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Empirical Analysis of the Behaviour of Small and Micro Enterprises towards Profit And Loss Sharing Financing in Kano (Northern Nigeria) Metropolis

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ABSTRACT

Small and microenterprises (SMEs) are the backbone of many economies in Sub-Saharan Africa (SSA).Because of its generally accepted capacity to empower the poor, SMEs are, central to possible revival of economic growth and the elimination of poverty on a sustainable basis. Despite the substantial role of the SMEs in SSA's economies, they are bedeviled by inaccessibility to finance either by self induced denial or otherwise. SMEs account for over 95% of productive non – oil activity in Nigeria. They also constitute the greatest number of banks clientele. The loan facilities channeled to them are insignificant when compared to funds advanced to large scale businesses. Finance is therefore a persistent problem that bedeviled SMEs in Nigeria. The problem of insufficient financing of SMEs will persist as efforts by the central bank of Nigeria (CBN) to force banks to channel funds to SMEs were always resisted. Banks reluctance is due to high prevalence of information asymmetry that SMEs lending is prone to. SMEs too are wary of accessing funds from the banks because of the interest rate factor, cumbersome and administrative bottle neck in accessing loan granted and forced savings,. The major aim of the study is to determine whether SMEs in Nigeria would accept an alternative Profit and loss sharing (PLS) arrangement as an alternative mode of financing. The study seek to identify the factor(s) that may make SMEs opt for an alternative financing mode,hence, primary in nature. Questionnaires was designed in such a way as to address hypothesis formulated; the questionnaire would be administered on SMEs within the study area. The population of the study is all SMEs in the study area, sample size was determined vide Yamane's formulae for sample selection. Stratified random sampling was used to sample the number of SMEs so determined by the Yamane. Logit regression was utilized to test the probability that SMEs would access finance through the PLS. Because of its nature, descriptive research design is adopted as the study's research design

INTRODUCTION

Poverty accentuated by inability of poor people to meaningfully participate in economic activities due to lack of resources, is the bane of the increasingly poverty rate in SSA. Poverty has been observed to be created by the capitalist economic and social system that have been designed for he world (Yunus, 2008) As a corollary, by stimulating their participation in the mainstream economy through basic personal financial intermediation otherwise known as microfinance, poor people may be alleviated of poverty (Lister, 2004). The argument being that by providing financial services to low-income households, economic and social structures can be fundamentally transformed and, as a result, much poverty can be alleviated. The importance of SMEs cannot be over emphasized, they invigorates potentials of the down-trodden, imbibe financial culture in the poor, instrument for poverty reduction ,and by extension, reduces crime rate and social vices. The desire to enhance growth and survival of SMEs has made the government in Nigeria to create specialized banks to cater for the financing needs of the SMEs- Microfinance banks. These banks, though established to cater for the financing needs of micro entrepreneurs, were not able to provide succor to SMEs because they operate true to what they are. The interest based nature of these banks and its attendant conditionality like collateralization of loans, raises cost of finance .The effect of this is the inability to alleviate financing problem that have perpetually rubbish growth of the SMEs. SMEs operators are poor not because they lack initiative, but because they are incapacitated by funds (Owualah, 2009).To charge interest rate on loans granted this sector invariably increases their financial burden, affects their prices reduces sales volume thus, affecting survival. Moreover its micro size exposes these categories of businesses to risks. Microfinance banks are profit oriented, hence charges interest rate like other banks. The risky nature of SMEs make them charge rate that is commensurate to the risk, therefore the rate must have to be high. Also the rigor of the paper-work required to complete the loan/financing agreement is sometimes viewed as uncalled for by SMES (Johnson,2004)

Microfinance is a by product of SMEs. It refers to the provision of a broad range of financial services including financial training, savings insurance, payment, and remittances to poor individuals who otherwise cannot access financial services in the mainstream formal financial markets (Johnson, 2004 Koveos and Randhawa, 2004, Rutherford, 1999).Basically, microfinance provides avenues from which the poor can accumulate savings, acquire assets and participate in local economies (Johnson, 2004) because "banks keep a considerable distance from women, the landless, the illiterate, and the poor" (Yunus1995). The poor often are excluded from main stream financial markets and resources because of lack assets (Meagher and Wilkinson, 2001).

