

## Assessing the Impact of Venture Capital Financing on Growth of SMEs

Article by Eric Kwame Buah  
*PhD in Management, Texila American University, Ghana*  
*E-mail: ericbuah09@yahoo.com*

### **Abstract**

*This paper assesses the impact of Venture Capital financing on growth of SMEs. Government all of the world are seeking to improve unemployment situation in their respective countries. One of the numerous ways governments can use to reduce unemployment is to ensure there is more SMEs and also accelerating it growth. This study therefore examining the impact of venture capital financing on growth of SMEs. Data for this study was collected from 40 SMEs who are being financing from the venture capital funds. The instrument used was mainly questionnaire. Descriptive statistics like frequency, mean score and percentages were the statistical tools used. ANOVA and regression were the inferential statistical tools used to ascertain the impact of venture capital financing on growth of SMEs. The main aim of this paper was to examine the impact of Venture Capital financing on the growth of SMEs. The study found that businesses have expanded, improved in the profitability, number of employees have gone up due to VCF financing. The study also found that VCF has significant influence on the performance of SMEs. The study found that most of the businesses have turnovers low the threshold of World Bank. It is therefore recommended that fund managers will intensify their advisory role to ensure that businesses increase their turnovers.*

**Keywords:** *Venture Capital, Financing, and growth of SMEs.*

### **Introduction**

Unemployment in Africa is on the increase due to high youthful population of the continent. The continent has a lot of resources however; governments of this continent have not utilized the numerous resources to the advantage of the continent. Over the years, many of its teeming youth have moved outside the continent in search for greener pastures and this has led to many of them losing their lives. Many of these countries that our youth travel to did not become self-sufficient just one night. Many of the big industries in those countries started as micro businesses, and then graduated to Small, Medium and Large scale industries. One of the major strategies which have been adopted by the various governments to fight unemployment to reduce poverty in Sub-Saharan Africa is to encourage Micro, Small and Medium Scale Enterprises.

This effort being put up by our governments has been hindered by political instability or strong dependence on a few raw materials. In the Democratic Republic of Congo, for example, most SMEs went bankrupt in the 1990s as a result of looting in 1993 and 1996 during the civil war. In Congo, Equatorial Guinea, Gabon and Chad, the dominance of oil has slowed the emergence of non-oil businesses. Between these two extremes, Senegal and Kenya have created conditions for private sector growth but are still held back by an inadequate financial system. In Nigeria, SMEs are key to the economy but insecurity, corruption and poor infrastructure prevent them from being motors of growth (Kauffmann, 2005).

According to Fjoses *et al* (2010), when we take a closer look at the role of SMEs in developing countries, pattern of growth has not been substantially stronger. It should be noted that growing SMEs is growing industrialization. SMEs play a pivotal role in industrial development and restructuring. It also helps in satisfying rising local demand for services, allowing for increased specialization and supporting larger firms with inputs and services. SMEs have become engines that sustain growth for

long term development. Many countries in sub-Saharan Africa have a large number of SMEs relative to the size of the economy, but these are almost exclusively micro companies and they are often not part of the formal economy.

Ghana has its own industrial policy agenda. This policy is set within the context of Ghana's long-term strategic vision of achieving middle income status 2020, through transformation into an industry-driven economy capable of delivering decent jobs with widespread, equitable and sustainable growth and development. The policy also provides clear and transparent guidelines for the implementation of Government's industrial development agenda, with particular respect to the growth.

SMEs in Ghana contribute about 70% to Ghana's GDP and in all account for about 92% to business in Ghana. According to Villars (2004), SME development is also seen as increasing the achievement of wider economic and socio-economic objectives including poverty alleviation. Therefore, Africa for that matter Ghana must look at how it can growth it SMEs to reduce unemployment and also reduce poverty.

### **Statement of the problem**

The growth of SMEs has been in the recent past a great concern to many countries, governments, policy makers and researchers or scholars all over the world, because of realization of their economic contribution to Gross Domestic product (GDP) and economic growth.

In spite of the major role play by SMEs in Ghana, it faces many challenges in their day-to-day operations and its ability to grow. More so the accessibility to funds and the cost of raising them have remained issues limiting the in-capitalization requirement leading to premature collapse of SMEs. Mambula (2002) also made it clear that funding has actually become one of the key managerial problems that keep confronting SMEs business in Ghana today. In considering, the financial short coming against the SMEs presently in Ghana, alternative sources of Funds have to be sought to sustain this urgent business or sector in Ghana in other to function well and contribute to the nation building. It is as a result of this problem that this study is necessary to find proper means of financing the small and medium scale enterprises in the country in other to grow and improve the GDP and the living standard of the people.

