Financing Options for Small and Medium Scale Businesses in Enhancing Nigeria's Economic Growth and Development

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Abstract:

Financial strength is the main determinant of the growth of Small and Medium Scale Enterprises in developing countries like Nigeria. Hence, the focus of this paper is the financing options available to Small and Medium Scale Enterprises in a way to enhance the economic growth and development of Nigeria. Herein, financing SMEs through Micro-Finance Institutions and other finance sources are examined with the view to determining the way forward from what is presently obtaining in terms of the gap between loanable funds abounding in the banking sector and the inadequate quantum which the SMEs could access for the development of their businesses. To this effect, various recommendations have been made towards better and improved financing of SMEs with the major goal of enhancing the economic growth and development of Nigeria.

Keywords: Small and Medium Scale Enterprises (SMEs), Financing, Economic Growth, Loans and Advances.

Introduction:

The contribution of small and medium scale enterprises to the economic growth and development of most countries the world over cannot be over-emphasized. Funding of this type of business therefore is important for the overall development of the economy. For instance, the 2007 Annual Report and Statement of Account of the Central Bank of Nigeria revealed through the maturity structure of Commercial Banks' Loans and Advances in Nigeria that, of a total loan and advances of ₦85,173.45 Million that was given to Small Scale Industries by Commercial Banks between the period of 1985 to 1987, ₦713,378.74 Million, ₦102,646.95 Million and ₦42,147.6 Million representing about 83.13%, 11.96% and 4.91% matured under 12 months, 1-5 years and over 5 years respectively. This is an indication that a greater portion of loans and advances given to SMEs matured less than 12 months, which invariably discourages investment in long-term projects. However, preliminary computation using data from the Central Bank (2011) revealed that Commercial Banks' total credit to Small Scale Enterprises reduced from ₦26,218.40 Million in 1992 to 1996 period to ₦24,146.96 Million in the 2007 to 2011 period. Also, Commercial Banks' Credit to Small Scale Enterprises as percentage of total credit to the private sector fell from 18.25% in the 1992 to 1996 period to 0.35% in the 2007 to 2011 period. This is an indication that Nigerian Banks lack the needed resource base to extend long-term loans and advances to Small Scale Enterprises.

Nonetheless, in spite of the numerous initiatives of financial stakeholders in funding and promoting the growth of Small and Medium Enterprises in Nigeria, it is not in doubt that the potentials of SMEs have not been fully exploited.

Small and Medium Enterprises are believed to be the engine room for the development of any economy. This is because they form the bulk of business activities in a growing economy like that of Nigeria. This is manifested in the underlisted ways:

- Employment Generation
- Rural Development
- Economic Growth and Industrialization
- Better utilization of Indigenous Resources.

The Small and Medium Enterprise subsector has become pivotal to the economic revival of Nigeria as the country braces for change under President Muhammadu Buhari (Okon 2015). In his inaugural speech on Friday, May 29, 2015, President Muhammadu Buhari stressed that the SMEs would be central to government's efforts to revive the economy and provide employment for the teeming youths.

One corporate organization that has been at the vanguard of support for the SMEs is the nation's premier development finance institution, the Bank of Industry. Prior to when the BoI started supporting the SMEs, the subsector was a no-go area for commercial banks and other financial institutions. Operators lamented daily their inability to access loans from banks that could not make provisions for lower interest rates and longer moratorium which SMEs badly needed.

Conceptual view of Small and Medium Scale Enterprises:

There is no consensus on the definition of small-scale enterprises. However, small scale business, small scale industries and small scale entrepreneurship are used interchangeably to mean a small scale industry firm. In Nigeria and worldwide, there seems to be no specific definition of small business. Different authors, scholars, and schools have different ideas as to the differences in capital outlay, number of employees, sales turnover, fixed capital investment, available plant and machinery, market share and the level of development. These features equally vary from one country to the other given the underlisted:

- In Nigeria, the Third National Development plan defined a small scale business as a manufacturing establishment employing less than ten people, or whose investment in machinery and equipment does not exceed six hundred thousand naira.
- The Central Bank of Nigeria in its credit guidelines, classified small scale business as those businesses with an annual income/asset of less half a Million Naira (₦500,000).
- The Federal Government Small Scale Industry Development Plan of 1980 defined a small scale business in Nigeria as any manufacturing process or service industry, with a capital not exceeding ₦150,000 in manufacturing and equipment alone.
- The Small Scale Industries Association of Nigeria defined small scale businesses as those having investment (i.e. capital, land building and equipment of up to ₦60,000 Pre-SAP Value) and employing not more than fifty persons.
- The Federal Ministry of Industries defined it as those enterprises that cost not more than ₦500,000 (Pre-SAP Value) including working capital to set up.
- The Centre for Management Development's definition of small industry in the policy proposal submitted to the Federal Government in 1982 defined small scale

industry as, “a manufacturing processing, or servicing industry involved in a factory of production or type of operation employing up to 50 full-time workers.”

