Capital investment decisions of small and medium enterprises in Benin-City, Nigeria

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ABSTRACT

The study examined the capital investment decision of small and medium enterprises (SME's) in Nigeria. The objective of the study is to determine if small and medium enterprises in Nigeria utilize investment techniques. The survey research method was employed to carry out the study. Data were elicited through the use of questionnaires and oral interviews. These data were analyzed and presented using a statistical technique such as tables and percentages. The result revealed that most small and medium enterprises in Nigeria utilized investment techniques in their investment decision. Based on the above findings, it was recommended that SMEs in Nigeria should be encouraged to employ the services of qualified professionals or someone who has knowledge on basic techniques for investment decisions, the government should organize frequent training for SMEs on financial and investment decisions.

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Introduction

Chris-Aladum (2013) of Stanbic IBTC PLC posits that eighty percent of small and medium enterprises in Nigeria close shops within the first five years of their existence. A lot of internal and foreign direct investments go down the drain after huge sum of money invested in physical and human facilities. In the past ten years, our media are awash with stories of collapse businesses, thousands of workers threw into the labour market, with attendant consequences of poverty and social vices like kidnapping, robbery.

Adebunmiyi (2020) posits that the United Nations Industrial Development Organization Investment and technology promotion office in Nigeria has called for the formation of effective strategies to address the increasing inability of small and medium enterprises to grow in the country. According to the organization, studies have shown that only 20 percent of SME's manage to survive in Nigeria. He further stressed that a financial expert with Price Waterhouse Coopers (PWC) Nigeria, Bola Adigun has said 80 percent of small business enterprises (SME's) that collapsed in the country failed, due to cash flow problems arising from poor financial management practice. McMahon and Holmes (1991) posit that careless and poor financial management practice has been identified as one of the reasons for small business failure. Wong (2010) explained that the financial distress of an organization can increase when such company fails to meet its financial obligation or has difficulty in making payment due to cash flow deficiency.

The failure of investment decision has largely been associated to the not adherent to best business or investment practices (Agyei-Mensah, 2011), therefore a firm decision to invest in a new project should be made according to whether the project increases the wealth of the firm's shareholders. Prather, Tupuz, Benco and Romer (2009), Akingunola and Oreoluwa (2011) posits that finance theory stressed that borrowed funds is only appropriate if rate of return on investment is higher than the cost of external funds, otherwise the firm will be exposed to high financial risk and over bearing interest rate. Organization must make correct investment decision to support the overall corporate business in order to improve its opportunities for success. Small and medium enterprises tie huge capital on investments that are not critical to the firm survival. Proper capital investment decision rules allow for the

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formalizations of the process and specify what conditions need to be met for any projects to be accepted by looking at different investment decision rule (Berk & Demarzo, 2014). To achieve such project analysis, there is need to adopt capital project techniques- pay back method, the accounting rate of return, Net present value (NPV). Some other measure like modified internal rate of return (MIRR), Profitability index (PI), NPV profile that are derivatives of the NPV and IRR measure (Block, 2007).

Sometimes investors are not always rational in their investment decisions, other anomalies like heuristics, social interactions, information from peers, media, and internet, attitude to risk, overconfidence, emotions, need for diversification, experience, macro-economic factors like interest rate, inflation, herd behavior formed investors biases which affect the investors investment decisions. When those biases are learned, it formed adaptive behavior which affects investment decisions. Therefore irrationality or anomalies shape investors decisions. Information available are limited to cognitive ability of the investors, the irrational decision may take a major part of the decision maker. Though efficient market hypothesis maximizes investors utilities, adaptive market hypothesis sometimes forms the basis for investment decisions.

There is therefore need to have an insight as to the level which SME's in Nigeria made prudent investment decisions in order to challenge the present situation of failures of some SME's in Nigeria. The study is therefore set out to know how investment decisions are made among Nigeria SME's and what level of professional techniques are adopted. This study aims to determine if SME's in Nigeria utilize investment techniques This paper question that whether SME's in Nigeria utilize investment technique or not?