### **Objective of the study**

To examine the impact of Venture Capital financing on growth of SMEs

### **Related literature**

#### **Overview of SME development in ghana**

Ghana for so many years has made an attempt to promote SME since 1970 even though enough have not been achieved. Some organizations were made to set up to assist and the prominent among them are the Office of Business Promotion and the current Ghana Enterprise Development Commission (GEDC). The main aim of GEDC was to support or assist Ghanaian entrepreneurs in other fine themselves into fields where foreigners mainly operated. It also had packages for strengthening small scale industry in general, both technically and financially (Kayanula and Quartey, 2000).

The Economic Recovery Programme (ERP) came into been in 1983 has supported the SMEs in some way. The National Board for Small Scale Industries (NBSSI) was also established under the Ministry of Industry, Science and Technology to help overcome the needs of small businesses in the country. The Entrepreneurial Development Programme was also established by NBSSI in training and assisting peoples who have entrepreneurial skills to establish their own businesses. In 1987, Appropriate Technology Industrial Service (GRATIS) also came into operation in Ghana and its main motive was to supervise the operations of Intermediate Technology Transfer Units (ITTUs) in the country. The main objective of GRATIS was to support and upgrade small scale enterprises in the

country by bringing in appropriate technology to small scale and informal industries at the grass root level. Intermediate Technology Transfer Units (ITTUs) was instituted in the regions with the intention to develop the engineering skills of small scale manufacturing and service industries engaged in vehicle repairs and other related trades. They are also to address the needs of non-engineering industries (Kayanula & Quartey, 2000).

In the year 2000, the government of Ghana created a new Ministry as Private Sector Development with the aim of focusing on the development of the small and medium scale enterprises (SMES) sector. The major obstacle confronting SMEs is lack of access to external finance. As a result of this problem, the World Bank assisted, SMEs through the Programme of Action to Mitigate the Social Costs of Adjustment (PAMSCAD) which created a special fund to support microenterprises, and the Fund for Small and Medium Enterprises Development (FUSMED) was initiated to increase the amount of credit available to SMEs through commercial and development banks. This was based on the presumption that poor availability of credit from formal sources was one of the major reasons why the private sector investment had not grown as expected. A major argument was that small firms with good growth potential were being discriminated against (Aryeetey *et al.*, 1994). As a result of financial constraints confronting SMEs sector seriously, in 2004 the government of Ghana found a means to support them by promulgating Venture Capital Trust Fund Act 2004, Act 680 in the country to assist the small businesses financially. The objective of the government on the fund was to provide financial resources for the development and promotion of venture capital financing for Small and Medium Enterprises (SMEs) in priority sectors of the economy as shall be specified from time to time (VCTF ACT 680, section 28).

### **Firm growth**

Growth could easily be used to place a higher demand on internally generated funds and move the firm into borrowing (Hall *et al.*, 2004). According to Marsh (1982), firms which have enough growth will capture relatively higher debt ratios. On the part of small firms which are more concentrated in ownership, it is hope that high growth firms will need more external financing and should display higher leverage (Heshmati, 2001). Aryeetey *et al.* (1994) insisted that the growth of SMEs seems to prove whether it is more likely to go in for external (outside) source of finance—even though it is not easy to come out with whether access to finance lower growth or increases it or both. Businesses undergo various stages in growth, such as micro, small, medium and large scale; and for that reason they are supposed move to the various sources of finances for consideration. According to Aryeetey (1998) firms are for some period in their operation are supposed to move from inside means of sourcing to outside ones as the firms keep on growing.

Michaelas *et al.* (1999) also said that there are major links that exist between the growth which have already occurred and those that are yet to come. These researchers argue that the problem of agency and its financing cost can be brought down if the firm decides to go through short-term loans instead of long-term loans. Myers (1977) is of the view that businesses which have got a better means of growing will also likely to have smaller means of debt in their capital structure. There is normally conflict of interest between the providers of the loans and the equity holders concerning asset that would be used as collateral for contracting loans for the near future if the firm wish to undertake that decision. It should be noted that, the chances of firm's growth can bring about moral hazard and small- scale business persons are to have the motivation of taking the risks to grow. The outcome of this growth, if come into reality the lenders who actually financed these firms will not in any way enjoy the fruits of the firm, but the lenders will only receive their loans and interest charged and this will bring about agency problem. This will result in the increase of costs on long-term debt as compare with the short-term debt.

