Barriers to SME Lending in Nigeria

Finding Context-Specific Solutions

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ABSTRACT

This research seeks to deepen the understanding of the causes of obstacles to bank lending to the smaller businesses in Nigeria, and to contribute to the literature aimed at finding solutions to this persistent problem. Smaller firms report access to finance as a major obstacle to their growth. With bank credit contributing up to 50% of their external financing, the research focuses on banking institutions. Perceived as a credit market failure, the economics literature ascribes these credit shortages to problems of informational asymmetry and institutional failure, and in turn, these two issues have dominated the applied research on the subject. This thesis contends that small business credit shortage is a complex phenomenon which needs to be understood within the context of the specific operating environment.

This research is a qualitative case study of a commercial bank in Nigeria that newly entered into the SME credit market using semi-structured interviews and documentary data to explore the obstacles to SME lending and possible solutions. Based on a thematic analysis of the data, the research found that a well-regulated finance industry within the growing economy stimulated opportunities for lending to SMEs. Attracted by these perceived lucrative opportunities, the commercial bank established a successful lending programme developing proprietary credit scoring techniques and innovative devices to overcome institutional barriers and informational obstacles. To encourage more banks to increase lending to the sector, the research concluded with proposals towards removing impediments to SME business lending. These included improving banks' knowledge of specialised techniques to lend to SMEs, business friendly policies to improve the business environment for smaller businesses to reduce their risk of failure, lower interest rates on loans and capacity building to improve management skills of business owners.

Key words: SME lending, institutional creation, Nigeria, SME risk

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List of Abbreviations

AMCON	Asset Management Corporation of Nigeria
ATM	Automated Teller Machine
BOI	Bank of Industry
CBN	Central Bank of Nigeria
CEO	Chief Executive Officer
EDC	Enterprise Development Centre
EPOS	Electronic Point of Sale Machine
ESRC	Economic Social Research Council
EU	European Union
GDP	Gross Domestic Product
ID	Identification
IFC	International Finance Corporation, World Bank Group
ILO	International Labour Organisation
IMF	International Monetary Fund
MSME	Micro, Small and Medium Enterprises
NEEDS	National Economic Empowerment and Development Strategy
NGO	Non-Governmental Organisation
NIE	New Institutional Economics
NSE	Nigerian Stock exchange
OECD	Organisation for Economic Developments and Cooperation
PPP	Purchasing Power Parity
SandW	Stiglitz and Weiss
SAP	Structural Adjustment Programme
SBA	Small Business Association
SME	Small and Medium-Sized Enterprises
SMEDAN	Small and Medium Enterprises Development Agency of Nigeria
SMEEIS	Small and Medium Enterprises Equity Investment Scheme
SMIEIS	Small and Medium Industries Equity Investment Scheme
SSA	Sub-Saharan Africa
UK	United Kingdom
US	United States of America
VAT	Value Added Tax

CHAPTER 1. INTRODUCTION

1.1 Overview

The aim of this research is to improve the understanding of barriers to small and medium-sized enterprise (SME) lending in Nigeria and investigate how to overcome them. Smaller businesses in Nigeria consistently cite insufficient access to finance as a major obstacle to their growth (World Bank, 2013). Given that bank credit is the main source of external finance to the SME sector, the research focus is on the Nigerian commercial banking sector, the major supplier of credit in the economy.

Perceived as a credit market failure, the economics literature has largely ascribed credit shortages to the problems of asymmetric information and institutional weakness. Recognition of this information barrier between small firms and lending institutions arose largely from research carried out in the US and Europe during the 1970s and 80s. The institutional weakness argument emerged more recently within the context of the economic development of poorer nations. As a consequence of these two complementary theoretical axes, much of the applied research on credit market failures has been directed towards the optimal forms of lending structure and institutional reforms required to increase bank lending to smaller firms. Following the development of successful small business lending programmes in advanced countries over the last 20 years, attention has turned to how similar structures can be implemented in emerging economies.

Undeniably, informational barriers exacerbated by institutional weaknesses constitute lending obstacles in developing countries. Nonetheless, the empirical evidence reviewed during the course of this research suggests other factors unexplained by these theories may be involved. The starting point of the research was a theoretical examination seeking a coherent understanding of the phenomenon in Nigeria. This research argues that the idiosyncrasies of the country’s business environment impact the supply of credit and therefore merit particular attention. It concludes that understanding the particularities of the local context, including the peculiar institutional structure of credit markets, is beneficial to help design products and policies to address this problem.

Increasingly, development research has been investigating how successful businesses in emerging markets are able to overcome apparent institutional failure using entrepreneurial techniques to effectively provide goods and services; thereby, creating markets for their products (Khanna and Palepu, 2006). Accordingly, this final piece of the research diverges from the positive perspective of market failure, as found in the economics-based literature, and through a detailed case study of a commercial bank entering into the SME lending market, investigates how obstacles can be surmounted to create new markets for SME credit products in Nigeria.

This thesis builds on the research carried out in previous research documents 4 and 5, which explored theoretical and conceptual gaps and provided the conceptual foundation applied in this case study. The work adapts concepts from the economic literature with recent thinking on institutions from the economic sociology literature on markets, and incorporates elements of motivation from the entrepreneurship literature. In so doing, a conceptual framework of market creation in small business lending is developed; this is then used in an exploratory case study of a Nigerian commercial bank setting out to expand its portfolio of SME loans.

1.2 Background to the Research

My interest in this topic arose from my prior professional career in banking, whereby I gained experience in the decision making and credit process of commercial banks. As a relationship manager and a member of the credit committees of two banks—the first of which was an established international bank and the second a relatively young domestic bank—I was trained in credit analysis and was responsible for preparing and approving loan applications for corporate clients. During a leave of absence to study for an MBA, I took several modules in Entrepreneurship. I studied its theoretical foundations, undertook projects interviewing and writing case studies on small business owners, and produced business plans. This helped me to develop academic and practical knowledge on entrepreneurial and small businesses.

Subsequently, I worked independently as a small business consultant in several Anglophone and Francophone countries in Sub-Saharan Africa. My direct interactions with owner managers of these smaller firms, as well as interactive business-owner seminars I organised, revealed financing of business activities as a recurring theme. I found that my clients, well-educated typically to the tertiary level, and often with international professional experience or qualifications, exhibited certain similarities concerning the operations of the financial side of their businesses. Usually competent in the technical aspect of their business, financial management remained a challenge; particularly in the areas of management accounting, record keeping, audited financials, cash flow planning and banking services. Further, they often felt that their growth potential was being inhibited by lack of access to external finance. Faced with negative responses to loan requests, or not knowing how to structure loan requests to begin with, one of my main tasks was to assist them in formulating credit proposal requests for working capital. I found that the initial response of the banks to loan requests tended to be negative even for these firms that were growing quickly, and had dedicated management and good cash flow.

In my dealings with SME clients in Nigeria, Tanzania, Ghana and Cameroon over 15 years, I noted that commercial banks did not appear to have systematic processes for lending to smaller businesses, or effective mechanisms for distinguishing between good risk and poor. I saw some of my clients, owners of potentially credit worthy businesses, demoralised by the reluctance of banks to lend to them. This suggested a "missed opportunity"—whereby banks were not exploiting this unmet demand. With my background in economics, this suggested to me that if this anecdotal situation I found in several countries was indeed generalised, the macro effect of this restricted access to funding for small businesses could be stunting the development of the emerging private sector that Sub-Saharan Africa needs.

This personal experience motivated my research as a basis to orient my career towards working with banks to set up SME finance units, in order to reach this untapped market as well as to advise policy makers in devising appropriate policies to encourage growth of the SME credit market. It is hoped that this research will also contribute to the literature on obstacles to lending to small businesses in developing countries by deepening the understanding of how commercial bank lending in this region operates.

1.3 Research Aim and Objectives

Insufficient commercial bank credit to SMEs is considered a factor which affects the growth and development of the smaller business sector worldwide. In Nigeria, this problem is particularly acute. According to the Central Bank of Nigeria (CBN), credit to SMEs accounts for only 1% of commercial banks' lending portfolios in the country. Thus, the aim of the research was to improve the understanding of the obstacles to lending in Nigeria and to investigate practical ways that they could be addressed.

This research study has two main objectives: one is theoretical and the other practical. Given the gaps in theory on SME lending difficulties, the first objective was to construct a theoretical framework identifying the key issues that need to be addressed in the creation of an SME credit market. The second objective was to conduct a field study of a commercial bank in Nigeria to examine how a lending model could be developed given the set of issues identified in the conceptual framework and propose solutions to address some the issues identified.

The research questions are elaborated after the literature review in Chapter 4.

1.4 Terms and Definitions

Terminology

The term SME, the acronym for small and medium-sized enterprises, is widely used for policy purpose internationally; however, in the academic literature in the US and UK, the terms smaller business or small business, particularly, may often be used. For example, the term SME is adopted by the European Commission for use in EU policy, and in the UK, the Bank of England's (1994;

2004) quarterly report on financing shortages used ‘SME’ in tracking bank financing to non-corporate entities. In the context of developing countries, ‘SME’ is commonly employed by governments, international development organisations and international financial organisations.

In Nigeria, the term SME is commonly used for public policy by both the Central Bank of Nigeria and by the banking sector. It is generally used to designate those firms that are not large businesses but excludes microenterprises. To avoid the repetitive use of the term in this research, ‘SME’ is used interchangeably with ‘smaller’ or ‘small’ businesses.

Definitions

For purposes of policy and research, smaller businesses are often defined on the basis of employment size and some criteria for annual revenue or asset base may also be included. There are difficulties with using all three of these parameters: monetary values for example, are not constant over time and thereby pose difficulties in longitudinal studies, requiring inflationary adjustments to maintain real values. On the other hand, using staff strength in cross-sectional data involving different types of industries—for example, labour intensive versus knowledge-based industry—is clearly problematic in comparative studies. Storey (1994) concludes that the heterogeneous nature of small firms operating in most sectors of the economy has defied any generic quantitative definition.

In the field of development, the World Bank in its World Business Environment Survey (WBES) (Batra *et al.*, 2003) defined SMEs as those firms with 500 or less employees, with small enterprises considered those with 50 or fewer employees and medium enterprises as those with 51 to 500. This survey, at the time providing the most extensive global data set on businesses and factors affecting their performance, has been used as a source for influential research on firms. Its methodology across the African continent stated 5-19 as the employment band for small businesses, 20 to 99 employees for medium businesses and 100 and above employees for large firms. However, in a 2007 Enterprise Survey on Nigeria (World Bank, 2007), small firms were defined as those with 1 to 19 employees.

Consequently, there is no unanimity on a specific quantitative definition of an SME. Small business specialists such as David Storey (2003) contend that researchers will need to adapt the definition they use in order to correspond with the purpose of their research.

Defining enterprises based on number of employees is considered appropriate as it aids the development of policy and can be comparable across countries at similar stages of development. Generally speaking, firm size characteristics, for the purposes of defining SMEs, differ between advanced countries and developing economies. For example, in the IFC's MSME (micro, small and medium enterprises) Country Indicators report—which provided a snapshot of smaller firms in 132 countries—the classification for SMEs was generally those firms with between 10 and 250 employees for developed countries, and between 5 and 100 for developing countries, although there were individual variances (World Bank, 2010). It is also noted that more recently development institutions use MSMEs when referring to non-large firms.

In Nigeria's National Policy on Micro, Small and Medium Enterprises**,** the framework for the government's economic action plan targeted to that sector, the following definition is used:

SME DEFINITIONS

Type of Firm	**Staff Strength**	**Asset Value (excluding land and buildings)** *Naira (₦)millions*	*(USD 000's)*
Micro Enterprises	Less than 10	Less than 5	(less than 31)
Small Enterprises	10-49	5 up to 49	(31 but less than 310)
Medium Enterprises	50-199	50 up to 500	(310 but less than 3,100)

Table 1- source: National Policy on Micro, Small and Medium Enterprises, Federal Republic of Nigeria (undated)

The policy notes that employment-based criteria take precedence over asset values; for example, in the case of a classification conflict, and in recognition that it is a more stable indicator over time. Other definitions have been used for policy purposes. To illustrate, the Central Bank of Nigeria has amended the criteria used for various SME funding programmes over the years. When the Small and Medium Industries Equity Investment Scheme (SMIEIS) was set up in 1999, it used the definition from 10 and up to 300 employees, with a maximum asset base of ₦200 million. The scheme went through several iterations and when it was amended to Small and Medium Enterprises Equity Investment Scheme (SMEEIS) in 2005, SMEs were using only an asset base of up to ₦500million (CBN, 2005). It was further revised in 2006 to ₦1.5billion, with no upper limit on staff (CBN, 2006).

The research in Document 4 found that while Nigerian commercial banks used the Central Banks's SME definitions at the time for the administration of the specific CBN led financing, individually, the banks used their own internal definition for SMEs according to the niche they were involved in and the products and services they provided. Despite the multiplicity of definitions, researchers have pointed out that there are also qualitative characteristics of a smaller firm and one of these is that most of them are owner-managed (Berger and Udell, 1998). In this research, an SME will typically fall into the category of an owner-managed firm with under 100 employees (excluding microenterprises), thus keeping with the World Bank definition used for its research in Africa. However, any definitions used by the organisation or individual understudy will be recognised.

In terms of size of the SME sector, unified data is still sparse. In the UK, several official sources such as Companies Account, the VAT Register, and the Census of Employment have been used by researchers for compiling estimates on the numbers of small firms (Storey 2003). In Nigeria, such databases are limited and information gathering is not helped by the existence of many unregistered businesses. As such, accurate population statistics data is difficult to obtain.

Indeed the World Bank (2010) in its report on survey of the sector in Nigeria says that *"the dearth and paucity of credible and reliable database is one of the main constraints to this sub sector"*. In this report, it estimates the population of the SME sector (firms within an employment band of 6 to 50 employees) at 1.68 million and microenterprises at 6.72 million, using data from 2004 collected by USAID and Chemonics. These figures differ significantly from the data provided by the only national population study of the sector in Nigeria carried out by the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) in association with the government's National Bureau of Statistics (NBS), which estimated the population of the sector as 72,848, using an employment band of 10 to 200 employees. This appears to be a serious underestimate of the SME sector given the size of the economy, population and the vibrancy of the private sector. I believe there are at least hundreds of thousands of SMEs; the IFC estimate of up to one million of such firms appears to be realistic.

1.5 Small Business Finance Research

The academic literature on firm finance is largely found within the field of corporate finance, the subcategory of financial economics. Corporate finance has historically been dedicated to the study of large firms, developing theories which have progressively become highly influential, not solely in describing firms' financial behavior, but also in seeking to determine their optimal financing structure and in influencing financial management (Jensen and Smith, 1985). The literature specific to small firm finance, on the other hand, has largely arisen within the study of small business research—a field which grew out of the need to address economic growth issues in the 1980s—following research from the US which showed that the small business sector was more important to the creation of jobs than large companies, contrary to prevailing belief (Birch, 1987). Reflecting this divide, large firm studies were conducted by finance experts in the field of economics, whilst small business finance research has traditionally been carried out by development specialists or small business and entrepreneurship researchers in the US, UK and elsewhere.

Small business researchers have made attempts to fill the gap in the corporate finance theoretical literature on small firm finance. Ang (1991; 1992) for example, points out that financing of small firms is structurally different from that of big businesses and explains why corporate finance theories have been unsuited to understanding finance and the smaller firm. Firstly, he notes that these theories were largely founded on the assumption that firms: (i) can freely choose their source of financing and; (ii) have access to finance from funds from the stock and bond markets. In reality, small firms are constrained in their choice of financing being largely excluded from these capital markets which provide wholesale funds. Even private equity funding—one of the most prevalent forms being venture capital, which owes its existence to the need for alternative equity financing sources for smaller businesses—has a minimum threshold for investments and is unsuited to all but the larger smaller to medium-sized businesses. Further, venture capital typically acts as early stage equity or bridge finance, with investors aiming to recoup their returns through a resale of their shareholding at a later date. This exit is often planned through a stock market listing or private placement, again making this suitable only for a certain category of these businesses: the fast growth firm. Lastly, the use of venture capital ordinarily means that the owners of the firm cede some control (usually financial control, and often overall management control) to the venture capitalists' nominees.

Relinquishing control is quite often undesirable to smaller firms and one of the factors that therefore enters into the small business' 'pecking order' of preference for business finance (Berger and Udell, 2003). Because of the 'Proximity Law of Small Business' (Torres, 2004), which states that small businesses favour closeness in business relationships and consider the firm as an extension of their identity, they may refrain from having external shareholders, preferring equity from family and friends. Trade credit and bank borrowing then become preferred options of external finance to these businesses. For these reasons, relating to both characteristics of smaller businesses and their preferences, as well as transaction costs which exclude them from certain financial markets, the major source of external capital to small businesses is bank credit, as reflected in their balance sheet. Accordingly, Berger and Udell (2003) report that the proportion of debt in the capital structure of small businesses is about 50%, which is represented by commercial banks.

Paradoxically, therefore, smaller businesses though dependent on commercial banks for their external financing needs, face myriad obstacles in accessing loans from these institutions. It is this conflict that drives this research to better understand why smaller businesses in Nigeria face finance barriers from the lending institutions they are dependent on and to seek solutions to resolve this problem. Whilst the issue of SME finance affects business across the world, it has been pertinent to use examples of the US as well as the UK for two reasons: firstly, SME lending techniques such as credit scoring came from the US and quickly adopted in the UK; secondly, in terms of policy design, the research and technical expertise that has come to Nigeria has primarily been through the World Bank and the IFC, as well as the UK which is very influential in working with Nigeria on her development policy since gaining independence.

1.6 SME and Access to Finance

Governments worldwide increasingly consider SMEs as the backbone of the economy, not only because of their macroeconomic importance in terms of contribution to GDP and employment as mentioned above, but also because they comprise the subset of firms that are innovative and entrepreneurial and thus essential for economic growth (Acs *et al.*, 2009)**.** The Nigerian government in its National Economic Empowerment and Development Strategy (NEEDS) (NPC, 2004)—the blue print for the country's economic programme—specifically identified the SME sector as one of the sectors that it believes will lead growth.

The small firm sector's contribution to employment has continued to retain the attention of policy makers. For this reason, policy-focused research has been particularly concerned with the factors affecting small firm performance. One of the most serious impediments to SME growth that early Economic Social Research Council (ESRC) small business research showed related to the availability and cost of finance (Storey, 1994). Studies have since then suggested that access to finance has largely ceased to be a generalised problem in advanced economies, as a result of numerous government-sponsored initiatives and innovation in the banking sector increasingly allowing smaller firms access to bank loans. In the UK, for example, the Bank of England stopped publishing its annual report on the availability of finance for small firms in 2004 as the Bank concluded that "*there was little evidence of smaller firms having difficulties in accessing finance"* (Bank of England, 2004). Yet, Fraser (2009) reported that smaller businesses in the UK faced poor access to finance following the financial crisis.

It is also recognised that particular sectors may face discriminatory lending practices, e.g. minority owned businesses and women entrepreneurs (Berger and Udell, 2003). Accordingly, in advanced countries, the focus of small business research has largely shifted towards public policy and implementation (Storey, 2003). By contrast, in Africa, Batra *et al.* (2003) found that access to finance was considered the most important constraint to these firms. Resolving these financing difficulties has therefore become a challenge to policy makers and to financial institutions seeking to grow their credit portfolios safely. The Nigerian government has tabled the tackling of this particular issue and the Central Bank of Nigeria has pursued it as part of its development initiatives (NPC, 2004; World Bank, 2002).

Seeking to address the scarcity of global data on smaller firms, one the most influential data sets in recent times has been that created by the World Bank with its WBES identified earlier (Barta *et al.*, 2003). The most recent enterprise survey on Nigeria showed that 59.3% of small firms and 34.8% of medium-sized ones considered access to/cost of finance to be a major business constraint, compared to just 10% of large firms (World Bank, 2007). Owing to statistics from the Central Bank of Nigeria, the extent of credit provision to the sector has been quantified. The CBN annual reports show a steady drop in the proportion of total bank credit to small businesses over the last 20 years. In 1992, loans to this sector comprised of 27% of all banks loans, but this had dropped to barely 0.1% by the end of 2013 (CBN 2014a; 2014c).

There are several reasons that may account for the relatively high proportion of lending to small businesses in 1992 and the successive significant drop afterwards. Prior to 1996, there was a regulatory requirement for banks to allocate 20% of total credit to small scale enterprises wholly-owned by Nigerians; this was subsequently lifted. Secondly, the definition of small business which included turnover figures was not adjusted systematically, meaning the threshold eroded over time, given inflation. Overall, these statistics suggest a deplorable situation of small business lending over the last 20 years.

1.7 Microfinance

Given the widespread adoption of the microfinance model in the developing world, a question that is often asked is whether the same techniques could be successfully employed in lending to small businesses. It is therefore important to distinguish between small business finance and microfinance.

Microfinance came about initially as a means of meeting the financing needs of microbusinesses run by the poor in developing countries, an economic group hitherto considered unbankable by financial institutions. The microfinance revolution, which started in the 1980s, was triggered by the success of Muhammad Yunus' Grameen Bank in Bangladesh (Ledgerwood, 1999). He sought to bring these financially excluded microenterprises into the banking system; a group whose only recourse, outside of family and friends, was to money lenders charging usurious rates. A social entrepreneur, believing in poverty alleviation by enabling access to financial services, Yunus shunned profitmaking as the primary objective for his microfinance model. In Africa, the K-Rep bank in Kenya started out as a grant making NGO and evolved into microfinance activities, finally establishing itself as a commercial bank. This successful microfinance bank has also served as a model in Africa.

From its origins based on lending small sums, microfinance now includes the provision of a range of financial products such as savings, insurance, personal loans, money transfers and remittances to the poor. The businesses concerned are more likely to be informal or unregistered, operating or starting from the homes of the owners and usually with low overheads.

Today, microfinance activities have evolved and microcredits are sometimes used to describe small loans to both businesses and individuals that differ socio-demographically from the original concept of lending to the poor. Unlike microenterprises, the small business owner is less likely to be poor; mainly coming from the lower or middle income sector of the economy. Owners are usually not excluded from financial services; they typically operate bank accounts but may not have access to loans. Their business premises are normally distinct from their home and the business asset ownership may be significant. Whilst there are variations in education levels amongst owners, proportionally many more SME owners will have a good level of education, even up to the tertiary level.

The principle behind microfinance lending is the group lending technique which is used to address the issues of adverse selection and moral hazard. These low income clients, often having little by way of assets, would form groups, jointly guaranteeing the debt of members. This group lending technique rests on social capital as collateral and/or peer monitoring as way of accessing information that borrowers have about each other but that the lender may not (Tirole, 2010). Thus, it is based on the social network characteristics of the borrowers—homogeneity and social cohesiveness—generally operating microenterprises run from their homes. By contrast, SMEs are more heterogeneous and autonomous, and the business location is usually quite separate from the home. Thus the group co-guarantor method on which microfinance is based is generally not appropriate for lending to SMEs.

The microfinance banking industry has expanded significantly from its roots in Bangladesh. Microfinance banks like K-Rep in Kenya and Accion, which originated in Latin America, have been recognised as successful models in developing countries. As the popularity of microfinance has grown, concerns have been raised as to whether it is achieving its aim to lift people out of poverty through the financing of microbusiness. There is evidence that much of the lending is now for consumption—a shift from the original "bottom of the pyramid" target customers. The need for profitability has been seen as one of the reasons for this move, in contrast to social entrepreneurship (Warwick, 2015).

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Lastly, while it is recognised that the number of employees might not be a conclusive way of distinguishing a micro-enterprise from a small business, and within the spectrum of firms there will be some ambiguity in categorising a firm as one or other, it is considered that this does not constitute a problem in the analysis, as this will likely concern relatively few firms. In this case, the income generation of a firm will take precedence as the differentiating characteristic. In the case study that follows, the commercial bank uses sales or revenues as a benchmark.

1.8 Why Nigeria?

The economic potential of Nigeria and other countries in Africa has recently been attracting world attention, bringing hope that many of the poorer countries in the region will be able to address the serious development challenges that they face. One of the main development goals is the eradication of extreme poverty, stemming from the first of the eight Millennium Development Goals, which all nations committed to following the United Nations Millennium Declaration in 2000 (UN, MDG). Sustained growth is considered to be the main driver of reduced poverty levels necessary to achieve this goal. In recent years, there have been indications that the continent is moving in the right direction with an average annual real GDP growth rate of over 6% in the years

2004-2008, and forecasts of over 5% in the next two years (IMF, 2014).

Nigeria, my country of birth, is a pertinent case study because of its significant economic potential. Nigeria's GDP growth over the last 10 years has averaged 6%, and its GNI per capita is $2,710 (World Bank, 2014b). With such consistent growth, the country was recently reclassified by the World Bank from poor to middle income. It is also the most populous nation in the continent with 175 million citizens (World Bank, 2014c) and its economy is now considered the largest in the African continent (EIU, 2014) after the rebasing of its economy last year. This rebasing exercise recalculated the GDP to reflect the actual composition of the economy by sector. It updated weightings which had not been adjusted for since 1990, allowing the proper addition of high growth sectors such as telecommunications and film making. Currently ranked the 25th largest economy in the world (EIU, 2014) measured in GDP PPP terms, Nigeria's economy is larger than those of several EU countries including Norway, Austria, and Denmark, reflecting the inherent advantages of population size. In contrast, GDP per capita is low, ranked only 147 out of over 200 countries and territories by the World Bank despite the overall positive macroeconomic picture. Additionally, its populace suffers from the inequalities that often arise with growth.

