

Investment in Technology Based Small and Medium Sized Firms in Malaysia: Roles for Commercial Banks

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Abstract—Financing is an important input in every business which allows for the smooth running of day-to-day operations, asset acquisitions, expert recruitment, and development of marketing and distribution channels. This is especially the case for high-tech startups that must undergo four development stages to turn ideas into commercial products and become full-blown enterprises; concept formation, amassing of resources, product development and business development. The purpose of this research is to understand the fundamental role of banks in Malaysia in bridging the startups financing gap, thereby, helping to grow technology based small and medium sized enterprises in the country. A qualitative research approach which aims first to identify all the commercial and investment banks in the country, then with a select sample size of ten biggest banks shall administer a semi-structured/open ended questionnaire. This methodology will allow respondents to open up on critical issues to be discussed and not limiting them to certain choices as in the case with a structured form of interview. Banks in Malaysia are not willing to finance high technology small and medium enterprises since it is a high risk industry. A the findings are compared to what is obtainable in other countries and Europe and America.

Keywords-banks; financing; technology based firms; small and medium sized enterprises; malaysia.

I. INTRODUCTION

There have been a wide acknowledgement of the fact that Small and Medium Enterprises (SMEs) constitute about 99.2% of overall business establishments in Malaysia and are a source of employment for more than 56% of the overall working population and are a significant source of growth for the country [1-2]. There was also a recognition that it will continue to play a substantial role in the country's New Economic Model (NEM) which envisions transforming Malaysia from a middle-income economy to a high-income knowledge-driven society as anticipated by the year 2020 [3,2]. Furthermore many authors have emphasized that technology small and medium-sized enterprises (SMEs) have been assumed to be a major influence in the economic development, employment and creation of new innovations [4]. Economists also argue that despite the heavy concentration of R and D expenditure in large firms, technology based small firms (TBFs) have consistently accounted for a vast majority of the important inventions and innovations. However, they reported

that inability to access adequate funding for either growth or expansion has been one of the main challenge facing TBFs [5,6,7].

It is argued further that technology small firms play a key role in innovation and industrial development by virtue of their numerous size and significant economic and social contribution, small and medium sized enterprises should be considered as an important engine to economic development of every nation. Not minding, their importance, small and medium sized enterprises are still generally perceived as higher credit risk by financial institutions, hence, limiting their access to formal financing sources [5,4,8]. In view of the foregoing, it is expedient to highlight that financial and investment policies play an increasing important role in entrepreneurial venture and economic development .The financial and investment policies are among the important operational priorities in developing countries to support investment by local firms, especially technology based firms, and transnational corporations investing in these countries [5,8].

Rothwell and Zegveld [9] while arguing that technology based small firms play an important role in innovating, point out the problems of access to finance, ability to cope with government regulations and lack of specialist management expertise as a few of the challenges bedeviling technology small firms all over the world. In a knowledge-driven economy such as Malaysia, economic growth is increasingly dependent upon innovation whereby access to finance is seen as a major challenge that may impede this process [10,8]. The importance of financing in gingering local economic growth of a nation cannot be underestimated, hence, the need for policy makers to inculcate the right approach to encourage financing agencies to provide adequate support to technology new ventures for speedy economic development of the nation. The intent of this study is to obtain a clearer insight into the roles of commercial banks in financing technology small and medium sized industries in Malaysia. And also examine the criteria adopted in selecting firms they fund. The findings of this study would be of immense benefit to conventional financial managers, public policy makers and other stakeholders and further enrich academic literature.

II. LITERATURE REVIEW

Malaysia small and medium sized enterprise is defined by two sub-groups; Firstly, in terms of number of full time employees engaged. Secondly, the annual sales turnover realized per year. The definitions as seen in Table 1 and 2 were a unanimous adoption by the National SME Development Council (NSDC) for Malaysia in order to achieve three basic objectives; [1]. Determination to create effective policies and programs for specific target. [2]. Technical and financial support will be easy to achieve by adopting a common definition [3]. Easy identification of SMEs in various categories.

