to rely on many financing options both at their conceptual and expansion stage. Majority of the SMEs were however not aware or had little knowledge about venture capital financing as an alternative financing option. Firms that had benefited from venture capital financing stated that they did not only receive capital inflow but was accompanied with monitoring, technical skills and expertise, access to management, marketing and distribution and reputation for attracting further finance.

Moreso, Memba (2011) examined the impact of venture capital on performance of SMEs in Kenya. The target population of this study consisted of 200 SMEs that have used venture capital. The research utilized a sample of 100 SMEs that have been financed by venture capitalist in the major towns of Kenya (Nairobi, Kisumu, Nakuru& Mombasa). Data was collected through semi structured questionnaire. Tests like ANOVA, chi-square, correlation analysis were carried out. The

findings revealed that venture capital had impact on the performance of SMEs they financed. Management style improved when firms used venture capital. The study concluded that SMEs that used venture capital experienced improved performance.

Juha (2010) examined the effect of venture capital investment on small and medium enterprises in Finland. Regression analysis was used to find out the effects of several determinants. Regression models were formed based on the presented theories. SMEs with and without venture capitalists were considered separately. The result showed that venture capitalists have a positive effect on SMEs in Finland. Yap (2009) analyzed the effect of venture capital firm's reputation on its start-up company's long term operating performance and survivorship in Singapore. Cross sectional econometric regression method was adopted. The result showed that venture capital companies' market share and IPO share have strong and positive association with the post-IPO long-term performance metrics, and the effects are statistically significant even after accounting for self-selection bias.

Dagogo&Ollor (2009) examined the effect of venture capital financing on the economic value added profile of Nigerian SMEs. Paired t-tests and multiple regression analysis were conducted to investigate the proportion of variation in the dependent variable explained by the regression of the independent variables. The result showed that the percentage growth of average economic value added by Venture Capital -backed SMEs from 2003 to 2007 was 1,678 percent, whereas there was a reduction in the average of economic value added non VC-backed SMEs by 3.3 percent. The result of the multiple regression analysis indicated that management support was the major driver in the high performance of VC-backed SMEs.

Thus, Balboa, Martí&Zieling (2006), in their work titled "does venture capital really improve Portfolio Company's growth in continental Europe?" examined 250 Spanish Venture Capital backed companies at the expansion stage. The results of the random effects panel regression showed that sales and employment growth of VC-backed companies at the expansion stage were not significantly different from that of comparable non-venture capital-backed companies prior to the investment, while it was different from that moment on. It was therefore concluded that the positive impact of venture capital was indeed driven by the funding and managerial support provided to portfolio companies. Engel (2001) evaluated the impact of venture capitalists on employment growth of new founded firms in Germany. Differences between high-tech and low-tech industries as well as the impact of other investors were analyzed using econometric models. The estimation results showed that surviving venture-backed firms realize higher growth rates compared to surviving non-venture-backed firms. Moreover, venture capitalists are able to push the firms to a faster and higher employment growth than other investors. In the case of SMEs when they were not trained, the outcomes took longer to be evaluated while others were not evaluated at all. The study shows that when evaluation takes longer, this leads to high mortality rate of the SMEs projects and thus does not contribute to growth of firms.

Methodology

Research design

The descriptive survey research design was used in this study. The researcher decided to use this design because it afforded him to garner opinions and information from the respondents on the effects of venture capital financing on the financial performance of SMEs in cross river stateThis research employed both quantitative and qualitative approaches.

Population of the Study

The population of study comprised all the SMEs in Cross River State that registered with Corporate Affairs Commission that have used venture capital.

Sample and Sampling Techniques

A two-staged sampling technique was employed in selecting the sample size. In the first stage, purposive sampling was used to choose threelocal governments, namelyCalabar Municipal, Calabar south and Ikom that had the highest number of registered SMEs in the state. In the second stage, simple random sampling was used to select SMEs from other local government areas.

Data Collection

Primary data were collected from respondents (SME directors/managers and officials of venture capital firms) through structured questionnaires. In order to evaluate the effect of venture capital financing on the performance of SMEs in Cross River State Nigeria.