Lastly, in the United States, the small business administration defines a small business as one that is independently owned and operated but not dominant in its field, and meets employment or sales standard developed by the agency. This also shows the same trend as in Nigeria, although the exchange value makes the financial criteria to be different.

However, Small and Medium Scale using Japanese experience, the size and importance of the role of medium and small-scale industry in the whole of the Japanese manufacturing industry is not widely known in the third world, neither is it known that there is a structure linking these industries with the more internationally famous Japanese enterprises in business and technology.

SMEs - The Nigerian Experience:

The Small and Medium Industries Equity Investment Scheme (SMIEIS) in Nigeria, defines small and medium enterprises (SMEs) as enterprises with a total capital employed not less than ₦1.5 million, but not exceeding ₦200 million, including working capital, but excluding cost of land and/or with a staff strength of not less than 10 and not more than 300. The small and medium enterprises (SMEs) in Nigeria are a very heterogeneous group of business, usually operating in different sectors of the economy. The SMEs consists mainly of those engaged in the distributive trade who constitute about 50% of the SMEs, 10% are in manufacturing, 30% in agriculture and 10% in services, which together account for well over 50% of Nigerian Gross Domestic Product. There are indications that the SMEs account for about 70% of industrial employment in Nigeria (Afolabi, 2013). The multiplicative effects of such employment generation on other sectors of the economy will enhance growth.

Nigeria is blessed with vast resources, including oil, gas and solid minerals, already confirmed to exist in commercial quantities. She also has enormous electric power resources; a large human population, forming a very big market and substantial idle capacity in all industrial sectors. In addition, small and medium scale industries are known to exist all over the country and most of them were established from the mid-1980s, with the inception of the Structural Adjustment Programme (SAP). All these indicate great potentials for the emergence of a vibrant industrial sector, particularly the small-scale segment. In this context, a well-focused SMI development programme in an investment friendly environment can achieve the long sought industrial transformation, which the programme of large-scale capital-intensive industrialization failed to deliver.

The SMEs operating in Nigeria are not shielded or immune from the typical problems and constraints of SMEs in other developed countries. Almost every country assists her SMEs largely because of the crucial inherent role they play in the economic growth and development. The SMEs in Nigeria have expanded following the adoption of the Structural Adjustment Programme (SAP) to fill the supply gap in industrial consumer goods created by the difficulties faced by large scale firms which have not easily adapted to the policy changes of SAP.

Moreover, a major gap in Nigeria's industrial development process in the past years has been the absence of a strong and virile small and medium enterprises sub-sector (SMEs) owing to financial constraints explained by high lending rates, high loan requirements and lack of viable entrepreneurial skills. Also, lack of adequate credit for SMEs traceable to the reluctance of banks to extend credit to them owing, among others, to poor documentation at project proposals as well as inadequate collateral by SME operators constitute one of the problems facing SMEs in Nigeria. The little progress recorded from the courageous efforts of the first generation of indigenous industrialists was almost completely wiped out by the massive dislocations and traumatic devaluation which took place under the Structural Adjustment Programme (SAP).

In recognition of these constraints and in order to ensure the realization of the potential benefits of virile SMEs in the economy, the Central Bank of Nigeria has remained committed to the growth and development of the small and medium scale enterprises in Nigeria. This stance has been successively reflected in the Bank's policies over the years. In particular, the CBN has through its credit guidelines over the years, and until very recently, required the erstwhile commercial and merchant banks to allocate stipulated minimum of credit to the preferred sectors including the SMEs.

Micro-Finance Institutions' Option of Financing SMEs:

Microfinance is the provision of a broad range of financial services such as deposits, loans, payments services, money transfers and insurance to poor and low-income households and their micro-enterprises. Microfinance services are provided by three types of sources:

- Formal institutions, such as rural banks and cooperatives.

- Semi-formal institutions, such as non-governmental organizations.
- Informal sources such as money lenders and shopkeepers.