Accordingly, the work is organized into introduction; which highlights the motivation for the research work and objective, theoretical and conceptual frame work; it explains the theoretical base for the research work and various conceptual models, empirical review; review of empirical data utilized in the past, methodology; method of collection of data and analysis, findings and discussion, implication of study, conclusion and recommendations.

Literature Review

Theoretical Background and Conceptual Framework

This study will be hinged on the Keynesian theory of investment (classical theory). According to Keynes, investment decisions are taken by comparing the marginal efficiency of capital (MEC) or the yield with the real rate of interest (r). So long as the MEC is greater than r , new investment in plant equipment and machinery will take place. However, as more and more capital is used in the production process, the MEC will fall due to diminishes marginal product of capital. As soon as MEC equated to r , no new investment will be made in any income earning asset. MEC is the rate of return at which a project is expected to breakeven.

The Neo-classical theory of investment could be based on the optimal capital accumulation (Jorgenson, 1963). Neoclassical theory of investment assumes of profit maximizing behavior by firms and the assumption that the management seeks to maximize the present net worth of the firm. Hence, an investment project should be undertaken if and only if it increases the value of their shares. Hence the rule is investing in all positive net present value projects and reject those with a negative net present value. The neoclassical model of optimal capital accumulation may be derived by maximizing the integral of discounted profits of the firm or simple by maximizing profits at each point of time (Eklund, 2013). Capital investment decisions involve a company making decisions about large investment analysis in return for a stream of benefits in future years. A company grows when it invests in capital projects, such as plant and machinery, to generate future revenues that are worth more than the initial cost. Put succinctly, capital investments are funds invested in a firm or enterprise for the purpose of furthering business objectives. Such investment may be acquisition of capital assets or fixed asset, whose usage may last several years. Such capital investment decisions are meant to expand capacity utilization of the firm that is expected to bring benefits in future years.

Investment decisions are among the three most fundamental decisions that a firm must make in financing decision and operational decision. The level of sophistication exhibited by SME's manager in the investment decision is vital to firm financial well-being. It is therefore important that investment managers understand how to evaluate project correctly so that they can make informed decision concerning prospective projects, because investment decisions drive financial performance and growth. Some projects carry high risk but have the potential to generate high inflation adjusted returns than other assets in the long term while some investment come with low risk and therefore lower returns. In making an investment decision, Hasan and Sharwani (2013) posits that all cash flows should be considered: the cash flow should be discounted at the opportunity cost of funds, select from a set of mutually exclusive project, the one that maximizes the shareholders wealth; managers should be able to consider one project independently from all others. Akintoye and Olowolaju (2007) posits that managers are vital in making prudent investment decision analysis that shall lead to better performance of a company.

To achieve project analysis, there is need to adopt capital project techniques- pay back method, the accounting rate of return, Net present value (NPV). There are some other measures like modified internal rate of return (MIRR), profitability index (PI), NPV profile that are derivatives of the NPV and IRR measures (Block, 2007). Investors used these quantitative measures to help them decide whether to undertake an investment or not based on their return requirements. The payback period is another method that is sometimes used. The method determines when the projects will break-even, that is how long it takes for revenues to pay investment outlays. However the method does not measure profitability, as it only measures the time it takes to recover the initial investment outlay but not the profit that is made after paying back the initial investment. The method ignores all revenues and cost after the

payback period and does not allow for the possible advantages of a project with a longer economic life. Also, the method does not recognize the time value of money, though that can be remedied by using the discounted payback method (Park, 2002).