Studies like Karwai (1997), Magaji (2003) and Hussaini (2007) reported the reluctance of SMEs in patronizing Microfinance banks. Whatever reasons that may be advanced for the attitude, SMEs entrepreneurs require financing. The objective of this study is to determine the factor(s) that may make SMEs in Northern Nigeria town of Kano be willing to access funds from an alternative PLS financing source. After this introduction, section two provide review of literatures relevant to the subject matter. The third section is on the methodology adopted for the study; while section four discussed the findings of the study. The last section concludes the paper.

2.0 LITERATURE REVIEW AND THEORETICAL FRAMEWORK

Micro enterprises were globally recognized to be a panacea to poverty reduction, because it economically empowers the poor. But funding is required for start-up/growth. Access to credit is important for firm growth, especially that of small firms (Beck, Demirguc-Kunt and Maksimovic, 2005), Country-specific studies and randomized field experiments confirm that access to capital can be critical for firm growth (Banerjee and Duflo, 2008; De Mel, McKenzie and Woodruff, 2008). However credit is not the only financial service that seems to matter. Recent evidence shows that access to savings services can also increase enterprise investment, especially among micro entrepreneurs (Dupas and Robinson, 2009). Broad access to financial services is not only important for individuals, but also for the economy at large; credit constraints reduce the efficiency of capital allocation and intensify income inequality by impeding the flow of capital to poor individuals with investment opportunities with high expected returns (Galor and Zeira, 1993; Aghion and Bolton, 1997; Galor and Moav, 2004, Beck, Demirguc-Kunt and Levine, 2007; Lopez and Serven, 2009).The Islamic PLS financing mode, by its risk sharing rather than risk transfer nature, hves been observed to enhance accessibility to finance, encourage savings, invigorates high productivity in SMEs and potentially reduced poverty (Husaini,2010) . The crux of the risk adverse posture of banks (conventional and specialized) to SMEs stem from the information asymmetry that SMEs financing is prone to. Various lending techniques were designed for financing this sector to mitigate the inherent risk in SMEs financing

2.1 Techniques Of Lending To Small Business

Accessibility to external finance has remained a lingering problem of SSB.A review of the lending techniques through which finance is currently accessed to SSBs is necessary for its appraisal. Lending technique refers to the methods and procedures that are taken before and after accessing funds to a user. The aim is to be able to determine a loan that may be bad. The availability of external finance for small and medium enterprises (SMEs) is a topic of significant research interest to academicians and an important issue to policy makers around the globe. Lending to small businesses by financial intermediaries is categorised into four main distinct lending techniques – financial statement lending, asset-based lending, credit scoring, and relationship lending. These techniques, posit Stiglitz and Weiss (1981) are deployed to avoid the problems that can lead to either credit rationing or prevention of over lending (De Meza and Webb 1987, and De Meza 2002).

These four lending methods can be further sub-grouped in to two-transaction based and relationship lending. The distinction between the two is based on source and timing of the information that was used in granting a loan. Transaction based is comprised of the first three lending chronologies. Under it, lending decisions are based on "hard" information that is readily available at the time of loan origination (Ongena, Steven and David C. Smith,).These information are extracted from the data provided by the loan applicant.

2.1.1 Financial Statement Lending

Financial statement lending is a technique that uses information evaluated from the financial statement of a loan applicant to determine the acceptability or otherwise of the financing request. The financial statement of emphasis for this purpose is balance sheet and income statements. The decision to lend and the terms of the loan contract are mostly based on the strength of the balance sheet and income statements (source). Financial statement lending is best suited for firms with certified audited financial statements. Thus, it is a technique of choice in lending to large firms (Berger and Udell, 2004). Small firms with long histories of profitable existence and evidence of persistent audited financial statements may also qualify for financial statement lending (Berger and Udell, 2004).

2.1.2 Asset Based Lending

The asset-based lending technique is concern with the quality of collateral presented to secure a loan. The required collateral here is usually account receivables and inventory. The nature of this type of collateral places a burden of intensive monitoring of their turn over on the bank. Monitoring is a cost, and therefore a factor that must have to influence the rate interest to be charged. Udell (2006) opined that asset based lending is available for small businesses, despite its requirement of account-receivable and inventory as collateral.

