

An appraisal of venture Capital financing on the growth and development of small and medium scale enterprises in Kumbotso Local government area of Kano State

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Abstract: This study aims to appraise the role of venture capital (VC) financing on the growth and development of small and medium enterprises (SMEs) in Kano State. The SMEs growth and development in Nigeria is crippled due to lack of financing. The survival of SMEs requires not only financing from bank loans but other alternative sources. The advent of venture capital financing in Nigeria served as sustainable financing mechanisms to resuscitate SMEs' performance. To achieve the research objectives, the study employs quantitative approach by distributing 50 questionnaires to the existing venture capital firms in Kano State. The simple random sampling technique was used to select 5 venture capitalist organizations in Kano State to participate in the study. The 50 questionnaires collected were analysed using descriptive statistics by using percentages and tabulation. Empirical findings demonstrated a substantial growth and development of SMEs through venture capital financing. The study also revealed that the operation of venture capital is successful, profitable and favoured SMEs in Kano State. Thus, entrepreneurs patronize and prefer venture capital financing than traditional banking loans. Therefore, it is recommended that proper policy framework should be developed to increase the number of venture capital firms in Nigeria. More so, awareness creation and provision of adequate fund are highly recommended.

Keywords: Venture capital financing, growth and development, small and medium scale enterprises.

I. INTRODUCTION

Finance has been identified as one of the most important factors that determines the survival and growth of any economic activities, small and medium enterprises (SMES) inclusive. Access to finance allows SMEs to undertake productive investment, expand business and acquire the latest technology (Bongomin et al., 2017). Poor financial system can seriously undermine the macroeconomic fundamentals of a country, resulting in lower growth and unemployment (Motta & Sharma, 2020). The significance of SMEs can never be over emphasized as it constitutes huge percentage of business in almost every country (Aremu and Adeyemi, 2011). Thus, it contributes immensely to the growth domestic product G.D.P and gross value added (G.V.A)(Achugbu, 2017). In doing so, SMEs provide the needed goods and services, generate wealth by providing employment opportunities, improving business

skills and entrepreneurship as well as standard of living and welfare among the populace across the globe (Asikhia, 2010; Agwu, and Emeti, 2014; Groot, et al., 2019). Moreover, SMEs serve as a stimulant for economic growth and development while they contribute to poverty alleviation (You, Dal Bianco and Amankwah-Amoah, 2020).

In developed countries, combination of a well-developed financial systems and appropriate government policies and programmes favours the growth and development of small and medium enterprises (Bonini and Capizzi, 2019). However, because of numerous challenges facing the sector, the contribution of SMEs to the economic growth and development of Nigeria is low (Okello et al., 2017). It is evident from the previous studies that small and medium enterprises have limited access to finance compared to large scale enterprises (Brixiova, Kangoye, and Yogo, 2020). In a situation where the finance is available, it is often at a higher cost compared to larger enterprises (Lee, 2004). Poor management and accounting practice hampers the ability of small and medium scale enterprises to raise finance (Ekpenyong and Nyong, 1992). Worst more, information asymmetry associated with lending to small scale borrowers restricts the flow of funds to small scale enterprises.

In Nigeria, several scheme have been designed in an effort to encourage the flow of the development finance to SMEs (Ugwu-oju, Onodugo and Mbah, 2020). In its effort to foster inclusive growth and widen opportunities for greater participation of innovative and young small enterprises, the Nigerian government established Small and Medium Enterprises Equity Investment Scheme (SMEEIS) in 2001(Central Bank of Nigeria, 2005). Under the scheme, all banks are required to set aside annually certain proportion of their profit after tax (10%) for equity investment and promotion of small and medium industries. This is to complement the effort of Nigerian Government by the banking industry towards stimulating economic growth, developing local technology and generating employment (Central Bank of Nigeria, 2005).

In spite of the above mentioned measures however, easy access to finance remain a major problem facing the SMEs (Lee, 2004). Hence, for SMEs to play their role effectively, a new approach or alternative means of financing is imperative. Venture capitalist as a financial body, do relatively finance infant, and potentially, high growing companies at an early stage of their development (Bonini and Capizzi, 2019). The venture capitalist like to invest their capital in such a business with long term growth prospect. Venture capitalists are vigorously involved in the management of the ventures they fund, usually serving as the members of the board of directors and holding significant economic rights in addition to their ownership rights (Salomon, 2016). Normally, they hold top organisational position and often take the position of a limited partnership, with the venture capitalists acting as general partners and the outside investors as limited partners. Thus, venture capital is a different form of financial intermediation, focusing in the provision of equity financing to SMEs for economic development (Breuer and Pinkwart, 2018).