Although small-scale enterprises play crucial role in the macroeconomics of developing countries, several empirical studies have shown that inadequate credit was a major obstacle impinging its production capabilities (Ihua, 2007; Osotimehin et al., 2012). The high cost of credit discourages the expansion of the economic activity of the small businesses. In most African countries, commercial banks traditionally lend to large-scale enterprises which are adjudged to be credit worthy. They avoid doing business with small enterprises because the associated cost and risks are considered relatively high. Also, strict collateral security being demanded by these banks and high interest rates charged by them are major constraints to access credit by small as well as medium-scale businesses. There is therefore the need to redress this lack of access to credit and the microfinance institutions have a prominent role to play.

Successive governments in Nigeria have introduced different measures to facilitate financing of small-scale enterprises in Nigeria. The measures include setting up statutory loans or credit schemes such as: Small-Scale Industries Credit Scheme (SSIC), Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBIC), National Economic Reconstruction Fund (NERFUND), Small and Medium-Scale Enterprises Development Agency of Nigeria (SMEDAN), Small and Medium Enterprises Equity Investment Scheme (SMEEIS), People's Bank of Nigeria (PBN), and lastly, Community Banks (CB). In 2007, the Central Bank of Nigeria (CBN) came up with the reform of Community Banks by renaming them as Microfinance Banks (MFBs) with the goal of making them money effective tools towards the development of the micro, small and medium-scale enterprise (MSME) Sector. Thus, private sector with the desire and ability to operate Microfinance Banks has been statutorily empowered to do so.

Microfinance Banks (MFBs) are expected to be vehicles of social-economic growth and rural transformation. This was to help reduce the burden of interest and other financial charges expected under normal bank lending, as well as provide financial advisory, technical and managerial supports. The latent capacity of the poor entrepreneurs would be significantly augmented through the provision of microfinance services which enable them to engage in productive economic activities and be self-reliant, increase employment opportunities, boost household income as well as creation of wealth. The significance of MFBs made CBN to adopt it as the main source of funding for MSMEs, especially those in the manufacturing enterprises having a long gestation period. Thus, there is need for more accessible financing especially medium or long-term funding.

Bank of Industry's Support for SMEs:

As Nigeria continues to seek avenues for diversifying its economy, government and corporate organizations are becoming aware of the huge potential of SMEs. While reviewing the impact of the BoI in the industrial sector in the past one year under the management of the Managing Director, BoI, Mr. Rasheed OlaOluwa, the Executive Director, Small and Medium Enterprises, Mr. Waheed Olagunju, remarked that from 2001 to 2014, the bank had dedicated less than 10 percent of its risk asset to SMEs. He noted that with a higher percentage of its risk assets going to the sector, the bank would have been able to create more jobs. He said the situation informed the decision of OlaOluwa to set up a separate Directorate for tackling the needs of SMEs on his assumption of duty as the bank's Managing Director (The Punch, Friday, June 26, 2015, Pg. 33).

Olagunju observed that in other parts of the world, the SME subsector played a very important role, adding that challenges like lack of funds and lack of access to market prevented the SMEs in Nigeria from measuring up to the level of their counterparts globally. He therefore urged the government to activate policies that could create market for the subsector. Anticipating the volume of job creation that could come from investing in the subsector, the BoI, according to Olagunju, decided that by 2019, about 30 percent of its risk assets would be accounted for by SMEs. OlaOluwa stated that the bank had disbursed over N127 Billion to SMEs in the last one year. He said, "Since we did that, a lot of things have been happening." The BoI MD stated that the bank had identified SME clusters all over the country and planned to design products to target specific clusters.

In keeping with the promise of designing new products for SMEs, BoI had launched five digital products for the subsector. The Online Loan Application Portal, which is one of the five products, according to OlaOluwa, shortens the loan process for customers by allowing them to fill and track their loan application forms from their homes as opposed to going to the bank for that purpose. He added that the online loan portal also shortened the loan processing turn-around time of the bank.

Another digital offering product, the loan application Tracking system, will enable customers to obtain online real-time updates on loan request submitted to the bank through an innovative loan status tracker on the bank's website. The BoI Managing Director explained that the Information Technology product was developed to enhance customer service delivery to SME loan applicants at the bank.

From the foregoing, it stands to reason that the current support of BoI will go a long way to make SMEs an engine room for economic growth and development in Nigeria.