2.1.3 Credit Scoring

Credit scoring is a method of ascribing weight to the information obtained from financial statements of SSBs as well as its owner(s) (Feldman, 1997 and Mester, 1997). In addition to using information from the financial statements of the business, the financial condition and history of the principal owner is also weighted. Because ownership and management is the same in SSBs, the credit worthiness of the firm and the owner are the same for most small businesses (Feldman, 1997 and Mester, 1997). The application of this lending technique is less even in the developed economies (Frame, *et al*, 2001)

2.1.4 Relationship Lending

Relationship lending is a collection and accumulation of information about a bank's customer over a period of time. The basic aim is to determine his creditworthiness. The sources of the information are multifaceted (Petersen and Rajan, 1994). The lender's decision to lend hinges on proprietary information about the firm and its owner through a variety of contacts over time. This information may be obtained through the provision of loans as posited by Petersen and Rajan (1994) and Berger and Udell (1995). Furthermore, it could be through deposits or even through other financial products (Nakamura, 1993; Cole, 1998; Mester, L. *et al.,* 1998; Degryse and Van Cayseele, 2003). Additional information may also be gathered from contact with other members of the local community. They include; suppliers and customers, who may give specific information about the firm and owner or general information about the business environment in which they operate.

The main thrust of relationship lending is its tendency to mitigate against ''asymmetry information '' problem that SSB financing is bedeviled with. The stronger the relationship between a fund provider and SSB, the higher the possibility of obtaining finance at a lower rate of interest (Karwai, 2007). Elsas and Krahnen (1998), report that the close relationship with owners of SSBs reduces the risk of information opacity. Similarly, Berger and Udell (1995), and Scott and Dunkelberg (1999) observed that relationship lending enhances relaxation of collateral requirement in SSBs financing. The risk inherent with SSBs finance hinders its accessibility to financing. Therefore, a lending technique that reduces these risks would enhance the availability of credit to SSBs.

Two of the lending chronologies - financial statement and asset- based lending were well known and used by Nigerian banks in accessing funds to SSB. The Credit scoring is hardly used, and relationship lending is a recent innovation that is rapidly gaining ground. The major impediment to the implementation of these two lending techniques, especially relationship, is the near absence of credit rating services in Nigeria. An officer of the bank that is practicing relationship lending is usually assigned to monitor the business activities of the borrower. This can aggravate agency problem as a result of closer tie with the assigned officer.

There is no one best lending technique (to the best of our knowledge), but Berger and Udell, (2004: 17) asserts the superiority of the relationship lending, thus ‘’there “are no data on the relative importance of these four lending technologies, Nonetheless, there is some evidence to suggest that relationship lending does play an important role in small business finance’’.

2.2 Concept of PLS

2.2.1 Profit and Loss Sharing (Pls) Mode Of Financing

PLS is a contractual arrangement between two or more transacting parties, which allows them to pool their resources together to invest in a project for the purpose of sharing profit and loss (Usmani, 1999).the idea of PLS gain prominence with the advent of the Islamic banking. Most Islamic economists contend that PLS is based on two major modes of financing, namely; *Musharaka* and *Mudarabah* (Jalaaldeen 2003). The emphasis of these modes of financing is that reward –sharing is related to risk- sharing.

2.2.2 Evolution of Profit and Loss Sharing

The profit and loss sharing mode of financing was adapted from traditional Arab trade financing system. Before the advent of Islam, Arabian merchants used to pool resources together, entrust the pooled resources to selected few from amongst them for Caravan trade .The profit from the venture is usually shared on pre-agreed ratio. The acceptance of this financing mode by Islam is inferred by its non prohibition as is the case with interest. Therefore, it is from the very early stages in Islamic history, that Muslims established a micro-financial system without' interest for mobilizing resources to finance productive activities (Udovitch, 1970). This they did on the basis of the PLS modes of, Mudarabah and Musharaka. Udovitch (1970, p. 44) observed that these modes helped mobilize the "entire reservoir of monetary resources of the medieval Islamic world for financing agriculture, crafts, manufacturing and caravan trade”.