The Nigerian government recognizes the importance of SMEs in stimulating and driving the economy (Gumel, 2019). As a result, the potential for venture capital investors is rapidly increasing. Though, venture capital industry in Nigeria is relatively new, there is growing interest in the concept and its relevance in the Nigerian society (Achugbu, 2017). In Kano State there are number of venture capitalist that assist to finance infant industries and these includes; Tony and Onyia.co in Kano Municipal, E.SO Lowomoran and company in Nassarawa Amra International limited in Tudun Wada Doguwa, Aim Asset Management limited in Fagge local government of Kano State and Unique Asset Management limited. However, empirical researches on venture capital financing are limited in the context of Kano State. Most researchers and studies are on conventional banking loan and micro financing. Against this background, this paper attempts to appraise the role of venture capital in financing SMEs in Kumbotso local government area to bridge the literature gap. The paper presents the statement of the problem, reviewed literature on the concept of venture capital and its role in the development of small and medium scale enterprises. The Importance and problems of venture capital are also reviewed. Finally, the paper presents the study findings, discussion and conclusion.

1.1 Problem Statement

Small and Medium Enterprises (SMES) are gate ways through which the objectives for growth and development of countries can be achieved. SMEs are essential instrument that encourage entrepreneurship, employment creation, improvement of standard, poverty reduction, mobilization of domestic savings for investment, reduction of inequalities, enhancement of resource utilization among others (Obadan and Odusola, 2000; Brixiova et al; 2020; Motta and Sharma, 2020). SMEs have huge potential for achieving sustainable development goals (Agwu and Emeti, 2014). Yet in Nigeria, the small and medium scale enterprises is stagnated and

remain relatively small in terms of its contribution to gross domestic product (G.D.P) (Aremu and Adeyemi, 2011). It is worrisome to see that its impact on Nigerian economy is negligible, despite the efforts made by the government to establish various micro lending institutions (Achugbu, 2017). The performance of SMEs in Nigeria has been slow due to number of challenges confronting the sector (Mpi, 2019). Some of the problems associated with the sector includes poor infrastructural facilities; poor managerial and entrepreneurial skills; financing challenges; limited demand for their products and services; poor research and development as well as innovation; poor technology system; corruption, lack of transparency arising from government regulations and regulatory bodies (Etuk, Etuk, and Michael, 2014; Ufua et al; 2020; Ugbala et al; 2020). However, Agbo (2020); Ugwu-ojuet al (2020) argued that the most critical problem facing SMEs in Nigeria is inadequate finance. The financing may be for the establishment of new business, innovate different ways in existing one or carry out expansion plans. It is regrettable to note that many creative individuals incubate new ideas that never hatch due to lack of finance (Achugbu, 2017).

To strengthen the growth and development of SMEs, a new sources of financing for start-ups is of paramount importance. In 2001, the Small & Medium-Scale Enterprises Equity Investment Scheme' (SMEEIS) was established by Nigerian Government to promote start-ups and SMEs through equity-based financing, rather than debt financing. The emergence of this financing structure is widely praised and seen as a solution to the financing problems of SMEs in Nigeria. Basically, the SMEEIS scheme entails using Venture Capital (VC) to support small and medium enterprises and other entrepreneurial ventures. To ensure steady growth and development of Nigerian economy venture capital financing is essential. Venture capital has the prospect and potentialities to reawaken and enhance the uptake of small and medium enterprises in Nigeria. Hence this study centres on appraising the venture capital financing in the growth and development of small and medium enterprises in Kumbotso Local government area of Kano State.