Net present value (NPV) is the difference between the present value of all cash inflows and cash outflows associated with an investment project. If the NPV (i) is positive for a single project, the project should be accepted since a positive NPV means that the project has greater equivalent value of inflows than outflows and therefore makes a profit. Internal rate of return (IRR) is the interest rate charged on the unrecovered project balance of the investment such that when the project terminates, the unrecovered project balance will be zero. In other words, the investment has zero NPV at this rate of return. Kyong-SooChoi and Jeongmi Choi (2015) writes that larger firms show relatively higher investment efficiency since those firms possess abundant resources such as investment experts.

Conceptual model

The above capital investment decision assumes that investors are rational so that they make decisions to maximize their expected utility. Behavioral finance theories have showed that the degree of investors' rationality is bounded due to cognitive limitations, psychological factors, information asymmetry. These factors cause biases and mistake in investors' decision making. To resolve this crisis, Adaptive Market Hypothesis (AMH) was propounded by Lo (2005) as in Lovric et al. (2008) where individual market participants adapt to changing environment by using heuristics, that is learning their irrational behavior for adapting to market environment. Conceptual model therefore focuses on the dynamic situations in the business environment and investment, the interplay contributes to bounded rational behavior where investors use various heuristics and biases behavior. Here the investor is seen as learning, adaptive and evolving entity that perceives the environment, processes information, acts upon it and update his or her internal states.

Investors exhibits irrationality or anomalies in their investment behavior, such anomalies are birthed by socially shared tips from peers, financial advisers, news in the media, internet portals, forums and news groups, risk; decision maker's attitude towards risk can be characterized as risk aversion, risk seeking, (risk tolerance, risk taking, risk loving) or risk neutrality. Thaler and Johnson (1990) as in Lovric et al. (2008) found that previous gains increase risk seeking behavior. While in the presence of previous losses those bets which offer a chance to breakeven seem particularly attractive. This is what Thaler called mental accounting. The need for diversification to minimize losses is also one of the important investor's behavior. This is a risk management technique where various investments are combined in order to reduce the risk of the portfolio, however, many investors do not (sufficiently) diversify their portfolios. This may be due to beliefs that the risk is defined at the level of an individual asset rather than the portfolio level and it can be avoided by hedging techniques, decision delay or delegation of authority (DeBondt, 1998 as in Lovric et al 2008). In choice theory, diversification is a heuristic strategy of seeking for a variety of options. Read and Loewenstein (1995) as in Lovric et al (2008) studied diversification biases in the context of consumer choices and found that people choose more variety when making combined choices of quantities of goods for future consumption than if they make separated choices immediately before the consumption.

In portfolio management, switching from security to security increase transactions cost and harms performance. Odean (1998) as in Lovric et al. (2008) found that a particular class of investor sells winners more readily than losers. Information, social interaction through person to person, media, emotions and heuristic forms biases which have powerful effect on decisions. Heuristic are rules of thumbs, procedures used for processing information and reasoning, often based on trial and error. They can lead to systemic biases. When a biased behavior becomes systematic and robust, it gives a foundation for predicting behavior. Personality traits, overconfidence, mood of investors, investor sentiments, financial goal, risk, herd behavior form biases which affect financial decisions. Macro-economic factors like interest rate, inflation influence investor's attitude.

Herd behavior means similar thinking among individual. If any experienced investors invest in any stock, other will follow same category of investment. Cheng and Khorana (2000) as in Harithan and Rashmi (2016) discussed herding behavior as a method by which market participants base their investment decisions on collective arrangements alone, defeating their own opinions. In real world setting, irrational or anomalies formed influence on investment decision and because of cognitive limitation, people can't access all information available to them, most often, they are swayed by irrational decisions. The repeated experiences form adaptive behavior.

Empirical Review

Olawale et al (2010) investigated if companies make use of sophisticated investment appraisal techniques when making investment decisions and the impact of investment appraisal technique on the profitability of small manufacturing firms in the Nelson Mandela Bay Metropolitan area of the Eastern Cape Province, South Africa. The study used survey data generated from one hundred and twenty four small manufacturing firms. The study ascertained by statistically testing the hypothesis of the study that small manufacturing firm owners do not use sophisticated investment appraisal technique when evaluating their proposed projects. A multiple regression analysis was employed to confirm the impact of investment appraisal technique on the profitability of the small manufacturing firm. The study concluded that the use of non- sophisticated investment appraisal technique has a negative impact on the profitability of small firms.