Regional underdevelopment in the north of the country is considered at least partially responsible for the terrorist activities that the country has suffered from in the last five years. Average incomes have risen dramatically but the country is still beset with poverty and unemployment. Over 46% of the population in 2010 was categorised as poor (World Bank, 2013). The Nigerian Bureau of Statistics estimates the unemployment rate at 23.9% for 2011 (NBS, 2011) though unemployment statistics with the International Labour Organisation (ILO) estimates the unemployment rate at around 7.5% (2014). In the development field, it is largely considered to be the private sector's role to drive economic development and employment generation (DFID, 2011). New and growing businesses are needed to boost the private sector, serving the purpose of providing much needed employment and contributing to economic growth. The small business sector is thus central to this goal as it accounts for the majority of private sector employment in most economies. In Nigeria, the MSME sector is estimated to contribute 50% of employment (IFC, 2009). With access to finance as a growth barrier for these firms, this research hopes to contribute to solutions to address this issue.

1.9 Structure of the Document

Chapter 1 introduces the research, providing a justification for the study and an overview of the researcher's personal experience of the research issue. It reviews the problem of credit shortages to small businesses, discusses the theoretical and empirical approach of the problem in the academic literature and sketches the context of Nigeria, the site of the research. It then identifies the gaps observed in the literature and concludes with an overview of its conceptual basis and a description of the research case study.

The rest of the document is structured as follows. The literature review is covered in two chapters. Chapter 2, the first part, reviews the classical theoretic literature in economics from the field of markets that has heavily influenced the empirical work in this area. It then reviews the major empirical literature and applied studies situated primarily in the advanced countries and latterly in developing countries. Results of the preliminary study carried out prior to this research (documents 3 and 4) support the identification of the main gaps and limitations of the existing economics literature, with particular emphasis on studies.

In order to provide a more suitable framework to study this issue, Chapter 3, the second part of the review, introduces literature from the relatively new field of economic sociology of market, which emphasizes the social aspect of influential actors in markets. Because of its strong emphasis on the role of social institutions, which market participants rely on to support exchange where formal institutions are weak, it resonates with empirical studies in emerging countries. The latter part of the chapter elaborates developing a model for understanding credit market, with a conceptual model of credit markets, to explore the case study of a Nigerian bank expanding into the SME lending market, thus elaborating the concepts. The chapter concludes with identifying the research questions and explaining how the concepts are to be utilised in the research to address these.

Chapter 4, the methods chapter, begins with a discussion of the epistemological and ontological positioning of the research work. It follows with the methodological considerations and how this influenced the choice of methods. The chapter then elaborates the research design and discusses the justification of methods, highlighting the issues of validity and reliability. It explains the case study choice with an elaboration of the research design, the data collection methods and the analysis. It ends with a discussion on limitations of the study.

Chapter 5 covers the data analysis and results; whilst the final chapter, Chapter 6, concludes with how the findings may contribute to their application in policy and practice. It discusses recommendations of further areas of research and identifies limitations of the research. References and other documents appear as appendices to the research paper.

CHAPTER 2: CRITICAL LITERATURE REVIEW (Part I)

ECONOMICS AND CREDIT MARKET FAILURE

2.1 Introduction

The first chapter introduced the research issue—small business lending shortages in Nigeria—and proceeded with an overview of the context of the study, Nigeria, and the small business sector. The chapter also discussed the researcher's acquaintance with the subject area. This chapter reviews the theoretical background from economics that deals with the research issue, as well as the empirical studies based on this literature. The chapter concludes by identifying the gaps in the theory and proposes complementary literature from the fields of economic sociology and entrepreneurship, which is explored in Chapter 3. Whilst the economics literature focuses on information economics and institutional economics, economic sociology benefits this research by incorporating a socialised perspective of market behaviour into its analysis; it for example shows how social institutions intervene when institutional gaps exist, helping to explain how markets can be created when formal institutions are weak: a situation prevalent in developing countries. The entrepreneurship literature helps to identify the factors that allow businesses to undertake new ventures and in so doing create new markets.

Concepts from these literatures are used to construct a conceptual framework for SME credit market creation at the end of Chapter 3, at which stage the research questions are formulated. The framework used a case study investigation of how a commercial bank in Nigeria seeks to enter into the underserviced market for SME loans in the face of numerous barriers, which using purely economic theory would suggest that the market would not be able to form.

The field of economics from the perspective of markets has provided much of the theoretical background for studies of small business credit shortages. This chapter reviews the relevant literature from the field and identifies theoretical and empirical research gaps. The following chapter, Chapter 3, introduces complementary literature on markets but from the relatively new field of economic sociology as well as from entrepreneurship.

2.2 Economics and Market Failure

Economics has looked at the credit market rationing as a market failure arising from adverse selection and moral hazard problems when information problems arise in loan contracting. The reasoning is that high transaction costs prevent the mitigation of these contracting problems, causing lending institutions to restrict credit supply. The main sets of theories have been derived from the schools of Information Economics, and New Institutional Economics (NIE). Stemming from these two perspectives, the focus of applied economics has centered on improving the information flow from borrower to lender in order to reduce default risk, and identifying the reforms needed to strengthen institutional systems that support credit markets. As these two theoretical axes were reviewed extensively in documents 3 and 4, below follows a résumé of the salient points.

2.3 Information Economics and Small Businesses Credit Rationing

2.3.1 Markets and Information

In microeconomic theory, buyers and sellers need accurate information to make choices. As a result, perfect information is one of the prerequisites for a perfectly competitive market to exist (Frank, 2010). The price mechanism of the market acts as a channel of information for both parties to a transaction, however, the complexity of many modern markets means that the information requirements for transacting to occur are more extensive than that which is contained by the price setting process. The credit market is one of these complex markets. Given the deferred nature of repayments in the loan contract, the lending institution needs to have sufficient information to accurately determine the capacity of the firm to honour its loan obligations. Joseph Stiglitz (1985), a pioneer of Information Economics, modelled the consequences of information difficulties in credit markets, demonstrating the effects on loan supply when imperfect information exists.

2.3.2 Selection and Incentive Problems in Credit Markets

According to Stiglitz and Weiss (1981), credit markets can fail where the borrower has more knowledge about its prospects than the financing institution, a situation called asymmetric information. The lender is thus faced with an adverse selection problem, that is, the inability to judge good risk from bad risk. A moral hazard problem compounds this when the use of devices such as collateral do not function properly to mitigate the selection risk. Making loans to these customers under the circumstance of poor information results in an unsustainable level of bad loans, therefore lenders will avoid making loans to such a group of firms.

This seminal work paved the way for further theoretical work examining the relationship between asymmetrical information and credit rationing. For example, Riley (1987) argued that this effect would be trivial at the aggregate level. De Meza and Webb (1987) in their model show that contrary to the Stiglitz and Weiss model, when projects have differing returns, asymmetric information can lead to over funding by financiers. Hillier and Ibrahimo (1993) drew attention to the difference in nature of financial intermediation and the effects on loan provision. They discuss work done by Bester (1985) and Chan and Kanatas (1985) who modelled how variations of collateral requirements and interest rates can cause borrowers to self-select, thus reducing the selection problem. Diamond (1984; 1989) and Bester (1985) suggest that the potential for moral hazard can be assessed by observing the performance of the borrower’s projects undertaken in previous periods for high incidences of failure. In the context of developing countries, Ghosh *et al.* (2000) argue that lending transactions often occur in the informal market where parties are known to each other, therefore informational opacity is less of a problem. Instead, they argue, moral hazard presents the bigger issue, leading to the reluctance of banks to lend to smaller businesses. Notwithstanding these nuances, Stiglitz and Weiss’ model, whilst not specifically developed to model credit market to small firms, is widely used as the theoretical justification for small business credit rationing.

2.3.3 Imperfect Information, Lending Models and Small Firms

One of the early papers to draw a link specifically between small business financing and asymmetric information was Pettit and Singer (1985), who contemplated whether as a consequence of this asymmetric information "*small businesses are denied credits or are in anyway discriminated against in financial markets*". Various forms of information are required by banking lending models to assess the credit worthiness of the firm. The traditional form of credit analysis is a structured and labour intensive process (Caouette *et al.*, 1998) requiring detailed, accurate and timely financial information to prepare cash flow statements and perform financial ratio analysis. Additionally, qualitative information is gathered about the ownership of the company, its management and its business reputation. For large companies which issue bonds and shares, such information is publicly available as it is a regulatory requirement. Obtaining this information on smaller firms, on the other hand, can be difficult (Crouhy *et al.*, 2001). Unlike large firms which publish annual audited reports and in some cases quarterly results, accounting standards for smaller companies are less demanding and financial statements may be incomplete or unreliable—the smallest firms may not even have any proper financial records. Secondly, their external business relationships, for example, with suppliers, customers and other third parties are limited and less visible (Udell, 1994 and 2003; Carey *et al.*, 1993).

Small business researchers have helped to explain the characteristics of small firms that lead to this information wedge between them and their lenders (e.g. Ang, 1991). Smaller firms often have limited capabilities in financial management and record-keeping, and owners may be reluctant to divulge detailed financial information stemming from the fact that the identity of small business owners and their firms are often intricately linked. The business environment may also discourage smaller firms from revealing their financial situation to outsiders. For example, burdensome tax regulations may drive firms to under-declare the extent of their business activity (Ang, 1992).

Overcoming these hurdles thus poses significant problems with using traditional credit analysis, given its extensive information requirements as a method of assessing the credit worthiness of a small firm.

Other models of lending have been developed to overcome these problems. The *relationship lending approach* relies on a trust-based banking relationship built over time between the business owner and the banker, through which the latter is able to accumulate information (Petersen and Rajan, 1994). This contrasts with the *transactional lending approach,* such as in the classic credit analysis described above, which requires detailed financial statements from the potential borrower. Relationship lending, however, is not without its difficulties. Much of the information gathered for this approach to lending may be qualitative information or *"soft information"* (Petersen, 2004). Compared with hard information in the form of financial statements and accounts, soft information generally does not travel well within the bank's organisational hierarchy, thereby making it difficult for loans to be approved at a centralised decision-making centre. Thus, devolved credit decision making is more suited to relationship lending. This approach also implies significant labour costs because of the amount of time that credit officers have to spend out in the field interacting with the client.

Credit scoring, a recent form of transaction banking which started out in the US, has revolutionised smaller business lending in many advanced countries (Berger and Frame, 2007). Small business credit scoring models are based on credit data history and use statistical models to evaluate default risk of the customer using a limited number of criteria. Caouette *et al.* (1998) show that compared with 23 financial ratios used in classic credit analysis, only eight variables are used in a typical credit scoring model, out of which only four are financial. In contrast to the expert system of traditional credit analysis, the credit appraisal process is technologically based and decision-making can be centralised.

Citizen's Bank, in the US, for example, which deals primarily with small businesses, uses credit scoring where the small business owner does not require direct contact with a bank officer to have a loan request approved, a process which is largely done using an automated system. In the development field, discussions have revolved as to how credit scoring can be adopted in emerging countries. With this technique based on credit history data, the World Bank has supported the start-up of credit bureaus in Africa and credit reporting has been shown as improving volumes of small business credit (World Bank, 2014a). Asset-based lending, another form of lending, seeks to circumvent the informational opacity problems of the firm by providing loans against a specific asset, which itself acts as collateral for the loan (Berger and Udell, 2002). Thus the quality of this asset is the major criteria in the decisions to advance credit, as opposed to the strength of the firm itself. Examples of this type of lending are: (i) account receivable financing, where the lender provides credit based on the sales made on credit; and (ii) inventory discounting, where short term loans are linked to the stock of finished goods the business has built up. A related but separate product is factoring, where the firm actually sells its receivables at a discount to the factor, which then collects without recourse to the firm. Unlike with asset financing, factors are typically non-bank institutions. Research has indicated that for such specialised lending to function, several institutional systems need to be in place; these include: commercial laws governing the use of assets as collateral, an asset registration system which allows for the creation of liens on assets, and bankruptcy laws and procedures which protect the rights of the borrowers in case of non-payment. Indeed, Berger and Udell (2002) point out that the existence of proper asset based lending exists in only four countries, notably the US, indicating that these supporting legal structures and institutional requirements for this mode of lending generally remain a hurdle.

The review of alternate lending models above has hinted at some of the institutional structures that are needed to support methods to redress the informational asymmetry between borrower and lender; indeed, institutions play a significant role in enabling the credit market to function. Section 2.6 will examine how institutions enable lending decisions. As a complete literature review of institutions was done in Document 4, the section provides an overview of the subject, introducing new literature on institutions and markets.

2.4 Empirical and Policy Studies

Empirical and policy studies on SMEs and access to finance generally predated theoretical work on credit rationing. In the UK, the 1931 policy study commissioned by the MacMillan committee (Stamp, 1931) had already reported the difficulties small businesses faced in accessing finance. Subsequently, researchers variously debated whether banks' reported reluctance to lend to smaller firms reflected a credit market failure, or a true reflection of the risk profile of small businesses. However, the general recognition of the importance of smaller business to the economy, following the recession in the 1970s onwards, prompted the concerted effort to commence the study of this problem. Another influential policy study commissioned by what is referred to as the Bolton Committee (Bolton, 1971) investigated the issues of credit ceilings and insufficient bank financing for small businesses. The UK government subsequently made efforts to improve funding to these firms through working with the banking system.

In the UK, following the credit crunch in the 1980s, the Bank of England sought to ease the financing crisis for smaller businesses by collaborating with banks to increase credit to these firms (Bank of England 1994; 2004). In the US, the Small Business Administration (SBA), set up in 1953 by Congress to assist small businesses, had its antecedents in the Reconstruction Finance Corporation: a lending programme created after the Great Depression to help finance smaller firms. Although the SBA has a wider mission, it made direct loans to businesses and provided credit guarantee scheme to banks to secure small business lines of credit.

Scholarly research has increasingly turned to the aspects of lending products that can help expand credit to small business. For example, Berger and Black (2011) speak about new 'lending technologies'; that is, the different techniques banks use to lend to small firms. These studies have mainly been carried out in the context of developed countries but there have been recent efforts to extend this to non-OECD countries. Beck (2007) concludes transaction costs and asymmetric information are driving forces explaining many SMEs' in developing countries limited access to finance. Diverse evidence suggests that asymmetric information and institutional weakness are only some of the many factors at play influencing the supply of credit to SMEs. For example, adverse macroeconomic conditions often cause banks to sharply curtail lending to all groups of borrowers and indeed SMEs tend to be disproportionally affected (Dunkelberg and Dennis, 1992).

During a credit crunch, government intervention to alleviate the problems in the small business sector often came into play through both direct and indirect intervention in the form of special lines of credit, loan guarantees or incentives to financial institutions to expand small business lending in attempts to improve. Others have shown that the competitive structure of the finance sector affects the volume of lending to SMEs. For example, Audretsch and Elston (2002) found that increasing competition in the financial sector increased access to capital for some smaller firms in a sample of German SMEs, contradicting Petersen and Rajan's earlier work (1994) which found that the more concentrated the banking structure, the more younger firms were able to raise funds. Generally, the evidence is mixed as to whether the competitive structure of the banking sector affects aggregate loan volume to smaller firms (Berger and Udell, 2003).

Studies have attributed the favourable economic climate—high economy growth rates and lower interest rates—in OECD countries in the decade prior to the 2008 economic downturn, a significant factor in improving access to loans. Berger and Udell (2006) find that in addition to the economic climate, the social environment, and tax and regulatory issues affect SME lending. The government's fiscal and monetary policy may also negatively impact SME lending. For example, in economics, deficit spending is said to contribute to a "crowding out" effect on private borrowing (Baumol and Blinder, 1988). Beck (2007) argues that high lending interest rates, which may crowd out private investment as the government takes up a large share of savings, especially hurts smaller businesses. Other empirical studies indicate government intervention, such as the imposition of anti-usury laws or an interest rate ceiling for SME lending, could in well-meaning attempts to assist SMEs by lowering the cost of finance, instead have a detrimental effect (Zagha and Nankani, 2005; Conning and Kevane, 2003). Banks faced with lower interest rates that do not adequately compensate for the relatively higher risks of lending to SME, could react by reducing the volume of loans to the sector.

However, without a binding theoretical foundation, independent variables in some of these studies (e.g. comparing bank size, competition, foreign vs. local banks) appear rather arbitrary, raising questions as to generalisability; that is, if these factors are context or time specific. Further, the specificities of the research context vary and the section below reviews some of the studies specific to Sub-Saharan Africa (SSA).

2.4.6 Research Context in Sub-Saharan Africa

According to Boateng and Abdulraham (2013), small business research has concentrated on developed countries with relatively little attention devoted to Sub-Saharan Africa, whereas financing choices of small firms in these developing countries differ from those in developed countries. They find that firm characteristics such as age, size and ownership type as well as relationship banking have an effect on the lending decision in their research on factors influencing bank lending to micro and small-sized enterprises in Nigeria and Ghana. Their research also points out several notable studies by African scholars in this field. Other noteworthy research includes work by Aryeetey and others. Aryeetey (1994) examined the financial market in Ghana, whilst Ayerteey *et al.* (1997) covered Ghana, Malawi, Nigeria and Tanzania, respectively. The first paper concluded that solutions to the problem of access to finance for small firms require adaptation in the financial system in order to be conducive to SME lending, alongside training SMEs in financial management and business skills. In the second paper, the authors conclude that banking sector liberalisation and reform need to be accompanied by institutional reforms in contract endorsement and informational availability, whilst integrating formal and informal financial markets. Eyiah (2001), in his study of construction contractors in Ghana, finds the four main factors of risk of transaction, cost of transaction, contract enforcement and lack of information responsible for smaller businesses' difficulties in obtaining finance from lending institutions. Neshamba (2003), in a study of bank managers credit decisions in Kenya and Tanzania, remarks that more than providing much needed lending, banking institutions have a social responsibility to business communities they operate in, by assisting small businesses to thrive by for example providing training and skills development. Studies such as these have been helpful in identifying how the relationship between the financial sector and the small businesses in SSA needs to take into consideration specificities of the business environment in expanding lending to the SME sector.

The paucity of context specific research and somewhat eclectic evidence without a cohesive theoretical framework, led to the approach taken in this research to start out with an inductive grounded theory approach in Document 3. Identifying seven categories of barriers to SME lending, I attempted to reconcile the existing theories with empirical evidence, observing the two main gaps below. One gap relates to asymmetric information and the other to institutional theory.

2.5 Credit Risk and Asymmetric Information: External Risk versus Internal Risk

In making loans, banks need to measure credit risk—that is, the chance or possibility that the sum of money lent will not be repaid (Caouette *et al*., 1998). This credit or default risk is composed of firm-specific, industry-specific and general macroeconomic factors (de Servigny and Renault, 2004). The industry and macroeconomic conditions comprise the environment of the borrower and together are called external risk, whilst internal risk relates to the firm-specific factors. However, though internal risk and external risk constitute credit risk, they need to be understood separately because they have different implications on models of SME credit rationing and on the banks' lending portfolio, as described in the following two sections.

2.5.1 External Environment and Small Business Performance

Two main issues arise with the use of the asymmetric information argument as a general model for small business credit rationing. Firstly, Stiglitz and Weiss' (1981) model was constructed to explain *how credit rationing can arise* in the presence of asymmetric information, without necessarily suggesting that credit rationing is caused solely by asymmetric information. In fact, in their paper, they briefly mention some of the other conditions that must also exist in order for information opacity to lead to credit market failure, such as high transaction costs. The implication of this is that asymmetric information may be considered as only one of other possible causes of credit rationing to small businesses.

Secondly, and more importantly, in the model, an information wedge exists between borrower and lender such that the lender is unable to distinguish between good and bad risk. The logic of this argument is that asymmetric information arises as the borrower has better information about its performance—and therefore about its own risk of default—than the lender. This information relates to firm-specific risk, being a function of the firm's individual characteristics. Now from the financial risk literature, it is known that default risk is a composite of internal risk and external risk, the latter of which arises from environmental conditions (Crouhy *et al.,* 2001). In contrast, information about the external environment is in the public domain and largely accessible to all. As information can only be asymmetric when one party has more access than another, the model necessarily then alludes only to firm-specific risk.

This distinction between internal risk and external risk is non-trivial, as smaller firms are known to be particularly prone to risk from the external environment (Freeman *et al.,* 1983). Indeed Storey (2003 p.1) says that *"the central distinction between large and small firms, then, is the greater external uncertainty in which the small firm operate"*. In studies of firm performance, changes in the macroeconomic environment used to describe non-firm specific external shocks, are generally captured through measures such as economic growth rates and interest rates. Whilst these variables can have profound effects on the performance of both large and small firms, they form only a part of the external environment that affects the performance of smaller businesses. The predisposition of smaller firms' performance to their business environment is one of the distinguishing factors between large and small firms (Freeman *et al*., 1983) and this sensitivity arises from their particular characteristics. Suffering from the *liability of smallness* (Freeman *et al.*, 1983), they have a higher mortality rate compared with large firms, having fewer resources to absorb negative events (Aldrich and Auster, 1986). Small businesses are largely undiversified: geographically, customer-wise, and in terms of product range (Brüdel and Schlusser, 1990). They are also affected by changes in government regulations which affect them disproportionately

(Sullivan *et al.*, 1999). This implies that external shocks can have a significant impact on operations of their business, and in particular, their cash flow. Studies such as these in the entrepreneurship and small business literature have alluded to different operating environment factors that small businesses are susceptible to.

Everett and Watson (1998), for example, examine external risk factors that cause business failure; studying the impacts of macroeconomic variables such as interest rates, unemployment rates and inflation in a sample of small businesses situated in managed shopping centers in Australia, they concluded that systematic factors were implicated in up to half of small business failure. However, there are other factors aside from macroeconomic ones that impact the operating environment of small businesses; studies that have specifically investigated these are rare.

Development scholars such as Sen (1999) have indicated that the operating environment is a major distinguishing feature of developed and developing countries. Thus, there is a need to bring understanding to the dimensions of the environment in emerging countries that affect business performance of its smaller firms and thereby their possibility of credit default creating barriers to loan finance. This question was considered in Document 4, which found that in the sample of almost 50% of commercial banks in Nigeria, decision makers considered the external environment as a major risk factor in small firms' credit failure. The thesis builds on these findings by looking at how bank credit process can seek to measure and mitigate this risk.

2.5.2 Small Firm Default Risk and Correlation

The risk of credit default from external forces, as opposed to internal, borrower-specific risk, has quite different implications for a lending institution's loan portfolio. Whereas internal risk is independent, external risk of default has a correlated effect amongst similar borrowers. This implies that external shocks could lead to systematic default of a small firm loan portfolio. Conceivably therefore, the occurrence of simultaneous default on small firm loans may arise from negative selection, a situation predicted by the Stiglitz and Weiss model due to informational opacity, or systematic failure from an external shock. Hence, the bank's decision to curtail credit following high small business portfolio losses could be as a result of the effects of external shocks to SMEs.

This systematic risk has been recognised by Storey (1994) who observes that when a bank cannot diversify away risk *"because of external unfavourable macroeconomic factors, the whole portfolio becomes more risky"* (Storey 1994, p. 250). Portfolio theory suggests that banks diversify their loan portfolio to reduce risk correlation. For corporate loans, a more heterogeneous loan book can be achieved by broadening industry spread to reduce default risk correlation (Caouette *et al*., 1998), whereas for a small business portfolio, industry diversification may not necessarily reduce overall default risk. Whilst some evidence points to exogenous factors as the overwhelming cause of small business failure (Sullivan *et al.*, 1999), there has been little investigation carried out to distinguish between external risk and internal risk as factors of small firm default in determining causes of small business credit rationing.

In conclusion, as the Stiglitz and Weiss (1981) model of asymmetric information implicitly deals with internal risk and not with external risk, it can only be a partial explanation for credit rationing. This research suggests that integrating the line of enquiry relating to external risk will enhance the understanding of impediments to small business lending in developing countries. This means that in studying the lending behavior of financial institutions in the evaluation of risk in SME credit markets, consideration needs to be given to the mechanisms used to mitigate external risk. The external environment thus has an important place in the study of how banks lend to small businesses and it is the reason for which this is contained in the conceptual framework developed at the end of Chapter 3.

2.6 Institutional Perspective of Credit Rationing and Contracts

This part of the literature review focuses on the second gap in the theoretical framework which relates to how institutional theory is used in empirical studies on credit market constraints. A comprehensive review of institutional theory was carried out in Document 4; therefore, the main part of the literature review that follows is dedicated to new material relating to institutions and markets. However, a brief overview of New Institutional Economics (NIE) is also included here, as it is from this field that the empirical studies of credit market restrains primarily draw their theoretical background.

New Institutional Economics refers to the branch of economics which incorporates institutional theory into microeconomic analysis, through the study of the relationship between institutions and economic performance (North, 1990; Alston *et al.*, 1996). Coined by Oliver Williamson, NIE incorporates transaction cost economics, agency theory and property rights. New institutional economists consider that the rationality proposition of neoclassical economics fails to provide a full account for market outcomes and the resulting economic performance of nations. Institutions, defined as *"rules of the game"* by North (1990), comprise of both the informal norms and customs as well as formal rules and laws that create incentives and deterrents, which facilitate or constrain actors in carrying out economic activity. Accounts of economic history in NIE convey how formal institutions evolved, as exchange in markets moved from personal to impersonal transacting over the course of centuries of development—particularly those that increased property rights, information, and contract enforcement, whilst reducing transaction costs and uncertainty. Indeed North's study has had a pivotal role on institutional studies in developing economies in explaining the divergences in the historical economic development of nations spawning empirical literature (North, 1990). One of the most influential empirical studies investigating this link between institutions and finance was carried out by La Porta *et al*. (2001), who found that countries with poor investor/creditor rights, coupled with poor enforcement, had smaller capital markets. Other noteworthy research in recent times by economists in the development field (Levine, 2001; Beck *et al.*, 2001; Djankov *et al*., 2007) has extensively reviewed the issues of formal institutions; for example, legal structures and creditor rights and their effect of lending. They have generally concluded that stronger creditor rights are associated with increased lending and financial sector development in countries around the world.