II. RELATED LITERATURE

2.1 Concept of venture capital

Venture capital financing is a form of financing that is employed to finance a relatively small size companies/ firms before they can be qualified for public underwriting (Ariyo, 2000). Venture capital is an important financial market intermediary that provide capital to small and young firms that have difficulties in attracting financing (Bonini and Capizzi, 2019). They often finance a firm in the early stage of development of the business. Hence, there are different kind of venture capital available for different stages of business development (Solomon, 2016). These type of venture capital include seed capital, start-up capital and development capital among others. Most of the firms that require venture capital financing faces a lot of uncertainties, operate in a dynamic

market environment and often, owns little tangible assets (Sahlman, 1990). Venture capital organizations finance these potentially but higher risky ventures by purchasing equity stakes (Kaplan and Strömberg, 2003). The venture capital industry not only possess the equity of the venture but also come up with various strategies to overcome the challenges that emerge at each stage of the investment process. Normally, the venture capital industry must pass through certain circle which starts from raising a venture fund and then, proceeds through the investment (Gompers, 1996). To ensure profitability of the business, monitoring and value addition to firms is essential. When the business turns out to be successful, the venture capital firm exits successful deals and returns capital to its investors, (Groot, 2019).

2.2 The role of venture capital in the development of a Small and Medium Scale Enterprises

The development and growth of SMEs in Nigeria is relegated to the back seat, which shatters the country's quest for industrial growth and development. Such poor growth is mostly attributed to the problems that surround the sector. Finance is usually considered as the main obstacle of SMEs in Nigeria. The emergence of venture capital in Nigeria has shown that the prosperity of SMEs depends on financing to small and medium enterprises (Okoh, 2020). The venture capital provides a long term investment for start-up companies and growing business that have the potential to develop into significant economic contributor (Ariyo, 2000). It helps the small firms to play crucial role in experimentation and innovation that leads to technological change and employment growth (Gompers and Lerner, 1999). Hence, it increases the shift of emphasis to the small business sector. It plays a key role in capitalizing the Nigerian economy into a knowledge driven, which spike the massive growth in technological know-how and other businesses (Daramola, 2012; Ariyo, 2000). Thus, it places the country on a stage with the capacity of creating a high paying jobs there by bringing wealth and prosperity for all.

2.3 Importance of venture capital

Venture capital have significant impact on micro and macro-economic indices. The potential benefit of venture capital according to Ollor and Dagogo, (2009); Poku and Frimpong, (2009) includes;

1. *Wealth formation*: The actualization of the growth potentials of high risk and innovative result in substantial wealth formation.
2. *High Return*: In addition to high capital gains that could be made on investment, venture capital could also drive income from the high returns of the successful investment in the portfolio making.
3. *Job creation*: The large number of potential venture in a country can create employment opportunities for a vast number of individuals in the country.
4. *Foreign exchange generation*: Successful venture capital backed projects often target international

markets and generate foreign exchange. Moreover, with an appropriate regulation framework, the venture capital industry may attract foreign participation.

5. *Improvement of productivity*: Arising need to achieve high return, venture capitalist would seek opportunity for growth potential in variably this has often led to exploration of technology areas. As the belief is common nowadays that improve productivity is technology driven.
6. *Capacity building*: Venture capital provides not only financial capital but also the opportunity to guide these young companies by offering managerial advice and controls. Unlike, traditional financial institutions who do not have time or expertise to grow the company.

2.4 Problems of accessing venture capital financing in Nigeria

Although, there are several benefits of venture capital financing, there are also certain challenges that surround its operation in Nigeria as opined by (Achugbu, 2017). These problems can be explained as follows;

1. *Macro level uncertainty*: Risk and uncertainty is inevitable in any business operation. But the nature of the risk of financing new and infant business is generally high. Venture capital financing usually involve investing in new businesses that relatively have high profit potential as well as risk exposure.
2. *Dearth of information about VC operations*: There has not been proper orientation and awareness on venture capital financing in Nigeria. Therefore, there is poor knowledge and information regarding operations, terms and policies of venture finance companies among many people.
3. *Dilution of control*: There is problem regarding the readiness to share the ownership, as some entrepreneurs may not be willing to share ownership and control with others.
4. *Proximity to venture capital firm*: It has also been noted that some venture capital finance firms are far located from the populace
5. *Inadequate fund and limited number of venture capital firm*:

The venture capital firm lack sufficient funds to extend to startups and expertise to function effectively. As a result, quite a number of entrepreneurs hesitate to fund their business through venture capital firm.