These financing arrangements were equally accepted by Jews and Christians to the extent that it usage suppressed the patronage of interest-bearing loans and other overly usurious practices. Goiteit (1966, pp 113) observed that “breach of the Jewish, Christian and Islamic laws against interest was found "only once in the record of a judgment, even though an unusually large amount of Jeniza documents deal, with credit." Schatzmiller also conceded to the notion of interest free capital when he noted that financial capital was developed during the early period by a considerable number of owners of monetary funds and precious metals, without the supposed interdiction of interest, usury, hampering it in any way.

At the beginning of the Tenth century, Muslim financiers were already organized. They had started performing most of the basic functions of modern banks. They had their own markets, something akin to the Wall Street in New York and the Lombard Street in London (siddiqi, 1983). They had most of their banking needs of commerce, industry and agriculture fulfilled within the constraints of the prevailing technological environments. They were known in the early Muslim history, as *sarrafs*. However, since these were not banks in the technical modern sense of the term Udovitch (1970) called them "bankers without banks".

The extensive mobilization of savings and their accessibility to businessmen provided a great boost to the growth of output and trade from Morocco and Spain in the West, to India and China in the East Central Asia in the North, and Africa in the South. This is clearly indicated not only by the available historic, documents but also by the Muslim coins of seventh to eleventh centuries which have been found in different parts of Russia, Finland, Sweden, Norway, the British Isles, and Iceland - countries which were on the outskirts of the then Muslim world (Siddiqi, 1983).The fall of ottoman empire to the crusaders, coupled with the invading wave of colonizers led to the imposition of the colonizers culture on these Muslim states. The effect of that was the gradual overtaking of Islamic socio economic values by western imperialist values (ibid, 1970).

The re-emergence of PLS mode of financing was a product of the agitation by Muslim economists for a replacement of the institution of interest by profit and loss sharing. This is in pursuance of the Quranic precept: “Allah has permitted trade and forbidden interest…… (Qur’an, 2: 282) .PLS as a financing mode was reincarnated with the emergence of Islamic banking. Although the financing mode was known and practiced by Arab merchants prior to the advent of prophet Muhammad (SAW), as it was practiced in the form of venture capital by the west before and after the emergence of Islamic banking. The impetus given to this form of financing by the advent of Islamic banking makes it a financing mode to reckon with.

The institutionalization of the imposed interest based economy ignited the desire for an alternative. The first and inevitable change envisaged was the abolition of interest and it replacement by PLS. This is in pursuance of the Quranic precept: "Allah has permitted trade and forbidden interest. . ." According to Siddiqi (1983) there is consensus among Islamic jurists that permission to trade implies the permission to profit thereby. The legitimacy of sharing profits under a variety of arrangements, including the one in which money capital is supplied by one party and enterprise by another, follows, being also established by *Sunnah*.

To appreciate the rationale for this change, observed (Siddiqi, 1998) there need to be an understanding of the Islamic view of the relations between man and the nature of the world in which men engage in productive enterprise. The world is so uncertain that the value product of enterprise cannot be predetermined. Therefore, a predetermined claim of positive return to money capital when it is the blend of capital and enterprise that jointly engage in production runs counter to the uncertain reality. It amounts to exploitation of the entrepreneur by the capitalist, as the entrepreneur is left alone to bear the uncertainty, which in reality should befall on both. It is an unjust arrangement. Islam abhors injustice and exploitation and seeks to forge human relationships on the basis of justice and cooperation. A replacement of the unjust and exploitative institution of interest by the just and cooperative arrangement of profit-sharing is, therefore, a socio-economic as well as a moral and spiritual imperative. It emphasizes that men are equal brethren in the community of

Allah, and so should face the uncertainties of life equitably and share the consequences thereof.

2.2.3 Features of PLS Mode of Finance

The main distinguishing features of PLS includes; Return sharing method is agreed upon before commencement of the business, Principal and return not guaranteed in the event of loss, except where it is established that the loss is as a result of negligence on the part of the active partner; it is based on trust; It does not necessarily requires collateral.

2.2.4 PLS Modes Suitable For Financing SMEs

The major PLS financing modes suitable for financing SSBs include *Mudarabah*, *Musharakah*, and diminishing *Musharakah*. Adaptability of each of these modes in financing SSBs is discussed hereunder.