Relativo et al. (2016) , in their study of capital investment decision of micro, small and medium enterprise in Digo City, result revealed that the influential factors affecting financing decision of MSME's owner include sources of finances, entrepreneurs prior experiences, business trends and diversification of investments. Sungun (2015) investigated how investment decisions are made in SME's in Turkey and to get an insight as to the level of professionalism and utilization of financial tools and technique for that purpose. A survey was conducted among 65 SME's located in Istanbul from production, construction and service industries. The result revealed that despite awareness on theoretically superior generally accepted evaluation measures, they are not used by the vast majority of the decision makers in the analysis of capital investment in SME's in Turkey. Master of Business Administration (mba) School of Business, University of Nairobi (2013) investigated the impact of investment decisions on performance of companies quoted at the Naorobi Security Exchange. The study adopted a descriptive survey design. The researcher analyzed the data extracted from annual reports and accounts for the period (2007-2012) quoted companies as at 31st December, 2012. Simple regression analysis was performed to establish the relationship between investments and performance. The study found out that there was a positive relationship between the invested amounts and performance (profitability) of the listed companies. Ottekunrin et al.(2018) examined the rationale behind selecting various types of investment open to companies. The project was primarily concerned with the strategies or techniques available to companies for evaluating investment proposals in relation to their expected return and risk. It was found that various type of investment decision are open to the company and that investment projects are carried out based on the cost and funds available to the company. Also there are various techniques for measuring the payoffs from those projects.

Research and Methodology

The population of this study is made up of all small and medium business in Nigeria while the research sample comprises of small and medium business in Benin City, Edo State, Nigeria. 100 sample of small and medium business were taken from Benin City.

Purposive random sampling method was used for selection, the respondents were either firms owners or those involve in investment decisions that affect the firms. The research made use of primary data. The technique used by the researcher to obtain data for analysis is questionnaire and interview. The research instrument is made up of two session: A and B. Section A sought information on type of firm, type of industry, number of years in operation, number of employee and qualification of investment manager. While section B contain two questions relevant to the subject matter.

The questions were adopted from Sungun (2015). The interview questions consist of questions that help elicit detailed information on the subject. The data collected were analyzed using descriptive and inferential statistics.

Findings and Discussion

This section captures items in the questionnaire relating to type of firm, type of industry, number of years in operation, number of employees, qualification of investment manager, evaluation technique, type of technique used and investment decision.

Table 1: Type of firms

Particulars	Frequency	Percent	Valid percent	Percent cumulative
Proprietorship	60	60.0	60.0	60.0
Limited corporation (partnership)	28	28.0	28.0	28.0
Joint stock company	12	12.0	12.0	12.0
Total	100	100	100	100

60% of the organizations considered were proprietorship, limited corporations were 28% and joint stock companies were 12%.

Table 2: Type of industry

Particular	Frequency	Percent	Valid percent	Percent cumulative
Production	28	28.0	28.0	28.0
Construction	11	11.0	11.0	11.0
Service	61	61.0	61.0	61.0
Total	100	100	100	100

Organizations that engage in production are 28%, construction and service organizations are 11% and 61% respectively. Most of the respondents are in service industry.

Table 3: Number of year in operation

particular	frequency	percent	Valid percent	Percent cumulative
1-3	51	51.0	51.0	51.0
4-7	24	24.0	24.0	24.0
8+	25	25.0	25.0	25.0
total	100	100	100	100

51% of the organization are in their formative year 1-3, 24% respondents belong to 4-7 years while 25% are in their stable year 8+.