The institutional perspective of credit rationing to smaller firms sees the issue of transaction costs as a critical feature in determining contract completion, as high costs affect the ability to overcome agency problems (Beck and Demirgürc-Kunt, 2006). The rationale is that given the relatively small size of the credit, small business loans have a limited ability to absorb costs needed to correct the agency problems of incomplete information and moral hazard. Applied research has thus examined how the informational asymmetry and incentive issues can be improved through different institutional structures. For example, the advent of modern technology has with the widespread use of computers and computing power allowed unit cost efficiencies in collecting and manipulating data to assess creditworthiness of informationally-opaque smaller firms. Attempts have been made to replicate this is in developing countries with credit bureaus promoted as a first step toward improving credit to smaller firms. The issue of legal rights in applied studies specifically considered improving the rights of the lender through court systems and over assets used to secure loans. Collateral is also an important tool to mitigate moral hazard (Berger and Udell, 1990). In their empirical analysis on alternative lending methods, Berger and Udell (2006) identify several sets of institutions that need to accompany the different *lending technologies* and their collateral requirements that have success in overcoming informational problems. However, institutional issues such as recognising property ownership, transferring of ownership, inefficient property registries and costly processes in developing countries, often preclude property as an efficient means of security. Similarly, slow, corrupt or costly legal processes and lack of alternative dispute resolution mechanisms deter lending. Common to all of these institutional problems is the role of the government in introducing the reforms needed to allow these institutions to function correctly. Therefore, these studies implicitly rely on the state as the main agent of institutional change necessary for improving creditor rights.

North (1990) in describing institutions as the *"humanely devised constraints that shape human interaction"* whose role it is to reduce uncertainty and to give structure in interactions, stresses his interest in both the formal institutions—rules and regulations—and the informal ones such as social customs and conventions. Eggerston (1996) also includes both in his definition of institutions: *"formal and informal rules that constrain behavior"*. Though development economists have borrowed heavily from this work in research on access to finance in markets, studies such as those cited earlier have focused primarily on formal institutions such as legal systems, which favour property and creditor rights, and those that improve information systems, such as credit bureaus which collect credit data (e.g. La Porta *et al.*, 2001; Berger and Frame, 2005). On the other hand, they have underplayed the role of social and informal institutional systems which may act as a proxy when formal institutions are weak, and have largely overlooked the effects of existing institutional structure. The section below discusses the relationships between institutions.

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2.7 Interdependency: Formal and Informal Institutions

In discussing the effects of institutional change, North says "*as revolutionary as its supporters desire, performance will be different than anticipated"* (1993). This is because institutions "*do not exist in a vacuum, they challenge, borrow from and to varying degrees, displace prior institutions"* (Scott, 2001). This interconnectedness of institutions is an often overlooked issue in the process of institutional reform. Policies intending to bring about institutional change therefore need to consider the existing institutions, both formal and informal, that the new institutions will interact with. Social institutions also have an important role to play; not only do they help determine the economic outcomes by their interaction with formal institutions, they may also take up the role of enabling transacting in markets in which formal institutions are weak or absent.

Institutional voids, a recent concept in development economics, refers to this absence or weakness of institutional structure required for markets to perform (Palepu and Khanna, 1998). It is thereby instructive in studying market formation in developing countries to ask how firms can create markets in environments where institutional voids exist. This idea of how firms straddle institutional gaps is further developed in the literature review on markets in the next chapter. The following section concludes with the process of institutional creation.

2.8 Creating Institutions for Markets

Institutional theorists investigating the issue of institutional creation have shown that institutional change arises in many forms. In the sociology literature, W. Richard Scott distinguishes two approaches used in analyses of institutional creation. The naturalistic approach, according to his typology, stresses the gradual process of institutional creation emerging from the *"collective sense-making and problem solving behaviour of actors"* (Scott, 2008). This contrasts with the agent-based view in which actors are seen as being purposefully engaged in effectuating institutional change. Within New Institutional Economics, Douglass North adopts an evolutionary perspective of institutional creation.

In discussing private markets, the state and corporate elites have merited particular attention from institutional scholars as they are considered most directly implicated in bringing about institutional change. The state has a uniquely important and visible position because of its capacity to enact the laws and policies that entrench formal institutions and make them enforceable. But this *state-as-agent* approach to institutions, in considering almost uniquely the government as the catalyst of institutional change, ignores the powerful, but less visible actions of producers in the process of institutional creation. For example, White (1981) describes the organisation of producers into business and professional groups, which sets the agenda for institutional creation needed to stabilise markets. This view of institutional construction depicts cooperation between interest groups and government as an antecedent to regulatory change. Although theoretical and historical insights of institutional creation have demonstrated the endogenous nature of institutional creation involving many agents, the prescriptive approach used in policy type or applied studies suggests institutional development as the singular responsibility of the state. This view underemphasizes the role of market participants in influencing the direction of policy change. To conclude, the forgoing review of institutions has discussed gaps in the literature with respect to the credit markets; namely, the role of informal institutions which can act as substitutes for formal institutions, the effects of the interaction of newly created institutions with the existing institutional structure, and lastly, the process of institutional creation which involves not only the state, but other agents, particularly producers.

2.9 Conclusion

This chapter has reviewed the literature on the economic perspective of market failure which dominates the research on small business credit shortages. Gaps in theory which preclude the understanding of this multifaceted phenomenon in Nigeria were identified: specifically, how external risk can give rise to systemic SME default risk; and, secondly, the role of alternative institutions, especially informal ones, that business may use or create in order to bridge gaps in the formal institutional structure in order to lend to SME. Given the conceptual issues highlighted above, the next chapter shifts from the market failure view in economics to a market creation from an economic sociology perspective. This enriches the understanding of how markets can work in developing countries despite institutional weakness. This literature also draws attention to the social nature of institutions, and the interests and motivations that combine to create new institutions that permit markets to form.

CHAPTER 3. CRITICAL LITERATURE REVIEW (Part II)

MARKET CREATION:
A PERSPECTIVE FROM ECONOMIC SOCIOLOGY

3.1 Introduction

The last chapter discussed the gaps in the economics literature relating to the theory of institutions, which failed to provide comprehensive explanations for how markets in developing countries function given institutional weaknesses. This chapter reviews the literature from economic sociology, which contributes by providing a fuller account of how institutions work and how they are created in markets. In this way, it builds on the view from economics of how markets function and this provides the background to the conceptual framework elaborated at the end of the chapter.

In economics, the market model features as its central institution (Swedberg, 2003), resolving the economic dilemma of resource allocation under scarcity. In the real world, perfect markets are rarely observed and this observation has led certain economists to model examples of imperfect markets existing at equilibrium and yielding sub-optimal welfare situations. Some New Keynesian economists (Mankiw and Rome, 1991) were concerned with sticky prices, such as in labour markets, which give rise to high unemployment and inelastic labour costs. Such examples of real world deviations from the perfect market model have been of particular interest in economics, challenging the efficiency hypothesis of the market model.

Despite its imperfections, the market model of the economy has continued to grow in dominance over other forms of resource allocation, as evidenced by the collapse of centrally planned economies of former Eastern bloc countries, and the marketisation of the economies of developing countries such as communist China, and India (Stern *et al*., 2005).The end of the 20th century witnessed an unparalleled increase in economic growth in the developed world, as well as many parts of the developing world adopting market led economic policies. As major emerging nations such as China and India have succeeded in lifting hundreds of millions of citizens out of poverty, aided by market reforms (Stern *et al*., 2005), well-functioning private markets have become increasingly accepted as indispensable to economic growth and development.

With the growing dominance of the market model, it is no longer considered the exclusive right of economics and the concept of markets is increasingly being studied by other branches of the social sciences. The importance of the study of markets has been reinforced in the last few years by the spectacular failings of the developed world's financial markets in 2008. The ensuing global economic and financial crises have been attributed to the insufficiently regulated sections of banking industry. In short, markets have become too important to be ignored, and for these reasons, there has been a renewed interest in markets by scholars outside the field of economics since the beginning of the 21st century. Focusing less on whether markets are the right means of economic distribution, the debate has increasingly shifted to the role of the state in encouraging markets to form, for example, in the situation of developing countries; or whether to control and regulate them, as is the case with the financial markets of the developed world.

3.2 Defining Markets

The field of economic sociology seeks to provide an alternative perspective to investigations of markets with a set of analytical tools with which to study the concept. The modern sociological view of markets with roots in Marxist thinking, owes its origins to the classic thinkers in sociology, such as Durkheim and Polanyi (Granovetter, 1985), who were concerned by the effects of industrialisation and rising capitalism on society. Whilst earlier scholars were primarily occupied with the social changes taking place, Max Weber's work about interests and motivation in capitalistic markets is more directly linked with this field, and is thus considered the antecedent of economic sociology (Smelser and Swedberg, 2005). In the sociological treatment of economic concepts, markets have become an important topic with leading economic sociologists developing and formalising concepts in advancing their analytical work.

Karl Polanyi's essay "*The Economy as Instituted Process*" (Polanyi, 1957) is a reference for the field. In redefining the term "economic", he distinguished the *substantive* meaning from *formal*, where the former broader meaning of economics related to all forms of *"interchanges made in order to obtain material wants"*. By decoupling the assumption of markets as *the* form of distribution from the term "economics" when invoked in every day discourse, he identified three types of economic interchanges*: reciprocity, redistribution and exchange.* It is the last of these, incorporating the price mechanism, which closely corresponds to the economists' formal definition of markets. Using this structure to illustrate the different forms of economic activity, he showed how social interaction varied according to the type of interchange in use. Contrary to the rational behaviour hypothesis in economics, he argued that the prevalence of the market model dominates the form of social interaction and social welfare. His methodological analysis demonstrated that the effects of markets vis-à-vis other forms of economic actions were not socially neutral. This work set the stage for subsequent work in the field of new economic sociology defined by Smelser and Swedberg (2005) as the "*sociological perspective applied to economic phenomena*".

Several key concepts have emerged from the field which have been adopted in the analytic treatment of social activity in markets. Notably, Granovetter's notions of *embeddedness* and of *networks* have revolutionised the thinking, becoming standard terminology in empirical approaches. The concept of embeddedness, which Granovetter developed directly from Polanyi's work, is the idea that economic actions are not independent but rooted in systems of social relations (Granovetter and Swedberg, 2001). He argued that economic transacting is not an autonomous process but needs to be analysed within the context of social relations, further developing this reasoning to show how social networks affect economic decisions and outcomes. These concepts have been used in advancing the empirical studies of the social action that operates in economic activity extensively in economic sociology.

The ubiquitous term 'market', has various interpretations well beyond its formal conceptual meaning in economics. Economic sociology scholars studying market often proceed by first defining the concept through identification of the economic activity which it represents. Swedberg's conception of economic activity deconstructs the capital process into four stages of a flow: the first stage is *production* which then leads to *distribution* in the form of exchange and results in *consumption* and *profit*. He proposes that social studies of these factors are made within the perspective of the legal, political and cultural systems that frame economic action (Swedberg, 2005*)*. Though recognising that production is necessarily the first stage of the economic process, he considers exchange, the method of distribution, to be of primary importance in the sociological analysis of capitalism because it is that which distinguishes markets from other forms of economic distribution. Swedberg (2005) points out that when exchange becomes the dominant form of distribution in an economic system, this in turn dominates the production process. Thus, his view of the market has focused on the way in which markets control the production process. This sentiment, the need to study markets from the perspective of production, is echoed by other prominent economic sociologists.

White's (1981) analysis is principally concerned with producer-dominated markets, the most predominant form of market in his view. Sharing certain similarities with industrial economics and the oligopolistic model of economics, he considered the power of producers in setting prices and determining output decisions of the markets. His W(y) model focused on the idea of networks of cooperation, or non-cooperation, between producers using a game theoretic approach, and he demonstrated how price and output decisions were reached by producers (White, 1981). Bourdieu's vision of the market as fields, on the other hand, is seen as comprising of the economic agents who create the structures: producers armed with the different types of capital they possess compete for a share of the consumer demand (Bourdieu, 1997). Fligstein's conception of the market adopts elements of White's idea of market domination by producers as well as Bourdieu's concept of markets as a space where economic action takes place. Whilst he describes markets as the *"social arena where buyers and sellers meet"*, acknowledging that the market comprises of both demand crowd and supply crowd, Fligstein (2005) emphasizes the role of producers as well as the state as the key in market creation. Power, in his analysis, is the main driving force in markets, with markets being shaped by the actions of producers seeking to gain and retain power (Fligstein, 2005). Specifically, he looks at the ways in which producers attempt to legitimise this power through engaging with the state in influencing the ways in which rules and regulations, i.e. institutions, are established that guide market participation. Consequently, themes of the state, laws and formal institutions strongly feature in his work.

Influential theoreticians such as these have paved the way for empirical research in the social relationships that create markets. In his well-received narrative of financial markets McKenzie (2006), concludes that *'markets… are not forces of nature but human creations'*. In one of the studies, he illustrates this with the example of how the Chicago Mercantile exchange was faced with the prospect of financial collapse due to the inability of traders to honour their obligations to counterparties after the US Financial markets crashed in 1987. It was saved from almost certain disaster, not by impersonal market forces, but through the intervention of three actors: the chairman of the exchange, an executive at the bank Continental Illinois, and its chairman who jointly agreed to put up $400 million—the shortfall required to prop up the exchange to enable it open the following morning. Thus studies of producers' behaviour have been accorded an important position in study of markets by economic sociologists especially in the context of legal structures and the role of the state. Recently, some of these studies have centered on the financial markets and financial institutions (Lépinay, 2007).

3.3 Market Creation: Who Creates Markets?

How do markets come into existence? Greif (2005) critiques the way the subject of markets is approached in economics, "*as if they come to being spontaneously without little analysis about how they do so*". The near absence of discussion in the neoclassic model of markets of the actors and the conditions that create markets, has compelled scholars from different fields to attempt to rectify this omission. New institutional economists have been concerned with the institutions that shape economic transacting, whilst entrepreneurship scholars have focused on the entrepreneur as a phenomenon. Early entrepreneurship research in the field, focusing on behavioural motivation, considered entrepreneurial ability as innate and used trait studies to attempt to identify the unique characteristics responsible for entrepreneurial behaviour. Core concepts such as McClelland's *need for achievement* and Rotter's *locus of control* emerged from such research (Delmar, 2006). Continuing in this vein, various empirical studies identified dozens of traits associated with entrepreneurial spirit. With little consensus on a definitive set of traits which accurately predict entrepreneurial behaviour, it became clear that entrepreneurs were not a different breed of humans in possession of distinct identifiable traits! With this, empirical effort re-orientated towards cognitive models and motivation theory as better predictors of entrepreneurial action. This work has generated various models that incorporate personal characteristics of the entrepreneur as well as demographic and environmental factors (Delmar, 2006)

In economic sociology, scholars point out that markets are generally created and dominated by a few producers. For example, White (1981) was particularly interested in the oligopolistic tendencies of industrial production. But this dominance of relatively few producers is also true in capital markets often controlled by big financial institutions, and thereby resonates with this research. Further, this imbalance between relatively few producers and many buyers is exacerbated in the case of small business lending because of the modest transaction size, such that smaller firms are "market-takers", unlike large companies that can exercise power in negotiating relationships with financial institutions. Thus, studies examining the one-to-one relationship between the small business borrower and lender may well expose issues in individual contract conclusion, but do not address the strategic issues of why and how lenders make decisions to enter or exit the small business credit market in the first place. In Nigeria, the commercial banking market comprises of just 21 banks—24 at the time of data collection. This number points to a far from perfectly competitive market model especially vis-à-vis the hundreds of thousands, or even millions, of potential small business borrowers. Thus, this research approaches the study of rationing of credit to small business borrowers from the perspective of bankers, whose actions largely determine the creation of credit markets.

3.4 Motivation: Opportunities and Interests

Studying the motivations and interests that underlie actions that produce markets takes an importance place in economic sociology. Indeed for Swedberg (2005), interests are central to understanding markets, as he states: "*interests drive the actions of the individual*" and "*are what supply the force in the economic system*" (p. 5). In studying the actions that lead individuals to build firms, entrepreneurship scholars have written extensively about motivation. Earlier studies considered motivation as innate, whereas, more recent studies have looked at the external environment as an important contributory factor for entrepreneurship activity to take place. In entrepreneurship studies, Shane (2003) builds a conceptual framework which postulates that it is the integration of the individual and the existence of opportunity that allows entrepreneurship to take place. Entrepreneurial ability must be exercised successfully for a market to be created. The conditions under which this can happen are the existence of opportunities, which are largely independent of the entrepreneur. Opportunity is the potential (Shane, 2003) of making a profit by undertaking activity and it is the perception of this that drives entrepreneurial action. When the motivated entrepreneur succeeds in creating and selling products or services in order to exploit a perceived opportunity, it leads to a creation of a market.

Opportunities are determined by external conditions that permit successful entrepreneurial activity (Eckhardt and Shane, 2003). Named after the way in which the two great entrepreneurship theorists conceived of opportunities, the entrepreneurship literature has distinguished between *Schumpeterian* and *Kiznerian* opportunities (Shane, 2003). The former term refers to those opportunities which are created when entrepreneurial action, such as innovation, disequilibrates the existing market by altering the equilibrium price for resources; in contrast with the latter, which describes entrepreneurial activity that exploits short term anomalies and restores equilibrium to the market (Shane, 2003). Schumpeterian opportunities are considered longer lasting, but more risky, because they require innovation to erode the entrepreneurial gain, whereas, Kiznerian opportunities are arbitrage-like opportunities arising out of information asymmetry. By contrast, the latter are said to be temporary, rapidly diminishing as others also gain access to this information and enter the market, driving down prices and thus eroding profits. Sarasvathy *et al.* (2003) construct a typology of opportunity and present three views of opportunity, namely: allocative, discovery and creative. The allocative refers to the situation in which supply and demand are known but need to be matched up; for example, in an arbitrage market. Discovery is related to where either supply or demand is known, whilst the creative view the opportunity as both creating new means and new ends. The discovery corresponds best to the SME credit market where there is unmet demand. According to Sarasvathy *et al.* (2003), information, institutions and absorptive capacity play essential roles in the discovery process, and markets in this situation are dynamic and evolving.

Profits have slightly different roles in entrepreneurship theory and economic theory: Entrepreneurship considers perceiving the existence of exploitable profitable opportunities as a motivation, whilst in economics, profit-maximisation is assumed to be the objective of the firm. In general, both disciplines treat profits as the end result of the action of successful economic activity of firms in markets. Shane's (2003) model of opportunity, for example, provides a schematic representation of the entrepreneurial process where profit appears as the outcome of the entrepreneurial decision making process.

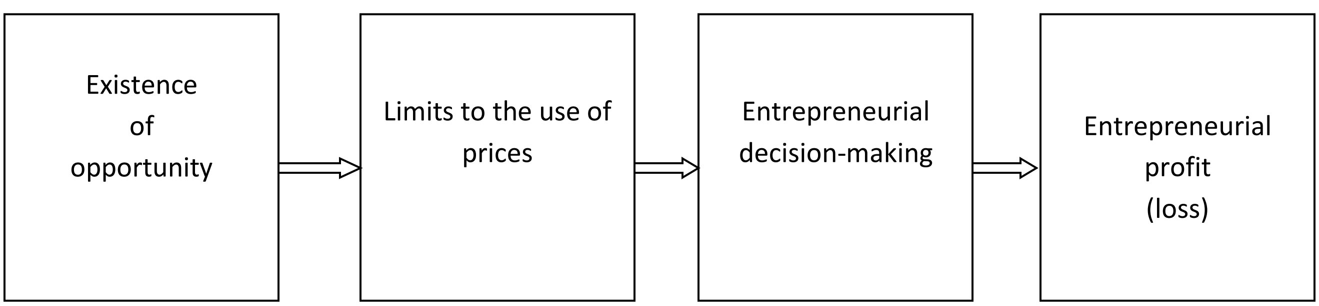


Figure 1 The Entrepreneurial Decision-Making Process, Scott Shane (2003, pg. 38)

Considering that profits play such a central role in driving economic action in both fields of economics and entrepreneurship, surprisingly, it has been economic sociology that has clearly articulated the dual purpose of profit-making in its analysis of markets. Apart from the motivation for the entrepreneur and a reward for successful business venturing, Swedberg (2005) demonstrated that profit is a necessary output of the market because it feeds back into production and is an indispensable input to grow the firm.

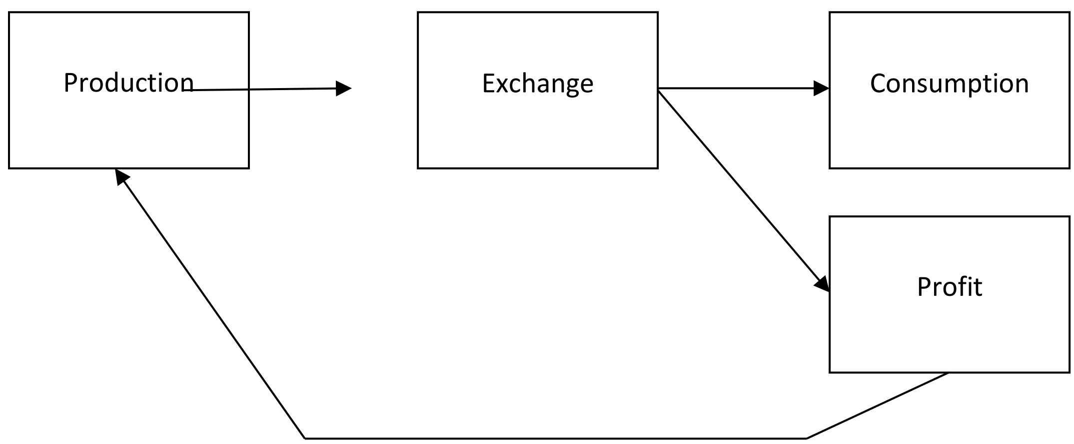


Figure 2: The Economic Process of Exchange, Swedberg (2005,p. 8)

Thus in the research, profits are acknowledged not only as a feature of entrepreneurial opportunity that motivates the entrepreneur, but also as the indispensable outcome of entrepreneurial activity to allow the sustainability and growth of markets.

The Role of Profits in Markets

Clearly not all ventures have profit-making as the primary objective; North for example, has been careful to mention that motivation is not always driven by profit, citing altruistic reasons (North, 1990). The new sub-discipline of social entrepreneurship has drawn attention to the pioneering work of individuals whose principal business objective is defined by the social advantages they bring to their clients or communities (Mair and Marti, 2006). However, for the purposes of this paper, we are concerned with the creation of markets where opportunities are profitable, a condition of sustainability for most private markets.

The collective effect of profit-making firms is the generation of economic growth which capitalist type markets have been successful at achieving. Thus, profits serve as a motivation to creation of market, fuel the productive cycle of exchange and are a necessary condition for the sustainability of private markets. Fligstein (2005), also recognising that profit making is a goal of firms and forms part of the opportunities that motivate people to create new markets, proposes that economic sociology's contribution to the study of profits should focus on the actions of actors in order to produce profits. To conclude, motivation is fuelled by the perception of profitable opportunities *and* the generation of profits; these are essential conditions for the stability and sustainability of markets.

3.5 Institutional Pillars of Markets

In over two hundred years since Adam Smith evoked an intangible mechanism, "*the invisible hand*" that drives the free market, scholarly effort from many fields has shone light on some of these unseen hidden processes that underpin markets (Smith ([1776] ed. Sutherland 1993). The fields of economic sociology, new institutional economics and entrepreneurship studies, have also spoken in detail about the institutional setting. The entrepreneurship scholar, Shane (2003) says "*the institutional environment is an important dimension of the context that influences opportunity exploitation*" (p. 145). In economic sociology, Fligstein (2005) argues that social relations between producers and the state need to be studied because this process leads to the creation of institutions which are needed for markets to achieve legitimacy and stability. Whilst naturally NIE has put emphasis on the significance of institutions in promoting—or hindering—market transacting, there are notable differences within the two schools in the way in which institutions are viewed and therefore conceptualised and applied in their analyses.

Institutional economists have largely treated institutions as if they were exogenously given, seeing them as enabling devices that facilitate transacting: reducing transactions costs and improving information flow. Thus, they stress the efficiency function of institutions and have studied economic transacting arise under different institutional arrangements. For economic sociologists, whilst they agree that institutions facilitate transactions—noting that these being man-made devices which legitimise economic action—they correspondingly emphasize the role of the parties who create institutions. Swedberg (2005) insists that interests must be central to the definition because in capitalist markets they "*come together in a particular way and drive the actions of the individual*" and he thus proposes a definition as "*durable lick-ins or amalgamations of interest and social relations*". In NIE, Douglass North also affirms that formal institutions "*are created to serve the interests of those with bargaining power to create new rules*" (North, 1990; 1993). The aim of producers is to achieve stability needed in order for repeat transacting to occur, and thus legitimacy is achieved through the action of powerful producers and the state. Further, institutions are deeply dependent on laws, institutions and governments for their existence (Fligstein, 2005). Hence the role of the state is of interest in studying institutional creation.

A second difference is the treatment of institutions, which NIE research has typically restricted to the formal rules and regulations. Williamson (2000) admits that NIE has been principally concerned with the institutional environments—that is, the formal rules and governance—rather than 'embeddedness' or the informal institutions such as customs, traditions, norms and religions which any formal institutions are a part of, and which NIE takes as given, being that they change very slowly. However, notable scholars such as Douglass North have emphasized the significance of the interaction of formal and informal institutions in that together they determine economic outcomes. Thus, within economic sociology research, these often overlooked social institutions are a critical part of analytical attention. Economic sociologists attribute the differences observed in outcomes of similar formal institutional change in different contexts to the specificities of the existing institutional environment in each particular setting.

3.6 Modelling Markets

Unlike in economics, economist sociologists are still to device a comprehensive theory of markets.

Scholars, however, have offered views on how the subject of markets should be treated. Swedberg (2005), for example, advocates for the coordination of efforts between economists and sociologists given that they "*each hold half of the truth*". Fligstein (2001), on the other hand, warns about the dangers in collaborative studies, advocating that sociological studies need to be independent from economics. He argues that viewing the social structuring of markets solely from the perspective of profit goal of actors, may move sociologists toward institutional sociology as institutional structure will be regarded as efficiency oriented. In this way, he suggests that there is natural tension between his work and that of institutional economists. Nonetheless, there are areas of observable commonality between the economists and sociologists in the subject of markets. Indeed economic sociologists have been drawn to the institutional perspective of economists, particularly, with the work of Douglass North, who himself has exposed sociological ideas such as embeddedness and interests in institutions that drive economic action (Swedberg, 2005). Because of the interests they inherently embody, institutions are central to sociologists' studies of markets.