## **The influence of venture capital on growth of SMEs**

Empirical evidence from the developed world has shown that a number of countries involved with venture capital targeting small scale industries have experienced significant growth at reasonable cost (McCormick, 1996). In the USA a well-developed venture capital market set up partnerships, pooling funds from variety of investors, sought out fledgling businesses to invest in, and then worked with these ventures as they grew in to public traded firms. By 1993 the amount invested by the partnerships grew rapidly to over three billion US dollars. The increase in the amount of money invested by venture capitalists is a clear indication of growth of SMEs. A survey carried out by European Venture Capital Association in 2001 on SMEs that have received venture capital funding concluded that:

- Some 95% of companies stated that without venture capital investment, they could not have existed or would have developed more slowly;
- Almost 60% said, that without venture capital the company would not exist today;
- For start-ups with high growth potential, the venture capital provision is more appropriate than debt financing;
- During several years, these start-ups would not be able to pay back a traditional bank loan: patient capital is needed, and
- Each SME following the venture capital investment created an average of 46 additional jobs.

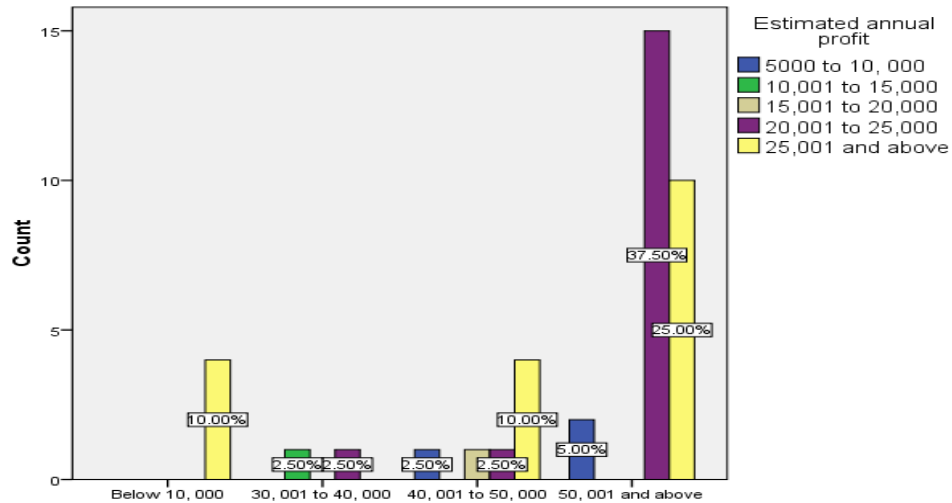
## **Methodology**

The study adopted both a qualitative and quantitative approach thus mixed method. Questionnaires were used to capture qualitative and quantitative data from entrepreneurs of SMEs. The population for this study is made up of all small and medium-scale enterprises in Ghana especially those that have benefited from venture capital financing investment in the country. The target population in this study consists of all the registered SMEs and which pay tax returns to Ghana Revenue Authority (GRA) and which have been assisted financially by venture capital firms. The study used fifty (50) SMEs that have been financed by Venture Capital Fund as the target population. The figures were drawn from major cities of the four regions (Greater Accra, Ashanti, Eastern and Western) in the country which have been benefited from the fund most. Forty (40) SMEs were convenient sampled. The cities were Accra, Kumasi, Koforidua and Takoradi. This paper uses frequency tables, charts, mean scores, ANOVA and Regression analysis to examine the impact of Venture Capital Fund on SMEs growth.

## **Results**

The strength of every economy in this world depends on what the country can produce, can process and can export. Establishment of small enterprises, medium enterprises and large enterprises largely increase economic growth. So, it is right for governments to make sure that businesses when established flourish. In view of this the respondents were asked to indicate their annual turnovers/sales before applying for Venture Capital Fund (VCF). The figure 1 below represents the cross-tabulation of the respondents' annual turnovers as against estimated annual profit before applying for VCF. This was to assess the viability of the business before the introduction of the Venture Capital Fund.