2.5 Empirical studies on venture capital financing

Venture capital is a bit new and still in its infant stage in Nigeria. Therefore, empirical studies in this field are scanty. However, Dagogo and Ollor (2009) study the effect of venture capital (VC) financing for small and medium-scale enterprise (SME) development in Nigeria by comparing the economic

value added (EVA) of venture capital-backed SMEs and those of non-venture capital-backed SMEs. The study found that VC financed SMEs clearly outperformed non-VC-financed SMEs, and that the distinctive performance is the effect of management support by venture capitalists in their portfolio SMEs. Based on in-depth interviews with 30 start-ups using systematic sampling technique, Achugbu, (2017) investigated the impact of venture capital (VC) financing on the growth of innovative start-up companies in Nigeria. The study found that venture capital financing has an impact on the growth of innovative start-ups. The use of VC financing increased profitability, spurred employment growth, boosted asset base, and improved the quality of management for VC-backed start-ups.

Abereijo and Fayomi, (2007) study the attitude of SMEs with regard to venture capital financing. The findings provide evidence suggesting Pecking Order financing behaviour is prevalent among manufacturing SMEs in Nigeria. A small proportion of SMEs that consider equity financing for both business start-up and expansion is found. Hence, equity financing through venture capital has not become as popular as other financing alternative in Nigeria. Agundu et al., (2009) examined the transformational financing window of venture capital and its instrumentality in enhancing the growth and development of SMEs. The study distributed 120 questionnaires to VC-backed and non-VC-backed SMEs. The study found that the VC-financed SMEs significantly outperformed their non-VC-financed counterparts.

Adawo and Atan (2013) advocated the establishment of venture capital bank managed by men of proven integrity to provide loans to unemployed graduates with promising ideas. Walter Offiong and Udoka, (2013) investigate the impact of venture capital financing on the growth and development of SMEs in Calabar metropolis Cross River State Nigeria. The study opted for exploratory studies in which 40 SMEs were selected using purposive sampling technique. The study discovers that, there was a critical effect of investment back on the general development of SMEs in terms of record keeping, volume of business, access to other sources of funding, sales value, and net Assets. Kato and Tsoka, (2020) assessed the impact of venture capital financing on growth of SMEs in Ghana. The study adopted quantitative method by distributing 40 questionnaires. The data were analysed using ANOVA and regression analysis. The study found that businesses have expanded, improved in the profitability, number of employees have gone up due to VCF Financing. It is also found by the study that VCF has significant influence on the performance of SMEs.

Puri and Zabruskie (2012) analysed VC-backed companies by comparing matched and non-matched samples. The study found that VC has positive effect on sales growth. However, the study found that VC-backed companies displayed higher growth rates of employment as the ratio of VC-backed 32 companies amounted to only 0.05 to 0.16 % of the total company's population, whereas the share of the employment

in VC-backed companies was at least 2.7 % and reached 7.3 % during the study period. Reynolds (1999) buttressed that VCs seeks to trigger, sustain and hasten the growth and performance of the small business, which enhanced profitability. Owusu-Adjei (2010) studied the extent to which private equity industry in Ghana contributes to private sector development. Based on in-depth interviews with five locally based companies the study found a significant contribution to businesses in Ghana through the provision of capital and technical assistance.

Hirukawa and Ueda (2003) examines whether VC investment are significantly related to labour productivity growth. The study employed Multi-Factor Productivity (MFP) by using growth as a measure of innovation. The study found that MFP growth is positively and significantly correlated with VC investments in the US. Manigart et al. (2002) discovered that venture capital is an alternative mechanism for raising fund to companies that encounter problem in accessing fund from conventional funding sources. In addition, they served as a robust financial system that strengthen a start-up companies that are prone to low profit to grow. Obeng et al. (2009) appraised the venture capital activities in Ghana. The study adopted a mixed method where 29 SMEs firms were selected. The study found that venture capital is an emerging industry with high growth prospects by considering increment in capital possession as well as investment. Poku and Frimpong (2009) assessed the prospects of venture capital finance in Accra Ghana. The study found that majority of the small businesses sees venture capital financing support as a solution to their devastating financing problems. However, they are reluctant to partner with venture capital firms in terms of managing and monitoring the business in fear of losing total control. The findings uncover that venture capital industry looks promising and can be maintained if the government creates enabling environment for its growth. A report on Canadian private equity market by D.J and MacIntosh (2006) exposed a gigantic growth of venture capital industry and high growth potential of SMEs access to venture capital. The report maintained that if the VC industry maintained the growth, it would remain as a significant part of the business and investment landscape, promote innovation and productivity, and support new job and wealth creation.