Economic sociology theorists have set the stage for the social studies of markets by identifying certain institutions critical to the functioning of markets. Swedberg (2005) points to private property as the starting point of exchange, remarking on its legal enforcement—in reference to Webber's work on property as a legally protected right— requiring coercion from the state's agents to enforce and restore. It is this view of the enforceability of property rights he identifies as being close to the economists' view of property. Similarly, the institution of property rights is fundamental for Fligstein (2001), featuring as one of the four institutional pillars he describes in his conception of the market. Unlike in economics where the focus is on the institution itself, Fligstein emphasizes the social relationships of the state and producers in defining the institutions. This theme of social relationships is reflected in the other three pillars he defines; namely, governance structures, rules of exchange and conceptions of control. Governance controls relate to both formal and informal instructions that regulate competition, i.e. anti-competition laws, while rules of exchange are the regulations that control standards and unified practices such as protection of consumer and rights of parties: standards, contract enforcement, insurance and the like. "*Conceptions of control*" has to do with market behaviour between producers leading to cooperation and competition. Greif (2005) focuses on the formal and informal institutions that affect the act of exchange; particularly, the system that deters parties from reneging—analogous to the moral hazard problem in economics. However, unlike in economics, Greif sets the informal systems alongside the formal. For example, he identifies the mechanisms that enforce and institutionalise behaviour, citing *"laws, regulations, customs, taboos, rules of behavior and constitutions* (Greif, 2005, pp. xix-xx) as well as informational systems such as credit bureaus and credit rating agencies.

Thus, in the work of economic sociologists, the socials norms and informal behaviour which encourage enforcement feature in the analysis side-by-side with the formal rules and regulations. This is helpful in understanding how businesses organisations function successfully in developing countries despite often weak institutional framework.

3.7 Property Rights[1]

The extent to which the private ownership of assets and capital should be allowed has generated vigorous ideological debates through the ages. The modern concept of liberty, from which private property arises, was debated by philosophers such as Locke and Hobbes who recognised that liberty meant individual efforts of man to pursue his needs and satisfy personal interests. However, they had different perspectives as to the extent to which the pursuit of personal interest should be controlled or allowed, given its effect on the general interest. For Hobbes, the autocratic state—the *Leviathan*—was necessary to preserve interests of the whole, whilst Locke instead saw people as being able to arrange a system of self-governance through a cooperative system of contracts in order to limit excessive self-interest. Economic sociologists acknowledge the importance of

[1] *A complete literature review of property rights was done in Document 4, thus this section only covers the main points and the view of the property rights from modern economic sociologists.*

private property rights for markets to function but draw attention to this conflict between self-interest and collective interest which arises from private ownership and appropriation (Swedberg, 2005).

Property rights formally entered into economic analysis with Coase's treatise *"The Problem of Social Costs"* (1960) in which he proposed the principle of reciprocity, that is, the allocation and determination of property rights which could bring about bargaining as a way of resolving issues of negative externalities, rather than resorting to government-imposed sanctions. However, it was Demsetz (1967), in his seminal paper '*Towards a Theory of Property Rights*', who first modelled how well-defined property rights facilitated economic transactions and the functioning of markets. This notion of centrality of property rights in transacting is also reflected in economic sociology analyses. Greif (2005), for example, considers property rights as fundamental to the economic process, and this thinking is reflected in his conception of exchange which he describes as "*an agreement among economic agents regarding property rights in goods characterized by their physical attributes as location over time and place*". However, in economic sociology, studying property rights is important because they "*define the social relationships between owners*" (Fligstein, 2001) by conferring power to parties in economic exchange. Yet, while exchange is generally contracted between private parties, the role of the state is ineluctable to market transactions because formal property rights require the enactment and enforcement of laws, a function of the state. Douglass North's treatise on the development paths of America and Europe illustrated how the continual evolution of property rights was necessary for the advancement of the market economy (North, 1990).

Property Rights in Credit Markets

In developing countries, weak property rights have been seen as a major constraint to private markets, in particular, not evolving quickly enough in response to demographic changes such as rapid population growth and mass migration to cities, as argued by De Soto (2000) in "*The Mystery of Capital*". Though this work was criticised for seeming to suggest that the establishment of property rights—primarily to do with land—was the single most important criteria for improving access to capital and the thriving of private markets in developing countries, it called attention to the serious barriers to growth that smaller firms face in developing countries. Ill-defined property rights, resulting in small business owners being unable to present evidence of asset ownership needed as security for bank loans, often prevent them from accessing formal finance for their businesses. Because of the nature of the deferred nature of the loan contract, borrowers require collateral as a form of security for the loan in the case of non-payment. Landed property has been the traditional form of security for loans, with borrowers taking a lien on the assets. Whereas, as the corporate loan markets have developed, and information requirements are more easily accessible, correspondingly, for large publicly quoted companies, lenders have relied less on property as a requirement for borrowers to raise loans, in contrast with small business lending where collateral is still the norm.

3.8 Markets in Institutionally-Weak Environments

Emerging nations, often characterised by institutionally-poor business environments, have turned to institution building to support markets and economic growth. Given that large scale institution building can be difficult and costly (Scott, 1995), it takes a long time to implement because it requires displacement of existing institutions (North, 1990). Researchers have thus become interested in studying successful entrepreneurial activities that have emerged and survived in weak institutional settings in developing countries. Of particular focus is how businesses have been able to create markets and scale-up despite these institutional issues. In strategy, Khanna and Pelepu (2005; 2010) in studying cases of successful businesses that have overcome institutional voids, have strongly advocated for a different strategic approach for western businesses entering into developing markets. Essentially, they describe building strategy around the idea of *bricolage*, the French word employed by the anthropologist Lévi-Straus (1966) to refer to 'making do' with whatever materials or resources are at hand to solve problems. They posit that success in these environments is as much from entrepreneurial activity around bridging institutional gaps as from the exploitation of market opportunities, suggesting that institutional voids should be considered an opportunity rather than a deterrent (Khanna and Pelepu, 2005). This idea of *bricolage* is used by economic sociologists Mair and Marti in their account of the activities of BRAC, a microfinance NGO in Bangladesh, to describe how it succeeded in its development mission to fund the ultra-poor. This was done by adopting a make-do attitude and combining existing resources in such a way as to achieve their goals (Mair and Marti, 2009).

In development economics, Dani Rodrik has discussed the problems of building the institutions needed for well-functioning markets in developing countries. Rather than duplicating institutions from advanced countries, he proposes institutions tailored to existing institutional contexts in the recognition that outcomes vary according to the specificities of the particular operating environment (Rodrik, 2008). He puts forward the idea of *"second-best institutions"* as an alternative to the best-practice advanced country models often proposed by development experts involved in policy advocacy to developing countries. This follows recent thinking by some development economists who believe in changing focus in policy development. Jeffery Sachs, for example, says that institutions are not generic one-size-fits-all arrangements, and proposes that in developing them, the historical and environment need to be considered such that they deliver the economic outcomes that are necessary for improving market efficiency, focusing on desired result (Sachs, 2005).

New institutions do not form in an empty space, they displace or replace existing ones, embedding themselves into the existing network of formal and informal institutions; therefore, it follows that an understanding of the prevailing institutional environment is needed before institutional creation takes place. Whilst economic analysis has been very active in empirical work to do with analysis of formal institutions, its tools are limited when dealing with informal institutions and *bricolage*, thus sociology can take a lead in this way. For example, in developing a typology for the process of interaction of formal and informal institutions, Jütting and Soyza (2007) argue that since the outcome of interaction of formal institutions with social ones lead to converging or diverging results, searching for 'good' institutions could be misleading, saying that they accommodate, substitute, or compete. Indeed, Nicholas and Maitland (2007) are more emphatic, warning that *"Transporting institutions into a developing country is unlikely to be successful and where* *successful, unlikely to be rapid. New institutions need to evolve from existing institutions"*.

3.9 The State and Markets

The state, having the exclusive authority through its parliamentary system to create laws thereby has significant influence over the shape of markets, given their dependence on regulation. Despite its unique position, the state role is underemphasized in the analysis of markets in the neoclassical economics model, with more attention paid to producers and buyers. One of the hallmarks of economic sociology is how it has brought attention to the state's influential action in markets through institutional creation. This has been an important aspect of Fligstein's work who says *"firms and markets are best viewed as deeply dependent on the laws and institutions and governments for their existence"* (Fligstein, 2005). Where NIE has tended to study institutions from the viewpoint of the effect they have on economic activity by reducing transaction costs, economic sociology has been concerned with institutions as man-made artefacts and therefore with the process of institutional creation and the interests they embody.

Government action facilitates the conditions for markets to be created, attain legitimacy and to gain stability. The state is responsible for promulgating laws, setting up the judicial and policing systems that enforce them, and creating the policies and regulations that guide market actions. It also regulates, polices and sets the environment for transacting. Thus, the state's role is central in discussions about institutions and the market in economic sociology.

The above discussion has reviewed the literature on the institutions that support market from the sociological perspective, recognising the role of the informal institutions, the powerful interests that determine and shape institutional creation, and how firms in developing countries may act to straddle institutional voids.

3.10 A Different Perspective of Economic Action in Emerging Countries

The initial challenge to conclude the research was to find a theoretical background to appropriately study this phenomenon. The first difficulty I experienced was that the purely economic model led to the inevitable conclusion that small business credit market was destined to failure, given the lack of the supporting institutional structures in the market. However, this was contrasted with my personal belief formed from professional experience, that there must be a way forward for an economy that was growing and needed finance to activate its small business sector even if certain institutional structures were weak. This meant recognising that the economics based literature on credit rationing, though instructive, had limited tools to explore how markets were created and could work in developing countries. Thus, including concepts from the economic sociology of markets, which seem well adapted to an emerging market context, meant moving to a more normative approach for studying market producers attempting to overcome operating difficulties. Additionally, economic sociology helps analyse how markets are created, emphasizing the role of the entrepreneurs, or producers, that work to create them. With significant input from the preceding research which helped to identity the barriers that banks face lending to SMEs, a conceptual framework was developed, as discussed in the section that follows. This framework uses concepts from the three literatures cited above to examine the functioning of a commercial bank's newly established small business credit lending programme in Nigeria.

This lens allows an exploration of the gaps in economic theory identified above, namely, the risk of the effects of the external operating environment on small firm default, and the social or informal institutions that can be created or that operate where formal institutional are weak. This research argues that these issues, the external environment, opportunities and motivations, are an important part of the context of small business credit markets in developing countries and addressing them is key to finding solutions to lending to these firms.

3.11 Conceptual Framework

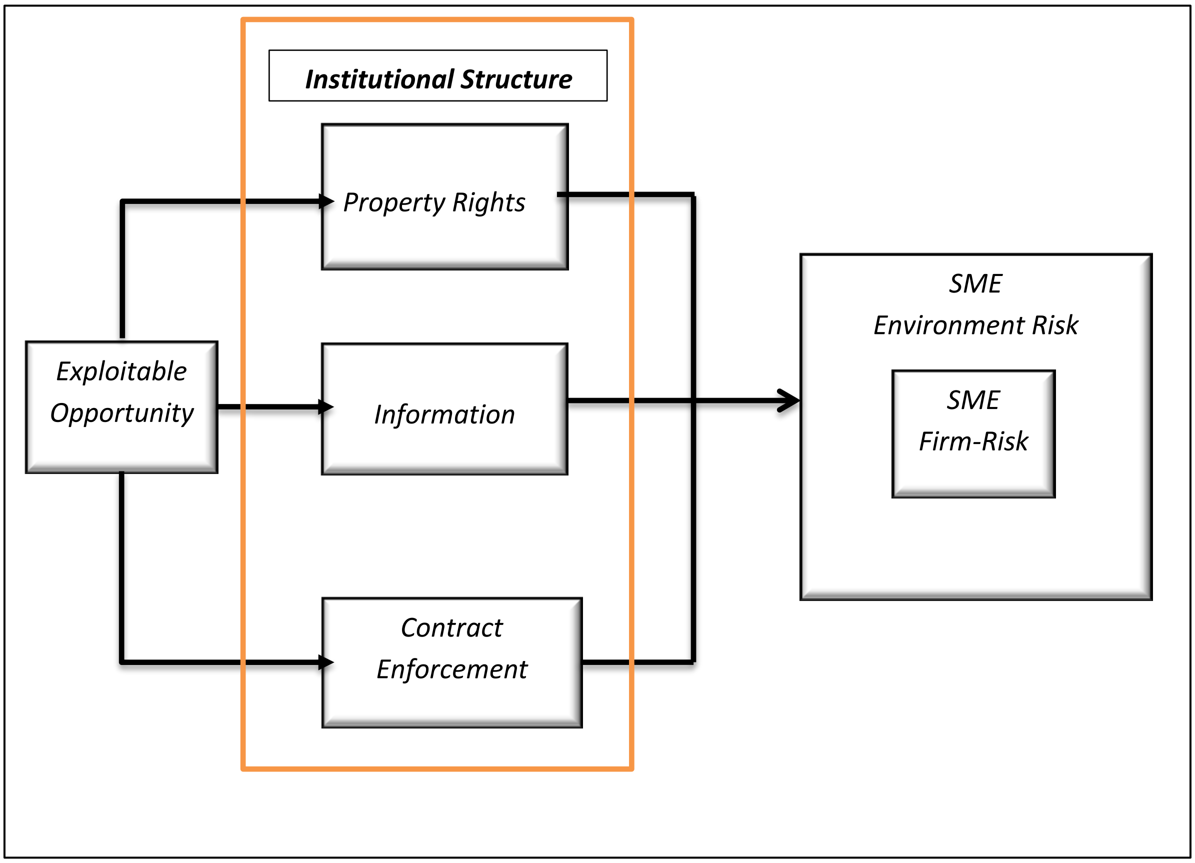
The conceptual framework drawing from economics and enhanced by theoretical perspectives from economic sociology and entrepreneurship, develops concepts used to study the small business credit market creation process at the firm level. The first part of the framework highlights the start of the process: the bank's decision to undertake the project, a phase which is much overlooked in discussion of credit creation. The main concepts and the sources of literature they are drawn from are as follows:

- **Exploitable Opportunities:** Developed from the entrepreneurship and economics literature, this concept explores the circumstances surrounding the entrepreneurial decision to enter into the credit market. This relates to how the bank perceives the opportunities of profitably lending to that sector and its ability to exploit them, operating within the specificities of the financial institution sector.

- **Institutional System:** Adopted from economics and economic sociology, the second part of the framework concerns the main set of the institutional pillars that support credit markets, namely, information, property rights and contract enforcement. Recognising that firms operate within the structure of both formal and informal systems of institutions, this concept here includes also the social and informal alternatives. Where the formal institutions are weak—a situation not uncommon in lesser developed countries—and do not adequately support the market, the entrepreneurial firm needs to develop alternative mechanisms to bridge these institutional gaps to support its business activities. These hidden devices, and how they are conceived and used, are studied within this context.

- **SME Risk Disaggregation**: This concept, which is found in the applied economics literature in finance, identifies factors that comprise default risk. The usage here requires that in order for banks to identify and mitigate business risk to SME sector, they also need to differentiate between external risk factors common to the SMEs, or groups of them, and the individual risk peculiar to each business. The lending model is examined to see how it is developed to address the issues of these two sets of risks.

The model is depicted in the diagram below, followed by an elaboration of these key concepts and their use in the case study.



Sources of literature:

└ *Entrepreneurship* ┘ └ *Finance/Economics* ┘ └ *Economics and Economic Sociology* ┘

Figure 3. Conceptual Framework—SME Credit Market Creation

The framework depicts the process of credit creation by a bank. The beginning of the process is represented by the concept of *exploitable opportunities* on the left side of the model, in Figure 3 above. The concept suggests that the creation of the market starts from the bank's recognition of opportunities lending to the SME market, before they commit resources to doing so. The middle section of the framework relates to the institutional pillar that supports the credit market, consisting of the information, property rights and creditor rights, which are indispensable for lending to take place. Finally, the right side of the model pertains to the risks in the SME sector which the bank intends to lend to. The bank needs to be able to disaggregate external risk from the firm specific risk, and be able to measure and mitigate those, in order to lend successfully to firms within the sector. Each section of the framework also encapsulates different barriers to lending that need to be overcome. Addressing each of the concepts is discussed in the sections below.

3.11.1 Exploitable Opportunities

The concept of exploitable opportunities draws attention to the often-overlooked phase of strategic decision-making by financial institutions in choosing whether or not to lend to the small business sector, and the parameters of the outcome of those decisions. Thus, the first part of the model is concerned with the *Schumpeterian*-like opportunities that motivate a bank to enter into this market, requiring a new way of lending to the small business sector. The concept used in the conceptual framework, *exploitable opportunities* is so named to reflect the organisation's ability to exploit a perceived opportunity in order to generate profits by setting up a small business lending programme. This concept captures the early stage of a nascent market.

The ability to exploit is linked to the *absorptive capacity* of the firm. Cohen and Levinthal (1990) define the firm's absorptive capacity as the "*ability to recognize the value of new information, assimilate it and apply it to commercial ends*". Zahra and George (2002) in extending this concept, speak about *realised absorptive capacity,* which is the organisation's ability to "*harvest and incorporate knowledge into its operations leading to the creation of new goods system, processes"* (p. 190). Determinants of absorptive capacity arise from external and internal factors (Daghfous, 2004). Within the firm, factors include the level of education and training of staff, investment in research and development, organisation structure and human resource practices, and external knowledge and interaction. Thus the firm's ability to exploit will depend not only on its internal resources, but also on how it can access information and knowledge from the external environment and use it successfully to achieve its performance goals.

Sources of Profit

Opportunities relate to the possibility for profit generation, a necessary condition for sustaining markets (Von Mises in Swedberg, 2000). In commercial banking, the core activity of the bank is lending, which generates the primary revenue in the form of the interest margin—that is, the difference between interest earned from lending and that which is paid to depositors, less provision for loan losses (Heffernan, 2005). Thus, to generate profits, the interest margin must also compensate for the risk incurred by lending to the group of clients. Whilst the gross profit from making a particular loan amounts to, at most, a percentage of the loan amount, the potential loss is the whole amount of the loan. Thus, the profit-loss structure of a particular loan is inherently skewed, explaining why banks typically prefer to have collateral to redress this imbalance.

Government policy also affects the risk-return profile of lending. For example, regulatory authorities may impose interest rate controls on small business loans in order to lower costs of borrowing to these firms. However, these may instead have an effect on curtailing lending, if the margin is not sufficient to cover the risks of lending to the SME. Commercial banks also generate income and commissions from non-lending activities such as 'float' on credit balances, i.e. non-interest earning balances on customers' current accounts, foreign exchange transactions and trade services, such as opening letters of credit, which add to the attractiveness of increasing their customer base.

Financial Sector and Macroeconomic Effects

The state of the economy and the financial sector has implications for bank lending strategies. A buoyant economic environment encourages banks to extend their lending. However, when there is an economic or political crisis, banks become more conservative, and if the situation is severe, a credit crunch arises, with the cutting back of loans skewed towards to riskier customers; thus, smaller businesses again suffer as a result.

The activities in financial sector also affect banks' lending strategy environment. Though banks' treasuries manage their institutions' liquidity positions by constantly borrowing and making placements in the interbank markets to manage short term liquidity shortages or excesses, these transactions are short term in nature, typically a maximum of one week, so funding a growth in loans, require banks to raise deposit liabilities. This means at any point in time, lending to any group of clients implies an opportunity cost of not lending to others. In making strategic decisions to lend, a major consideration of investing funds is the risk profile of that group of borrowers. In the continuum of risk, SME loans are considered most risky and corporate loans moderately risky. The safest assets are considered to be those financial instruments issued by the government, which could be shorter term treasury bills or long term bonds. The level of government borrowing thus affects private sector lending. In particular, when governments run large deficits and finance them by borrowing from the domestic financial markets, this can displace private sector borrowing, an effect known as the *'crowding out effect'*. In terms of competition, the structure of the industry will affect banks' appetite to enter into new areas, including competition and strength of the sector.

3.11.2 Institutional Structure

The three main institutional pillars identified from the literature that are needed to support the market structure for lending are the property rights system, the informational structure and contract enforcement.

Property Rights

Banks usually require collateral as security for loans in order to mitigate risk. In the case of small businesses with perceived higher risk, the collateral requirement is an indissociable element of a loan contract. As evoked earlier, using assets as security can be problematic when the legal systems that recognise ownership, transferability and title may be weakly defined or enforced. New institutional economists have written extensively about the strong correlation between well-defined property rights systems and the development of efficient markets (North, 1990). In economic sociology, theorists have also evoked this linkage between property rights and exchange. Swedberg (2005) notes that not only must property rights be defined, they need to be legally protected and restored by coercion if infringed upon. Property rights are thus deeply dependent on the state, through its legal systems and its agents to determine, enforce and protect them.

Traditionally, landed property was the main form of collateral used for business loans. In Nigeria it is estimated that 80% of the country's population lives on property without formal legal title. Even in its largest cities, Lagos and Kano, it is estimated that only 1% of property transfer is done formally (USAID, 2010). It is this lack of clear title to land that Hernando de Soto (2000) discusses in his book, '*The Mystery of Capital*,' in which he suggests that unlocking of this blocked capital is the key to investment and economic growth for the poor in developing countries. In many countries in Africa, the formal documented property rights system dates back to the recording of property requisitioned from the local population by colonial powers resulting in the coexistence of two forms of ownership, individual and customary. Written records that are legally recognised exist, but clannish or feudal ownership were often not documented such that ownership and transfer of property is recognised through verbal accounts. This is problematic in distinguishing clear property rights, especially with the ensuing huge population growth and urban migration. Additionally, political interests may control transfer of landed property. In Nigeria, for example, land ownership is mired in political interference with different political regimes directly implicated in the controversial acquisition and allocation of rights to politicians and the politically connected. In a legal quirk, all land is owned by the government and the legal rights that can be secured are a right of occupancy for a maximum of 99 years. Thus, all transfer of such rights requires the consent of the government, through the country's 36 state governors. With a population of over 175 million people, this creates a huge bottle neck in the transfer of ownership. Though recent amendments have allowed state governors to delegate powers, the process remains slow. In 2013, World Bank ranked Nigeria poorly, at 185 out of 189 countries, for property registration taking 77 days (an improvement, however, from 102 days in 2003) and costing a prohibitive 20.8% of the asset value on average to do so (though an improvement from 22% in 2003). It concluded that the rate of reform has been slower than other countries as a whole (World Bank 2013; 2014a).

An even more serious problem for small businesses and their owners is that they may be capital poor, and not have landed property in any case, to pledge as collateral. Elsewhere, alternative assets have been developed for adaptation in the small business credit market. Asset-based finance looks at the asset as both the source of repayments and the collateral. Yet the success of these types of financing instruments depends also on the functioning of registries, which are need to record claims of creditors in the event of non-payment (Berger and Udell, 2006). Research suggests that the dearth of these structures in most countries account for the fairly restricted usage of these methods of financing outside the US and a few other countries.

Rights recognised by the laws and registries need to be supported by an enforcement system to serve their purpose as efficient means of collateral taking; arbitration systems and court procedures that are just, affordable and timely are necessary. A loan recovery system needs to function so that assets can be recovered and sold to cover unpaid loans. Whilst the methods used in microfinance—social networks and trust—have proven viable alternatives to collateral requirements, these are not general suited to SME finance, as has been discussed in Section 1.7. However, other informal or social systems of securing loans to SMEs have not been well examined in the empirical literature. The mechanisms that the lending institutions use to overcome this problem will be examined in the case study that follows.

Information

Economic sociologists recognise the contribution that the Economics of Information has made in revealing the formal information structures that support market structure such as "*credit bureaus, business associations, consumer reports and stock exchanges*" (Greif, 2005). Nevertheless, they have also spoken of the need to study the social institutions that exist alongside the informal ones. Important concepts emerging from economics sociology, such as networks, signalling, and trust, are social devices that in effect act as information transmission mechanisms. For example, in a study comparing entrepreneurial activity and the growth of small firms in rural agricultural and fishing communities, Granovetter (2000) finds that solidarity and strong networks between sellers fostered trust and increased the information flow, which allowed members to set up lending schemes amongst themselves to raise credit for financing their business activities. However, these sellers are closer in characteristics to micro entrepreneurs than small business owners. Fukuyama (2003) talks about informal norms or reciprocity, trust and shared values being necessary for an information economy to function efficiently. I therefore examine the issue of information using the economic concept complemented with these ideas from the economic sociology literature.

Soft vs. Hard information

Research in economics has distinguished between two forms of information below, soft and hard, which in turn are closely related to informal and formal sources of information respectively. The social relations between banks and small businesses result in an information flow which may have a positive impact on the credit offering in relationship banking. In environments where a weak information structure makes hard information less readily available, there will be more reliance on soft information, suggesting that an examination of the information asymmetry problem from the economic sociology perspective may yield fruitful insight as to how financial institutions may seek to overcome this problem. Socially based alternatives such as community and business networks that could be tapped may provide a complementary information source to lenders. Thus, the analysis will look at the alternative types of information that banks seek and how they are used to build the risk profile of the client.

Contract Enforcement

The final set of institutions forming the pillars to the credit market relates to the enforcement mechanisms which limit moral hazard and create incentives for repayment. Environments in which creditor rights are weak encourage a culture of non-payment, deterring transacting in complex markets (Sacerdoti, 2005). Addressing this is a critical factor of the ability to lend to small businesses. NIE based studies have looked at the formal process of the legal systems, including courts, policing and third party dispute resolution. However, there is much less clarity on the informal, social and alternative approaches that organisations may use or develop to supplement the gaps in this legal structure. Thus, this part of the conceptual framework investigates how the bank creates a system, or employs methods, to fill gaps within the formal enforcement mechanism.

