

## **Problems Of Funding Small And Medium Scale Enterprises In Nigeria**

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**Abstract:** *This paper examined the problems of funding small and medium scale enterprises in Nigeria. The study identified the sources of finance, types of finance available to small scale enterprises and the various financial challenges bedevilling the smooth operation of small and medium scale enterprises and suggested the way forward. Observation and review of relevant documents were employed in carrying out the study. It was discovered that though adequate finance is indispensable for the successful operation of small and medium scale enterprises, government still needs to create a more conducive environment for small scale business to thrive by streamlining business tax policies to eliminate extortion from small scale businesses.*

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### **I. Introduction**

Governments are often seen making frantic efforts in developing small and medium scale enterprises (SMEs). These enormous efforts are as a result of the activities of these enterprises having significant contribution to the employment generation, manpower development and gross domestic product of the country (Kadiri, 2012). It should be noted that the definition of small scale enterprise varies from one author to another. Nevertheless, small scale enterprise is an enterprise that has relatively little capital investment that produces in small quantity and as a result control small share of the market with less than 50 employees (Olatunji, n.d.). Also, management, marketing and entrepreneurial functions are vested in the proprietor. Ironically, in spite of the vital roles of small and medium scale enterprises in the economic growth and development of a nation, the effectiveness of these enterprises is still hampered by many factors. Some of these factors are:

- inadequate capital (finance)
- poor record keeping
- poor or wrong location
- poor planning
- inadequate infrastructural facilities
- lack of skilled manpower etc.

Of all the above identified problems, finance arguably seems to be the greatest challenge. Many of the SMEs have to content with the problem of raising sufficient start-up capital and how to attract credit facilities from financial organisations like banks. Even where these facilities are available, small scale enterprises still have to provide collateral securities normally demanded by most lending institutions. These are in addition to high interest rate charged on loans given by these lending institutions. Without any doubt, the problem of finance is a major one particularly to the establishment and survival of small and medium scale enterprises. The discussion of this issue is therefore, the basis of this paper.

### **II. Objectives**

The main purpose of the paper was to examine the problems of funding small scale enterprises. Specifically, the paper seeks to:

- examine the problems of funding small scale enterprises
- find out the sources of finance available to small scale enterprises
- ascertain the prospect of financing small scale enterprises
- Consider the strategies for overcoming financial challenge in small scale enterprises.

### **III. Literature Review**

#### **Concept of Small and Medium Scale Business**

In his review of activities of SMEs, Ukaegbu (2004), states that, prior to the introduction of the structural, adjustment programme in Nigeria small and medium scale industries were virtually neglected in all the development plans of the country. However, since the advent of democratic government in 1999, there have been significant changes in attitude to small and medium scale industries and entrepreneurship among policy makers and managers of Nigeria economy.

This change in orientation has been attributed to an acknowledgment of the continuous importance of the sector in terms of the number of such enterprises, job creation and the promotion of its contribution to the Gross National Product (GNP). Oyedijo (2008) opines that the definition of small and medium industries should reflect the level of technology within the economy, the development needs or objectives of the economy and such other facts that are dictated by the social and cultural value of the economy. These considerations he asserts, suggest that there is no universally accepted definition of small and medium scale industries, the world over.

It is however important to realize that there is need for a standard definition of small and medium scale industry within an economy. This need is paramount in the context of providing a frame of reference for the various agencies responsible for policy formulation and implementation in respect of small and medium scale industries. Adidu & Olannye (2006), states that different countries have different basis of defining small and medium scale enterprises, some on capital investment, while others define it on the basis of management structure. There are many definitions on small and medium scale enterprises (SMEs) as there are experts on the subject. The Nigerian industrial policy describes SMEs as those whose total investment is between N100, 000 and N2million exclusive of land but including working capital.

There are however, some qualitative indicators that are common to most definitions namely; Size of capital, the number of employees, the annual turnover. Adidu & Olannye (2006), states that in summary, SMEs are those business whose capital investment does not exceed N5million (including land and working capital) or whose turnover are not more than N25million annually. The Small Business Administration (SBA) in the USA measures SME as one which posses at least two of the following criteria.

- Managers are also owners
- Owners supply the capital
- Area of operation mainly local
- Small in size within the industry.