TABLE 1. ANNUAL SALES TURNOVER OF SMES [2]

	Primary Agric	Industry	Services
Micro	<5 workers	<5 workers	<5 workers
Small	5-19 workers	5-50 workers	5-19 workers
Medium	20-50 workers	51-150 workers	20-50 workers

TABLE 2: ANNUAL SALES TURNOVER OF SMES [2]

	Primary Agric	Industry	Services
Micro	< Rm 200,000	< Rm 200,000	< Rm 200,000
Small	Rm 200,000-1m	Rm 250,000-10m	Rm 200,000-1m
Medium	Rm 1m-5m	Rm 10m-25m	Rm 1m-5m

A. Definitions of Technology Based Firms

Several researchers have defined the term Technology Based Firms (TBFs) considering a variety of parameters. Among them are [11,7], who viewed TBFs as, those companies in which their sales revenue is generated through the use of at least 51 percent of technology based operations e.g. internet, electronics, mechanical, automobile, clean energy, biomedical, communications, telephone, fax companies and so on. Meaning that, the main trust of their business relies heavily on the use of high technology. One of the main features of technology based firms is that they have a high level of business internationalization [12]. It was further reported that TBFs are much more likely to engage in global markets than non high growth small and medium sized firms [13]. Other characteristics of TBFs include above-average levels of productivity growth [6,12], strong levels of innovation [14,6], strong levels of export-orientation [15] and a high level of internationalisation [16]. Cooper [17] identified that technology (based) businesses can be referred to as businesses that engage in technology related products, processes and services, whether low, medium or high technology. He emphasized that an aspect of majority of growing economies that have encountered significant growth is that focused on new technology-based products and services and the high-technology sectors are perceived as major sources of future economic prosperity and employment growth [17]. Some of such high-technologies include nano-technology, bio-technology, ICT, and so on.

They classic expressions of technology based firms as exposed by [11,7] are the young entrepreneurial company, an inventive design which has been nurtured into a high technology organization. The most successful of these companies as they mentioned become the popular and most talked about giants such as Microsoft, Netscape, Face book, Amazon.com, Sun Microsystems to mention a few. In [18], opinion is that high growth firms are those young firms that has the potential to produce spectacular results, facilitate development of leading edge technologies and, perhaps, move on to initial public offering to take their place in “the fortune 500 of tomorrow”. On the other hand, [19] grouped high-technology based firms on the definition of the National Science Foundation (NSF) as technology generating and technology employing industries. While [20] carried out an empirical observation of 400 ethnic Chinese firms and categorized technology based firms into technology-intensive start-ups, which is those that aim to create whether tangible or intangible products embodying a significant amount of technology knowledge or skills.

B. Debt Financing for Technology Based SMEs

There has been an emphasis by previous researchers that the technology based firm’s founder’s savings, as well as the assets of family and friends are often the foundation of seed capital [21-22]. However, while financing requirements do vary by sector [23,6], for the majority of technology based firms internal equity and profits alone are insufficient to meet the high capital requirements for development and progression to the next growth stage. Winton and Yerramilli [24] show theoretically that venture capital financing is preferable to debt financing only under conditions of high risk and uncertainty. DeBettignies [25] models preference for debt over equity with aligned interest and lower cost of capital for entrepreneur. They both agree that equity contracts dominate when interest of entrepreneurs and investors are poorly aligned and as investors’ cost of capital increases. Therefore, while they are still in the very early stages of development many technology based firms are forced to seek external investment capital. For many technology based firms, external equity finance is more appropriate for their financing needs than debt finance [23,6]. But in the opinion of many new venture owners they would exhibit a strong desire for raising growth funds from sources that would minimize the intrusion of others into their businesses [23,10].