III. METHODOLOGY

This study employed quantitative approach to get useful information from the respondent. According to Creswell, (2013) a quantitative research refers to logical investigation of a phenomena by collecting information using sampling method and sending out survey through questionnaire, the result of which can be illustrated numerically. Hence, this study selected Kumbotso Local Government in Kano State as the study area because there are a number of start-up business that embark on venture capital financing. The simple random sampling technique was used to select 5 venture capitalist organizations in Kumbotso local government to participate in the study. The data was gathered through distributing 50

questionnaires, wherein 10 questionnaires were distributed to five selected organizations. The questionnaire was structured in such a way that it matches the study objectives. The data collected were analysed using descriptive statistics by using percentages and tabulation.

IV. FINDINGS

Table 1: Demographic information

Male		50					
Female		-					
Age range	30-35	36-40	41-45	46-50	51-55	56-60	
No. of respondents	1	10	30	9	5	5	

Source: Field survey, 2020.

The table above shows that all the respondents are male not female. The age range of the respondents is between the ages of 30-60 and majority of the respondents are within the age range of 41-45. This is followed by 10 respondents at the age range of 36-40. The least is the age range 30-35 which constitute only one respondent.

Table 2: Profitability of the business

Is venture capital profit oriented and for economic development?

Responses	No of response	Percentage%
Yes	50	100
No	-	-
Total	50	100

Source: Field survey, 2020.

The above table indicates that venture capital is profit oriented and for economic development as 50 respondent representing 100 percent believes that venture capital financing is profit oriented form of business for SEMs development. The finding reveals that venture capital firm is a successful business and the overall profitability is remarkable.

Table 3. Role of venture capital

What role do you play in the development of your portfolio company?

Responses	No. of respondents	Percentage %
Provision of fund for high risk	5	10
Assessing and revising the proposed business plan	8	16
Formulating the overall strategies	6	12
All of the above	31	62
Total	50	100

Source: Field survey, 2020

The above table shows that venture capitalist played an important role for the development of SMEs through various ways as 62% of the respondents admitted to participating in all the processes leading to venture capital engagement. This is so because the fact of engaging in all the activities mentioned entailstaking part in decision making and day to day management for the portfolio of their company.

Table 4: Provision of capital

What type of capital do you provide?

Responses	No. of respondents	Percentage%
Seed-capital	2	4
Start-up capital	4	8
Development capital	-	-
Expansion capital	-	-
All of the above	44	88
Total	50	100

Source: Field survey, 2020.

The table above shows that venture capitalist provides different form of capital to their portfolio company ranging from seed capital, start of capital, development and expansion capital. Two of the respondent representing 4% maintained that they provide seed-capital whereas 8% provides start-up capital. The higher frequency of forty-four standsfor 88 % of the population who buttressed that they provide capital ranging from seed capital to expansion capital to SMES.

Table 5: Source of fund

What is your source of fund?

Responses	No. of responses	Percentage%
Personal saving	-	-
SMIEIS	10	20
Investors	10	20
All of the above	30	60
Total	50	100

Source: Field survey, 2020.

It is indicated by the above table that 20 percent of venture capitalist get their fund from SMIEIS, 20 percent get their fund from investors. It is revealed from the above result that Nigerian venture capitalist are not wealthy enough to finance their portfolio companies with personal money.

Table 6: Venture capital performance

How will you rate the overall performance of venture capital in Kumbotso?

Responses	No. of responses	Percentage %
Very successful	40	80
Partially success	10	20

Complete failure	-	-
Total	25	100

Source: Field survey, 2020.

Table 6 above shows that 40 respondents representing 80% responded that the overall performance of venture capital in Kumbotso Local Government of Kano State and Kumbotso are very successful in their business while 10 of the respondents (20%) revealed that the success is partial. However, no respondent ascribed complete failure of venture capital in Kumbotso Local government.

Table 7: Patronization

Does Nigerian entrepreneurs patronize venture capital finance?