Contribution of other Banks as Represented by Skye Bank:

Other banks have been contributing their quota to the development of the SME subsector. Some of the banks, classified as SME-friendly by operators, offer concessions in loans and interest rates to the operators. A few of them have gone beyond just giving loans to organizing capacity building seminars that will help equip operators for the business world. One of such seminars was organized recently by Skye Bank Plc in Lagos. The bank, which had in the past organized such seminars in Onitsha and other states in the South Eastern part of Nigeria, hosted more than 200 SME operators to the Lagos edition of the business seminar. The Group Managing Director of Skye Bank, Mr. Timothy Oguntayo, also stressed that SMEs were major contributors to employment anywhere. He said, "Skye Bank wants to facilitate knowledge sharing and offer banking solutions that will help businesses. There is no way for multinationals to employ all the teeming young people who are seeking employment, therefore, the role of SMEs in employment cannot be overemphasized".

Vice Chairman of Tantalizers, an SME outfit, Mr. Folu Ayeni, also shared his success story with the operators at the seminar, recalling how his business started from a small living room and grew to a large scale venture with 53 outlets nationwide. He said Skye bank provided the initial N2.5 Million seed capital that was used to start the business.

The above-enunciated contribution of Skye Bank is an expression of the fact that commercial banks too do in their own little way assist SMEs development in Nigeria though there is room for improvement.

Other Sources of Finance:

- ✓ **Sale of Disposable Assets:** A firm which is a Small or Medium Scale Enterprise can turn some of its assets into sources of finance. This is done by selling some of the existing assets of the firm for various reasons to achieve other more beneficial goals. Such assets include amongst others, landed properties, Shares owned by the firm in another firm or company, equipment and assets in excess of its present and immediate future needs or equipment that are becoming obsolete. Among some of the reasons for sale of a firm's assets are changes in future technology, under utilization of the asset, rapid depreciation of a particular asset and foreseeable negative government policies or market rejection. Although it is a veritable source of income for all times by different kinds of firms or companies, there are some of a firm's assets that are key to the existence of the firm. Such assets may not be disposed of without endangering the continued existence of the firm. Secondly, firms that are new may not have this source open to them because at that stage, they are more interested in assets acquisition than disposal.

- ✓ **Mortgage of Property:** A firm which is a Small or Medium Scale Business that is in need of funds for its business may decide to mortgage some of its properties or any of its property in order to raise money. This can be done by way of a legal mortgage or an equitable mortgage. Most times, legal mortgages are created over realty. It involves an owner with a legal title, which he passes on to the mortgagee upon redemption for a definite consideration and time. It is usually used to raise both short term and long term loans.
- ✓ **Debentures and Charges over Assets:** A Debenture is defined in Section 650(1) CAMA as a written acknowledgement of conditions of indebtedness. It is in many ways similar to a share, but the fundamental difference between them is that the holder of a debenture is not a member of the company but its creditor. Most times, a debenture creates a charge on the company's assets. This is because banking and financial institutions naturally insist on collateral securities before they grant loans to their customers. In the case of a company or a firm within the purview of SMEs, the loan may be secured by any part, or all of its assets. For most practical purposes, a charge should be regarded as a specie of mortgage. Nevertheless, there is an essential difference between a mortgage and a charge. A mortgage is a conveyance of property subject to a right of redemption, whereas a charge conveys nothing and merely gives the chargee certain rights over the property as security for the loan. It is the offering of the assets of a company or a firm, as security for the payment of a loan. A charge could be fixed or floating. A fixed charge is one that attaches to a particular property of the company or firm. It follows that when a property is specifically charged, it is fixed and cannot be disposed of or encumbered without the consent of the chargee. The effect of this is that in the event of the firm being wound up, a

debenture holder secured by a specific charge is on the highest ranking class of creditors.

- ✓ **Trade Credits:** Trade credits means a credit that a customer gets from his suppliers of goods in the normal course of business. Trade credits are major sources of finance open to all forms of on-going businesses. It consists of the supply of goods and services the firm needs in the course of rendering services or production. It is the amount of credit its customers and raw-materials' (services inclusive) suppliers are ready to supply in the short term before payment. Its volume will depend on its production and marketing circles.
- ✓ **Equipment Leasing:** It is an alternative source of finance by which a company or a firm can gain the use of an asset without having to pay at once, the full cost of the asset. Usually such equipment is required by the user who is not financially buoyant to afford the capital needed for outright purchase of the equipment in question. There are basically two types of Equipment leasing. Firstly, there is the operating lease and then there is the finance lease. An operating lease finances the acquisition of equipment at less than their useful life. It is usually for short repeated periods. The equipment may be leased out to a series of different lessees in sequence, each taking the equipment for the period in which he needs it and paying rent reflecting its value. It may also be let to the same lessee repeatedly.
- ✓ **Creation of Joint Ventures:** As a company or firm grows, its operational cost may become higher than its initial anticipation and so, it may decide to go into a joint venture with another firm. When this is done, both firms put resources together and share the operational cost of running the business. The main advantage of the joint venture is that the financial burden of meeting the set objectives is shared between the members of the joint venture although we must not forget that this also means that the profit made at the end of the day will also be shared between them.