Debt funds have been reported to have a lower capital cost to technology new ventures than shares although it increases the financial risk attached to the shareholders investment [22,7]. This is because the payment to shareholders ranks last in event of business liquidation meaning that their investments are at a greater risk. Hisrich et al [26] identified that, debt financing is a financing method that involves an interest-bearing instrument, usually a loan, the repayment of which is only indirectly related to the sales and profits of the venture. Typically, debt financing requires that some asset of the borrower be used as collateral security [23,10]. They highlighted that through this method of financing, an entrepreneur repays his loan as well as a fee expressed in terms of the interest rate. Venture owners however, are advised that

care should be taken so as not to amass too much debt as it may inhibit growth and development and possibly lead to bankruptcy in case the borrower company is unable to pay back interest regularly. The economic recession in the United Kingdom in the recent past resulted in the majority of the traditional lending institutions to adjust and become more cautious in their lending decisions. Further evidence was shown that commercial banks in UK has to tighten their lending criteria which then resulted to an exaggerated effect on technically small organizations [27]. This policy led to key changes in the way banks initially evaluate firms for funds; Firstly:

- Overdraft facilities; There have been a more reduction in the rate at which short term overdraft facilities are granted to small and the medium enterprises, this is rather because of the constant use of these facilities by mostly undercapitalized firms as an alternatives for equity rather than working capital. Second, financial institutions are now asking for more security for loans and there is the need to raise additional equity finance beyond what the originally could raise from personal sources and this is due to the renewed importance placed on the level of gearing [23,6].

More evidence in previous literature further revealed that commercial banking institutions have three main assessment criteria they adopt in determining the appropriate firms to allocate funds to;

- Risk assessment; The lessons learnt from the recent financial crisis encouraged banks to develop a more sensitive risk pricing strategy and has resulted in the better quality proposals now receiving lower margins [27]. Bank managers have resulted to considering the better businesses to be the ones with large size as against the smaller businesses, hence they are becoming more comfortable assessing businesses based on their size.
- Profitability in lending; Past research pointed out that it has become increasingly unprofitable lending to small businesses because of the attendant low margins and high losses encountered by banks and other lending institutions [27,10]. In a further confirmation from one of the banking gurus in the United Kingdom, Sir Brian Pearse, former chairman of midland bank, “asserted that the banks have probably broken even on lending to small businesses in the last three decades”. This view was also supported by other banking giants such as accountants, bankers and other financial managers who cautioned that growth firms should seek for finance from other sources such as venture capital companies, business angels and other equity financing companies [27,7,22].
- Prospect based lending; considering a new thinking by banks that availability of collateral security may be a secondary factor in lending to small businesses. Banks are increasingly looking at making their lending decisions based on the analysis of the borrower’s business plan and cash flow as very important [27,10].

Although they consider this new strategy as very expensive in that they bank need to commit lots of resources to their staff in order to ensure proper monitoring of their investment with the small business borrowers, recruitment of more high quality personnel, training of personnel and cost involved in carrying out due diligence and business evaluation will definitely increase bank charges.

C. Why Banks do not Lend to Technology Based SMEs

- The lack of expertise in this sector; The need to finance technology ventures require that commercial banks officials be more knowledgeable in the specific sectors in which they invest, including a familiarity with the specific technologies, processes and market involved [10,29]. However, the commercial banks staff do not always possess this knowledge and may therefore not be able to provide the technology based firms with the industry-specific technical, production, marketing expertise and facilities which are vital for its success [23,6,28]. Indeed, empirical studies from various countries [28,6] have found that technology firms usually require that investors provide other value added activities apart from financial support which unfortunately they are not in a position to do.
- Unavailability of collateral security: More common reasons include a lack of tangible collateral security. Although a venture capitalists view a good idea whose time has come as representing intangible collateral. But to traditional and the very conservative lending institutions new ideas are not always very attractive to them, they prefer to deal with that which is old and tested [29]. However, investee companies may find it difficult to raise debt finance as they are required to provide sufficient collateral and it’s even more complicated in situations where they are expected to provide asset- backed collateral at “Carcass value” prices to ensure the loan is realistically covered [28,7].
- The problems of distinguishing between good and bad investment: As a result of the inability of commercial banks to recruit enough personnel that will cater for the various areas of specialization of technology businesses, it has been very cumbersome for them to understand and evaluate technologies that are considered good investments. In view of this shortcomings coupled with the high risk nature of potential investments they have chosen to stay away from financing this category of investee firms.
- High risk nature of investment; The degree of risk involved in technology investments which is reflected in the innovativeness of the products and processes, the specificity and size of capital inputs required, the often intangible nature of capital base, the financial inexperience of the founders and the attitudes, practices and imperfections in the capital markets [28,4,6]. Again, on the financial experience of the owners. It was discovered that majority of innovative entrepreneurs all over the world especially in America were at their early

twenty's, hence they mostly do not possess the managerial and financial ability to manage such a venture, and also they do not even possess a higher education or professional qualification (an MBA) needed at that level.