Mudarabah

It is a PLS means of accessing funds whereby a financier invest his funds/asset in a commercial enterprises for the purpose of sharing the profit made from the use of his money/asset and also share loss .The maximum of which, is the forfeiter of his invested money /asset. The parties to this financing arrangement are the owner(s) of fund and the Entrepreneur, in this case the SSB. The financier is not expected to partake in the management of the business, but he can keep a watchful eye where he is doubtful. (Khan, 2004)

Practically, *mudarabah* can be used to finance SSB when funds are invested in, for example, a transportation business, to finance the supply of cars to a parastatal. The financier provides all or part of the funds required, while the Business provides its expertise .Profit would be shared according to the sharing arrangement agreed upon at the time of providing the financing. The same business can be financed via *Musharakah*.

Musharakah

Musharakah, as a financing mode, occurs when a provider of funds decides to enter into partnership agreement with the business for the purpose of becoming part owner in the entity (Usmani, 2006). The decision to be part owner may be influenced by either of the parties. A partner under the *Musharakah* has a choice of being an active or passive partner. The former entitles him to partake in the management of the firm, while the latter denies him that right.

This PLS mode can be used to finance SSBs in various ways. The general form it takes is that financing is needed to finance either part or the whole business. The business or its promoters has this amount of capital, and require a certain amount to either take off or execute a required project. The financier, either because of the track record of the business/promoters or viability of the project agreed to invest in the SSB on partnership bases. This agreement imposes acceptance of rules and regulations governing *Musharakah* on the financier (Siddiqi, 2001).

The rate of profit accruable to the partners is agreed upon at the time of signing the agreement. Rate of loss is in accordance with the ratio of investment in the business, in addition to loosing one's investment. When for example, an SSB require financing to finance a project that has a gestation period of a year or more, it can propose to a financier to invest in the project and henceforth be partner in the business. The period of *Musharakah* can be more or less than a year, the important thing is that *Musharakah* confers the right to closely monitor the activity of the business through being part of the management or otherwise (Khan, 2004). Diminishing *Musharakah*

The postulate of the diminishing *Musharakah* is that at the initial stage of the arrangement, the financier and financee participate in the joint ownership of a property or equipment or in a joint commercial enterprise. But over time, the financee buy-back the share of the financier in the business. (Chapra, 2005)

Diminishing *Musharakah* can work in many ways. A practical example is where a SSB require a machine for its expansion, but cannot finance the cost of purchasing it. It can enter into a diminishing-*musharakah* arrangement with a financier. The financier provides a higher percentage of the finance, for example,80%,while the financee provides say,20%.The agreement was for sharing profit on ratio 8:2. In addition to sharing the profit, the two parties had agreed for a re-purchase of the financee's share in the business (i.e. the equipment).The share of the fund owner was divided into a certain equal number.

Whenever profit generated by the use of the machine is shared, the financee buys back a portion of the financier's share in the project, thereby increasing the share of the financee by the amount of the financier's share bought. Gradually, overtime the whole share of the co-partner (financier) is re-purchased (Khan, 2004).

2.3 Appraisal of PLS as a Financing Mode for SMEs

Appraisal of the PLS mode of financing requires the evaluation of its effectiveness as a financing means by organizations that operationalise this mode of financing. The increasing number of venture capitals in the western world can be said to be an indication of the viability of the PLS. PLS is synonymous to Islamic Banking, because it was the evolution of Islamic banking that reincarnate the concept of PLS. Venture capital, though, slightly Different from PLS, is also based on the principle of sharing risk and reward (Rashid,2003). Profit and loss sharing contracts according to Ahmad (2003), currently accounts for not more than 10%.of Islamic banking assets. This is an irony because Islamic banking is primarily based on profit and loss sharing .Agency problem has been identified as the major reason for this discrepancy (*Ibid*, 2003).