Findings and Discussions

HO1: venture capital financing does not affect the Net sales of SMEs in cross River state

From the table below, the minimum sales increased from Ksh 290,000 to Ksh 4,000,000. The maximum sales increased from ₦ 70, 800,000 to ₦500, 000,000. The mean sales after use of venture capital are ₦ 139, 043, 076 up from ₦10, 349,661. Generally, there was improvement in sales volume after use of venture capital.

This finding is in conformity with the studies by Steiner and Solem (1988), Cuba, et al (1983), Khan and Rocha (1982), and the United States Small Business Administration (1980) which has used sales growth as a key indicator of small business success and overall performance. Their study reported that there was substantial sales growth by firms that used venture capital. However, availability of finance is no guarantee to increase in sales. Cook (2000) observed that proper marketing strategy, pricing policy, research and development, proper management among others contribute to sales growth. The presence of venture capitalists in a firm provides guidance to all the above hence sales growth.

Table 1: Sales Before and After use of Venture Capital

	N	Minimum	Maximum	Mean	Std. Deviation
Sales before	65	290,000	70,800,000	10,349,661	17,281,467
Sales after	65	4,000,000	500,000,000	139,043,076	137,616,652.

A correlation test was run to test the extent of interdependence of the two variables considered above. The result indicates that there is a significant relationship between the sales before and sales after use of venture capital. The correlation coefficient, r = 0.933 and r^2 = 87% which means that 87% of the variation in sales can be explained by variation in the use of venture capital. A number of factual evidence on the economic impact of venture capital has been published especially for the USA economy which supports the finding of this study.

According to a study carried out by Astrid & Bruno (2004) on venture capital funded firms for the period 1970-2000, the sales doubled, paid almost twice the federal taxes, generated almost twice the exports and invested almost three times as much in research and development as the average non-venture capital backed firms. The European Venture Capital Association (2001) has also established that venture capital backed firms report a high growth in sales as compared to other firms. The result reveals that venture capital leads to growth on sales of the firms that use these funds.

Table 2: Correlations of Sales Before and After use of Venture Capital

		Sales per annum Before	Sales per annum After
Sales per annum before	Pearson Correlation	1	0.933(**)
	Sig. (2-tailed)		0.000
	N	65	65

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

HO2: Venture Capital Financing does not affect the net profit of SMEs in cross river state

Profit Before and After use of Venture Capital

A descriptive statistical analysis was carried out on annual profit figures provided by respondents from the field to further prove that profit upon use of venture capital has shown any change. This analysis showed that the increase in profitability is significant in business growth. The minimum profit before use of venture capital was ₦ 34, 866. Upon use of venture capital, the minimum profit increased to₦600, 000. This shows an increase in minimum profit of 94%. The maximum profit respondents reported before use of venture capital was ₦ 38, 98% 2% Stagnant Upwards 81% 14% 5% Poor Fair Good 76 567,951 which increased to ₦62, 864,152 an increase of 63%. The average profit also increased by 69% (from ₦7,204,653 to ₦12, 202,775).

This finding then implies that firms that use venture capital experience growth in profit. Similar trend was reported by Chaganti and Mahajan (1983) in Indian SME that used venture capital. The important aspect here is not just the finance the venture capitalists provide value creation in the venture. Empirical evidence (Brav and Gompers 1997) confirms that increase in profit by venture capital-backed firms is often attributed to better management teams and corporate governance structures that help these companies to perform better in the long run.

Table 3: Profit Before and After use of Venture Capital

	N	Minimum	Maximum	Mean	Std. Deviation
Profit before	65	34,866	38,567,951	7,204,653	11,544,019
Profit after	65	600,000	62,864,152	12,202,775	18,860,127

The test of ANOVA was also carried out to test whether use of venture capital has any influence on profits. When the test was run at 0.05 significance level, the p value was 0.000. Since the p value (0.000) is less than α (0.05) then the result is significant implying use of venture capital does have a significant difference between profits before and after use of venture capital. A study carried out by Engel and Keilbach (2002) which compared venture capital financed firms with non-venture capital financed firms in Germany indicated that venture capital financed firms showed high profitability. In this study, the findings also indicate that firms that use venture capital realize a general increase in profits.