D. Government Guarantee for Bank Financing

The most pronounced research on banks involvement in developing the technology small and medium enterprise sector at both the early stage and later stages of development came from continental Europe such as Germany and France [10], Hungary [30], U.K and Ireland [31] and a few American banks around silicon valley and Boston [28]. The banks in Japan played significant roles in the industrial development of the country. As such the background of venture capital firms were set up as affiliates of financial institutions such as insurance companies, securities companies and commercial banks [32], they were the primary source of financing to high tech start-ups. Whereas in China, they were also very active and played prominent roles during the development of new ventures in the formative era [33]. They, rather than the government bureaus directly, provided the majority of the investment in spin-off projects under the Torch Program. The banks themselves did not have the capabilities or access to critical information to assess risk at the initial start-up stage. Instead, they relied on a project's designation as a recipient of Torch Program support as policy guidance. The majority of banks financing, however, were available only at the expansion and later stages of a venture's development [33], with local governments acting as guarantors. Another important role played by the technology zones in the mid-1980s as reported by [33] was the licensing of new ventures in order for them to qualify for preferential treatment under the Torch Program and other government policies, and to access funding from various sources, especially banks and venture capital firms. In Malaysia and other part of the world, although venture capital (VC) was acknowledged as one of the most important technology financing mechanisms assisting research and development activities, from promotion of basic scientific research to technology development and commercialization [34]. This assertion notwithstanding the role of traditional lending institutions such as the commercial banks cannot be underestimated.

III. METHODOLOGY

A. Research Design

This research is based on field study carried out in Malaysia. The data were gathered and assembled using 10 interviews with 10 prominent commercial banks in a manner consistent with grounded theory research design [35,36]. In addition; data were collected from the website of 5 other commercial and financial institutions to add to the quality of our result.

B. Sample Selection

The commercial banks interviewed were initially identified from the list of registered financial institutions in Malaysia found on the internet. Request for interview with our university letter-head paper was sent to 25 randomly selected commercial

banks headquartered in Kuala Lumpur, among which we were able to secure acceptance from 10 through referrals and 5 of them asked us to go find the information we want on their website. The researcher did a follow up to the request letters that were sent through registered mail to solicit for participation. Some of the banks visited complained of the huge volume of request they receive from students and researchers on a daily basis, which as a result of their very busy schedule could not attend to. One of the senior officials of the banks confessed that "*they do not normally want to partake in survey of this nature because of fear of divulging certain information that may be detrimental to their activities or may be useful to competitors*". However, all the 10 senior officials interviewed were responsible for decision making in their various banks.

C. The Interviews

As is common in qualitative method, in each organization, when the responses reached to a saturation point, the interviews were stopped [36]. In the saturation point, new respondents no longer give new or unique information about the interview subject [36]. The time allocated for each interview was ranged from 60 to 90 minutes. As a result of the cumbersome and lengthy nature of the questions adopted and responses we received from our respondents, we summarized our questions under five main themes and the responses follows under each theme. Thus, over the course of the interviews a consistent picture of debt financing began to emanate. This mode of investigation is called replication approach, and is broadly consistent with a grounded theory approach to data gathering and analysis [35,36]. Fried and Hisrich [37] used a similar method in examining venture capital decision making in the US. The interviews were tape recorded, transcribed and analyzed through content analysis. We asked the bank officials to discuss.....

D. Summary of Interview Schedule and Responses

Q1. How does your bank encourage Technology SMEs development in Malaysia?