The analysis as presented by the figure 1 shows that 10% of the respondents' annual turnovers were below GHC 10, 000. Majority representing 67.5% of the respondents' had annual turnover of above GHC 50, 000.



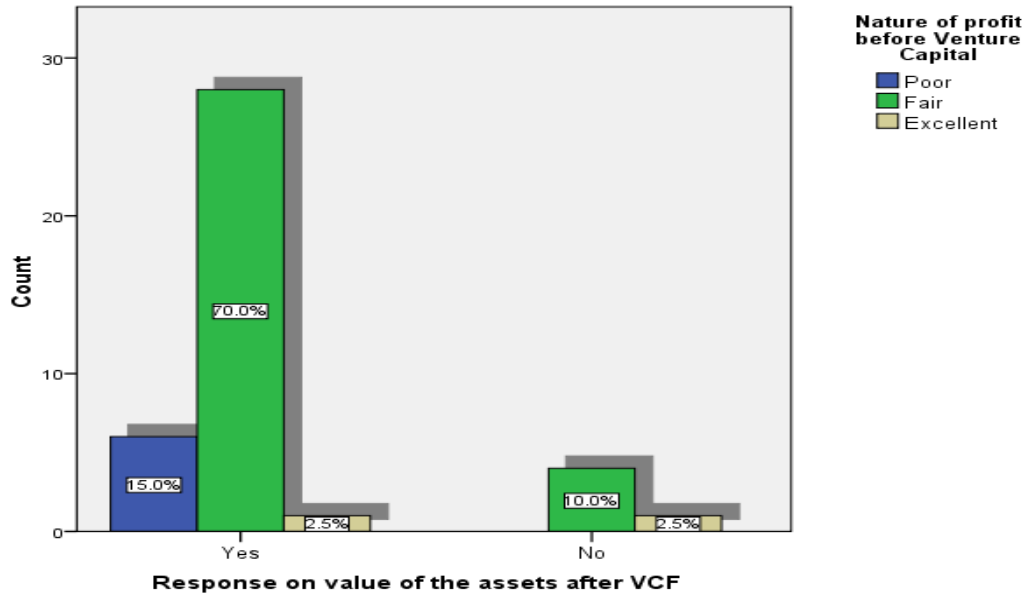
**Figure 1.** Cross-tabulation of estimated annual profit against annual turnover

Sources: field work, 2017

Majority of the respondents (45.0%) have their estimated annual profit above GHC 25, 00.00. 42.5% also have their estimated profit to be around GHC 20, 001.00 and GHC 25, 000.00. It could also be observed that majority of the respondents whom their turnovers were above GHC 50, 001.00 had estimated above GHC 20, 000.00. It is also clear that most of the respondents whose turnovers fell below 10, 000 had estimated profit above GHC 25, 000.00. It is therefore clear that majority of the respondents had estimated profit above GHC 25, 000.00.

Respondents were asked to give reasons for their turnovers and these were some of the responses:

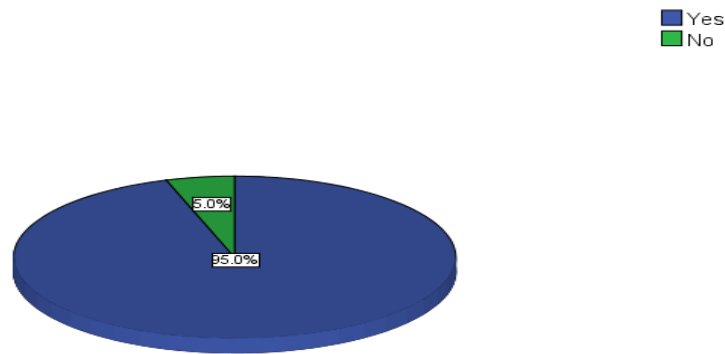
1. Patronage is high during farming season
2. No pre-investment revenue since it is a new business
3. High purchasing power
4. Good personal relationship
5. Quality product and quality personnel
6. Good management term
7. The company was making profit before the entry of VCF



**Figure 2.** Cross-tabulation of value of asset after VCF and the nature of profit before VCF

Source: field work, 2017

Figure 2 depicts that 87.5% of the respondents chose yes whilst 12.5% chose no when they were asked to indicate whether their asset value have increased after the introduction of VCF. It means that majority of the respondents agreed that value of their assets have gone up with the introduction of VCF. Figure 2 also shows that 80.0% of the respondents chose fair when they were as to give the outlook of their profit before VCF. 15% of all the respondents who said their assets have increased after the introduction of VCF asserted that their profit margin before was poor, 70% of them also said it was fair and 2.5% chose excellent. This is an indication that business margin before VCF was not all that good.