Table 4: **ANOVA Test Annual Profit After / Before use of Venture Capital**

	Sum of Squares	Degrees of freedom	Mean Square	F	Sig.
Between Groups	2.27616	23	9.89614	11736.382	0.000
Within Groups	3.45712	41	8.43210		
Total	2.27716	64			

HO3: Venture Capital Financing does not affect the Return on Assets of SMEs in Cross River State

Net Assets Before and After use of Venture Capital

Net assets were used as measure of growth. Liao, et al (2001) define enterprise growth as a unidimensional construct operationalized by a variety of growth measures which include sales, value of net assets, profit, number of workers, and market share among others. Barmes (1990) also observed that assets are particularly useful indicator of impact because their level does not fluctuate as greatly as others.

Thus net assets are indicators of growth. Table 5 shows that assets of firms grew by a significant amount after use of venture capital. The maximum value of net assets reported increased from N 600 million to N 640 million. The average net assets also increased from N 75.2million to over N 102.5 million. This increase in value of net assets after use of venture capital is a worthy evidence to say that there is growth. Literature (Brigham and Houston, 2001 and Pandy, 2003) confirms that growth in assets can be directly linked with availability of funds as the business expands. Since venture capital is equity capital to the business then net assets also increase.

Table 5: **Net Assets Before and After use of Venture Capital**

	N	Minimum	Maximum	Mean	Std. Deviation
Assets Before (N)	65	4,000,000	600,000,000	75,205,056	136,940,638.
Assets After (N)	65	8,000,000	640,000,000	102,547,692	163,907,711.

Return On Assets (ROA) which is a financial ratio that shows how efficient a firm is in generating returns in the business was also calculated shows the return on assets before use of venture capital and after use of venture capital. The minimum returns reported before use of venture capital was 0.2% and the maximum reported was 84 %. After use of venture capital, the minimum reported was 0.9% and the maximum was 123%. The financial returns on asset on average increased from 17% to 20%. This finding then implies that firms were efficient in use of assets and this led to growth in returns after use of venture capital.

The increase in efficiency may be as a result of the presence of the venture capital member in the board of management. Similar findings have been reported by Huck and McEwen (1991) from a survey of 54 Jamaican

entrepreneurs involved in manufacturing and service businesses using venture capital. More specifically, these researchers identified competencies in management, planning and budgeting as most crucial for the efficient operation of a small business.

Table 6: **Return on Assets Before and After use of Venture Capital**

	N	Minimum	Maximum	Mean	Std. Deviation
ROA Before %	65	0.2	84.	17	17
ROA After %	65	0.9	123.	20	22

Conclusion

This study investigated the effects of venture capital financing on the financial performance of SMEs in Cross River State. The article presented one of the most extensive empirical studies exploring the major indicators of venture capital financing and financial performance of SMEs.some of the indicators used for the study include; Net sale, Net profit and return on assets.

The findings revealed that before use of venture capital average sales were ₦ 10,349,661, average Profit was ₦ 7,204,653 and 81% of the respondents confirmed that profits were poor. Average net assets were ₦ 75,205,056 and asset turnover was 0.3 times. Firms employed a total of 9,404 workers. Upon use of venture capital average profits almost doubled (₦ 12,202,775) and 98% of the respondents indicated that profitability trend was upward in majority of the SMEs. The value of assets (₦ 102,547,692) improved drastically (approximately 36% increase) as funds were available for expansion or for diversification and also asset turnover increased to 107 2.9 times on average. Sales drastically increased (₦ 139,043,076). The findings therefore revealed that there was significant increase in net sales, net profit and return on assets. Hence, it was concluded that venture capital financing has significant effects on the growth of SMEs in Cross River State.

Recommendation

Based on the findings and conclusion of this study, it was therefore recommended among others that; since most of the businesses have turnovers low the threshold of World Bank. It is therefore recommended that fund managers should intensify the advisory role to ensure that businesses take advantage of increase their turnovers.

The study also recommends that government should put in place an all-inclusive regulatory framework that addresses the venture capital exit problem wrought in venture capital financing in Cross River state and the country at large.

The study recommends that owners of new start-up ventures should embrace the capacity building proffered by venture capitalists as this would enhance both their managerial expertise in the management of information asymmetry and technical capabilities in a global competitive business environment.

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