Responses	No. of responses	Percentage
Yes	48	98
No	2	2
Total	50	100

Source: Field survey, 2020

Table 7 above shows that entrepreneurs are patronizing venture capital lending as attested by 98% of the respondents. They maintained that entrepreneurs are patronizing the option and are prepared to engage venture capital funding to other sources of funding in Kumbotso Local Government of Kano State.

Table 8. Is distribution of venture capital financing across small, medium and large scale enterprises in Kumbotso Local Government area?

Responses	No. of responses	Percentage
Small and medium enterprises	25	45
Large scale enterprises	10	20
All of the above	15	35
Total	50	100

Field survey, 2020

As demonstrated by the table above, venture capital investment in Kumbotso Local government area favoured small and medium enterprises because most of them are in dire need of financing. Findings show that 45% of the respondent agreed that more financing is given to SMEs, 20% of the respondent indicate that the financing is mostly given to large scale enterprises and 35% of the respondent reveals that the financing is given to all the small, medium and large scale enterprises.

V. DISCUSSION AND CONCLUSION

The research findings on the appraisal of venture capital in financing small and medium scale enterprises shows that venture capital is a successful business and the overall profitability is remarkable in Kumbotso Local Government of Kano State. The study findings similar to the findings of

Reynolds (1999); Abereijo and Fayomi, (2007); Ollor and Dagogo (2009); Agundu et al., (2009) as well as Kato and Tsoka, (2020) who uncover that VC financing is profitable and their performance quite remarkable. The study exposed that, venture capitalist played an important role for the development of SMEs in Kumbotso local government area through providing funds/ capital at any level to SMES with potential growth. Their priority is to give more fund to SMEs that have the prospect to grow. The study finding corroborates with the findings of Manigart et al. (2002); D.J and MacIntosh (2006); Obeng et al. (2009); Poku and Frimpong (2009); Walter Offiong and Udoka, (2013) which demonstrate that venture capital served as a robust financing mechanism that strengthen a start-up companies that have the prospect to grow through giving various form of capital and other technical assistance. However, it is revealed that venture capitalist gets their fund from Small and Medium Industries Equity Investment Scheme (SMIESIS) and investors. This finding relates to the studies of Ariyo (2000) and Ugwu-oju, et al., (2020) who found that most venture capital firm in Nigeria source their fund from SMIESIS or investors. shows that entrepreneurs are patronizing venture capital lending as attested by 98% of the respondents. Furthermore, the study also shows that SMES are patronizing the option and are prepared to engage venture capital funding to other sources of funding in Kumbotso Local Government of Kano State. This finding correlate with studies of Daramola, (2012); Abereijo and Fayomi, (2007); Adawo and Atan, (2013); Achugbu, (2017) and Okoh, (2020).

VI. SUMMARY AND CONCLUSION

This study attempts to appraise the role of venture capital in financing small and medium enterprises in Kano State. The study findings revealed that venture capitalist play an important role for the development of SMEs through various form of capital ranging from seed capital, start of capital, development and expansion capital. Thus, the study finding shows that entrepreneurs in Kano state are patronizing the financing and prefer venture capital funding than other sources of financing. It is also revealed by the findings of the study that the overall performance of venture capital business in Kano state is successful. Therefore, venture capital financing contribute immensely towards employment opportunities for Kano state teeming population, which subsequently boost the total well-being of the people as well as their standard of living. Equally, the growth and development of SMEs could increase the government tax generation. This study contributes to the literature on venture capital financing in Kano state. The study provides empirical evidence about the profitability, performance and patronization of venture capital financing in Kano which are under explored studies. Hence, this study disclosed an existing gap in the literature. As this study focus on appraising the role of venture capital financing on the development of SMEs in Kano State. Future research should be carried out on the impact of venture capital financing on SMEs by seeking the

opinion of individual SMEs. More so, this study only selected Kumbotso local government area as a case study, further research should take a wider coverage by considering Kano State as a whole.

VII. RECOMMENDATIONS

The following are recommendations derived from the findings of the study.

1. A proper policy framework need to be developed to increase the number of venture capital firms in Nigeria.
2. There is the need to create awareness about the operations of venture capital firm to encourage greater participation.
3. Adequate fund should be given to venture capital firms as to meet the pressing financing need of the SMEs.

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