**Figure 3.** Response on whether number of workers has increased after introduction of VCF

Source: field work, 2017

The researcher sought to find out whether businesses have increased workers' numbers after introduction of the VCF. Majority, representing 95.0% of the respondents chose yes. This means that workers numbers have increased.

Table 1 below present the paired sample t-test of the status of workers before and after the introduction of VCF. The mean of workers before the introduction of Venture Capital Fund was 13 and that of after was 25. The difference in mean is 12. With t-value of -6.248 and p-value of  $0.000 < 0.05$ , it could be said that the difference in mean is highly significant.

**Table 1.** Paired samples test status of workers before and after VCF

Question Number	Mean	Mean difference	Df	t	P-value
<b>Workforce</b>					
Before	13				
		12	39	-6.248	0.000
After	25				
<b>Permanent Workers</b>					
Before	10				
		12	39	-6.177	0.000
After	22				
<b>Casual workforce</b>					
Before	0				
		7	39	-6.958	0.000
After	7				
<b>Male workforce</b>					
Before	8				
		11	39	-5.852	0.000
After	19				
<b>Female workforce</b>					
Before	4				
		3	39	-5.417	0.000
After	7				

Source: field work, 2017

This is an indication that workforce of businesses that are beneficiaries of VCF have increased. The average permanent workers increased from 10 to 22. The difference was statistically significant with p-value of  $0.000 < 0.05$ . Apart from the difference in contract workers which was statistically insignificant, casual workforce, male workforce and female workforce have all seen significant increased after the introduction of VCF. This means that workforce of businesses which are beneficiaries of VCF have seen significant increased.

**Table 2.** Reasons for VCF

Variables	Mean	Std. dev.
To expand my operations	4.15	1.051
Because their items were more reasonable compared to banks	3.60	0.871
Because they believe it is the only way out for my business	2.62	1.055
The price of venture capital is cheaper compared to other financing firms	3.42	0.984
Ability to get other technical assistance in addition to the financial Assistance	3.73	1.012
Absence of collateral requirements from loans	3.35	1.167

Source: field work, 2017

The respondents were asked to give reasons for negotiating for VCF financing. Table 2 above presents the responses of the respondents. The mean cut off that will be considered for this study will be 3.5, which is approximately score 4 (agree). Respondents rated “to expand my operation” higher with a mean of 4.15. This was followed by “ability to get other technical assistance in addition to the financial assistance” with mean 3.73. The third reason was “because their items were more reasonable compared to banks” with mean score of 3.60.

**Table 3.** Reasons businesses will sign-up contract for VCF financing

Variables	Mean	Std. dev.
Number of years in business	3.72	1.281
Because the prospects of my business is high	3.67	1.309
Because of the clear and straightforward ownership structure of my business	3.60	0.982
Strong entrepreneurial characteristics	3.60	1.257
Good business plan	3.60	1.081
Satisfactory reputation and trustworthiness	3.80	1.244
Good track record of loan repayment	3.22	1.165
Because of good performance of my business in the past	3.00	1.198
Because of my high educational background	3.32	1.228

Source: field work, 2017

Table 3 present the responses of the respondents on reasons businesses will sign-up contract for VCF financing. With mean scores of 3.00, 3.22 and 3.32, it could be said that the respondents were uncertain about “because of good performance of my business in the past”, “good track record of loan repayment” and “because of my high educational background” as some of the reasons businesses consider in signing-up contract for VCF financing. The following were considered by the respondents as reasons for successfully signing-up a contract for VCF financing:

- Satisfactory reputation and trustworthiness
- Number of years in business
- High prospects of business
- Clear and straightforward ownership structure of the business
- Strong entrepreneurial characteristics
- Good business plan



**Table 4.** Performance of the business after introduction of VCF

Variables	Mean	Std. dev.
Venture capital financing has enabled my business to expand	3.75	1.316
Venture capital financing has enabled my business to be profitable	3.65	1.210
Venture capital financing has enabled me take advantage of business opportunities quickly	3.32	1.118
Venture capital has enabled me employ more workers	3.72	0.986
The technical and business advisory services has enabled my business to reach higher heights	3.55	0.876
Overall, venture capital financing has been beneficial to my operations	3.65	1.011

