

VENTURE CAPITAL FINANCING AND THE GROWTH OF SMES IN KOGI STATE

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ABSTRACT

Small and Medium-Sized Enterprises (SMEs) are essential drivers of economic growth and job creation. However, access to adequate financing remains a major challenge for SMEs in Kogi State, Nigeria, limiting their ability to expand and sustain operations. Traditional financing options such as bank loans are often inaccessible due to high collateral requirements and interest rates. As a result, venture capital financing has emerged as a viable alternative to support SME growth. This study examines the effect of venture capital financing—specifically venture capitalists and business angels on the growth of SMEs in Kogi State. The study adopts a quantitative research methodology, employing structured questionnaires to collect data from 268 SMEs operating in the state. The data were analyzed using descriptive statistics and multiple regression analysis. The findings reveal that venture capitalists ($\beta = 0.228, p < 0.000$) and business angels ($\beta = 0.542, p < 0.000$) positively and significantly impact SME growth by providing financial resources, mentorship, and strategic guidance. Based on these findings, the study recommends that the government of Kogi State, through relevant agencies, should create enabling policies and incentives (such as tax reliefs and co-investment schemes) to attract more venture capital firms to invest in the SME sector. The study also, recommends that Stakeholders should encourage the formation and formalization of business angel networks within Kogi State.

Keywords: Venture Capital, venture capitalists, Business Angels, SMEs Growth.

INTRODUCTION

Venture capital (VC) financing has played an increasingly significant role in the development of small and medium-sized enterprises (SMEs) in Nigeria. Its emergence as a financing alternative for SMEs stems from the need to bridge financial gaps left by traditional lenders. The venture capital evolution in Nigeria can be traced through three significant phases. The pre-1997 era witnessed the establishment of Nigeria's first venture capital company, the National Risk Fund Plc in 1987. This was further strengthened by the Venture Capital (Incentives) Act No. 89 of 1993, designed to boost private sector investment in VC financing (Akingunola, 2011). The second phase (1998–2002) was characterized by policy reforms such as the Small and Medium-Scale Industries Equity Investment Scheme (SMEIS), which mandated banks to allocate 10% of their profit after tax to SME equity financing. This period also witnessed the liberalization of critical sectors like telecommunications, drawing the attention of global venture capital firms such as Actis and Aureos Capital, and the rise of local players like African Capital Alliance (Ariyo, 2005; Olawale & Garwe, 2010). The third phase (2003 to present) saw the expansion of venture capital financing, driven by technological advancements and the growth of startups. Successful startups like Interswitch, IrokoTV, and Paga became symbols of VC success (Ekanem, 2015; Onugu, 2005). These investments demonstrated venture capital's potential to drive SME growth and economic diversification. In Kogi State, SMEs thrive in agriculture, mining,

manufacturing, and commerce, leveraging the state's strategic location and natural resources. However, direct venture capital inflows into the state remain limited. Nonetheless, national policies such as SMEIS have indirectly impacted SMEs in Kogi by improving access to funding, business mentorship, and training programs (Eneh, 2010; Oni & Daniya, 2012).

However, despite their potential benefits, venture capital financing is still underutilized among SMEs in Kogi State. The reasons for this underutilization include low awareness of venture capital as a viable funding option, limited availability of venture capitalists and business angels within the region, and a lack of an enabling environment that attracts such investments (Olalekan, 2023). Most existing studies on venture capital financing in Nigeria have focused on large cities like Lagos and Abuja, with limited empirical evidence on the application and impact of venture capital on SMEs in less urbanized areas like Kogi State (Afolabi, 2021; Audu, 2022). The unique socioeconomic environment and business landscape of Kogi State necessitate a localized study to understand how venture capital financing can be adapted to suit the specific needs and challenges of SMEs in this region. Moreover, there is a gap in understanding the effectiveness of various types of venture capital financing on the growth trajectories of SMEs in Kogi State. While previous research has established the benefits of these financing options in other regions, there is a lack of data on their specific impact on business performance, innovation, and long-term sustainability within the context of Kogi State (Ojo & Ibrahim, 2022). This gap highlights the need for a comprehensive study to evaluate the role of venture capital financing in enhancing the growth of SMEs in Kogi State, thereby providing policymakers and investors with insights on how to create a more supportive venture capital ecosystem.