When commercial bank executives in Malaysia were asked to respond to questions pertaining to the roles they play in helping to finance technology small and medium enterprises in the country. There was a kind of unanimous agreement that they recognized that "SMEs are the backbone of every economy whether developed, developing, emerging or least developed economy". Particularly in Malaysia they emphasized that technology SMEs and SMEs in general are vital in the growth of the nation to be a developed country by the year 2020 and beyond as envisioned by the current government's Economic Transformation Program (ETP) as embedded in the New Economic Model (NEM). A bank's senior manager among those interviewed posited as follows "*Our bank is willing to facilitate and assist this kind of industry to flourish in Malaysia*" through the following methods;

- Provide advisory roles on money and banking facilities and assist high tech SMEs to develop proper and appropriate financial planning of the organization so that the firm will be sustainable in the long run. Hence ensuring quick and prompt loan repayment and be on

the part of profitability. We provide talks, motivation, and workshop and advertise the facilities that are available to SMEs.

- We emphasis on a clear understanding and in-house analysis on the technology of clients this is aimed at building a long-term relationship with our clients as our main goal.
- Entrusted to promote local business relationship to overseas and global platform.
- Render help to enhance R n D to clients in various industries, or technology in order to enhance speedy development of the nation.
- Provide monitoring roles, special grants and subsidy in compliance with local authority regulations such as SME Malaysia Corporation's rules.
- We allow SMEs enjoy a high yield deposit investment that guarantees returns at the tenure of its choice that is huge interest on deposits and offer special financing rates/loan structure to cater for small and medium sized firms.
- Provide short term loans compatible with SMEs business and income patterns, provide repeated loans where full repayment for previous loans gives you an opportunity for another higher amount of loans and also provide very small loans or bank overdraft facilities for meeting day-to-day financial requirement.

This opinion is similar to that of other respondents interviewed during the survey.

Q2. What are your investment preferences? (High-tech or low-tech firms)

- When asked the question relating to the investment preferences of commercial banks, majority of the responses elicited from the respondents asserting that in Malaysia, most commercial banks do not consider whether a firm is high tech or low tech before lending to them. They specifically emphasized that what they are interested in is “do you meet our requirement for debt financing”? Then if so we are ready and willing to go along with you in your business. And most importantly and in addition the content of your business plan also will help the technology firm to secure our loan.

Another of the respondent puts it this way “our investment preferences depend on the high potential for growth and prospect for profitability whether high tech or low tech any one that meets our financial requirement will be funded”

One of the respondent posited that for his bank they give special preference to the agricultural sector in response to the growing population of Malaysia “alternatively, agriculture industry is another main focus of our bank considering the ever growing potential of the population of the country”.

Q3. How do you monitor your investments?

Financial executives were asked questions on how they monitor their financial investment in technology small firms they finance.

- The bank manager responded “we monitor our investment by been very close to the business we finance by carrying out frequent on-site visit and observation of the financial operations of the companies we fund”.
- Majority of those we discussed with agreed that the best way to monitor investment/loans awarded to new ventures is by asking to be furnished with financial review and status of their company and this is done on a quarterly basis. One of the executives says “we carry out constant review of the financial status of the company”. Another puts it this way “we mandate new venture owners to provide us with bankers performance report on a quarterly basis”.

All the managers involved in the discussions confessed that the best way that commercial banks monitor their loans is that they impose terms and conditions that new venture managers must abide by in order to minimize risk exposure. To achieve this they agreed that they usually expect that venture owners will cooperate with the bank by making their books available to carry out yearly and half yearly audited accounts and financial statements with full and transparent disclosure of information. A few of the terms and conditions are that they provide flexible loans with tighter terms and conditions to reduce risk exposure, impose third party guarantee against the risk, provide smaller structure with progressive disbursement schedule, impose higher than usual loan rate with higher pledging assets (fixed assets) and fixed repayment amount.

Q4. What are the important criteria your bank adopt to select TBFs the fund?

Considering what traditional lending institutions look for in potential investee companies before loans approval. The analyses of responses from the interviewees are summarized into five main sub headings for easy understanding and explanations;

- track record with satisfactory profit record, potential for profitability, healthy balance sheet with surplus assets position credibility of client in all aspects including financial compliance with rules and regulations, loan amount, repayment period and break-even point
- prospect and long term planning which is justifiable and feasible with availability of resources on hand
- Provide adequate collateral security; traditional lending institutions like commercial banks will only finance technology based firms who are able to show enough collateral security commensurate to the value of cash they are asking for. Also technology new ventures who have received initial grants from government as seed capital or early staged fund or who may have the backing of reputable retired business angels such lawyers, accountants, bankers, politicians and are known in the community and are longtime friends to

the commercial bank they should have the support of reputable venture capital firms as co-investors.