Alchian and Demsetz (1972) viewed PLS as appropriate for small firms; especially partnerships. They observed that there is a spectrum of business contracts in an Islamic framework making it easy to choose a partnership contract and size of the firm to determine optimal profit sharing ratios. Alchian and Demsetz suggest an equal division of profits and losses between transacting parties if the optimal number of contracting parties is two. Their conclusion was that' there are a number of contractual arrangements for small-scale business 'including, inter alia, partnership in artistic or professional intellectual skills, and business based on acquisition of resources from consumers by promises of future delivery (*bai al-salam*)

The call for, and adoption of the *Shari'ah* law in some states of Nigeria has given impetus to Islamic ways of financing. Nigeria Banks, are oblivious of the fact that the increasing Islamic awareness of Nigerians may negatively affect their business .They therefore have started accessing funds to SMEs on Islamic modes of financing. Though it is too early to assess the performance, but the increasing introduction of varieties of financial products that emanate from the Islamic PLS is an indication of its viability.

2.3 THEORETICAL FRAMEWORK

Perking Order Theory (POT)

The POT was developed by Myers and Majluf (1984).This theory presupposes that it is only after the less costly sources of financing are exhausted that a firm should consider a costlier source. According to this theory, internally generated funds should always be preferred by firms in financing its project .It is only when the internal source is inadequate that external financing should be used. And when external source becomes inevitable, the firm should issue debt first and equity as a last resort only. That is, when all short-term and long-term borrowing possibilities have been exhausted. This pecking order of finance, according to Majluf (2004) "results from the information asymmetry between management and investors…..", which induces the latter to undervalue the issuing firm's securities and this under valuation being greater for equity. It is the main approach arising from asymmetric information settings.

The Pecking Order Theory (POT) is a financing hierarchy that assumes a hierarchical stage for the funding of projects. That is, it presuppose that firms do not target specific source, it is only when internal funds are insufficient that they would then turn to external financing that is next to the internal in terms of lesser cost. The reason behind this behavior is that external financing is costly under informational asymmetries between the management and investors. Myers and Majluf (1984) support this theory with an illustration, of entrepreneurs who are currently managing some assets, but needs to raise funds for undertaking a new project whose profitability is known only to them. If managers act in the interest of old passive shareholders, they may pass up some positive net present value (NPV) investment, avoiding issuing shares at a bargaining price.

Potential investors, who are mindful about these incentives, take the not-issuing event as a good symptom and the issuance of new shares as a bad sign. Under this scenario of asymmetric information affecting firm's issue-invest decisions, the authors introduce the concepts of the POT. This theory predicts that firms would rely first on internal other than external sources of funds and, when external financing is needed, they would prefer to issue the safest security first ,then debt before equity. Even though the availability of risk-free debt financing would make the described problem disappear, risky debt only gets to alleviate the problem–reducing the states of the world in which a positive NPV is passed up.

The POT postulates that more profitable firms borrow less, because they have more internal financing available from retained earnings. Myers and Majluf (1984) suggest that firms always seek to maintain financial slack to avoid the need for external funds. Also ,they observed that firms with a more tangible asset structure are more able to issue low-risk (collateralized) debt, and consequently, would tend to have a higher share of debt in their optimal financial structure(Myers and Majluf,1984)

The PLS is relatively the cheapest source of finance. It requires little or no transaction costs and also no cost of borrowing. The cost that firms would have to contend with is the information asymmetric problem. The POT tries to proffer a solution to it. Nigerian firms constitute an ideal sample to test this theory, since many SMEs in the country suffer from weak transparency and disclosure requirements, and poor accounting standards that exacerbate the information asymmetries.

Cressy and Olofsson (1997) suggest that the POT may be adapted to smaller businesses because they are more financially risky and consequently face higher difficulties in accessing external finance. Their conclusion in our opinion perfectly fits into the Nigerian SMEs.

The POH has some implication that may hinder its application. The emphasis placed on internal source of financing can aggravate owner reluctance to widen finance because of fear of loss of control. Also the theory's assumption that information asymmetry is related to size is questionable (Adediji, 2005). The POH assume internal fund deficit to be the only reason for seeking debt. But other variables like tax, size tangible assets and collateral value may affect the use of debt by firms .Difficulty in obtaining data on the internal workings of firms (large and small) in a country like Nigeria can invalidate the postulate of POH. These shortcomings notwithstanding, the emphasis of the POH on cost consideration in finance seeking makes it our choice of theoretical framework.