In spite of all the afore-enunciated sources of finance available to SMEs, there is still a wide gap between available loanable funds and the quantum which SMEs could access because of various reasons amongst which are issue of collateral to back up the SMEs' borrowings, high interest rate charged on the loans made available to SMEs as well as rate of default in repaying the loans taken by the SMEs.

Conclusion:

Funding of Small and Medium Scale Enterprises is important for the overall development of the economy. It is in recognition of the role of Small Scale Enterprises that governments of developing countries like Nigeria have employed series of monetary, fiscal and industrial policy measures, all aimed at ensuring their proper funding and development. It is on this note that this paper examined the financing options available to Small and Medium Scale Enterprises in enhancing the economic growth and development of Nigeria. It is therefore the conclusion of these authors that there is still much to be done by all stakeholders of SMEs in making adequate finance available to the sector which is a purveyor of economic growth in its own right. It is the wide gap between the loanable funds abounding in the banking sector and the inadequate quantum made available to SMEs overtime that calls for the recommendations made by the author of this paper.

Recommendations:

In view of the strategic importance of Small and Medium Scale Enterprises in enhancing the economic growth and development of Nigeria, coupled with the financing options available to SMEs, the following recommendations/suggestions cannot but be viewed as germane.

- Government should pursue policies that would promote access to short, medium and long-term bank credit finance at concessionary interest rates by small scale investors.
- Apart from relaxing certain credit conditions to SMEs investors, such as the provision of collateral, the institutional framework responsible for mobilizing credit to SME should be strengthened. Measures that would enhance the liquidity position of these banks would go a long way to increase the volume of Loanable funds within their disposal that can be given out to SMEs investors as loans.
- Policies that would enhance the installed capacity utilization rates of the manufacturing sector should be pursued. For instance, effort should be directed towards improving upon the erratic power supply in the country. The recent privatization of the power sector is a bold step by the government to improve upon the erratic power supply and should be encouraged.
- Government should ensure proper funding of the sector. Apart from ensuring that money allocated to SMEs through participatory banks is disbursed timely and at CBN approved rates and conditions, government should make SMEs a priority area in her expenditure schedule.

- ❖ Government should pursue policies that would ensure macroeconomic stability. Such policies should be tailored towards the reduction of exchange and interest rates in the country. To reduce exchange rate, proper monitoring and regulation of the foreign exchange market is imperative.
- ❖ Government should formulate policies that will compel commercial banks to relax their restrictive regulations and operations which discourage borrowing and offer more credit facilities for SMEs.
- ❖ Government should re-introduce and enforce the mandatory minimum credit allocation by banks to SMEs in the Annual Monetary Policy Circular and Guidelines. Also, the government should empower the SMEs to access and get credits from the commercial banks through formal and informal entrepreneurship education for SMEs to develop their managerial capabilities, accounting skills and over-all, be more credit worthy. Certificates of attendance obtained from such trainings should be more a prerequisite to obtain loans.
- ❖ Mandate should be given to commercial banks to reduce credit allocation requirements in terms of collateral and interest in order to increase credit allocation to SMEs to enhance economic growth in Nigeria.
- ❖ There is the need to create an enabling environment for SME development in terms of clear tenure rules, simple business registration and export procedures, and accessible tax and financial incentive schemes in order to enhance their potentials in promoting economic growth in Nigeria.
- ❖ Group borrowing should be encouraged as it minimizes the rate of repayment default.
- ❖ There should be alliance of MFBs, SMEs' Associations such as SMEDAN, and Business Department of Tertiary Institutions to provide training and education to entrepreneurs in the art of financial management, business plan preparation, and project planning and evaluation.
- ❖ MFBs should form alliance with the Bank of Industry (BOI) to provide medium/long term loans.
- ❖ Government should develop infrastructure like power and transport systems in order to reduce the cost of production. Developing small businesses will assist in curbing the alarming rate of youth unemployment in Nigeria.

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