- Background information, credibility, strong management teams. The educational level sometimes does not matter in as much as there are capable people behind the organization and or the venture owner is able to meet up the bank's loan requirement.
- Geographical location of the business is another important criteria adopted by banks in selecting a firm to fund. The firm must be located at a reasonably near distance to the bank. In the case of finance it is argued that greater geographic distance between small business borrowers and their banks will reduce in person visits

due to the high costs of travel by bank staff, particularly

time costs, there by exacerbating information asymmetries which, in turn, increases the risk of adverse selection leading to higher default rates and loan losses [6,28].

Q5. What other services (value-added contribution) does your bank provide to TBFs apart from cash?

In order to elicit whether conventional money lenders add value to investee companies as that of external equity investors. We deliberately asked if the commercial banks in Malaysia do contribute in any other way to the growth of technology new ventures aside from cash support. The majority of senior bank officials we discussed with reveal that though they do not take up equity positions nor intervene directly in the day to day operations of companies they grant loans to, but in some ways they do provide some kind of value added responsibilities to their customers/client. They summary of a few of the roles they provide are;

- Advisory services on various financial and planning aspects of the organization and issues relating to the investments
- instructions and advice on fund transfer with special interest rates and charges
- exchange rate for conversion of foreign payments and receipt to and from international business partners of new venture manager
- coordination and introductory role with other industries or entrepreneurs or agencies who may be interested in participating or investing into the clients business
- Ease of payments and receipt transfer between subsidiary company locally and internationally.

IV. CONCLUSION AND RECOMMENDATIONS

Findings from responses from our respondents have confirmed the fear nursed by commercial banks in Malaysia and this is consistent with the general perception from investigation carried out by previous researchers in other part

of the world which indicate that financial managers from conventional lending institutions are very careful or almost unwilling to commit their fund to technology business investments. Since there is general consensus that banks are investing capital that belong to stakeholders and are managing this funds in trust and should not be mismanaged. Government are advised to adequately guarantee [33] such funds to be made available to technology new ventures in case of such situations as failure of business. An example of such guarantee is in the case of small business guarantee fund in USA [28]. Although during the course of our interview, and information revealed on the website of some banks, we found that a few of Malaysian banks have been very active in promoting the venture capital concept by setting up a separate entity for that purpose. An approximate 11% of commercial banks in Malaysia is involved in venture capital financing among 101 membership of the Malaysian venture capital and private equity association. This may be an alternative strategy adopted by Malaysian banks to help grow technology business firms, even though most of these commercial banks have one way or the other some percentage of government funds in their investment capital. The establishment of the venture capital and private equity firms by these banks is perceived as a way to support technology business financing as a means of keying into the government transformation agenda. Public policy makers in Malaysia could help more to accelerate the growth of technology new firms by;

- Provide more friendly import duty, tax rebates, subsidies and sales tax exemption on machinery and equipments purchased by technology new ventures for their operation.
- Provide grants to be used by banks to support technology ventures and provision of guarantor responsibility to early-stage tech firm.
- Close monitoring on the progress of technology new firms formed and render help when necessary, establish agencies to evaluate and recommend high tech firms to commercial banks for financial support.
- Encourage local financial institutes to offer short-term flexible loan facilities to cater for eligible companies
- Assist to source for external investors (local and overseas) to participate in this new ventures.
- Banks are also advised to be patient enough to look at the potentials of the company's products and services and evolve strategies to help bridge the financing gap especially in Malaysia.

Future Research: The researchers are currently working on a paper that looks at commercial banks in Malaysia who have established venture capital unit as independent companies aimed at supporting the technology small businesses.

ACKNOWLEDGMENT

Authors wish to acknowledge the university Teknologi Malaysia for supporting this publication under the RUG vote No.00J74 and the International Doctoral Fellowship (IDF).

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