It is therefore glaring that there is a universal cord that links all the above definition and that SMEs are generally low in terms of number of persons employed and the amount of investment and annual turnover. Thus, a review of existing literature on the subject suggests the following as the mostly used criteria for the definition of small and medium scale industries:

- No of employees
- Sales Volume: The size of sales volume in any business will determine where to group it. I.e. whether to a very small, small or medium business.
- Financial strength: This as well determines whether it is a very small, small or medium business. The amount of fixed assets and current assets each business is having helped to determine where to categorize them.
- Relative Size: The relative size of the business is determined by number of people working in this business, that is, the number of employees helps in determining whether it is a small, very small or medium business.
- Initial take-off capital: This means that the amount of shares you used to start or incorporate your business will help in large way to determine where to categorize the business.
- Personal management style.
- Independent ownership
- Name of business
- Composition of ownership and types of industry.

Even if there are controversies on definitions, what is not contestable is the contribution SMEs are making to the Nigerian economy.

### **Problems Of Small Scale Enterprises In Nigeria**

In spite of all the efforts and supports of governments and multilateral institutions such as World Bank, SMEs have not been able to make the desire impact on the Nigeria economy. This therefore, underscores the fact that there exist fundamental issues confronting small scale enterprises that have not been adequately addressed. From personal interviews of some small scale entrepreneurs in Igabi Local Government of Kaduna State and observation of their business activities; it is evident that SMEs are bedevilled by financial, management and technical problems. The financial problem of these enterprises is multifaceted. It ranges from lack of sufficient start-up capital to inadequate working capital. These are in addition to poor record keeping culture by these SMEs. Other problems that have constrained the role of SMSEs and make the realisation of the benefits of their existence farfetched according to Mba and Emeti (2014) include:

1. Discrimination from banks which are somehow averse to the risk of lending SMEs especially start-ups.
2. Lack of knowledge on how to package appropriate bankable business proposals.
3. Weak demand for products arising low and dwindling consumer purchasing power and aggravated by preference for foreign products at the expense of locally produced goods.
4. High incidence of multiplicity of regulating agencies, taxes and levies that result in high cost of doing business and discourage entrepreneurship. This is due to the absence of a harmonised tax regime which would enable business owners to build in recognised and approved levies.
5. Wide spread corruption and harassment of SMEs by some government agencies over unauthorised levies and charges.
6. Exorbitant interest rates charged by banks and other financial institutions on loans granted to SMSEs. This is a big disincentive to seeking financial support from these institutions and thereby stifling the growth of these SMEs.
7. Wide spread pilfering and outright stealing prevalent among most SMSEs staff constitutes a major financial challenge. Funds that could have grown the business end up in private pockets of staff.

### **Small Scale Businesses and the Nigerian Business Environment**

In his review of the performance of small scale business, Asika (2004) states that, the history of small scale businesses, in many countries, especially Nigeria is replete with instances of firms which became extinct or stunted after an era of relative affluence in which they had attained leadership positions in their respective industries. Everyone who had at any point in time owned or managed a business firm will agree that the vicissitudes in businesses environment are like powerful currents, which can either blow a particular firm right to the top or sweep it underneath completely.

The Nigerian business environment according to Ukaegbu (2004), is characterized by its free enterprise though the economy witnessed depression some years ago resulting in the destabilization of so many small scale businesses and other organization alike. Presently, the economy is being affected by the global economic meltdown, which is sweeping so many economies of the world and businesses struggling to survive, depreciation of the naira against the dollar, over dependence of the country on oil and inconsistency in government policies are what has characterized the Nigerian business environment.

### **Sources of Finance for Small Scale Enterprises**

Leon (2008) lists the following as various sources of finance for small scale enterprise:

1. Personal savings: Personal savings is a major source of finance for SMEs. To a large extent, one may say that it is the most assured source of finance. Most start-ups are usually planned; therefore, we may safely assume that the prospective owner will provide the initial capital. Such capital comes from savings kept for various eventualities and unforeseen mishaps that may require money.
2. Borrowing from friends and relations: Apart from sourcing finance from personal savings, many businesses are set up or financed by money borrowed from friends or relations. In some cases the finance is provided either as a gift or soft loan to be repaid at mutually agreed terms. One major problem associated with this source however, is that it is not easy to get because friends and relations may not trust the sincerity of the borrower to repay the loan.
3. Borrowing from commercial and microfinance banks: One major function of commercial banks is to lend money to customers be it individuals or corporate organisations. Part of the purpose of such loans is to enable the customers undertake capital projects that ordinarily their savings cannot finance. Usually the loans are repayable within a specified period of time and at an agreed rate of interest per annum. In addition, most banks normally require collateral securities before any loan is granted.
4. Lease financing: Lease financing is a type financing that is available to small and large business organisations. Basically, a lease is a contract whereby one party (the lessee) hires equipment from another party (the lessor) in a way that the lessee uses the equipment without purchasing it. But in return the lessee pays the lessor agreed periodic fees called lease rentals. At the end of the lease period, the lessee may have the option to purchase the equipment. Typical equipment financed through lease agreements are oil tankers, luxurious buses, tractors etc.
5. Borrowing from the Bank of Industry (BOI) and other government institutions: The Bank of Industry Limited is Nigeria's oldest and industrial financing institution. It was reconstituted in year 2001 out of the defunct Nigerian Industrial Development Bank Limited which was incorporated in 1964. The mandate of BOI is to provide financial assistance for the establishment of large, medium and small scale enterprises as well as expansion, diversification and modernisation of ailing ones. Presently, huge sum of funds are being channeled through this bank for small scale enterprises.
6. Borrowing from cooperative society: This is a major source of funding for small scale enterprises. Small enterprises have a great difficulty in obtaining capital, due to the poor match between their capital needs