Source: field work, 2017

Table 4 above present perception of respondents about the performance of their businesses after the introduction of VCF. With a mean score of 3.32, it could be asserted that most of the respondents were uncertain about VCF aiding them to take advantage of business opportunities quickly. However, they were of the view that VCF financing has help them to perform in the following areas:

- a) Business expansion
- b) Profitability
- c) Size of workers
- d) Technical and business advisory services

### Regression analysis

To establish whether the performance of the businesses after the introduction of VCF has relationship with reasons for VCF and reasons businesses will sign-up contract for VCF financing, regression analysis was performed. From table 5, the coefficient of correlation of 0.930 shows that there is a strong relationship between the dependent variable performance of the businesses after the introduction of VCF and the independent variables reasons for VCF and reasons businesses will sign-up contract for VCF financing. With the coefficient of determination (R Square) value of 0.865, it could be said that 86.5% of variation in performance of the businesses after the introduction of VCF is explained the independent variables.

**Table .5** Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.930	0.865	0.857	0.786

Source: field work, 2017

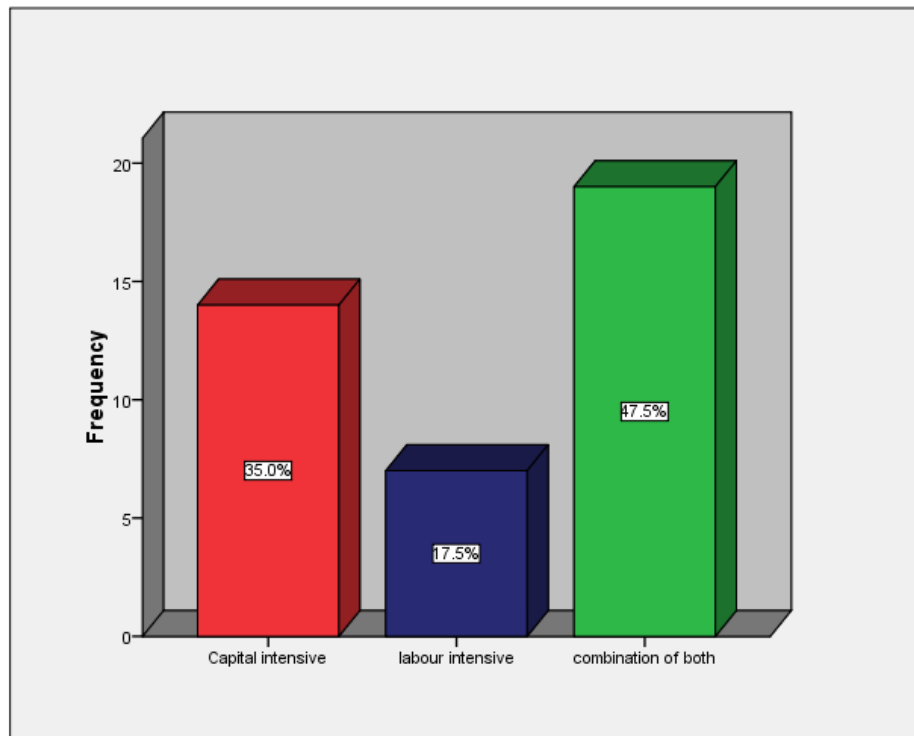
Table 4.8 presents the ANOVA. With F-value of 118.245 and p-value of  $0.000 < 0.05$ , it could be said that the model fit for prediction.

**Table 6** ANOV

Model	Sum of Squares	df	Mean Square	F	P-value
	Regression 146.115	2	73.057	118.245	0.000
1	Residual 22.860	37	0.618		
	Total 168.975	39			

Source: field work, 2017

Performance of businesses has strong correlation with accessing VCF financing. It could therefore be said that VCF has significant influence on the performance of SMEs.



**Figure 4.** Responses on the operations of the business before VCF

Source: field work, 2017

The respondents were asked to indicate the operations of the business before the introduction of VCF. Figure 4 depicts the responses of the respondents. From the analysis it could be said that all the respondents agreed that their business operations were both capital intensive and labour intensive.