3.0 Methodology

Logistic regression is adopted for this study to used to test the hypothesis formulated for the study because it is not only a priori analysis for statistical methods, but also an analysis on its own in practice, especially in socio-economic studies that is aimed to partition observations. Logistic regression predicts the probability that the dependent variable event will occur given a subject's scores on the independent variables. The predicted values of the dependent variable can range from 0 to 1. If the probability for an individual case is equal to or above some threshold, typically 0.50, then prediction is that the event will occur. Similarly, if the probability for an individual case is less than 0.50, then the prediction is that the event will not occur. Logistic regression is related to, and answers the same questions as, discriminant function analysis.

The general framework for the logit analysis is that there are m groups to be compared ,with group i consisting of n_i terms, of which y_i exhibits a positive response and n_i-y_i exhibits a negative response. It is then assumed that the probability of a positive response for an item in group "I" is given by

π =exp(β_0 +$\beta_1 x_{i1}$ +β_{2xi2} +………+$\beta_n x_{in}$) /

1+exp(β_0 + $\beta_{1\ xi1}$ +$\beta_{2\ xi2}$ +……...+$\beta_{n\ xin}$)

Where; x_{ij} is the value of variables x_j which are the same for all items in the group. Thereafter, the variables X_i to X_n are allowed to influence the probability of a positive response, assumed to be the same for all items in the group, despite the positive or negative responses of the other items in that o r any other group. In addition, the probability of a negative response is defined as 1-π $_I$ for all items in the ith group (Andersen, 1997, cited in Jalaludin, 2002)

Both primary and secondary sources were used to generate data for this study .The secondary source consisted of all documentary literature that relates to the subject matter. Population includes all registered and operational SMEs in Kano, (Northern Nigeria) metropolis within the study period. Tracking the actual number of operational SMEs in densely populated commercial centre like kano is basically impossible, especially as the agency that is vested with activities of SMEs is unable to accurately determines the population, hence, we treat the population as infinitum.We adopted a sample size of 1000, as suggested by Ikeagwu (1998) for population that is viewed to be infinity.

Small and Micro Enterprises operating in Kano are selected for this study for two main reasons. Firstly, SMEs are widely spread across the country and secondly they share similar features in terms of legal requirements for capital and ownership structure. They are also concentrated in the urban areas. Kano is not only the commercial nerve of the North, but also the most populous state in Nigeria (FOS, 2006), hence it attracts diverse business activities. This is so because, the more the population of a state/nation, the more diverse are its needs and wants, and by extension, the higher number of business activities that will have to be created to satisfy these diverse needs and wants. Finally, Kano is the second city by ranking, in terms of concentration of diverse small scale business enterprises in Nigeria (NSSB, 2005). The cosmopolitan nature of Kano coupled with its commerce origin, attracts business minded people from the nooks and corners of Nigeria.

The study used a combination of stratified random sampling and simple random sampling techniques to generate a sample size of 1000 SMEs from the sampling frame, because stratification is suitable when the population under study is heterogeneous. Small businesses are heterogeneous, hence choice of the sampling technique. Our choice of the stratified sampling technique concurred with Ikeagwu's (1998) assertion that "stratification is a means of using knowledge of the population to increase the representative and precision of the sample". In order to make coverage of the research comprehensive, all lines of business were proportionately represented in the sample selection. The owners of the SMEs were requested to fill the questionnaire on the spot. Out of the administered 1000 questionnaires, 860 were successfully retrieved, representing 86% response rate. Data used for the logistic regression were extracted from questionnaire administered.

For the purpose of this study; respondents were asked to use a scale of 5 – 1 thus; strongly agree, agree, undecided, disagree, strongly disagree to indicate their degree of acceptance with the statements below.

Var 001: The PLS arrangement do not allows interest rate

Var 002: The PLS do not strictly impose collateral as a condition for loan

Var 003: In PLS, cost of financing is not fixed

Var 004: PLS would enhance SMEs growth as it allows for monitoring of the micro-enterprise

Var 005: PLS would enhance SMEs growth as it allows for monitoring of the micro-enterprise Cost of finance linked to profitability

These Statements were represented by the following variables:

Variables: 001= X_1, Variables 002 = X_2, variable 003 = X_3 variable 004 = X_4 variable 005 = X_5. The criterion variable was "Y" where, Y=1, stands for businesses that were ready to seek financing through the PLS arrangement, and Y = 0 for businesses that wont seek financing through the PLS, otherwise Group N.