Contracts—formal agreements setting out obligations of concerned parties—need to be enforceable by law to be effective (Fligstein, 2001). Laws evolve as the nature of transactions change and become more complex; correspondingly, the systems of monitoring and enforcement also need to be pertinent. Yet, in economic theory, the law of incomplete contracts (Hart and Moore, 1985) recognises that a legal contract cannot set out all the dimensions of the business agreement between parties and fully protect against misperformance because it is costly to do. As there is usually a residual element of information asymmetry, economic actors are unlikely to knowingly enter into contract with a dishonest counterparty, relying solely on the contract for protection. Thereby, some measure of trust is an integral part of contracts. Informal institutions can play an important part in this process of establishing trust; repeated transacting can help ascertain trustworthiness. Economists have posited that poor enforcement of commercial laws and weak legal systems increase the cost of doing business in developing countries (World Bank, 2005), however wide-scale reforms are costly. Rodrik (2008) cites the examples of two developing countries, Ghana and Vietnam, with similar problems with weakness in legal institutions, where firms avoided resolving commercial disputes through the legal system. Yet in the latter, the system of contracting did not seem to have negative impact on economic growth, which he attributes to the informal substitutes that can still support substantial business contracting. In conclusion, the nature of informal institutions may positively contribute to contracting in the absence of effective formal ones.

3.11.3 SME Risk Disaggregation

The last part of the conceptual framework relates to the main components of SME default risk which arise from the business environment and from the firm itself. From the research in Document 4, banks recognised that certain aspects of the external businesses environment can negatively impact the performance of resource-poor small businesses more significantly than larger businesses. If serious enough, these can cause systematic failure to the SME portfolio. Macroeconomic effects such as economic recessions and interest rates fluctuations are well-known factors that affect all businesses. However, SMEs are also vulnerable to other aspects of the business environment, which can affect their performance, such as unfavourable or unexpected changes in government regulation and poor infrastructure (World Bank, 2002; 2013), by increasing operating costs significantly. The literature has not been expansive on all the specific aspects of the operating environment that affect SMEs and how banks can identify, measure and mitigate this external risk. This is also a subject of investigation in this research. As relates to the internal risk of the borrowers, the problems with obtaining financial and business information on small firms were elaborated earlier. Given an information poor environment, the method by which this risk is computed, the selection process, and the substitutes are important areas of investigation in this case study.

In summary, the three broad concepts have been elaborated above to address the research objective of investigating obstacles to lending to smaller businesses in Nigeria and how to overcome them. They are as follows: (i) Exploitable opportunities, focusing on the factors that affect the bank's perception of lending to SMEs as being profitable; (ii) Institutional system, underpinning the SME credit market and specifically focusing on how a lender can use inventive means to bridge gaps in the formal institutional structure; and lastly, (iii) SME risk—distinguishing external risk from internal risk—and how banks attempt to measure and mitigate these different types of SME risk in order to successfully lend to these firms.

3.12 Limitations

The conceptual framework provides a novel way to consider a nascent credit market to smaller businesses in developing countries where businesses often use resourceful methods to overcome the market barriers. This framework has not directly evoked the state as a separate area of attention, and for the reasons cited above, some readers may consider this an omission. Indeed, Document 3 identified actions of the government that could unwittingly create barriers to SME credit. It was a conscious decision to have the role of government running through the themes rather than approached as a separate focus, as much has already been studied about the government's role in markets. The intention is thus to focus attention on the actions of the banks to overcome the barriers, and through using the lens of the bank, this may yet identify or prioritise areas for state intervention.

3.13 Conclusion

The conceptual framework provides a holistic structure for understanding the functioning of small credit market, focusing on the strategies and coping mechanisms that a bank adopts to overcome barriers. Rather than focusing on simply identifying obstacles, this framework allows an exploration of how the organisation sets out to overcome the classic credit barrier issues and also those newly identified in this research. With this, the research seeks to address the following research objectives:

- Exploring the motivation and opportunities that drive/hinder interest in bank lending to the SME market in Nigeria.
- How institutional voids in the institutional structure—property rights, information, contracting/legal enforcement—are bridged, and the informal alternatives employed to address them.
- How banks attempt to identify and mitigate business environment risk as well as firm specific risk to SMEs.

CHAPTER 4. RESEARCH METHODOLOGY

4.1 Research Objectives

This chapter presents the philosophical perspectives and the research design adopted in this qualitative study. The purpose of this research is to shed light on obstacles to lending to SMEs in Nigeria, and to examine how they could be addressed in order to increase lending to the sector. The research was based on the case study of a commercial bank in Nigeria, Innovation Bank (pseudonym), which was the first and only commercial bank in Nigeria at the time of data collection to set out specifically to lend to the SME sector. The bank developed a strategy and a specialised process for lending to this sector despite the information and institutional difficulties that economics predicts leads to credit market failure. The study investigated how the bank was able to do so given the inherent challenges of lending to small firms reported by the banking sector.

The research objectives are to explore:

- The motivation and opportunities driving interest to lending to the SME market in Nigeria.
- How institutional voids in the institutional structure that support the SME credit market are bridged, and how alternatives can be employed to address them.
- How business environment risk, as well as firm specific risk—which together comprise default risk to SME—can be measured and mitigated.

The rest of the chapter is organised as follows. It starts with the discussion of the ontological and epistemological bases of research and a justification of the approach chosen, followed by an explanation of the research methodology. The issues of reliability and validity in research are raised, including an explanation on how they are addressed in this work. Finally, a detailed account of the research design including the methods used, data types, collection and procedures are elaborated.

4.2 Ontological and Epistemological Considerations

Ontological and epistemological issues are intricately linked in research. The former relate to the philosophical view that is concerned with the nature of reality, whilst the latter relate to the nature of knowledge to be revealed. Bryman and Bell (2007) identify two opposing ontological positions, namely, objectivism, which holds that that there is an external reality or fact; and constructionism, where reality is considered as fashioned by actors. These two philosophical traditions closely correspond to the epistemological positions of positivism and interpretivism, respectively. According to Bryman and Bell (2007), positivism is the view that knowledge can be revealed through deduction or empirical evidence, or that it can be accurate and value free, as is the case with much of scientific research; and on the other hand, interpretivism is the view that an alternative research logic and accompanying procedures are required to understand and interpret behaviour of the social world.

The linkages between ontological and epistemological issues in research practice were studied by Kuhn (1962). In tracing scientific research revolutions, he found that communities of scholars demonstrated specific preferences for certain methods and procedures, interlined with particular philosophical perspectives. He termed these set of practices paradigms. The main contribution of his work was to demonstrate that scientific knowledge was not a steady progression or accumulation of new knowledge, as it was previously believed, but that it resulted in paradigm shifts where revolutionary findings challenged the status quo of how research should be done and brought new ways of developing knowledge. At the same time, he was careful to note that whilst a particular paradigm embodies philosophical perspectives and research methodologies, it did not prescribe rigid rules of procedures, but rather described domains of coherence in research practice.

The term ‘paradigm’ originally described research practice in scientific world that was appropriated by the social sciences. For example, Willis (2007) defines paradigm as “*a comprehensive belief system, world view or framework that guides research and practice in a field*”. He observes that in the social sciences these views tend to include three paradigms:

post-positivism, critical theory and interpretivism.

Research paradigms employing non-positivist standpoint have become influential in investigating social, management and organisational phenomena. In the social sciences, phenomenology, an anti-positivist philosophical stance, is concerned with how individuals make sense of their world. Its use in the social sciences has been attributed to Schutz (1967), whose idea was that people ascribe meaning to their social world by developing constructs by which they interpret and experience that world, which in turn motivates and determines their behaviour (Bryman & Bell, 2003).

The challenge in the post-positivist paradigms has been what constitutes, and how to decide on, a coherent research paradigm. According to Crotty (1998), most research does not start from an epistemological standpoint; rather, the starting point is with the issues that need to be addressed. The choice of research paradigm is discussed below within the context of studies of financial market.

Research Paradigms in Studies of Financial Markets

Studies of banking and financial markets have traditionally been considered the domain of economics adopting a positivist standpoint. However, this research has argued that economic theory has not fully explained the phenomenon of small business credit shortages in Nigeria, and in particular, that gaps in the understanding of management decision making and contextual factors could be addressed by employing a constructionist view point. This view point follows relatively recent sociological studies such as, Abolafia (1996), Smith (1981; 1999), and Levin (2001) referenced in Keister (2002), which have contributed to the understanding of how influential actors shape financial markets. I believe that positivist and constructionist approaches to studying credit shortages to small business in Nigeria can be complementary; the positivist view in economics has highlighted the specific obstacles to credit making, whilst constructionist approaches can add value by helping to elucidate on other hidden barriers to credit, which can be overcome by managerial action and examining how influencers may shape the formation of market. Thus, a realist-constructionist perspective was chosen as an appropriate philosophical perspective using interpretivist methodology.

Methodology and Methods

How does a researcher then go about choosing the appropriate methodology and methods? According to Crotty (1998), the answers lie with the research question and the researcher's theoretical perspective. The schema below (adapted from Crotty, 1998) draws linkages from epistemology to theoretical perspectives, methodology and methods. Though certain choices would be clearly philosophically inconsistent—for example, a positivist perspective based on a constructionist epistemology—it highlights the multitude of methods and therefore the many pathways that could lead from philosophical and theoretical perspectives to chosen methodology and methods. In the choice of methodology and accompanying methods, the strength and weakness of various methodologies need to be evaluated in order to lead to sound research (Crotty, 1998). The following section discusses the considerations leading to the research approach taken.

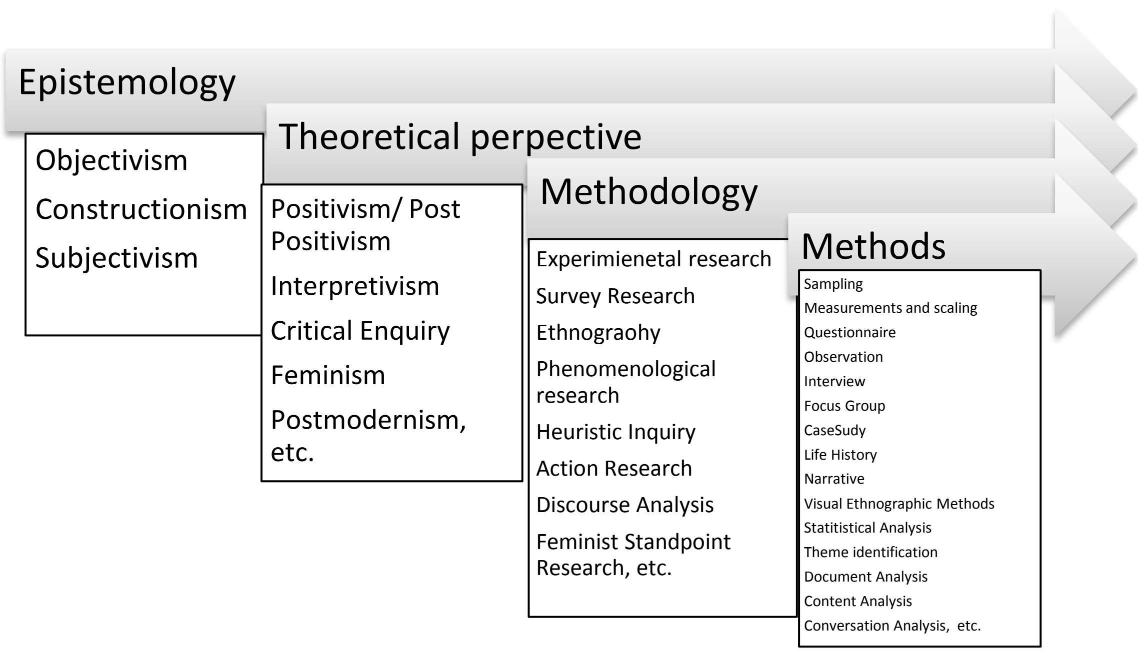


Figure 4 Schema: From Epistemology to Methods, adapted from Crotty (1998)

Research Strategy

The starting point for choosing a research strategy is a real life issue that needs to be investigated, rather that the philosophical perspective (Crotty, 1998,). In this case I was interested in deeply investigating the obstacles to SME finance in the Nigerian context and how the action of powerful agents could affect or overcome them. Qualitative research, which has the ability to reveal processes in social action that might affect organisational decision making, and is often employed when the researcher is interested in obtaining detailed and rich knowledge of a specific phenomenon (Miller and Salkind, 2002), was thus considered suitable. Using a qualitative research design would allow in-depth investigation of issues that are not publicly available, and therefore assist in gaining a deeper understanding of obstacles to SME commercial lending in Nigeria.

In situations in which a phenomenon is not fully understood, or is complex, such as is the case here, scholars have proposed benefit in exploring this using an interpretivist perspective (Ritchie *et al*., 2013). Thus, the research shifts from the objectivist economic view towards a constructionist perspective of socialised economic action. Constructionism is the belief that "*different people conduct meaning in different ways even in relation to the same phenomenon*" (Crotty, 1998). The inquiry, using a normative perspective, which according to Barrow and Bell (2009) means that "*although factors within an environment should be taken into account, it is up to managers to make decisions about how they respond to these in order to achieve the impact on organisational performance that they want"*.

The philosophical perspective is that of realist-constructionism, meaning that a real world exists independently of our beliefs and constructions but knowledge of that world is inevitably our own construction (Creswell, 2013). In relation to this study, that is, whilst there are obstacles lending to SMEs, how some of these are understood by bankers is dependent on their interpretations; they construct their own individual meanings of what some of these obstacles are and how they may be overcome, and therefore may react differently.

4.3 Choice of Research Strategy

Background

During the literature search, it was observed that the predominant approach in research on SME credit rationing focused attention largely on issues related to the lending contract, that is, from the perspective of agency and incomplete contracts as the cause of failure. However, in my professional experience as a credit analyst, I had seen how the decision of whether to lend to a particular customer took place firstly within the context of the overall bank's lending strategy towards a sector or a group of borrowers; in other words, well before a specific borrower approached the bank for a loan. Thus, I felt there were omissions in the research, concerning factors which affect banks' strategic decision making in relation to small business lending. I recollect thinking that the decision makers needed to be interviewed as to the reasoning behind their decision making. This intuitive feeling, the need to conduct an exploration through interviews, was the precursor to what would eventually develop into a qualitative case study using semi-structured interviews.

This direction of the research contrasted my expectations prior to the research, where I had assumed quantitative data and statistical analysis would be the methods that would be employed—as that was my understanding at the time of how to conduct research. It also fit into my personal analytical style, which was numerically based given my background as a credit analyst. Consequently, there was an underlying tension between my early expectations about how to go about the research—that is, to identify a theory and quantitative data to test it—and my underlying sense that there was a need to examine what goes behind management decision making process in the bank. This dilemma took time to resolve and I eventually realised the lack of a unifying theory that explained credit obstacles to SMEs in Nigeria implied qualitative research methods to seek answers to the questions I had formulated.

Key Approaches

Qualitative research features a number of key approaches and the table below from Creswell and

Maietta (2002) highlights the main ones and their applications. Data in qualitative research is often associated with field studies, that is, the collection of primary data which may occur naturally; but secondary data can also be used. Thus, qualitative research encompasses a range of methods such as interviews, ethnography or participant observation, focus groups, and document analysis. Forms of qualitative analysis, such as content analysis, document analysis, and theme identification, usually involve data reduction. Generally speaking, qualitative research works with a relatively small number of cases, sacrificing scope for detail, and thus the qualitative paradigm is beneficial in the detailed study of unusual or complex study phenomena.

Dimensions	***Narrative Research***	***Phenomenology***	***Grounded Theory***	***Ethnography***	***Case Study***
Focus	Collecting the stories of lived in experiences	Understanding the essence of experiences surrounding a phenomenon	Developing a theory grounded in data from the field	Describing and interpreting a cultural and social group	Developing an in-depth analysis of a single case or multiple cases
Data collection	Primarily interviews and documents	Long interviews with up to 10 people	Interviews with 20-30 individuals to saturate categories and detail a theory	Primarily observations and interviews with additional artefacts during extended time (6-12months)	Multiple Sources: documents, archival records, interviews observations physical artifacts qualitative data
Data analysis	Stories Resources Themes Description of Context	Statements Meanings Meaning themes General descriptions of experience	Open coding Axial coding Selective coding	Description Thematic Analysis Interpretation	Description Themes Assertions
Narrative Form	Chronological story of an individual life	A description of the "essence" of the experience	A theory or theoretical model	A description of the cultural behaviour of a group or individual	In depth Study of a case or multiple cases

Figure 5 "*Five Inquiry Approaches in Qualitative Research*" *(Creswell and Maeitta, 1991, p. 146)*

These five enquiry approaches are discussed briefly below together with the justification of the case study as a method for this research.

Narrative research involves eliciting and collecting accounts of peoples' lives and stories of their own individual experiences. The purpose of this is to understand what people make of their own experiences rather than the facts in of themselves. This has been increasingly used in management research following Weick (1995) and has been beneficial for researchers interested in organisational culture (Bryman and Bell, 2007; Creswell, 2013).

Phenomenology explores how people derive meaning relating to a concept phenomenon. Research studies involve identifying the central phenomenon, conducting interviews with the participants, analysing data to identify significant statements, and reducing the data to units or themes to capture the essence of peoples' meaning.

Grounded theory is where the researcher's purpose is to develop interrelated categories of information to formulate theoretical propositions or hypotheses from a process of analysis. Data is collected in interviews during field studies. Glass and Strauss (1967) first articulated this method, which is described as the deductive approach to theory generation.

The next two research strategies, focus groups and action research, have become increasingly important, particularly in marketing, management and organisation studies.

Focus groups are a form of group interview with several participants. The topic is usually tightly defined and the interaction of the group is key, resulting in a joint construction of meaning. An original purpose was to help to define business problems and elicit innovative and creative to solve them (Bryman and Bell, 2007). It allows the interviewer to probe peoples' reasons for holding certain views and gives participants the opportunity to challenge ideas in a way that does not occur in one-to-one interviews. In this way the researcher hopes to achieve a more realistic account of what people think. *Action Research* is an experimental research strategy focused on real problems within organisations, with an aim to assist finding solutions. The objective of action research is to change patterns of thinking and action, thus the researcher must specific the expectations of the project to participants.

Narrative research and phenomenology were not considered suitable for this research because the focus on the individual narrative did not allow the external context to be considered and analysed. Grounded theory was also ruled out as it was more suitable to developing concepts for an unknown phenomenon. Case study research was chosen as a suitable research method allowing the treatment of different sources of data.

Qualitative case study methodology investigates a contemporary phenomenon within its real-life context when the boundaries between phenomenon and context are not clearly evident (Perry, 1998; Yin, 2003). The case study is the process by which the researcher seeks to develop an in-depth understanding of the case through collecting multiple forms of data **(**Creswell and Maietta, 1991). The case is a bounded system (Creswell 2013, Miller and Salkind 2002) which in this instance is found within an organisation, and located within the larger context of the banking organisation. The ability to bring in the context into the analysis, in particular, makes a case study suitable for this study given the importance of the external business and economic environment, which this research has earlier mentioned are critical for this study.

4.4 Reliability and Validity

Reliability and validity are criteria used to evaluate the rigour and accuracy of a piece of research. From the positivist paradigm, these relate to questions such as whether the constructs correctly measure the concepts that are under investigation, if the constructs are consistent, and how accurate the representation is over the whole population being considered—and therefore if the results are generalisable (Golafshani, 2003). Qualitative scholars in the social science have argued that whilst a quantitative study's objective is to explain, the purpose of qualitative research is to generate understanding. Accordingly, Corbin and Strauss (1990), noting that the canons of scientific research have positivistic connotations, recommend that standards for quantitative research need to be redefined to fit the realities of this type of research.

To deal with issues of reliability and validity in qualitative research, social scientists have suggested what they consider as more appropriate criteria to evaluate rigour in qualitative research. The notion of trustworthiness has been offered as pertinent in qualitative cases, in other words, that results are credible or believable. In this way, Lincoln and Guba (1985) proffer four criteria as being more suited to judging the soundness of the qualitative research, namely: credibility, transferability, dependability and confirmability. Maxwell (1992) considers that as understanding is the purpose of qualitative research, his concern is that this type of research produces valid results which can be relied upon for policies, programmes or prediction. Thus, he identifies five types of validity—descriptive, interpretive, theoretical generalisability and evaluative—and how research ensures these hold depending on the understanding that the research seeks to generate.

Others have posited that the rigour of qualitative research is strengthened by providing a full account describing the context and the assumptions in the research, so that the applicability of the research in a different setting can be evaluated by a reader. For example, Strauss and Corbin (1990) stress the importance of the process in the evaluation of a piece of qualitative research, including how the sample was collected, and the events and external environments that were involved. Speaking in similar terms to Lincoln and Guba, they state that by providing sufficient detail of the process and identification of the limitations of the study, plausibility can be established.

To address the issues of validity and reliability, this research follows Yin's case study protocol, a set of processes, which was developed to respond to concerns about rigour of case study research (Yin, 2003). The overview of the research protocol used is provided in Box 1. An important measure taken to enhance reliability and validity of the data was to guarantee confidentiality and anonymity to respondents to ensure they felt comfortable about responses. This confidentiality agreement was written into the letter of request to the organisation and reiterated before each interview was conducted with the respondent.

To improve validity, multiple sources of evidence (Section 4.42) were used. Yin (2003) advocates doing this, however, it is recognised that the use of multiple sources to strengthen quality of research has been a matter of debate. For example, Silverman is more cautious saying that "*data triangulation … [is] usually inappropriate to validate field research*" (Silverman, 2001, p. 248).

Finally, throughout the research, informal interviews with industry experts were used to review and validate findings relating to the external context.

Qualitative research could be considered to have a subjective element, making reliability a possible concern. Internal reliability can be ascertained by asking if another researcher with the same data and following the same procedure would emerge with the same results. As I went through the process of the research, I realised that as a former bank and credit officer myself, this provided certain advantages, such as, an understanding of the credit process, the ability to interpret documentation, and knowledge of appropriate follow-up questions to be asked. Would the researcher's "sense making" affect the interpretation of the results? I believe that the use of a rigorous conceptual framework which acted as a template for data gathering and analysis was beneficial in the process in strengthening the research. It is recognised that using a different theoretical background as a lens to the data could yield different results, however, in this case, the research would be asking a different type of question and it would not be valid to compare those results with the ones found here. With respect to generalisability, given that this is a case study, the research has been clear to indicate the extent to which the results can be considered representative, and the limits of the research are stated in Chapter 6. Overall, I believe that the uniqueness of the case and the level of access provided have, together with the background of theoretical and empirical research conducted beforehand, contributed to yield important insights into the small business credit market in Nigeria.

Box 1. Case Study Research Overview and Protocol

Purpose of Research

This research posits that credit rationing is also affected by specificities of the lending context and develops a conceptual framework to depict issues a bank deals with in the process of SME credit creation. Three sets of factors are identified; namely: opportunities, institutional structure and assessing SME risk. Within these, the objectives of the exploratory research are to specifically examine three elements that have been scarcely addressed in the previous literature: (i) The motivations of banks to lend to smaller businesses; (ii) The methods banks can use to bridge institutional gaps; and (iii) How banks can measure and mitigate credit risk SMEs face, arising from the external environment, as distinct from internal risk.

Case Description

The unit of analysis in this research case study is a commercial bank, Innovation Bank, the first commercial bank in Nigeria to actively seek to enter into SME/systematically lend to SMEs. Innovation Bank, a relatively young bank was set up in 1990 with focus on corporate bank business. It became publicly quoted in 2005. As a mid-sized player two decades later in an industry of 24 commercial banks at the time, it had a reputation for its conservative and professional management. In 2007, it announced a decision to become the number one SME bank. This unique case made the ideal case study to examine how the bank sought to overcome barriers to lend to the small business sector.

Methods and Data

The case study of Innovation Bank involved the use of several data sources to examine the three objectives above. Publically available secondary data from the World Bank and the Central Bank of Nigeria databases were the main sources to examine the context of the external macroeconomic environment and the Nigerian financial sector. Data specific to Innovation Bank involved primary and secondary data obtained from a study lasting over a week, semi structured interviews and observations, internal records, proprietary documents and confidential documents.

CONCEPTS/THEMES	DATA SOURCE/ EVIDENCE USED
1. Exploitable Opportunity: Financial Sector/ Opportunities **RQ (i): Motivations and Opportunities Driving SME lending**	World Bank, Central Bank of Nigeria databases Semi structured Interviews (SSI), Strategy Docs,
2. Institutional System Information/Property Rights/ Creditor Rights **RQ (ii): How Institutional Gaps are Bridged**	SSI, Observation, Bank documents
3. Assessing SME Risk External Environment/ Internal risk **RQ (iii): How to Measure and Mitigate Components of SME Risk**	SSI Interviews, Observation

Data Analysis

The analytic strategy relied on theoretical propositions using a process of thematic and content analysis following the typology of the concepts in the framework to code the data. A process of triangulation was performed using several forms of data, including a series of informal interviews with industry experts in banking throughout the research to corroborate findings in order to improve validity.

Results

The main motivation for the bank to lending to SMEs appears to derive from its perception of profit making. Given the buoyant economic conditions, democratic rule and growing private sector over the last fifteen years, the opportunities seem realistic. Following major reforms, the emerging competitive and healthier financial sector market were the context to the bank's strategy. Despite major gaps in the institutional structure—such as the absence of widespread credit history data, complicated property rights system and weak credit rights—the bank was able to develop innovative, home-grown solutions to bridge the informational gaps and collateral issues. It created its own credit scoring system based on proprietary credit history records, as publicly available credit history is limited. It tested different lending products. Barriers to lending were not just external relating to the SME, but also internal due to skills shortages and process issues; the bank had to adapt to overcome these. The bank devoted resources to training and new systems, demonstrating commitment to lending to this sector as a strategic decision. It was involved in business development services to SMEs, which are often lacking in business skills and access to resources.