Table 4: Number of employees

particular	frequency	percent	Valid percent	Percent cumulative
1-10	57	57.0	57.0	57.0
11-20	17	17.0	17.0	17.0
21-50	19	19.0	19.0	19.0
51+	7	7.0	7.0	7.0
total	100	100	100	100

57% of the organizations considered have 1-10 employees, 17% of the organizations have 11-20 employees, while 19% and 7% organizations have 21-50 employees and 51+ employees respectively.

Table 5: Qualification of investment manager

particular	frequency	percent	percent	Percent cumulative
Pry six/SSCE	18	18.0	18.0	18.0
B.Sc/M.Sc	75	75.0	75.0	75.0
Ph.D	7	7.0	7.0	7.0
total	100	100	100	100

Table 5 above showed that 18% of the investment managers have pry six/SSCE, while 75% of the investment managers have B.Sc/M.Sc and 7% of the investment managers have Ph.D. The implication of this is that most of the respondents understood the concept at staked, they are able to make rational decision.

Table 6: Evaluation technique

Particular	Frequency	Percent	Valid percent	Percent cumulative
Payback	21	21.0	21.0	21.0
Net present value (NPV)	13	13.0	13.0	13.0
Internal rate of return (IRR)	9	9.0	9.0	9.0
Modified internal rate return (MIRR)	1	1.0	1.0	1.0
Profitability index (PI)	12	12.0	12.0	12.0
Others	14	14.0	14.0	14.0
No technique	30	30.0	30.0	30.0
Total	100	100	100	100

Researcher's field work, 2021

Table 6 showed that most of the organizations considered, made use of techniques in their investment decisions, this may be due to qualifications of the investment managers. 30% of the investment managers do not make use of any techniques and proprietorship accounts for 22%, may be due to the low level of education at that level which also account for low number of firms under 8+ of operations. 28% of limited corporations considered, 20 respondents made use of technique while 8 respondents do not. 12% of joint stock companies considered, 11 respondents made use of techniques while 1 respondent does not. The limited corporations and joint stock company had such trends of usage because they are large corporations who may have the ability to be listed in Nigeria stock exchange and also employed professionals in their organization.

Table 7: Type of techniques used and years of operation

Particular	Technique	Non-technique	1-3years	4-7years	8+
Partnership	38	22	35	12	13
Limited corporation	20	8	10	11	7
Joint stock company	11	1	4	3	5
Total	69	31	49	26	25

Researcher's field work, 2021.

Table 7 showed that out of 60 proprietors, 13 respondents are in 8+years, 28 respondents in limited corporations; 7 respondents are in 8+ years, while in joint stock companies, 5 respondents are in 8+ years.

Table 8: Investment decision

Particular	Frequency	Percent	Valid percent	Percent cumulative
Project analysis	27	27.0	27.0	27.0
Source of funds	31	31.0	31.0	31.0
Entrepreneurial prior experience	23	23.0	23.0	23.0
Diversification of investment	14	14.0	14.0	14.0
Rule of the thumb	5	5.0	5.0	5.0
Total	100	100	100	100

Researcher's field work, 2021.

Table 8 showed that 31% of investment managers made use of source of funds in their investment decisions, 27% made use of project analysis which is reflections of managerial qualifications. 23% relied on entrepreneurial prior experience in their investment decisions. Diversification of investment and rule of the thumb accounts for 14% and 5% respectively.

Discussion of findings

70% of the small and medium firms evaluate projects for investment based on techniques while 30% of the firms do not consider any techniques. Those that do not consider any techniques came more from proprietorship organizations and limited corporations, probably because the joint stock companies can employ professionals who have the ability to adopt accounting techniques in a structured organization. The proprietorship organizations may have more in the number of failed enterprises. Because at that level, they do not have the required resources to employ professionals and most often relied on entrepreneurial prior experience which may lead to poor investment decisions, secondly, their level of education may also impede on organizational development. Findings showed that 5% of respondents relied on rule of the thumb in their investment decisions, this number is so insignificant to promote the failures of small and medium enterprises in Nigeria.