The following research questions was generated: to what extent do venture capitalists influence the growth of SMEs in Kogi State? What role do business angels play in supporting the growth of SMEs in Kogi State?

The main objective of the study is to examine the effect of venture capital financing on the growth of small and medium-sized enterprises (SMEs) in kogi state; the specific objectives are to examine the impact of venture capitalists on the growth of SMEs in Kogi State. to evaluate the role of business angels the growth of SMEs in Kogi State.

The following null hypotheses were formulated for the study; **H₀i**: Venture capitalists have no significant impact on the growth of SMEs in Kogi State. **H₀ii**: Business angels do not significantly contribute to the growth of SMEs in Kogi State.

REVIEW OF RELATED LITERATURE

The Concept of Venture Capital

Venture capital financing has played a catalytic role in entrepreneurial development by identifying, funding, supporting, and nurturing growth-oriented businesses with strong entrepreneurial drive (Boadu et al., 2014). Venture capital typically involves direct equity or equity-linked investments with a clearly defined exit strategy, and it serves as a significant driver of economic development both nationally and globally. According to the Organisation for Economic Co-operation and Development (OECD, 2006), venture capital refers to capital provided by investors who partner with management teams of unlisted, early-stage firms in pursuit of high

returns. These partnerships not only offer funding but also provide strategic guidance and professional expertise to enhance business growth. The European Private Equity and Venture Capital Association (EVCA) defines venture capital as professional equity co-invested with entrepreneurs to finance early-stage (seed and start-up) or expansion ventures. Due to the high-risk nature of such investments, venture capitalists typically expect above-average returns. Venture capital is a subset of private equity, which broadly refers to equity investments in privately held companies. While private equity often targets firms in their growth or expansion phases with established markets and stable cash flows, venture capital focuses on earlier stages of the business life cycle, where the viability of the business model is still being established.

Venture capital financing, therefore, is particularly suited for supporting high-potential, early-stage businesses. These investments are commonly made by professional venture capitalists and business angels, who not only provide capital but also contribute strategic insight and operational expertise, thereby enhancing the performance and long-term sustainability of small and medium-sized enterprises (SMEs) (OECD, 2006; Cumming, 2012).

Venture Capitalists

Venture capitalists (VCs) are professional investors or institutional firms that provide equity financing to high-potential startups and small and medium-sized enterprises (SMEs) in exchange for ownership stakes. Unlike traditional bank loans, venture capital does not require collateral or regular repayments, thereby offering SMEs the flexibility to prioritize innovation, market expansion, and long-term growth (Davila et al., 2003; Gompers & Lerner, 2001). VCs typically focus on high-growth firms and actively participate in strategic decision-making processes to foster rapid business development. Their role extends beyond funding, as they contribute mentorship, industry expertise, and access to networks that support SMEs in scaling operations, improving management practices, and achieving financial sustainability (Kaplan & Strömberg, 2009). Gompers et al. (2016) emphasize the dual function of VCs as both financiers and strategic partners, helping firms optimize resource allocation and explore new market opportunities. Empirical evidence indicates that SMEs backed by venture capital are generally more innovative, competitive, and likely to expand into international markets (Bruton et al., 2015). Additionally, venture capitalists enhance financial discipline by enforcing strict reporting and accountability standards, which promote transparency and long-term viability (Harrison et al., 2016).

In developing economies such as Kogi State, Nigeria, where traditional financial institutions are often risk-averse and underdeveloped, venture capital fills a critical funding gap. It enables SMEs to invest in research, product development, and market entry strategies (Colombo & Grilli, 2010; Chemmanur et al., 2011). VC involvement also aids in building robust business structures, improving operational efficiency, and enhancing strategic positioning. Their extensive networks grant SMEs access to new markets, suppliers, and additional investors, accelerating business growth and competitiveness (Colombo & Grilli, 2010). Ultimately, the participation of venture capitalists contributes significantly to entrepreneurship, innovation, job creation, and broader economic development at both regional and national levels (Cumming, 2012)

Business Angel investors

Business angels are high-net-worth individuals who invest personal funds into SMEs, particularly at their early development stages, often in exchange for equity. Unlike institutional VCs, business angels offer more flexible investment terms and typically invest smaller amounts, making them highly suitable for startups and SMEs lacking access to formal financing (Mason & Harrison, 2015; Wong et al., 2009). Business angels play a critical role in bridging the financing gap for early-stage SMEs that are often considered too risky by conventional lenders and venture capitalists. Their contributions go beyond funding to include mentorship, strategic guidance, and access to valuable business networks (Politis, 2008). Mason & Harrison (2020) describe business angels as informal investors who leverage their entrepreneurial backgrounds and industry knowledge to guide SMEs toward growth and sustainability.