Conclusions

As profit-making entities, banks need to perceive lending to SMEs as a lucrative business segment in order to drive sustainable lending to the sector. Recent economic conditions in Nigeria have been favourable to the growth of small business sector and government needs to address remaining challenges to the business environment, such as improving basic infrastructure and electricity production, which are fundamental to the development of a significant manufacturing sector. Regulatory authorities can further help by ensuring financial sector stability and providing incentive for banks to lend to the small business sector through the provision of tax breaks and credit guarantees, rather than imposing lending quotas or interest rate ceilings. In recent years, the Central Bank has been instrumental in building awareness, within the banking sector, of the importance of the SME sector. It can further build on this momentum by helping banks to develop knowledge of specialist SME lending practices. Small business associations and SMEDAN need to build a bridge between SMEs and Bank, helping banks to better understand SMEs, and assist firms to acquire management skills and access to business resources.

On the part of the banks, there is evidence of increasing interest in SME lending. Banks need to acquire expertise in SME lending, including staff training in credit and loan management techniques. It also requires innovative ways to overcome the institutional gaps whilst large scale institutional structures such as credit bureaus, ID card systems and collateral registry, and a legal system supporting creditor rights come on stream in Nigeria. However, previous experience with institutional building indicates that institutional design needs to take the existing formal and informal institutions into account to avoid unintended consequences. This may be facilitated by policy makers working with banks to address the obstacles lenders experience in this under-banked sector.

Limitations:
This is a single cross sectional case study and whilst examination of the process of lending has revealed unique ways to address lending obstacles, the specific findings of the particular lending model adopted by the bank should not be taken to propose a generalised method across the banking industry. With time, and as more commercial banks systematically lend to the SME sector, further qualitative research on the different methods in use, as well as quantitative studies on the success, or failure, of these lending models will enrich the understanding of how SME lending can be further facilitated to become successful in Nigeria.

4.5 Methods

4.5.1 Case Selection

Case study research involves investigating a contemporary phenomenon within its real life context especially when the boundary between phenomenon and context are not clearly evident (Yin, 2003). A case study is a detailed and intensive analysis of a case (Bryman and Bell, 2003) and is concerned with its complexity (Stake 1995). In designing a case study, the choice is made between a single or multiple case and this needs to be decided prior to data collection (Yin).

This research chose a single case study from the onset. According to Yin, there are five instances in which a single case study is appropriate: (i) the **Critical Case** – to test a well formulated theory; (ii) an E**xtreme or Unique case** such that the single case is worth documenting and analysing; (iii) the **Representative case or Typical case,** which captures an everyday or common place situation; (iv) a **Revelatory case,** which is the opportunity to analyse a phenomenon previously inaccessible to scientific investigation, and finally; (v) the **Longitudinal case,** which involves studying the single case at two different intervals where there is interest in how conditions change, and the intervals chosen to capture when those conditions change.

Using Yin's terminology, the case study of Innovation Bank was a unique case. Stake (1995) sheds further light on unique cases, categorising them into the intrinsic and instrumental case study. In the case of the former, the interest lies in learning about that particular case, and in the latter case, in understanding something other than the particular case.

In this case, Innovation Bank was chosen as it was the first commercial bank and the only of the 24 commercial banks to create a specialised lending programme for SMEs at the time in Nigeria. Whilst all commercial banks lent to SMEs to a small extent, none had a systematic well-defined SME lending programme outside the central bank mandated SMEEIS scheme, which eventually was wound down. The Innovation Bank case was therefore of significant interest particularly given the serious issues of informational opacity and weakness in institutions that support credit markets. It thus made an excellent case study to be examined by the conceptual framework developed in this research, which identified elements required to be in place for a SME credit market to develop.

Further, being a mid-size bank, Innovation Bank's strategy to launch into the SME lending market was of particular interest as none of the top three banks by size, with a wider retail banking network, had at yet broken into this market. Innovation Bank, one of the *'new generation'* banks, in local parlance describes the set of banks licensed during the financial sector liberalisation programme of the Nigerian government in the early 1980s. About 20 years later, several of these new banks had failed and the integrity of management of banks was generally under public scrutiny, requiring the Central Bank of Nigeria to intervene and stabilise the industry. Innovation Bank's management team had a good reputation and was considered relatively conservative: where some of its competitors had rapidly grown organically and by large scale acquisition, Innovation Bank remained a mid-tier bank in terms of size. It had started out with a focus on the corporate sector, but by this juncture, was looking for further avenues for growth.

Scholars have spoken about the rationale for selection of cases. In this instance, it was theoretical sampling, which has as intent to 'extend emergent theory' (Eisenhardt 1989), as contrasted to random sampling. It also corresponds to Yin's *'revelatory case'*, which according to him is "*when an investigator has an opportunity to observe a phenomenon previously inaccessible to scientific investigation;* or a 'unique case' (2003, p. 42); or an 'intrinsic case' *being* unusual; or *'instrumental'*, serving to illustrate a specific issue, according to Miller and Salkind (2002).

At the beginning of this research, none of the 24 commercial banks specialised in SME lending aside from the CBN lending scheme. Whilst conducting an interview with the Country Manager for the IFC in 2007, as part of data collection for a previous paper, I learnt that the organisation was seeking to work with Nigerian commercial banks to provide technical assistance for SME funding. In 2008, as I was deciding on the next phase of research when carrying out the literature review, Innovation Bank announced its intention to focus on lending to the small business sector and it became the first to do so. I felt that this made an ideal instrumental case study. I was not certain of gaining access, but was eventually successful in securing privileged access.

Case Study Protocol

Yin's (2003) protocol for case study—considered to be the reference point in case study research because of its methodological attention to detail—was used. It also conferred an additional advantage to this research because of its ability to deal with the full spectrum of evidence, permitting the address of contextual considerations, a major consideration of this researched raised in the literature review.

The protocol broadly consists of four elements:

- The overview of the project indicating the objectives, issues and the literature review
- Field Procedures—introduction and access to the sites, data sources and procedures
- Case study questions used for data collection
- Case study report guide including structure of the data presentation, bibliography and other parts of the finished written report

For ease of reading, the overview of the protocol for this research is provided in Box 1, page 76.

Prior Case Study Research Experience

A successful research project, Document 3, was carried out using case studies which allowed me to gain experience in this method. In that project, grounded theory was used, and the concepts that came out of this research were subsequently refined to provide a frame work for this study. A well-received study by Goss *et al*. (1971) used a single case study of an elementary school experiencing innovation, examining the obstacles to change. This extensive detailed study employed several methods, formal and informal, building a rich and informative account of factors that inhibit and facilitate implementation of organisational change. The research design and use of methods provided an informative reference for this study.

4.5.2 Case Study Questions

This case study analyses why and how a commercial bank in Nigeria seeks to overcome the obstacles to lending to smaller businesses, given the well-known information and institutional barriers in small business lending that exist in Nigeria, as well as the external environment risk that also cause small business failure. In doing so, the following research objectives are elaborated, together with how they relate to the conceptual framework:

- **To shed light on the motivations and opportunities that drive the bank's interest to enter into the SME lending market.**

  This relates to the concept called exploitable opportunity in the first step of the conceptual framework, and examines the bank's motivations to lend to small business sector as well as the external business conditions, such as the economic and regulatory environment.

- **How the bank straddles the institutional voids or weaknesses in the credit market and how it creates or employs alternatives.**

  The second part of the framework identified three sets of institutions—property rights, information and contract enforcement—which are required to support the credit market for SMEs. This research question examines how the bank is able bridge gaps in the formal institutional environment.

- **How SME proclivity to external risk is identified and distinguished from internal risk and how techniques are developed to mitigate this risk.**

  The last part of the conceptual framework distinguishes between SME firm-specific risk and SME business environment risk being separate components of SME credit default risk. Because they have different effects on SME portfolio risk, they need to be separately identified and mitigated.

The research is led by theoretical propositions adopting Yin's preferred analytical research (Yin, 2003). The conceptual framework developed in the preceding chapter, forms the theoretical structure guiding the research, and the research questions above are explored with the three sections of the framework, respectively: (i) Exploitable Opportunity, (ii) Institutional Structure and (iii) SME risk mitigation.

4.5.3 Types of Data

Case study research characteristically involves the use of diverse sources of data to develop an in-depth understanding of the issue studied (Eisenhardt, 1989). Sources typically are documents, interviews, observations, and audiovisual materials and physical artifacts, but also include less common evidence such as psychological testing, life history and non-verbal communication (Miller and Salkind, 2002). Increasingly, recordings such as video, films and photographs are being used in case studies as data sources. It is desirable to use several sources in this type of research (Yin, 2003).

The use of multiple sources often implies mixed methods, as the evidence may require different types of analysis. Using mixed methods has generated debate largely stemming from different interpretations about the link between epistemology and methodology. Some scholars believe that as methods embody particular epistemological approaches and therefore argue that the use of mixed methods implies incoherence in epistemology. However, others have responded to this criticism saying that the choice of research method is determined by the research approach, describing situations in which mixed methods can be used validly. For example, mixed methods are considered appropriate where research is progressive in nature. At the exploratory stage where a phenomenon is not well understood and concepts are being developed, inductive research using qualitative methods is appropriate. Subsequently, as a theory is formulated, quantitative research can be used to test the theory in the interpretivist fashion. Fisher (2004) agrees that using multiple methods, methodological pluralism, is possible; however, he cautions that using different methods to measure the same concepts in an additive form may not be meaningful. Clearly, there must be consistency between research methodology, methods and data, but this coherence derives from the research idea and is not predetermined by to the philosophical standpoint (Bryman and Bell, 2007).

With this in mind, the methods used in this research I feel were justified given the exploratory nature of the research, where the empirical evidence was only partially supported by existing theory. Anecdotal evidence from my professional experience as a bank credit committee member and a small business consultant also reinforced a belief that the phenomenon of small business credit constraints was more nuanced. Thus, without an encompassing theoretical explanation for the phenomenon, I felt an inductive study approach would be a useful starting point for the first research study, prior to this one. In the case study here, several types of data were used to illuminate the various elements of the concepts set out in conceptual framework. The types of data and procedures used in collection are discussed below.

4.5.4 Sources, Description and Data Collection Procedure

There were two categories of data collection, internal and external. Internal data related to those specific to the organisation, Innovation Bank, which was the site of the field study. External data pertained to the context of the lending environment, which was the financial sector and business environment. The types of data are detailed below

External Data Sources

The purpose of the external data was twofold. The first was a preliminary investigation to gain a thorough understanding of the structure and practices of the SME finance industry by interacting with key participants, banks, financial sector regulators and representatives of small business, such as the chamber of commerce and a small business umbrella organisation. This was conducted over the course of the research. In this regard, I attended several conferences and seminars addressing the theme of SME finance, which permitted an insight into the state of play of SME finance in

Nigeria, and the cutting edge of small business finance practice internationally. In July 2004, I attended the 15th International Conference on SMEs, which was held in Abuja, Nigeria's capital. The conference's theme was *"Promoting SMEs for Global Competitiveness'*. The Nigerian president at the time, President Olusegun Obasanjo, in his address to open the event spoke about the difficulties faced by SMEs in securing funding saying, *"scarcity of loanable funds has been a major obstacle to growth of SMEs"*. He also spoke about the then recently formed Bank of Industry (BOI) –an amalgamation of previous development institutions—whose primary mission was to provide long term funding to SMEs, and establish the SMIEIS funds. I was able to informally meet with several key individuals at the conference who were involved with funding small firms, including: the newly appointed Chief Executive of the BOI, Dr. Lawrence Osa-Afiana; Alhaji A.T. Balewa, Special to Assistant to the President on Small and Medium Enterprises; and from United Bank for Africa, one of the country's largest commercial banks, Ms. Chinwe Ugo. She was the Head of Special Projects at the time and in charge of the SMIEIS funds at her bank.

In August 2006, I attended a practitioners' seminar on financing microenterprises and SMEs, *"Financial Institutions for Private Enterprise Development"*, held at the John F. Kennedy School of Government. The programme aimed to showcase the different models of lending to micro firms and small firms. Incidentally, whilst the course material for microfinance was extensive, that for SME finance was quite limited. This observation was raised with the course director, to which he answered that there was much less literature on how to lend successfully to smaller businesses. This served to further highlight the real gap in best practice in small business lending. The seminar also provided the opportunity to network with private sector development financiers, including two from my home country Nigeria—one of whom was the chairman of a large commercial bank, and the other, the head of a microfinance institution. In 2007, an international SME finance symposium was held in Geneva, entitled *"Investing Private Capital in Emerging and Frontier Market Small and Medium Enterprises"*. It was a forum for international finance experts and researchers from the OECD as well as emerging markets to present and debate cutting edge research and techniques to improve financing to small business in emerging markets. I contributed to the elaboration of the planning, chairing a break out session at this conference. The networking opportunities further allowed interaction with experts interested in the sector from around the world (proceedings detailed in Leleux and Orlick, 2009).

In addition to the interviews with members of the organisations elaborated in the case study, over 30 key decision-makers in the industry were interviewed. While these interviewees were largely chief executives and other senior executives of commercial banks, they also included policy makers from the central bank, and heads of local and international development finance institutions. The interviews with Central Bank officials and development financial institutions permitted a sense of the thinking of key players in resolving the institutional barriers and the ideas behind policy measures to stimulate SME bank lending. Thirdly, I interviewed the heads of two key organisations, Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) and Enterprise Development Centre (EDC), both dealing directly with assisting the SME sector. SMEDAN, which serves as the umbrella body for small businesses, is a government agency reporting to the presidency that was set up in 2003. Its mission is to *"facilitate the access of micro, small, medium entrepreneurs/investors to all resources required for their development"* (SMEDAN). The Enterprise Development Centre (EDC), an off shoot of the country's premier business school, Lagos Business School (Pan African University), was established in order to provide business development and support to SMEs and entrepreneurs, working in partnership with major financial local and international financial institutions. In-depth interviews and site visits were also conducted with individual SMEs and their representative organisations through the Lagos Chamber of Commerce. An SME case study at the business school, EM Lyon, in France, was written and presented to the MBA class, but these were not recorded here as the research intentionally focused on the demand side. These interviews with firms also provided important insight into the internal and external challenges of businesses and how organisations that work with them to develop their capabilities through training sought to resolve this. Lastly, over 40% of commercial banks responded to a questionnaire on the lending to smaller businesses and their perceptions of the SME sector used in Document 4.

In terms of the business context, data on the recent antecedents of the financial sector and the business environment that shaped the financial sector were collected from a variety of externally published records. Industry data on the Nigerian financial sector was sourced from the Central Bank of Nigeria's published reports on the structure of lending and the composition of commercial banks, and the Nigerian government's National Bureau of Statistics whilst the World Bank reports provided macroeconomic data.

Internal data – Innovation Bank

Internal data was collected on Innovation Bank. This comprised of semi structured interviews of key staff members and the observation of the SME lending process during a field visit. Secondary data consisted of the bank's proprietary records and public records such as annual reports and newspaper reports. The data sources and procedures are discussed below.

(i) Documentary data

Two main forms of documentation specific to Innovation Bank were gathered. First, were documents in the public space, such as media and newspaper reports and the bank's published annual reports. Internal documents proprietary to the bank which were collected included a confidential SME business strategy document on the SME business proposition, loan documentation, operational documents, such as internal approval process documents, and account opening documentation.

(ii) Primary Data

Primary data and some documentary data were collected during the field visit, mainly in the form of interviews of key executives at the head office and staff members involved in the process of SME lending. It also entailed an observation of the SME lending process at a branch office.

4.5.5 Procedures

Personal contact was established with the Managing Director of Innovation Bank through an intermediary and a verbal request for research access was made. After a positive response was obtained, a formal letter to the Managing Director (Appendix I) was sent by email, to request a week-long field visit to study their SME lending programme for research purposes. I was then invited to contact the head of Human Resources (HR) to discuss the arrangements for the data collection period. In the interview with the HR head, the responsible executives were identified; namely, the commercial and retail banking head, in charge of the SME business segment; and the technical head of the SME program, seconded from the IFC. Interviews were scheduled by bias of personal secretaries. I was also introduced to the SME unit head who helped in arranging the field visit in a key branch in the commercial district of Ikeja, where the SME expansion project was launched. Data was collected during the period of April 22nd to 29th, 2009. Sound recordings were made of the interviews and hand written and typed notes were taken during the observation.

Interviewee list:

- **Human Resources Manager**. Along with discussing research needs, the manager provided insight into the structure of the organisation, and introduced, and provided access, to relevant executives and staff.
- **Retail and Commercial Banking Group Head**. Amongst his other responsibilities was the new SME business. He was responsible for leading the SME strategy and defining the viability of the project.
- **SME Resident Advisor.** A specialist consultant hired in collaboration with the IFC under a two-year contract to design and implement the SME programme. He was responsible for the technical aspect of the lending programme.
- **SME Unit head**. The officer was based at the head office and was responsible for the overall operations of the SME project.
- **Branch Manager, Ikeja Branch**. This was the branch manager at the site of collection of data relating to process of SME lending and the interface with the client.

- **Satellite Branch Manager, Ikeja sub division.** The branch also served as a hub for three other branches.
- **Relationship Manager.** The manager was responsible for customer interface and booking the loan. This branch was recommended as it was the first to implement the SME product.

4.5.6 Field Visit: Head Office and Branch

Data collection took place during one week at the head office in Victoria Island district and at the branch in Ikeja district in Lagos State, the economic capital of Nigeria. At the head office, interviews were formal and took place in the private offices of the executives and officers concerned. Each interview lasted for approximately 45 minutes. At the branch, the data collection was a mixture of formal interviews, informal interviews, observation and documentary data. The starting point was the introduction to the branch staff. I first explained the research project to the branch manager, then to the senior credit officer who was in charge of the SME proposition. I also interviewed the satellite branch manager, in charge of three branches. There were also several informal interviews and discussions with relationship managers and other departments, such as treasury.

The interviews proceeded well from the onset. There was openness in the discussions and in divulging information. However, as the data collection progressed to reviewing documentation and overseeing the operation of the automated credit system, there was an initial reticence about granting access to physical records. I did not perceive this to be resistance to access, but a concern with protecting proprietary information for what was a new product. There was a brief delay whilst clearance was sought from the head office, and once this was received through a phone call, the formality decreased and discussions became more informal. Majority of the time was spent in observation, participating in some of the tasks and overseeing the credit process. Formerly a branch manager and credit officer, I was acquainted with the system of branch banking and was able to rapidly understand the structure of the internal organisation and processes. As data collection proceeded, a professional and congenial rapport was built with members of staff.

Direct Observations

[Section Abridged: Proprietary and fiduciary information]

4.6 Ethical Considerations

The main ethical question in this study relates to the confidentially of the information provided by the bank given the fiduciary nature of the business. Through banking personal relationships in the sector, I was allowed access to information and strategy of the bank, which ordinarily would be considered intellectual property. Though a pseudonym has been used, because of the unique strategy of the bank, the identity is easily discoverable. A high level of trust was developed such that consent given throughout the process of data collection was verbal. Strategy and other documents were provided on trust and the commitment was given that they would not be released to third parties.

At the beginning of the doctoral research process, the DBA course leader, Colin Fisher, told students that if in any instance confidentiality was required, the university would take care to ensure that research documents were kept under limited access, given that the nature of management research involves working with organisations. In further discussions with my supervisors, they echoed his statement. Explaining the issue of confidentiality to my supervisors thereby ensured limited transmission of the document.

Finally, proprietary documents which form part of the data collection, such as the business strategy, are not included in the appendix to the thesis, but are available for inspection by the committee and supervisors.

4.7 Limitations

The main issue driving the research is the dearth of bank financing for SMEs in Nigeria. As the case study data was collected in 2009, this may pose questions as to the relevance of the data today. However, there is still evidence that insufficient access to bank finance for smaller businesses is a major problem which persists to-date in Nigeria, preoccupying policy makers. The previous Central Bank Governor, Mallam Sanusi Lamido Sanusi, in his address at the Annual Micro, Small and Medium Enterprises (MSMEs) Finance Conference in Abuja in August 2013 said:

> *Between 2003 and 2012, commercial bank loans to small scale enterprises dropped at an exponential rate. Analysis of the annual trend in the share of commercial bank credit to small scale industries indicates a decline from about 7.5 per cent in 2003 to less than 1 per cent in 2006, and a further decline in 2012 to 0.14 per cent.* (CBN, 2013)

The subsequent CBN governor, Mr. Godwin Emefiele, in July 2014 convened a working group of commercial banks' CEOs on the issue of financing to priority sectors, namely the SME sector and Agriculture. Subsequent to that meeting the Central Bank announced a fund of ₦220 billion for the MSME sector, with the portion of funds for SMEs to be disbursed through commercial banks. Anecdotal evidence through discussions with industry insiders suggest that the banks still need to find ways to successfully on-lend these funds. Whilst several banks are now making headway into the SME lending, this sub sector of credit making is still in its infancy. In December 2014, the governor of the Central Bank convened a follow up session on financing SMEs with banks and other key players.

Lastly, the fiduciary nature of the bank prevented video recordings, which would have been a rich source of data. This type of data would perhaps have allowed a deeper analysis of social processes involved in the credit making process, or provided a source for secondary data analysis. However, it is considered that this did not create a handicap given the variety of data that were collected, and the unique opportunity and insight to observe the inner workings of a bank.

The following chapter, Chapter 5, presents the data analysis and the findings of the case study.

CHAPTER 5. DATA ANALYSIS AND RESULTS

5.1 Introduction

The previous chapter outlined the methods and data collection procedure involved in the case study, the purpose of which was to improve the understanding of small business lending issues in Nigeria and to investigate how these problems could be overcome. In order to do so, a case study of Innovation Bank was selected as it was the first of the 24 commercial banks at the time to voluntarily set up a lending programme for SMEs. Whilst obstacles to lending are an issue in many parts of the world, the research focus was to examine the particularities of the Nigerian context in order that appropriate solutions could be found. The literature review and previous research paper identified the main areas of study that it found necessary to give a holistic understanding of the issue and the following three themes with the corresponding research objectives, were developed from the conceptual framework.

Exploitable Opportunities:

- To shed light on the motivations that drive the bank's interest to enter into the SME lending market.

Institutional Structure:

- How the bank straddles the institutional voids or weaknesses in the credit market and how it creates or employs alternatives.

SME External and Internal Risk:

- How SME proclivity to external risk is identified and distinguished from internal risk and how techniques are developed to mitigate his risk.

The external data collected related to the context of the business environment and the financial sector, and the internal data related specifically to how and why Innovation Bank approached the idea and the practice to lending to the SME sector. This chapter explains the data analysis process and the results of the findings in addressing the objectives.

5.2 Analytic Process and Methods

Case studies often involve a variety of data sources with few set down procedures for analysis. Case evidence requires a strategy to define priorities for what to analyse and an analytic strategy relying on prior theory is preferred (Yin, 2003; Perry, 2003). Accordingly the conceptual framework, informed by the literature review and results of previous research documents 3 and 4, formed the theoretical background guiding the data collection and also shaped the data analysis.

Thematic Content Analysis

Thematic analysis one of the most prevalent approaches to qualitative data analysis (Bryman, 2012) and was used to analyse the interview data. A theme can be described as a category identified through the data, relating to research focus or questions, and which provides basis for theoretical understanding building on codes. There are a variety of ways in which themes can be identified. In this instance, they developed through the use of theory related material using social scientific concepts as a springboard for themes (Bryman, 2012), which is beneficial where there is already some identification of the focus areas to the research. Creswell defines themes as *"broad units of information that consist of several codes aggregated to form a common idea"* (2013, p. 186).

Bryman notes that thematic analysis is not explicitly identified in qualitative data analysis, whereas it is widely employed in grounded analysis, narrative analysis, critical discourse analysis and qualitative content analysis. In a previous research, Document 3, codes had been identified leading to seven categories of obstacles. These categories became the basis of the themes identified into the conceptual framework paper in this research.

Data Analysis Process

Data analysis is the process of giving meaning to the data collected. Particularly, in qualitative research, there is no precise moment when this starts (Stake, 1995). As such, data analysis is continuous. The data analysis process was conducted in stages as illustrated by the diagram below. These steps elaborated in the diagram below serve to identify distinct phases in this process, which was iterative in practice, rather than linear as might initially appear from the diagram below.

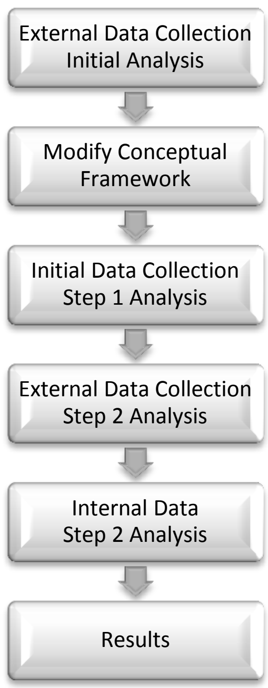


Figure 6. Steps in Data Analysis

Data Types

The first step was the collection of external data. As it will be recalled, data comprised of two types: external data, which related to the business environment and the financial sector, whilst internal data were those collected specific to Innovation Bank. There was a need to distinguish between the internal conditions and the external context because the latter are those elements that the banks and the SMEs have less direct control; therefore, the corresponding actions were reactionary, whilst the internal elements related to those conditions that the firm could exercise control and make decision about.

The external data analysis largely related to political and macroeconomic conditions and the financial sector; they form the context within which individual banks formulate their lending strategies to SMEs. Preliminary data was collected through the course of the research in form of interviews with key players in the industry, such as regulators, development institutions, small business organisations and bank executives, as detailed in Chapter 4. External context came from secondary sources gathered from database searches on the macroeconomic environment and financial sector, principally from the World Bank and the Central Bank of Nigeria (CBN), according to the themes. The Central Bank data provided a source of records of the size of SME loans in relation to credit to other sectors in the Nigerian financial market compiled from the quarterly returns (reports) banks are required to make on the composition of their lending portfolio. CBN records also provided historical accounts of the changes in the private sector composition of banks, regulations and circular on policy changes, and information on interest rates as well as some macroeconomic data. Macroeconomic data from the Nigerian Bureau of Statistics was not readily available and this was supplemented with the World Bank research databases, which are widely used in policy.