The dependent variable is therefore, the two groups of small businesses (Group Y and Group N), and the independent variables were the variables outlined above.For the purpose of this study,we adopt the definition as approved by the organ ofnthe Nigeria government vested with responsibility for SMEs,Thus we defined SMEs as;: An industry with total capital employed of not more than 1.5 million naira ($9090), including working capital but excluding cost of land, and or a labour size of ten [10] workers;

4. FINDINGS

RESULT OF LOGIT ANALYSIS

Table 4.19 Attitudes of SSBs in Kano towards PLS financing

	INDEPENDENT VALUE	LOGIT
Variables	Constant	-6.4431 (-6.0075)
Var001	The PLS arrangement do not allows interest rate	1.36210 (5.7660)*
Var002	The PLS do not strictly impose collateral as a condition for loan	0.49516 (3.4645)*
Var003	In PLS, cost of financing is not fixed	0.12789 (0.67789)
Var004	PLS would enhance SMEs growth as it allows for monitoring of the micro-enterprise	0.93100 (4.765)*

Var005	Administrative bottle-necks	-0.73198 (-3.5348)*
	Log of likelihood function	320.782
	R – Square	0.193
	% Correct Prediction	71.9

Source: Field Survey, 2010

Chi-square	Df.	Sig.
511.263	776	0.000

Source: Field Survey, 2010

The five explanatory variables were used to investigate the probability of applying the PLS principle of finance by SMEs in Kano. The Criterion variable was the type of preference (x),

Where;

X=1, if the SME was prepared to apply PLS

X=0, if the business was not prepared to apply PLS

The critical t - value is 1.96, hence Variables 1, 2 and 4 are statistically significant and positive. The implication of this is that the more interest based financing is eschewed, the less emphasis is placed on collateral as a pre condition for funds,the greater the growth of SMES, the higher the probability that SMES will apply the PLS for their financing needs. The Logit result also reveals that the coefficient of the variable management intervention is negative and statistically significant. This suggests that the lower the administrative bottle-necks and delay in accessing funds, the more likelihood that small businesses would accept the PLS.

The statistically insignificance of the variable cost variability coefficient means that surveyed SMEs were indifferent regarding cost variability of loans.

5. Conclusion

Perusal of literatures indicates that Conventional Interest based mode of financing and its conditions is the bane of the financing problem facing SMEs in Nigeria. The result of this study indicated that SMEs would be willing to access funds through the PLS financing mode of finance because it is interest free and it attached cost of finance to actual performance of business. Also it eliminates cumbersome and administrative bottle necks, this would entice patronage of PLS compliant financial institutions. It is the recommendation of this study that the Islamic modes of finance from which the PLS emanated should be explored as a financing mechanism for alleviating the funding problem of SMEs. Firstly in Muslims dominated states of Nigeria, then to other states. The government should also exploit the possibility of encouraging micro saving through the PLS, because if properly harnessed, it can encourage capital formation

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APPENDIX- QUESTIONNAIRE

NAME OF ENTERPRISE……………………………………

WORKING CAPITAL…………………………………

Please indicate your agreement with the following statements;

Profit loss sharing (PLS) Do not allows interest in transactions

a. Strongly agree
b. Agree
c. Undecided
d. Disagree
e. Strongly disagree

PLS enhance growth through monitoring of its fund

a. Strongly agree
b. Agree
c. Undecided
d. Disagree
e. Strongly disagree

PLS cost of borrowing will not be a fixed cost item because the outcome of the business will be shared by entrepreneur and financier

a. Strongly agree
b. Agree
c. Undecided
d. Disagree
e. Strongly disagree

PLS do not strictly impose collateral as a condition

a. Strongly agree
b. Agree
c. Undecided
d. Disagree
e. Strongly disagree

PLS would cumbersome process and administrative bottle neck

a. Strongly agree
b. Agree
c. Undecided
d. Disagree
e. Strongly disagree

Thank You Sir

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