The impact of business angels on SME development is profound, especially in areas like Kogi State where entrepreneurial support ecosystems are underdeveloped. Business angels provide SMEs with risk-tolerant capital that enables product development, market entry, and operational scaling (Mason & Harrison, 2015). Moreover, their hands-on approach in mentoring and strategic planning helps SMEs overcome common business challenges, improving their financial management and market competitiveness (Riding, 2008). Business angels also offer SMEs access to their extensive networks, creating opportunities for partnerships, new customers, and additional financing rounds. This networking advantage enhances the credibility and market visibility of SMEs, enabling them to attract further investments and achieve sustainable growth (Wiltbank et al., 2009). Research indicates that angel-backed SMEs tend to perform better in terms of growth rates and innovation compared to non-angel-backed counterparts, largely due to the personalized support and patient capital provided by these investors (Kerr et al., 2014). By fostering disciplined growth strategies and promoting long-term sustainability, business angels contribute significantly to local economic development. Their involvement in Kogi State enhances SME resilience, job creation, and productivity, ultimately stimulating broader economic growth (Harrison & Mason, 2007).

Growth of Small and Medium-Sized Enterprises (SMEs)

The growth of small and medium-sized enterprises (SMEs) is a multifaceted process involving operational expansion, innovation, competitive resilience, and sustainable practices (Ayala & Manzano, 2014; Wiklund et al., 2015; Jindal et al., 2021). In Kogi State, Nigeria, external financing, particularly from venture capitalists (VCs) and business angels (BAs), plays a critical role in SME development by strengthening internal structures, promoting innovation, and enhancing managerial capacities (Beck & Demircuc-Kunt, 2006; Zahra & George, 2002). Access to VC and BA funding improves financial performance, enabling SMEs to overcome capital constraints, enhance profitability, and manage market risks (Wiklund et al., 2015; Fadahunsi, 2012). Business expansion, supported by VCs and BAs, allows SMEs to diversify markets and scale operations efficiently, enhancing competitiveness and revenue streams (Prasanna et al., 2019; Hitt et al., 2001; Wiklund et al., 2009). Furthermore, VCs and BAs promote sustainable growth by encouraging eco-friendly practices, strengthening risk management, and fostering ethical and resilient business models (Schaltegger & Wagner,

2011; Ayala & Manzano, 2014). Overall, their involvement ensures that SME growth in Kogi State is innovative, financially stable, expansive, and aligned with long-term sustainability goals.

Theoretical Review

Agency Theory

Agency Theory Agency Theory, propounded by Jensen and Meckling (1976), explains the relationship between principals (investors such as venture capitalists and business angels) and agents (SME owners/managers). The theory assumes that while principals seek profit maximization and long-term growth, agents may pursue personal interests that conflict with these goals (Eisenhardt, 1989). Due to information asymmetry, agents possess more knowledge of day-to-day operations, making it challenging for principals to assess performance accurately. To mitigate agency costs and moral hazards, VCs and business angels employ monitoring mechanisms such as board representation, performance-based incentives, and mandatory reporting (Gompers & Lerner, 2001). This oversight aligns the interests of both parties and fosters sustainable SME growth (Sapienza et al., 1996). Although monitoring could be costly, it often enhances managerial efficiency, innovation, and access to valuable networks and mentorship (Audretsch, 2002). Agency theory provides a strong framework for understanding how venture capital financing and business angels contribute to SME development by reducing risk, improving governance, and aligning objectives (Fama & Jensen, 1983).