Preliminary thematic analysis was performed using seven categories of obstacles identified in Document 3. Reviewing the data, these categories evolved into the three sets of themes, which allowed the conceptual framework to be refined. These themes defined the key areas that banks must address to lend to SMEs in a sustained way and foster the development of the SME lending market. They are: (i) **Exploitable Opportunities** - The bank must be able to identify that lending to SMEs is profitable and must have the capacity to carry out such activity; (ii) **Institutions -** The market for SME lending relies on the functioning—or viable alternatives—to three sets of institutions relating to information, creditor rights and collateral/security in order to function correctly; and (iii) **SME disaggregation** - The bank must be able to identify internal risk and external risk of lending to SMEs, and mitigate them to safely lend to this sector.

These three themes were used to analyse data collected on Innovation Bank during a field visit. Data was both primary and secondary. Primary data was from semi-structured interviews of key staff members identified in Chapter 4, supplemented by observations—interview summaries are provided in the appendix. Observations comprised of shadowing the data entry process of the computerised score card system, customer interfaces (face-to-face and telephonic) and staff interactions. These were considered beneficial as it allowed me a first-hand overview of how the practical process of SME lending took place, in particular, the operation of the bank's computerised credit scoring system and the loan analysis process. It also revealed processes that might not have otherwise come up in an interview. It reduced the need to burden staff who were at work with prolonged interviews, whilst providing an opportunity to authentic and triangulate data from interviews. Secondary data came from the bank's classified strategy document for SME banking, SME credit approval forms, a customer loan documentation check list and account opening forms, which were all collected during the field visit.

The data analysis process started by identifying the subthemes that corresponded to the overarching theme. Unlike coding which may use small sections data, such as a few words or lines, the themes related to larger segments of data. This aided the analysis as the objective was to understand why certain things were happening and not only what was happening. For example, on the theme of profitable opportunities, it was important not only to ascertain from the bank's perspective what aspect of SME lending it had identified as profitable, but why they perceived this to be so. In this example, the executive director of the retail and commercial banking group citied higher interest margins and profits from specialised SME products and services as the source of profits, but, also, his view was that this opportunity existed because of the lack of competition from other banks in the SME space. The resulting themes in the case study were also referenced back to the findings from the external data on the environment, such that linkages were drawn between the bank internal decision making and events in business environment that might have had a role in shaping certain processes or approaches.

The table below shows the three main themes: **exploitable opportunities**, **institutional structure, SME risk evaluation,** emerged from the three sections of the conceptual framework.

Themes	**Internal : Innovation Bank (Internal)**	**External : Private Sector and Banking Environment**
Exploitable Opportunities	Profit Opportunities Absorptive Capacity: *Skills* *Resources*	Macro-Economic Environment: *Political Environment* *Economic Growth* *Private Sector Development* Financial Sector: *Reform/ Competition* *Banking Technology*
Institutions	Information Creditor rights Collateral &Security	Information Infrastructure Legal rights & Enforcement Property Rights
SME Risk Evaluation	Internal risk assessment External risk assessment	External Business Environment

Table 2: Thematic Display and Sub themes

The findings are presented according to the main research objectives below:

5.3 Exploitable Opportunities – Credit to SMEs

The case study is situated within the business context of SME lending. The section below presents the findings of this context and provides the historical background and evolution of the financial sector, which have had an impact the lending to the small business sector.

5.3.1 Introduction

A crucial question is why banks might want to lend to SME, leading to the emergence of a small business credit market in Nigeria. Central to the idea of development of a market is the existence of opportunities. Aldrich and Fiol (1994), for example, describe nascent markets as when entrepreneurs are successful in mobilising resources in response to perceived opportunities. According to McMullen *et al*. (2007, p. 273b), "*the nature and source of opportunities are important for understanding how markets function and come into being*". The conceptual model identifies the first stage of a market creation as the recognition of the opportunities to expand lending to the SME sector and the strategies and entrepreneurial decisions taken by a commercial bank to exploit them. In this case study, Innovation Bank, deviating from its strategy at inception to be a corporate focused bank, in an entrepreneurial fashion focuses on lending to SMEs. This concept of exploitable opportunities relates to the organisation's perception of the possibilities of profit making and the methods it employs and the resources applied in order to realise gains.

Entrepreneurship and strategic management scholars have attempted to define opportunities and their sources. Companys and McMullen (2007), noting that there is general consensus that opportunities relate to the generation of new goods or services, develop a typology whereby they consider opportunities to be objective or subjective depending on the strategies used to discover or exploit them. According to Shane (2003), opportunities—the possibilities for profit making—are external to the firm and arise from three types of changes: technological, political and regulatory, and social and demographic (Shane, 2003). Technological changes facilitate the way resources can be put together in new ways to create new products or more efficient process. Political and regulatory changes can reduce uncertainty, allow private appropriation and thereby encourage new investment. They can also provide the economic environments that stimulate markets by developing the physical and institutional infrastructure, thereby reducing transaction costs, increasing access to resources and information, and improving increased intellectual capacity and skills of the workforce through education and training systems. Finally, social or demographic changes can increase demand as tastes change, incomes increase and the population structure is altered through growth, migration, or movements in birth rates and longevity.

The findings below analyse sources of the opportunities, as they relate to the context of the economic environment and the financial sector that have had an impact on financial sector lending in general, and specifically, the Innovation Bank's management's perception of that opportunity and the organisation's ability to exploit the opportunity perceived.

5.3.2 Context of the Financial Sector

The following section outlines findings of the external data which form the context to SME lending, identifying major changes that have shaped the financial sector and had an impact on small business credit.

All three types of changes elaborated by Shane above—that is, technological, political and regulatory, and social and demographic—have had a major impact on financial sector in the last 25 years; particularly with the political, economic and regulatory environment allowing the banking industry to become one of the fastest growing industries in the country.

Rapid Growth of Banks

During the 1980's, increasing the number of banks was central to the government's plan of economic liberalisation under the structural adjustment programme. At Independence in 1960, there were 12 banks, and by 1986 there were 41 banks (out of which 21 were merchant banks, which did not conduct retail banking activities). By 1995, the number had risen to 118 (out of which 54 were merchant banks).

The 'mushrooming' of banks was fueled by the arbitrage opportunities in trading foreign exchange created by the Central Bank's policy of controlled exchange rates. Interventionist policies kept the naira (currency) artificially overvalued, leading to a significant differential between the official and parallel market exchange rates, as against the US dollar. As oil revenues accrued to the government through its joint venture crude oil production with foreign oil companies, the government dominated the foreign exchange market as the largest supplier to the market. The country was import dependent—there was high demand for finished imported consumer goods with manufacturing displaced by the petroleum industry and non-oil exports discouraged by the overvalued exchange rate—and demand for foreign exchange was high. Given the divergence in official and parallel market exchange rates, unscrupulous practices arose whereby some banks would buy the foreign currencies procured from the CBN at the controlled rate and resell at inflated rates, a practice prohibited by the Central Bank, but weakly enforced. With the regulatory and supervision mechanisms struggling to cope with the burgeoning financial sector, and weak bank management, many banks in the banking sector eventually ran into difficulties.

Return to Democratic Rule and Macroeconomic Boom

The sudden demise of General Sani Abacha—the military dictator during whose regime the indiscriminate licensing of new banks accelerated—heralded the transition to democratic rule in 1999. Under the government of President Olusegun Obasanjo, a former military head of state who returned to leadership as an elected politician, major reforms started to take place, notably in the telecommunications industry, with the licensing of the first mobile telecommunications company, and the privatisation agenda. With oil prices as well as oil production rising, the country's revenues began to increase. One notable success in strengthening the country's finances was the successful write-off of most of the country's external debt due foreign creditors. This was negotiated by the country's Minister of Finance, Mrs. Ngozi Okonjo-Iweala, formerly a vice-president at the World Bank. She is credited with strengthening the country's finances by bringing transparency into the system, resulting in the buildup of foreign currency reserves from petroleum revenues by the end of 2003, compared with the deficit situation from the 1980s. Along with the more stable political environment, sound macroeconomic policies and an improving regulatory environment strengthened Nigeria's ability to operate in the international financial markets. Nigeria for the first time raised long term bonds of $500 million in 2010. Though a relatively modest amount, it allowed interest rate benchmarking of long term funding necessary to create stability to the financial markets by reducing the dependency on erratic short term funds and encouraging long-term financing for infrastructural development and investment projects.

Banking Sector Consolidation

Overdue major banking sector reforms at the beginning of the 21st century were led by the Central Bank governor at the time, Mr. Charles Soludo, an economist who had authored the government's economic programme NEEDS. Appointed in 2004, he oversaw wide-sweeping reforms to strengthen the banking sector, including the increase in bank capital requirement. By 2005, the banking population which had peaked at 114 had fallen to 89; informal estimates were that up to 50% of the banking population was technically illiquid. From a previous capital requirement of $25 million dollars, banks were given 18 months to increase their capital to a minimum of $200 million, prompting large scale equity injection into the industry. Some of the top tier banks had already reached this target, others were able to raise capital though the stock market by initial public offerings (IPOs) or rights issues—and in the case of foreign owned banks through equity injections from their parent—but for the smaller or weaker banks that could not achieve this, an industry consolidation was forced where the stronger banks absorbed them. Illiquid banks were taken over by the Central Bank and eventually 24 much larger banks emerged from this exercise.

With liberalisation and a much improved macroeconomic situation, the stock market soared, helped along by the banking stocks; many of the banks are now listed on the Nigerian Stock Exchange (NSE). The global economy was also buoyant in the early part of the 21st century, with

OECD investors looking internationally for better returns, with excess liquidity and low interest rates that characterised their financial markets. There was increasing confidence in emerging markets with high growth rates; Nigeria, with her improved political situation and stock market performance, started becoming attractive to foreign investors and investment capital flowed in. Domestically, the stock market also started attracting first time investors for the growing middle class of Nigerians. However, without strong regulatory oversight at the NSE, trading market malpractices set in. Some banks were eventually found to have been involved in margin lending to artificially fuel their share prices. In essence, they were betting on ever increasing stock prices, and loans were made to clients and stock brokers to buy the banks' shares with the expectation that the appreciation would rise to cover interest and capital repayments on the initial loan. This practice was considered to be contributory to an over inflation of stocks prices.

Global Banking Crisis and Nigeria Stock Market Crash

Once the global banking crisis set in around 2008, the Nigerian Stock exchange experienced capital flight as foreign institutional investors needing liquidity at home or wanting to divert into less risky investments sold off their stocks. Various factors, including this withdrawal of funds and lack of confidence, triggered the crash of the Nigerian stock markets (Nwude, 2012). As prices fell, banks tried to recover the margin loans they had made, which were dependent on stock market appreciation. A downward price spiral ensued: the stock market at its high point in February 2008 had a valuation of ₦12.5 trillion which fell to ₦5 trillion by December 2009, losing up to 60% of its value (CBN, 2014c). The NSE became the worst performing stock exchange in the world. Just two years prior in 2007, it was considered one of the best performing. The bubble had burst, creating a liquidity crisis in the banking sector.

Bank Insolvencies

Several of these banks were technically insolvent and had to recourse to the Central Bank for lines of credit to avoid becoming illiquid. It was amidst this banking crisis that the new Central Bank governor, Mallam Lamido Sanusi Lamido, was appointed on June 3rd, 2009. One of his first actions, only two months into his tenure, was a surprise announcement of taking over control of eight concerned banks, dissolving their boards and replacing executive management (Economist, 2010). In total, eight banks were taken over in two phases. The Central Bank, strengthening banking supervision, also saw through the establishment of the Asset Management Corporation of Nigeria AMCON; a vehicle to in 2010 takeover non-performing loans from the banking system, providing them much needed liquidity, as well as to acquire the failing banks that CBN had taken over and to manage the sale of these assets (CBN, 2010). He took steps to strengthen the banking sector by improving governance in the risk and risk management culture, which was a priority during his mandate. Indeed, prior to this appointment, he had been recently promoted to the chief executive of largest bank in Nigeria, First Bank of Nigeria, after holding the post of its chief risk officer.

These bold steps which were applauded internationally and were considered to have saved the banking sector from disaster were not without controversy at home because of the abrupt takeover and vested interests in those affect banks. The now Central Bank-managed financial institutions, through AMCON, were eventually restructured and successfully sold to existing banks or international investors. The last two transactions were concluded over the last year. With financial sector reform and a healthier economy, well capitalised banks began to look at new opportunities, albeit cautiously, given the bad loan crisis. Industrial manufacturing generally weakened after decades of being displaced by the petroleum sector; there was little incentive to many of these banks to invest in the real sector outside the telecommunications sector, the oil sector and other large corporate names.

Credit Crunch

A credit crunch ensued with banks now reluctant to lend, doubly affected the SME sector; SMEs reportedly experienced difficulty in accessing borrowing. However, with the sector being one of the main target areas of the government's economic programme, the Central Bank announced a bank-led initiative for financing the SMEs. In reality, during interviews, banks reported it was actually a scheme designed for the CBN which made it mandatory for them to contribute 10% of pretax profits to fund the small business sector. The scheme went through several iterations and was formally abandoned in 2010.

Technological Innovation in Payment Systems and Banking Products

Lastly, on the technology side, innovation in payment systems, have also provided new avenues for reaching smaller customers. Real-time banking was introduced into Nigeria only in 1986 when Citibank, the American commercial bank, opened in Nigeria. As a niche bank catering primarily to the corporate sector, this service was only available to large customers. Increasingly, banks adopted new technology with setting up of the Nigeria Interbank Settlement Service (NIIBS) in 1994, which facilitated interbank transfers and settlement. This would subsequently also allow automated processing and electronic payments. The game changer was the central bank spearheading cashless banking initiatives. During the tenure of the past Central Bank Governor, cash payment systems were launched. They focused on electronic payment systems using cards, on-line banking, ATMs, and e-banking; increasingly, mobile payments are bringing financial services within easy reach of retail and small business customers. The positive developments in the banking sector which have led to stronger, more competitive, dynamic banks with technological changes have led to the launch of diverse services and products to a broad range of customers with fewer banks, but within a better regulated industry during the longest period of democracy the country has enjoyed, amidst growing economic prosperity.

5.4 Exploitable Opportunities

Shane (2003) contends that an entrepreneurial opportunity is the *belief* that the new activity will yield a profit, thus the findings look at the bank's own assessment of why it considers SME lending to be a profitable opportunity, given the difficulties lending to small businesses in Nigeria. The banks' management considered that the SME market was untapped and they adopted an entrepreneurial approach to the SME credit market. Innovation Bank's retail banking head said *"No universal bank or microfinance bank appears to have specific products aimed at this sector"*, [Abridged: Proprietary Information] Historically, banks were set up to serve larger firms and the corporate sector and small firms were largely ignored. The profit potential in their view was apparent. [Abridged: quote]

Profit—a "lucrative" opportunity—was indicated in the strategy report as the primary motive for entering into the SME market coming from increased volume of lending business by attracting a new segment of customer. SME loans are typically prices higher than corporate loans, so the profit margin from lending are expected to be higher. However, there were advantages other than interest margin on SME loans. [Abridged- Proprietary information on strategy]

5.4.1 Competitive Strategy

The business head of Innovation Bank evoked first-mover advantages. [Abridged: section- Proprietary information on strategy]*"*.

5.4.2 Skills and Expertise

To exploit an opportunity, scholars have spoken of a firm's absorptive capacity which, according to Zahra and George (2002), is its ability to combine existing knowledge with new knowledge and apply it to services and products from which financial benefit can be derived. One of the factors affecting small business lending in Nigeria that was identified in the earlier studies in this research was the limited expertise within the banks, both in terms of skills and the lending know-how for this sector.

Specialised Skills and Training

During interviews for Document 4, bank executives mentioned that the skills needed for SME lending were different to those for corporate lending. One bank chief executive specifically noted that lack of specialist skills of the staff was a contributory factor to failure of their small business lending programme; the bank found that officers who had responsibility for the customer relationships had marketing and sales skills rather than good credit skills. Another bank chief executive said that not having the right skill set was one of many reasons why his bank would not go into small business lending. In the case of Innovation Bank, the SME lending programme fell under the business segment for retail and commercial banking. The executive director of the division was a 20-year veteran of Barclays Bank, hired internationally. The programme itself was headed by a foreign technical expert, the SME resident advisor, seconded through an alliance with the IFC on its programme to support banks to upscale their small business lending. These are only two senior foreign expatriate employed by the Innovation Bank, which was primarily Nigerian owned and otherwise run by a Nigerian management team.

[Abridged–Proprietary HR information]

High Salaries

Another problem raised by the retail manager was high staff costs, saying that compensation for skilled banking staff was as *"high as in the US or even the UK"*. The following table from a private survey of compensation levels in the Nigeria financial sector in 2013, undertaken by KPMG, the firm of auditors, shows high average salaries ranging from over $42,000 for a loan officers to six figures for the division head in Consumer/Retail Banking.

Job Title	**Average Total Cash Compensation Naira (N), millions**	**US Dollar Equivalent (Exchange rate: N156/$)**
Head, Consumer/Retail Banking	N34.1	$218,590
Head of SME Banking	N22.3	$142,949
Relationship manager	N 7.3	$46,795
Loan officer	N 6.6	$42,307

Table 3 Examples of Compensation, extract KPMG Financial Industry Remuneration Industry Report Nov 2013

Staff Motivation

[Abridged: Proprietary Product information and internal HR]

This example illustrates how obstacles can arise from internal organisational barriers.

5.5 Institutional Structure- Overcoming Institutional Holes

The findings that follow relate to how Innovation Bank proceeded to overcome gaps in the institutional structure. The key institutions required for the proper functioning of the SME credit market are those relating to information, property and creditor rights. The World Bank (2005) Doing Business report considers that the weaknesses in these key institutions, elaborated in the literature review, are considered to impede bank lending to SMEs.

5.5.1 Information

Identification

Information difficulties evoked in credit barriers to SMEs are usually understood as the lack of financial and business information required by lenders to assess the business prospects of the borrower; in particular, reliable financial reports such as profit and loss statements, balance sheet and cash flow statements as well as information on reputations of the business owners, assessments of management, history of the business performance and credit history. However, even more basic information poses a problem in SME lending in Nigeria. For example, verification of individuals is evoked by bankers as a major problem due to the lack of comprehensive and centralised national records—it is estimated that more than half of births and deaths in the country go unregistered.

The country has experienced various stop-and-start attempts with providing citizens with National Identity cards. Given that majority of the population do not have national identification cards, a borrower with a history of unpaid loans could restart a new business under a different identity with little possibility of being detected.

The first national identification system was only launched in 2003. Whilst reportedly 60 million Nigerians registered, it is not clear how many cards were actually issued before the process was beset with difficulties and was eventually wound up. In January 2014, a new commission, the National Identity Management Commission was officially inaugurated and in July of the same year, the President announced the commencement of this new ID system. Recent newspaper articles suggest that this system has faced difficulties with a technical partner in the issuing of the cards. As recently as May 2015, however, the commission advertised for individuals to enroll into the database for a National Identification Number (NIN), which will be mandatory for certain administrative processes after September of this year. However, other alternative identification systems developed by banking sector are now in use. In particular, last year the bank verification number (BVN) scheme was launched by the CBN in conjunction with the commercial banks. This consists of a unique number ID issued to each bank customer upon the capture of biometric data. It was spearheaded by CBN and was scheduled to become mandatory for certain banking transactions after the deadline of June 30, 2015. Details of numbers have not been published but it is estimated that approximately 20 million have been issued so far. The effect on the accessibility to SME loans is still too early to be reported.

In the case of Innovation Bank, passport and driving license acted as proxy documents for identification, as listed in the account opening documentation checklist. Given that many individuals are unlikely to possess either of these documents, I enquired as to the alternative options if the business owner did not have any of these documents. The credit manager explained it was a Central Bank requirement and therefore no other options were acceptable. The findings showed that the first set of customers for the SME product at Innovation Bank were existing customers migrating from non-credit transactions and who had been previously ineligible for loans before this product was launched. The implication of this ID requirement is that persons without those these documents, according to the banking regulation, are likely to be excluded from opening accounts and receiving loans. In practice, banks have been receptive to other forms of ID, such as those issued by organisations to their employees or students. However self-employed or those without regular jobs may still meet difficulties and may be required to seek other individuals who already have bank accounts to identify them.

Financial Information

Lack of reliable financial data on small business, as listed in the section above, is one of the main problems evoked in the literature on information economics. Applied research shows that credit scoring models using credit history data collected primarily by private credit bureaus have been effective to overcome this information barrier. In the UK, the well-known bureau, Experian, and Call Credit and Equifax, provide most of such data used by banks. In Nigeria, the credit bureau industry is still at its infancy. In operation since 2008, yet they only covered 4.9% of the adult population in 2013, severely hampering the expansion of credit scoring based lending.

Without this source of credit data, Innovation Bank developed its credit scoring system using proprietary data.

[Abridged: Results on Bank's proprietary credit system]

The bank considered its credit scoring system to be highly successful with a reported rate of less than 2% credit loss, less that the 3% loan write off reserve requirement by the CBN.

5.5.2 Property Rights

Collateral Requirement

The issue of property rights is critical in lending to small business; collateral is used as an alternative source of repayment if the loan defaults, but more importantly serves as an incentive to discourage non-payment. Given the difficulties with collateral lending in Nigeria, including the slow functioning court system and inefficient property and collateral registries, alternative processes to resolve the issue of securing lending have emerged. Firstly, it was seen that the requirement for assets as security was more than just being a preference for the banks. In fact, in Nigeria, it is a requirement of the Central Bank that all but microloans loans must be collateralised.

This policy was created after the widespread bad loans problem that caused the several banks to collapse, prompting the CBN to intervene and rescue the systemically important ones. It was found that in many instances banks risk management processes were weak; the granting of credit facilities without appropriate due diligence was indicative of a lack of prudence, and there was evidence of insider lending and lack of proper collateral to help recover loans in the case of non-payment. Though, these bad loan problems were mainly to do with large loans, the new collateral requirement covered all classes of credit. However, recent changes in banking regulations are helping to remove onerous collateral requirements for the smallest credits. Firstly, property—specifically landed assets—which has been the traditional form of collateral for bank loans and still is for larger business, is no longer a requirement as security for small business loans. Furthermore, there is no longer a statutory collateral requirement for the smallest of businesses. This allows the banks to develop other mechanisms for enforcement.

Types of collateral

The findings showed that Innovation Bank accepted up to six types of collateral listed, including the more traditional stock and inventory, cash and guarantees. [Abridged: Proprietary information on innovative use of collateral]

Collateral Registry

Collateral registry help to improve creditor rights by recognising the claims of ownership to the assets used to secure the loan by the lender in question in the case of the default of the borrower. Given the absence of a proper functional registry in Nigeria, the bank devised a system to improve creditor rights, reducing reliance on inefficient or non-existent formal institutions, instead using a combination of private sector services of insurance and bailiffs. [Abridged: Proprietary information]

Thus alternative institutions also involve their own transaction costs which may interfere in contracting between borrower and lender.

5.5.3 Enforcement of Contracts

Applied research based on institutional economics has advocated for strengthened creditor rights in the forms of enforceable contracts, based on appropriate laws; effective legal system, both in terms of time and costs; legal recognition of creditors' claims; recognition and transfer of property rights from borrower to creditor in the case of default; and systems to aid policing and recovery of assets and collateral. As discussed in the literature review many of these systems are inefficient or at their infancy in Nigeria. In order to guard against this risk, Innovation Bank utilised a system of close monitoring and early warning recognition, focusing more on preventative measures than recovery.

[Abridged: Proprietary Information]

Monitoring

The second, traditional method of monitoring was regular site visits. Prior to the disbursement or approval of loans, a site visit is mandatory to assess if the physical attributes of the business corroborate with the information given, to avoid as overstatement of size of the business. For example, physical verification of stock level is carried out to assess if it was commensurate with the sales figures that the customer provided. The physical monitoring involved meant there needed to be geographic proximity between the bank and the client, and that such clients are clustered geographically according to location of the branch.

5.6 Internal and External Risk - Identification and Mitigation

5.6.1 Background

The thriving Nigerian economy over the last 15 years or so has provided the small business sector opportunities for growth and there is an increasing awareness by the banking sector of the importance of SME sector to the economy. The survey based research in Document 4 showed that bank executives' overall perception of prospects for the SME sector was good.

In their strategy plan, Innovation Bank refers to SMEs as *“the backbone of all economies”*. The bank recognises that this sector has difficulties accessing finance, stating that 59% of micro, small and medium enterprises (MSME) report difficulties in accessing financial services, with only 5% having access to finance. [Abridged: Proprietary market data and analysis]

The conceptual framework identified two different types of risk—external risk and internal risk—and the need to distinguish between the two given the different consequences they have on credit default; specifically, the propensity for the former to lead to systematic portfolio default. The literature review discloses that the former, external risk, forms an important component part of firm default, yet is little researched in the literature on small business credit default. The findings below reveal how the risk assessment method used by Innovation Bank addressed these differences.

5.6.2 Risk Analysis: Score Card System

One of the major difficulties with trying to lend to smaller firms is the incompleteness of financial records that transitional credit methods require to assess firm risk. Innovation Bank’s risk analysis system was based on a score card, as the bank termed it, which did not require any formal statements. This proprietary credit scoring system evaluated the credit worthiness of the firm using qualitative and quantitative information.

In terms of quantitative information required for evaluating internal risk, a simplified balance sheet is worked out using basic financial data. [Abridged: Proprietary information on Credit Scoring]

Once this information is gathered, it is entered into the system by the loan officers; a process that is scheduled to take no more than 45 minutes in two sessions. After the loan documentation is signed off by the credit officer, the branch manager and then at the head office, the whole loan process approval takes two to three days, compared to a corporate credit which would require a few weeks for a new borrowing customer.