### **Discussion of results**

The results of development according to Boadu (2008), is job creation, wealth creation, increased revenue through taxes and business growth and expansion. It was found that businesses have improved in the following areas as a result of accessing VCF:

- a) Business expansion
- b) Profitability
- c) Size of workers
- d) Technical and business advisory services

Businesses are established with future in mind. That is to see the business grow, employing people and making profit for sustainability. It was established that most of the businesses had annual turnover of above GHC 50, 000 and their estimated profit was above GHC 25, 000.00. Some of the reasons for high turnovers were:

1. Patronage is high during farming season
2. No pre-investment revenue since it is a new business
3. Purchasing power was high
4. Good personal relationship
5. Quality product and quality personnel
6. Good management term
7. The company was making profit before the entry of VCF

It could be said that most of the businesses before accessing VCF were not SMEs in terms of their annual turnovers. According the World Bank, SMEs must have annual turnover US\$15 million. By estimation, the equivalent of GHC 50, 000.00 in US\$ terms is approximately GHC 12, 500.00 using a rate of \$1 to GHC 4.0000. By using Dalberg Global Development Advisors (2011) assertion too, most of the businesses are not SMEs, since their annual turnovers were not up to US\$3 million. It was discovered that profit margins of businesses before were not encouraging. This was attributed to businesses operating under low capacity. However, it was observed that most of the businesses assets have gone up due to the introduction of VCF.

Roger (2003) found that 78% of Japan workforces were employed by small and medium scale enterprises. The study found that, businesses have increased the number of employees significantly. On the average, all the businesses who participated in this have employed 23 people. The average permanent workers have increased from 10 to 22. Casual worker numbers have also increased significantly. The number of males and females employ by these businesses has also gone up significantly. These were statistically significant at 5% significance level. These then support the definition channel by Egypt, Vietnam and American Development Bank. In Egypt, businesses with 5 to 50 employees are considered as SMEs. Vietnam also considers any firm with 10 to 300 employees as SME. The Inter-American Development Bank, also regard SMEs as any business employing up to 100 employees (Dalberg Global Development Advisors, 2011). This means that workforce of businesses which are beneficiaries of VCF have seen significant increased. The study found that the introduction of VC financing has improved businesses in the following areas:

- a) Business expansion
- b) Profitability
- c) Size of workers
- d) Technical and business advisory services

This is in firm support of the objectives of VCF. That is to help businesses to expand, increase their profit margins, employ more people to reduce unemployment, and to offer technical and business advice to businesses. This study outcome supports the assertion of Kaplan Stromberg, (2004); Tykvova, (2007); and Heger and Tykvova (2009). They all agreed that VC provide value-added services to businesses. They indicate that a more intensive involvement of venture capitalists enhances the probability of change in the initial executive teams. Performance of businesses has strong correlation with accessing VCF financing. It could therefore be said that VCF has significant influence on the performance of SMEs. The study also found that business operations were both capital intensive and labour intensive before VCF.

## **Summary and conclusion**

The main aim of this paper was to examine the impact of Venture Capital financing on the growth of SMEs. The study found that businesses have expanded, improved in the profitability, number of employees has gone up due to VCF financing. The study also revealed that technical and business advisory services were round for the businesses by the fund managers. The study also established that most of the businesses assets have gone up due to the introduction of VCF.

It was established that the increase in the number of employees was statistically significantly. The study also found that VCF has significant influence on the performance of SMEs. It could therefore be said that venture capital financing has significant impact on the growth of SMEs.

## **Limitations**

Due to the scattered nature of the businesses, the researcher has to travel several times to these companies to observe their activities. This was time consuming and capital intensive. It was also difficult in sighting the businesses since they were scattered. Getting the managers to respond to the questionnaire was also a challenge.

## Recommendations

The study found that most of the businesses have turnovers low the threshold of World Bank. It is therefore recommended that fund managers will intensify the advisory role to ensure that businesses increase their turnovers.

The study also found that most of the businesses were into estate and construction and few were into agriculture. Ghana's growth sustainability has been said it is depended on agriculture, it is therefore recommended that fund managers finance agricultural firms to sustain Ghana's economic growth.

Exporting raw materials to developed nations yes, bring revenue but how much. It is better if governments will add value to get more revenue. This can be done by government increasing the number of micro and small businesses. Graduate turning out from higher educational institution must be given skills to set-up businesses of their own by the government providing financing which they will pay in the long term.

## Proposal for further studies

It is recommended that further studies will be carried out on this same topic to include all the investees in the ten regions.

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