Pecking Order Theory (POT) Pecking Order Theory, introduced by Myers and Majluf (1984), suggests that firms prefer internal financing due to the costs and risks of external financing stemming from information asymmetry. If external funds are necessary, firms prioritize debt over equity to avoid ownership dilution and negative market signals (Myers, 1984). However, for SMEs, limited access to debt markets and high borrowing costs often force a deviation from this pecking order. Many SMEs turn to equity financing through venture capitalists and business angels, despite the associated risks (Cassia & Vismara, 2009). These investors help bridge the financing gap, especially when internal funds and debt are insufficient for growth (Serrasqueiro & Caetano, 2015). While POT highlights SMEs' preference for retained earnings, it also underscores the importance of external equity financing from VCs and angels when growth opportunities arise, helping to overcome the challenges of limited internal resources and high capital costs (Colombo et al., 2004; Sogorb-Mira, 2005). The study is anchored theory Agency Theory, as it best explains how VCs influence SME growth by reducing agency costs, enhancing governance, and aligning managerial actions with long-term business goals.

Empirical Review

Benkraiem et al. (2023) provided robust evidence from a large dataset, showing that corporate venture capitalists (CVCs) significantly enhance the market valuation of their backed firms, especially when there is a strategic technological alignment. Although the study focused on developed markets, it highlighted the importance of non-financial value such as innovation support, which is relevant to Nigerian SMEs seeking

both capital and technical expertise. Similarly, Brander et al. (2015), through a Canadian case, confirmed that VC-backed SMEs experienced higher growth rates, innovation outputs, and increased sustainability. However, they also cautioned that the long-term sustainability of such SMEs is often tied to continuous VC support, which could pose challenges in markets like Kogi State where follow-on investments might be scarce. Their call for complementary government support and institutional collaboration aligns with the need for similar frameworks in Nigeria to mitigate the risk of dependency on venture capital. The contributions of business angels are also well-documented. Ramadani (2016) in the Balkans, and Politis (2014) in Sweden, emphasized that beyond financial investment, BAs significantly contribute to SMEs' strategic management, financial discipline, and innovation capabilities. Ramadani highlighted how BAs foster innovation through mentorship and technology adoption in developing economies — a scenario that mirrors the entrepreneurial challenges in Kogi State. Politis added that angels promote innovation by helping SMEs embrace new business models and global competitiveness. In France, Bonnet and Wirtz (2012) found that BAs positively impact SMEs by improving managerial capabilities and innovation performance, particularly in product development and market expansion. They noted, however, that involvement levels vary, suggesting a need for clarity in expectations — a lesson crucial for SMEs and angel investors in Nigeria aiming for effective partnerships.

METHODOLOGY

The study employed a survey research design to analyze data from 266 valid responses out of 280 distributed questionnaires, targeting 938,740 registered SMEs in Kogi State (SMEDAN, 2021). A stratified random sampling technique ensured representation across the state's three senatorial districts. A five-point Likert scale was used for data collection, and SPSS version 20.0 was utilized for analysis, with multiple regression applied to test the study's hypotheses.

Model Specification

$$GSME = \alpha + \beta_1 VC + \beta_2 BA + e(\dots\dots\dots 1)$$

Where:

GSME = Growth of Small and Medium-Sized Enterprises (Dependent Variable)

α (alpha) = Intercept (constant term); the expected value of GSME when VC and BA are zero

VC = Venture Capitalists (Independent Variable 1)

BA = Business Angels (Independent Variable 2)

β_1, β_2 = Coefficients measuring the impact of VC and BA respectively on GSME

e = Error term or residual (captures unobserved factors)

DATA ANALYSIS AND DISCUSSION OF FINDINGS

Table .1 Regression Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.644 ^a	.414	.410	1.104

a. Predictors: (Constant), BA, VC

The results show that business angels (BA) and venture capitalists (VC) have a moderate to strong positive relationship with SME growth, as indicated by an R value of 0.644. The R Square of 0.414 suggests that 41.4% of the variance in SME growth is explained by the combined influence of BA and VC. The Adjusted R Square of 0.410 confirms the model’s stability when applied to a broader population. Furthermore, the Standard Error of the Estimate of 1.104 reflects a reasonable level of accuracy, indicating how much observed values deviate from the predicted regression line.

Table 2: ANOVA Result

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	226.620	2	113.310	93.018	.000 ^b
	Residual	320.376	263	1.218		
	Total	546.996	265			

a. Dependent Variable: GSME

b. Predictors: (Constant), BA, VC

The regression analysis reveals that the model is statistically significant, with an F-statistic of 93.018 and a p-value of 0.000, which is below the 0.05 threshold. The regression sum of squares is 226.620, with 2 degrees of freedom, and a mean square of 113.310. This indicates a significant linear relationship between the independent variables (Business Angels and Venture Capitalists) and the dependent variable (SME growth). Therefore, both Business Angels and Venture Capitalists have a significant influence on the growth of SMEs in Kogi State, Nigeria.