5.6.3 Capacity Building

Another aspect of the business risk mitigation is management training or capacity building and access to information which forms part of the SME product programme. As revealed in an earlier research paper, bank executives cited poor management skills as one of the risks of small businesses. Innovation Bank, as part of its services to SMEs, included support services and capacity building to small business. This took the form of training seminars, networking events and assistance to set up websites, amongst other initiatives. The bank set up a monthly programme for SMEs pairing them with successful entrepreneurs or experts to act as advisors on specific problems, and monthly business seminars that identified critical business areas for successful running of the business. The bank subsequently set up a help desk, which provided various services such as a newsletter on industry trends, marketing strategy, managing cash flows, and resolving legal and tax issues. Finally, the bank offered a programme to support SME access to markets, leveraging the internet. In 2010, Innovation Bank strengthened its capacity building services by collaborating with the Enterprise Development Centre (EDC), a training institute that started out as an offshoot of the Lagos Business School. I visited the head of the centre to explore training services provided. The EDC provided its own general diploma in management training for small business owners. With Innovation Bank, they pioneered a specialised entrepreneurship training programme, which was they promoted as *"contributing to the pool of skilled small and medium scale entrepreneurs"*

5.7 International SME Lending Practices

For illustrative purposes, this section shows how Innovation Bank's SME lending model compares with banking practices in a sample of 91 banks in developed and developing countries. For illustrative purposes, Table 6, below, presents comparative data on banking practices for SME lending, using averages from the aforementioned dataset. Banks in both regions of the world generally had a positive perspective of the SME market as a business segment (82%, 83%[2]—of banks responding positively to the question of whether MSE market prospects were big and good). Correspondingly, the overwhelming response was that profitability was the driver to enter this market (81%, 72%). Few banks considered the competition for corporate business as a motivation for lending to SME (0%, 9%).

Best practice from the sample of developed countries show that collateral requirement is still usually necessary for SME loans (78% for small firms and, 88% for medium firms). The predominant form used remains real estate for medium firms (80%), whilst for small firms it is used in 56% of cases. In particular, for small firms, cash and liquid assets are the second most important means for securing for small business lending (22%), as well as personal guarantees (22%). These collateral requirements are likely to prove more difficult in the Nigeria context; as developing country small businesses are often assets poor in terms of property and cash resources. In contrast, because the businesses are less likely to be service based, inventory, machinery and other fixed assets may provide more suitable alternatives. Additionally, where collateral is poor, government credit guarantee schemes may help provide additional security to the banks.

[2] (Developed countries %, Developing countries %)

COUNTRY/BANK: LENDING MODEL:	DEVELOPED	DEVELOPING	INNOVATION BANK
Banks' perception of obstacles:			
Macroeconomic	*9%*	*39%*	
Regulations	*9%*	*17%*	
Legal and Contractual	*0%*	*8%*	
SME market prospects big and good?	*82%*	*83%*	*Yes*
Drivers of SME lending:			
Profitability	*81%*	*72%*	*Yes*
Competition for large corporates	*0%*	*9%*	
Collateral for medium firms:	*80%*	*40%*	*Yes*
Real Estate	*80%*	*40%*	*Yes, incl. other options*
Cash/ liquid assets	*10%*	*15%*	*Yes, incl. other options*
Collateral for small firms:			
Real Estate	*56%*	*37%*	*No*
Cash/liquid assets	*22%*	*23%*	*Yes*
Personal guarantee	*22%*	*14%*	*Yes*
Collateral at all:			
Small	*78%*	*87 %*	*Yes,*
Medium	*88%*	*93%*	*Yes*
Evaluation criteria, medium firms:			
Financial assessment	*63%*	*59%*	*Yes, minimum requirement*
Credit history/ with bank	*0%*	*14%*	*Yes*
Credit history with credit registry	*9%*	*14%*	*No*
Size of loan	*18%*	*0%*	*Loan limits*
Evaluation criteria, small firms:			
Financial assessment	50%	49%	*Yes*
Size of loan	20%	0%	*Loan limits*
Credit history/ bank	0%	16%	*Yes*
Credit history/ registry	10%	4%	*No*
Scoring models:			
Small	82%	64%	*Yes*
Medium	55%	51%	*Yes*
Share of credit to:			
SMEs	*18%,*	*23%*	*negligible*
Large firms	*28%*	*33%*	*n/a*
Share of non-performing loans:			
SMEs	*7%*	*6%*	*negligible*
Large Firms	*3%*	*4%*	*n/a*

Table 4– Bank SME Lending practices round the world Data source: Beck and Demirgüc-Kunt, 2008

In terms of evaluating the credit request, the data show that for developed countries in the sample, financial assessment is largely required for medium firms (63%,) and for small firms (50%). No banks used their internal credit history as a method of assessment but up to 10% of SME loans were based on external credit registry history. Scoring models were by far the most important lending model used (82% for small business loans and 55% for medium firms). The data was not fine grained enough to permit details on the financial assessment used, but it could perhaps be safely deduced that since credit scoring model was largely used, this would align with the minimal finance data used in these kinds of models, as discussed in the literature review. The credit scoring system has thus become an essential element of lending techniques to smaller firms.

The share of credit to SME is 18% compared with 28% to large firms. This contrasts to less than 1% of bank credit in Nigeria and this gap is even wider when compared with banks in other developing countries which recorded 23% of credit going to small businesses on average. Lastly, with respect to the risk of lending to SME in developed countries, non-performing loans were about 7% for SMEs, compared with 3% for large firms in developing countries, confirming the riskier nature SME lending but still a relatively acceptable rate.

5. 8 Conclusion

This chapter has presented the main findings of this research, the main purpose of which was to improve the understanding of the credit market for SMEs in Nigeria by investigating the peculiarities of the lending context, and how the obstacles may be overcome. The following research objectives were defined for the case study, which were to explore: (i) The motivation and opportunities driving interest to lending to the SME market in Nigeria; (ii) How institutional voids in the institutional structure that support the SME credit market are bridged, and how informal alternatives can be employed to address them, and lastly; (iii) How business environment risk, as well as firm specific risk which together comprise default risk to SMEs can be measured and mitigated.

Summary of Findings

The conditions surrounding SME lending in Nigeria today evolved from the major changes in the financial sector over the last quarter of a century. The banking population witnessed a period of rapid growth during a turbulent political period during which the country's government was led by successive military administrations and while economic performance of the country was variable. The liberalisation of the financial sector, which occurred under conditions of arbitrage opportunities with a managed exchange rate system and weak banking supervision, led to a banking sector predisposed to quick gains. The economic conditions and government policy were not particularly favourable to the development of the SME sector and small business lending was not an attractive proposition for the banks.

In contrast, as the last 16 years have experienced relative democratic stability, rapid and continuous economic expansion with specific government policy specific to the SME sector, bankers consider that the small business sector has started to thrive. With major banking reforms undertaken by the Central Bank since 2004—strengthening of the banking sector, rooting out weak banks and better competition—the banking sector which had hitherto focused mainly on corporate lending, investing in treasury bills, shows signs of seeking other business opportunities.

Technology platforms in the form of interbank payment systems have revolutionised banking products into the retail sphere with mobile banking, online banking, credit cards, and payment cards which can be used abroad. The payment cards also sometime providing functionalities, such as SMS and email alerts for transactions that are not standard even in many Western countries.

These advantages of this retail banking revolution are also filtering into the SME banking. Firstly, there is evidence that the smaller SMEs banks are willing to issues credit cards to business owners as an alternative to classic working capital loans. A young entrepreneur who owns a property development company, in recounting how difficult it was to get loans to grow his business said: "*It was difficult to get loans but I was surprised when my bank said now I have up to twenty million [~$100,000] coming into my business account I can have a credit card to use like an overdraft*".

At the same time, the main institutional structures that are needed to support small business lending are weak; thus, the banks have to find ways to overcome them in order to reach the smaller business sector. It is against this backdrop that Innovation Bank, the subject of the case study, set out to expand lending to the SME. The opportunities it perceives for profit making are central to the strategy of the commercial bank for seeking out this lending which is still in its infancy.

As a private sector organisation, profit-making was the primary objective for the bank lending to the SME. The historical legacy of the banking industry, given the turbulent economic and political past, has not predisposed commercial banking to lending to SMEs. SME lending has been seen as a development objective and policy measures were designed to coerce banks into lending to this sector, rather than to make it attractive. Government designed or mandated schemes in the past have consistently failed to achieve the desired goal of sustainable SME lending. In recent years, however, there has been increasing interest by banks to lend to the sector. However, SME lending requires a specialised set of skills, demonstrated by the example of our case study, which banks will need to develop.

With regard to the country's institutional structure that supports lending—that is, relating to information, property rights and creditor rights—the World Bank has attempted some objective measure to assess their efficacy. Some of these ratings for Nigeria are quite discouraging. In its recent report on Nigeria, the World Bank (2014) ranked the country 185 out of 189 for registering property, with information from credit bureaus covering only 4.9% of adults, compared to the averages of 25.2% for SSA and 73.9% for OECD countries. As far as lenders' rights are concerned, it reports that there have been no significant reforms in the five years preceding this report. On the face of it, this dismal state of the institutional system seems to point to a classic case of market failure for small business lending. However, these figures mask the following dynamic: the state of reform that is taking place. For example, just recently in September 2014, the Central Bank of Nigeria announced the regulatory framework for a collateral registry (CBN, 2014c). As implementation is undertaken, it is expected to ease the problems of using assets as security for loans. On the information side, the Bank Verification Number Scheme (BVN) which provides a unique identification number for all users of banking services, serving as a virtual identification card system with biometric data captured, became effective in March of this year and banks are expected to ensure that all customers have this number by March 2015. Though informal enquires suggest that the conversion rate is slower than planned, as banks are still installing the required equipment in branches, this is expected to deal with the problem of establishing and verifying identities, as necessary for a credit bureau system.

In considering the different approaches to deal with informational opacity of small business, the literature has distinguished between relationship lending, which relies on soft information, as an alternative to transactional lending, which relies on hard financial data, and is as an alternative way of lending given institutional weaknesses. However, Innovation Bank's approach effectively has elements of both as it adopts the technology of credit scoring, considered a transactional approach, as well as client monitoring and site visits, more characteristic of the relationship lending technique. This duality suggests the needs to be adaptive in dealing with vagaries of the specific lending environment. In terms of collateral and security, there was evidence of non-conventional alternatives used. For smaller loans for a start, there was no collateral requirement, a situation which was permitted by recent changes in Central Bank regulations. Circumventing problems of acquisition and transfer of property rights, the lease of the business premises was assigned to the bank for the duration of the loan, allowing it to take possession in case of non- payment of the loan. Further, to limit adverse selection and moral hazard, it devised a dual structure of physical and remote monitoring, by regular visits to the business premises and monitoring cash flow through daily checks on cash balances with the bank. Monitoring infers high labour costs, which the bank mitigated by leveraging its branch network; it marketed to SMEs that were within the vicinity of the branch. Technology was also beneficial; bank officers had terminals on their desk which allowed easy access to daily monitoring of client bank balances.

In terms of the risk management techniques, there was evidence from its credit scoring model that the bank was differentiating and separately measuring internal risk and external risk.

Responding to some of the internal risks of small businesses relating to management capacity and access to business resources, the banks worked on a collaborative skills training programme for entrepreneurs with a business training centre, as well as organised networking opportunities for business owners. Two years after the site visit, the bank reported it had almost $32 million in loans, with a default rate of less than 1%. This was well below the normal 3% bad debt provision which banks are required to make by the Central Bank. The bank announced that as of May 2015, it had granted 60,000 loans under this programme, totaling ₦200 billion ($1billion), and more than 16,000 SMEs had attended at least one of its business development seminars. This loan programme could be considered successful given the growth in volume of loans made in the six year period from its launch.

This case study of Innovation Bank situated within the context of the financial sector and business context in Nigeria had as its objectives to bring further understanding to the impediments to SME lending in Nigeria and how they may be resolved. Specifically, it sought to shed light on the driving force to banks' interest to extend credit to SMEs, how the bank can overcome the gaps in the institutional structure that is critical for lending to SMEs, and lastly, how the bank can measure and mitigate internal and external risk to SMEs.

Obstacles in the Business Context

Relating to the obstacles in the credit market, it appears that there are issues beyond the classic informational asymmetry and institutional barriers. External conditions, such as the macroeconomics conditions, political situation, financial sector policy and the competitive structure of the banking industry, affect banks' interest in lending to this sector. Most commercial banks in Nigeria are relatively young, less than 30 years old, and they were set up to service the corporate sector and not SMEs; therefore, there is an industry wide lack of specialised skills and lending techniques appropriate to SMEs. Whilst there is a general growing interest in the SME sector, no other banks had specifically set out to access this sector, suggesting that the profitable opportunities for lending may not have been fully identified.

Perceived Opportunities and the drive to Overcome Institutional Barriers

In contrast to economic theory models which predict banks will not lend when there are institutional failures in the information and property rights systems, the case study demonstrates that a bank perceiving profitable opportunities can devise ways to overcome these barriers. The institutional structure for lending to SME is still weak in Nigeria. Credit bureaus, recognised as a source of credit history for smaller business and thereby facilitating lending to them, has only captured about 4% of the adult population in Nigeria. Information structures are weak and the legal processes for establishing credit rights are poor. The World Bank survey ranked Nigeria a low 176 out of 185 for ease of lending to SMEs.

Despite this seemingly dismal situation of the institutional structure, Innovation Bank was able to come up with home-grown creative solutions to bridge the institutional gaps. It built a proprietary credit scoring system and found original alternatives to traditional collateral and device mechanisms to address issues and to encourage credit repayment. It also invested in capacity building for its staff as well as for SME customers. There were indications that its SME loan portfolio grew rapidly and maintained a low level of non-performing loans a few years into the programme.

SME Risk Identification and Mitigation

Finally, one area that this research has highlighted is how to effectively identify, measure and mitigate the external risk of lending to small businesses. Interviewed about the situation of changes in SME lending in 2015, an executive director in charge of risk at a commercial bank explained that interest rates today form a major risk for external SMEs. He said that with the level of interest rates, the costs of borrowing are too high for smaller banks to absorb. The central bank benchmark rate is high: it is 13% and lending rates are from 17% to 25%, and being more risky, smaller businesses are subject to the higher rates. He felt that could explain the tendency that relationship mangers noticed for some of the smaller borrowers to try to divert the funds into risker projects, higher return projects, instead of the purpose of the original loan. His bank had recently set up a specialist SME unit over a year ago but loans to SME only amounted to less than 2% of their portfolio. He suggested that the Central Bank could set up specific funding schemes for smaller business at lower cost interest rates. He felt that the existing CBN credit guarantee scheme for SMEs was too restrictive given the extensive documentation requirements, which made it unattractive for the banks. He explained also that CBN was in turn concerned about moral hazard, in that banks may not exercise sufficient due diligence in lending to smaller businesses as their risk would be covered by the guarantee.

Findings from the research have explored the processes involved in the first commercial bank to embark on a specialised programme of lending to small businesses, how it has sought to overcome the obstacles to doing so, and the context of the business environment in Nigeria that banks and smaller business operate in. The main implications of the research have been as follows: that the contextual conditions—political environment, macroeconomic conditions and the structure of the financial sector—are critical factors for commercial banks and affect SME lending.

Further, that the barriers to SME lending are broader than institutional and informational barriers; such as those to do with the SME business environment and banks themselves. The difficult business environment for SMEs increases their propensity to be risky. In Nigeria, these are conditions such as high interest rates, the devaluing naira for businesses that import, and insufficient power supply. On the part of the banking, antecedents indicate that they were not set up to lend to SMEs, and the lack of specialised knowledge and skills in lending to SME sector may dissuade banks from lending the sector.

Thus, the absorptive capacity of commercial banks need be improved to acquire skills in this specialised area of lending. Individual banks are starting to wake up to the potential opportunities to the SME market and are setting up specific departments and products for that sector. However, preliminary investigations show that these banks are not necessarily adopting credit scoring techniques that may be better suited to lending to SME's and may still be using traditional lending methods that rely on collateral requirements, such as property to secure the loan. The findings indicate that the SME sector is of growing interest to the banking sector, but the level of lending to

SMEs is still low, as banks reported less than 2% of their loans go to smaller businesses. CBN needs to encourage capacity training in small business lending as it has done in other areas of banking.

The final chapter concludes with practical suggestions for solutions to some of these issues as well as the limitations of this research.

CHAPTER 6. CONCLUSION

The preceding chapter presented the results of the research. This final chapter notes the contribution of the research to theory and practice, discusses the findings within the broader context of the commercial banking system in Nigeria and its applications to policy making and commercial banking lending. It concludes with a discussion of the limitations of this work.

6.1 Theoretical Contributions

The premise of this research was that existing theory was limited in the study of obstacles to SME credit in Nigeria. A new conceptual framework was proposed using results of a preliminary study which indicated that the impediments to small business lending by banks in Nigeria is impacted not only by the well-known issues of asymmetric information and institutional failure, but also by idiosyncratic factors. These included the external operating environment for small businesses, which could give rise to systematic default, and the adaptive capacity of the banking sector in learning new ways to lend to this sector.

The conceptual framework using interpretive perspective reasoned that the small business credit market should be looked at as a nascent market since few commercial banks were lending on a large scale to smaller businesses. Using the entrepreneurial literature, a concept called exploitable opportunities was developed, given that profits are considered a prerequisite for the creation of sustainable markets. The research also saw how an innovative entrepreneurial approach can seek to overcome institutional gaps, contrasting with economy theory that would suggest market failure when certain institutions are absent or weak. The research suggests that in order to develop context-appropriate, effective institutions to support the SME credit market, an understanding of the nature of the embeddedness of existing institutions, both formal and informal, is critical. Importantly, the process of institutional creation by regulators should evolve from a process of interaction with the banking sector given their knowledge and experience with lending. Their first-hand experience of failure and overcoming challenges may bring useful input to the design process and reduce costly failure in creating formal institutions.

6.2 Implications for Policy and Practice

Business Environment and Banking Sector

For development reasons, the government in Nigeria is keen on encouraging and supporting the SME sector and adequate finance has been targeted as a policy action. This research has argued that the operating context is an important factor in understanding and addressing challenges to small business lending. This is because, as well as the firm's capabilities, the fate of smaller businesses is inevitably linked to the general economic environment and the specificities of the business environment in which they operate. In Document 4, specific areas such as the impact of government policy changes and adequate infrastructure were considered by bankers as affecting the performance of small business.

On the side of the financial sector, the regulator has a key role in continuing with necessary reforms in order to encourage a conducive lending environment through a well-structured and well-regulated financial sector. The organised SME lending market is still at its infancy; banks in Nigeria are not naturally predisposed to lending to small firms for path dependency reasons, and therefore, the banking industry is still going through a learning process. There appears to be a positive change in mindset toward lending to smaller businesses. The government's narrative on the importance of the SME sector is likely to have contributed to stimulating interest combined with well capitalised banks operating within a competitive industry looking for growth opportunities. Further, Neshamba (2003) in a study focused on Kenya and Tanzania, has argued that banks have a social responsibility toward small businesses and providing them financial services, including funding, which generates symbiotic advantages for the business communities.

However, the developmental objectives of the government and the business objectives of the banking sector are sometimes in conflict when regulatory action is taken to improve access to finance to this sector. Several interventionist initiatives to create SME lending programmes by the Central Bank have generally been short lived, proving unprofitable for the banks. The Central Bank could instead provide incentives to encourage the banks' investment in innovative SME credit models. Such incentive could be tax breaks on profits to lending to SME, or on R and D investment into SME lending models, whilst the proposed credit guarantee scheme is still to take off. Boateng and Abdulrahman (2013) have suggested that appropriate low interest loan guarantee schemes could help alleviate the dearth of loan finance to smaller firms. There are working groups of the Banker's Committee led by the Central Bank on SME funding. Discussions have been about obstacles and how to improve SME funding and the obstacles. One of the areas that this research has highlighted is that there is a set of skills and expertise distinct from corporate banking necessary for lending to SMEs. The Central Bank of Nigeria could kick start the process, through building the awareness, a sensitisation programme through chief executives at the bankers' committee, and facilitating SME credit training programmes within risk departments of the banks.

Creating the Institutional Framework to SME Lending

The implication of the research in relation to institutional gaps is that the institutional creation can be looked at in two ways. Firstly, formal institution creation can be a lengthy, dynamic and bumpy process in developing countries and firms need an adaptive strategy in order to tap into profitable opportunities in market in the interim. In relation to the SME credit market, for example, two key institutions, credit bureaus and collateral registries—which research has indicated are beneficial to SME lending—are in various stages of development in Nigeria, as discussed in Chapter 4. The case study showed instances in which Innovation Bank was able to create its own responses to institutional weakness; for example, creating its own credit history records and developing collateral substitution or enhancing methods. Thus institutional inventiveness can be effective in bringing about solutions in the interim.

With respect to institutional creation, the government and its advisors need to ensure that new institutions are designed, taking into account the system of supporting institutions, as the performance of newly created ones is also dependent on their interaction with existing ones. This also means that institutional transfer from another context—especially from advanced countries to developing ones—may not deliver the desired results because of the unique nature of the institutional context in the receiving country. The case-in-point is the credit bureau industry considered key for SME lending; after six years, coverage remains minimal and this failure has been largely attributed to the absence of a unique identification system in Nigeria. A banking identification system, expected to help resolve this problem, was only launched in March of this year. Closer collaboration between the regulatory authorities, their advisors and the banking sector in the design of credit market may help in developing an appropriate institutional framework for the Nigerian context.

Lending Models

Whilst the basic tenet of successful lending remains the same irrespective of the type of borrower —the willingness and to ability to repay—small business lending is a specialist one, which requires a different credit model from corporate lending. The bank in this case study was able to device ways of coping with lending obstacles, demonstrating that a structured approach to SME lending does not have to wait until the "right" institutions are in place. The findings of the case study are not to promote the particular methods that Innovation Bank has used, which are in any event proprietary, but they elaborate on how credit models can be designed to address the barriers in small business lending within an enabling environment.

Given the characteristics of small business—incomplete record keeping and the ownership/management role which results in informational opacity—a narrower set of financial information will be available on these firms and correspondingly, methods of risk assessment will have to be based on this limited data. Small business credit scoring has attractive attributes in this regard, but also inventive thinking about substitute data sources which will be needed. One way of doing this is to shift focus to actual evidence of cash flow generation, this being the primary source of loan repayment, rather than complex computation of simulated cash flow analysis as in corporate lending. **[Embargo –Proprietary information]**

This study has also pointed out the need to differentiate between internal and external risk as they can have profoundly different effects on a small business lending portfolio- the former implies that default risk is independent whereas with the second it is correlated across the portfolio. The risk assessment model must therefore have the ability distinguish between these composites of risk and identify the elements of the environment that small businesses that are sensitive to. The finding in the preliminary research in documents 3 and 4 indicated that bankers recognised that elements of the external business environment were implicated in failure of SMEs to repay loans and that bankers their perception of external risk to SMEs performance was high. Fluctuation, vacillation and reversals in government policies were identified risk factors, and banks' risk assessment and selection process may need to identify which firms are more susceptible to risk from government policy changes and how to mitigate this risk.

Relating to gaps in the information and credit rights institutional structure, Innovation Bank created new forms of security and collateral, **[Embargo: Proprietary information].** Unlike with lending to larger businesses, where collateral serves primarily as a source of repayment if the loan goes bad, the role of collateral taking for small firms is primarily a tool to discourage default. But there has to be flexibility with the use of such collateral substitutes. In the case study, when the stock market crash occurred, it suspended the use of share certificates as loan security.

Innovation Bank also developed a proactive dual approach to monitoring, one physical and the other technology based. In effective monitoring, requiring geographical proximity to the client, credit decision-making may need to be devolved to the branches where relatively soft information is gathered and to allow for speed in processing loan requests. Where the literature has spoken of transactional banking and relationship banking as different options for lending, in the case study we see that elements of both types of lending systems were used: credit scoring, which is a transactional methodology, and monitoring, which is associated with relationship lending. Indeed, the complexity of the obstacles in the lending environment in Nigeria suggests that banks will need to incorporate both systems into their lending models. Additionally, as SME lending is specialised, requiring specialist staff skills, unique technology and specific organisational structure, it perhaps needs to be run on a platform of products, systems and staff, independent from corporate lending. This recommendation differs from the way in which the SME credit business was run by Innovation Bank at the time of data collection.

Lastly, with new and growing businesses in the SME sector, banks will likely need to take an active role in helping owner managers improve their business management skills. As SMEs often operate in an atomised setting and lack the networks for accessing information and other resources, banks lending to smaller businesses need to work with them on skills development programmes and business resources. Improving business ability will allow businesses to deal with the uncertainty in the environments and to take advantage of growth opportunities. Amidst a rapidly expanding economy, attracting these businesses at this stage and supporting them over the years as they grow, may enable financial institutions build long term revenue streams for their banks.

6.3 Limitations of the Study

The case study of the bank expanding lending to smaller businesses has provided a comprehensive insight into the initial stages of development of the credit market for SMEs, and how the lending model of a commercial bank in Nigeria seeks to address the barriers identified in previous studies. It reveals how the bank has used innovative ways to circumvent institutional barriers, and given informational difficulties, it has devised techniques to measure and to mitigate risk in the absence of collateral registries and inefficient court system. The conceptual framework also helps to identify some of the conceptual issues lending to SMEs that the bank's model did not seem to capture. However, as a single case study, the results cannot be expected to be generalisable across the commercial banking industry; the particular lending model the bank used is specific to the organisation, its business strategy and its understanding of small business credit risk. Rather, the research demonstrates how the conceptual framework can be useful in analysing banks' SME lending systems and elucidates how the institutions attempt to overcome barriers to lending to SMEs. As banks are progressively developing lending products for SMEs, a comparative study of the performance of different SME lending models could yield insights as to industry best practice, with particular emphasis on how institutions can be designed or improved upon to support the SME credit market. More research is needed to identify the specific elements of the environment that pose risks to SME businesses in Nigeria in order that they may be better measured and mitigated by banks' lending models.

Finally, as more detailed quantitative data emerges, further research to refine the concepts and advance the conceptual model may well contribute to comprehensively developing a theory of small business credit for Nigeria or indeed for developing and emerging nations.

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