The findings further revealed that 31% of respondents made use of source of funds in their investment decision. Some sources of funds could be cheap and easy, which make most investment managers think of where to invest it without adequate financial analysis. 27% respondents carry out financial analysis on their projects before investing. A well analyze projects have ability of success. The study also showed that 23% respondents relied on entrepreneurial prior experience in their investment decisions, good as it may be, it must be done in line with risk profile of the organization. 14% respondents relied on the need to diversify in their investment

decisions, this could be catastrophic, if not done with caution. The study also showed that payback period and net present value accounts for 21% and 13% respectively in evaluation technique of investment decision which is very encouraging and promotes financial health of the organizations.

Implications

The research was intended to find out how many small and medium enterprises in Nigeria apply the professional technique of project evaluation before investment decision. It was amazing to note that 70% of SME's relied on investment techniques. The 30% that do not rely on any techniques, 22 respondents were from proprietorship. The implication is that proprietorship accounts for most of SME's failures probably because of the low level of education, lack of financial resources to employ qualified professionals. Traditional approaches to managing risk in a capital investment analysis are helpful but limited. This un-sophisticated approach may have impeded on the growth of the firms and unnecessary exposure to risk which may impaired their loan assessment. Most often, capital is tied down in their investment decisions which sometime affect cash flow. 8% respondents of the corporate organizations that relied on no technique, may have accounted for their abysmal performance and their inability to sought for fund in Nigeria stock exchange. Their limited resources impede on their expansion and growth which may lead to failure if not well managed.

Those that made use of technique more, are the large organizations which have the tendency for being listed and have the financial capacity to employ qualified personnel in a structured organization. The failure at this level is minimal. 37% respondents relied on project analysis, 31% respondents on source of funds, 23% respondents relied on entrepreneurial prior experience while 5% respondents relied on rule of the thumb; the implication is that the failure of most SME's in Benin City may largely be due to other factors not necessarily limited to poor investment evaluation. The proprietorship should be encouraged to do better so that they can assess enough funds to weather the storm of business. The limited corporation must of necessity expand their scope of finance or listed in Nigeria stock exchange to be able to take advantage of professional investment managers.

Conclusions

Capital investment decision remain one of the most important and difficult decision a firm must make in order to challenge the current level of SME's failure in Nigeria. The findings revealed that 70% of respondents adopted technique in their investment decision. This negate the positions of some researchers who believed that most SME's in developing economy like Nigeria do not avail themselves of critical tools for investment decision which account for 80% failures rate of their SME's. This high failure rate could be a combination of many factors. The proprietorship is more culpable because of their educational background, poor financial resources and managerial skills. 12% of joint stock companies considered, 11 respondents made use of investment techniques which may have accounts for their low failure rate.

Source of funds top the list of investment decisions, this is a prudent approach to investment analysis as most organization leverage on sources of funds to boost their productivity. Project analysis is also a critical investment decision, it equip managers with critical thinking about their investment decisions. The entrepreneurial prior experience, as sound it may look, must be critically examined not to get into financial troubled water. As experience may not always counts.

The researcher encountered a great deal of problems in sourcing for information from the limited corporation and joint stock companies. The research work was initially expanded to cover the impact of project decisions on the profitability of firms, unfortunately, most firms were not willy to disclose information on their financial profitability that result from project decisions. They were not ready to divulge information on financial matters because they were scared of tax related issues. Organizations in Nigeria try as much as possible to evade tax. I will recommend that other researchers takes a look into the impact of project decision on the profitability of a firm, such information help to ascertain if SMEs unnecessarily tie down funds that affect its cash flow or invest in projects that causes its failure.

Recommendations

- i. *Small and medium enterprises should be encouraged to employ the services of qualified professionals or someone who has knowledge on basic techniques for investment decision*
- ii. *The government should organize frequent training for SME's on financial and investment decision.*

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