Table .3 Coefficients

Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	5.496	.524		10.492	.000
	VC	.110	.024	.228	4.650	.000
	BA	.445	.040	.542	11.029	.000

a. Dependent Variable: GSME

Test of Hypotheses

The formulated hypotheses were tested using multiple regression analysis

Ho₁: Venture capitalists have no significant impact on the growth of SMEs in Kogi State.

The regression analysis shows that the constant value (intercept) is 5.496, representing the predicted baseline level of SME growth when both Venture Capital (VC) and Business Angels (BA) are at zero. The coefficient for VC is 0.110, with a t-value of 4.650 and a p-value of 0.000, indicating that a one-unit increase in VC support leads to a 0.110 unit increase in SME growth, holding other factors constant. The coefficient for BA is 0.445, with a t-value of 11.029 and a p-value of 0.000, indicating that a one-unit increase in BA support leads to a 0.445 unit increase in SME growth. Additionally, BA has a higher standardized beta value (0.542) compared to VC (0.228), suggesting that Business Angels have a stronger impact on SME growth than Venture Capitalists in Kogi State.

Ho₁₁: Business angels do not significantly contribute to the growth of SMEs in Kogi State.

The coefficient for Business Angels (BA) is 0.445, with a t-value of 11.029 and a p-value of 0.000, indicating a statistically significant relationship between BA support and SME growth. This means that for every one-unit increase in BA support, SME growth increases by 0.445 units. Furthermore, BA has a higher standardized beta value (0.542) compared to Venture Capital (VC) (0.228), suggesting that Business Angels have a stronger positive impact on the growth of SMEs than Venture Capitalists in Kogi State.

Discussion of Findings

The study highlights the significant roles played by both venture capitalists (VCs) and business angels (BAs) in driving the growth of SMEs in Kogi State, Nigeria. While both sources of funding are impactful, BAs exert a stronger influence on SME growth ($\beta = 0.542$, $p < 0.000$) compared to VCs ($\beta = 0.228$, $p < 0.000$). The study applies Agency Theory and Pecking Order Theory to explain these differences. Venture capitalists contribute by providing substantial financial resources, structured governance, and facilitating access to broader markets, thus promoting rapid expansion and innovation. Their involvement aligns with the Agency Theory, where VCs mitigate agency risks by imposing strict monitoring and aligning incentives for long-term business success, as supported by studies by Benkraiem et al. (2023) and Da Rin et al. (2020).

In contrast, business angels play a key role in the early stages of SME development by offering financial support, mentorship, and capacity building. Their involvement aligns with the Pecking Order Theory, where SMEs prefer less formal and more relational financing options due to limited access to debt and equity markets. BAs invest their personal funds and are highly engaged in guiding entrepreneurs, which enhances managerial efficiency and supports sustainable growth. Their contributions are backed by studies from Ramadani (2016), Politis (2014), Bonnet and Wirtz (2012), demonstrating that BAs often act as both financiers and strategic partners

CONCLUSION AND RECOMMENDATIONS

The study found that venture capitalists (VCs) positively contribute to SME growth by offering structured financing, governance frameworks, and strategic oversight, in line with the Agency Theory. Their involvement helps align goals, reduce managerial inefficiencies, and drive business scaling. In contrast, business angels

(BAs) have a stronger impact on SME growth. Their support is more personal, flexible, and relational, making them particularly valuable for startups and early-stage firms. Beyond funding, BAs provide mentorship, guidance, and access to networks, aligning with the Pecking Order Theory. SMEs, facing high information asymmetry and limited access to credit, often prefer the informal and internal financing options provided by BAs.

The study therefore recommends the following:

- i. The study recommended that the government of Kogi State, through relevant agencies, should create enabling policies and incentives (such as tax reliefs and co-investment schemes) to attract more venture capital firms to invest in the SME sector. These policies should also include support structures such as startup hubs and business incubators that can connect SMEs with venture capitalists.
- ii. The study also recommended that Stakeholders should encourage the formation and formalization of business angel networks within Kogi State. These networks can act as platforms for matchmaking between entrepreneurs and angels, provide training for both parties, and enhance trust and transparency in funding relationships.

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