and the operating rules of the capital markets. Of all financing options available to SMEs, including a reluctant financial market and doubtful relations; cooperatives appear to be a most reliable option. Cooperatives, particularly financial cooperatives are response of the market itself to mobilize resources and make same available to SME and other users through appropriate institutional arrangement, thus explaining the recourse of some development agencies to channel funds meant for SMEs through cooperatives (Nwankwo,2012).

### **Prospect of Funding for Small Scale Enterprises in Nigeria**

According to Okereocha (2014), the future of small and medium scale enterprises sector looks promising. Of late, local and foreign financial institutions, government agencies state governments and well meaning individuals have been focusing attention on the sector.

The World Bank has in a bid to help close the funding gap for small and medium scale enterprises, approved \$500m (N21.7b) lifeline for the sector in Nigeria. This is coming on the heels of similar intervention by the central bank of Nigeria, which has launched N220b small and medium scale enterprises (SMEs) fund. If these enterprises could take advantage of these efforts and also key into several capacity building programmes of some states, then, the sector will no doubt fulfill its role of creating jobs and ensuring inclusive economic growth and development.

While the Central Bank of Nigeria and the World Bank are showing the way in the area of access to finance, some state governments and public agencies have concluded partnership arrangement that promises to put the sector on the path of sustainable growth.

Already, the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) in conjunction with United Nations Development Programme (UNDP) have conclude plan to train women entrepreneurs with the hope of leveraging the CBN N220b SMEs fund.

Bank of Industry and some state governments have also stepped up the tempo of their support programmes for small scale enterprises. For instance, the bank in partnership with Kaduna state government recently signed an MOU to provide N1b matching fund for small scale enterprises in the state. This has further fuelled the hope of a revitalized small and medium scale sector capable of generating employment and creating wealth thereby reducing the high rate of unemployment and crime in the state.

### **IV. Conclusion**

Small and medium scale enterprises have been fully recognised by governments and development experts as the engine of economic growth and a major factor in promoting private sector development. The development of the SMEs sector therefore represents an essential element in the growth strategy of most economies and Nigeria is not an exception.

No wonder that great efforts have been deployed towards making sufficient funds available for SMEs both by governments and international agencies. In fact availability of fund seems no more a problem of SMEs but lack of awareness and requisite education on the part of operators to access the available funds. Billions of Naira meant for small and medium scale enterprises at relatively low interest rates are lying idle in the custody of both CBN and commercial banks waiting for prospective users to access.

Many SMEs operators are not aware of the various avenues to access credit facilities at cheaper interest rates. Most of the efforts of small scale entrepreneurs for loan are directed at commercial banks and microfinance houses whose interest rates are not entrepreneur friendly.

It should be noted that lack of financial discipline is also a major problem of SMEs. Some operators rather than use available funds to grow their businesses end up using them on wasteful personal aggrandisement like taking additional wives, purchasing exotic cars or building grandiose houses.

### **V. Recommendations**

It is obvious that small and medium scale enterprises in Nigeria have a long way to go for the sector to be relevant, focused, and for it to play its expected roles.

Government should therefore, create an enabling environment that is devoid of corruption and bureaucracy; and at the same time motivating and entrepreneur friendly. Corrupt officials found unduly harassing and extorting monies from SMEs operators should be sanctioned to serve as deterrent to others. Similarly, tax regime should be harmonised and the administration of these taxes and levies should be transparent. For the government to succeed in its drive to stimulate the growth of SMEs sector in Nigeria it has to intensify efforts in reforming our educational system to make more functional and result oriented. The thrust should be more of modern technology and entrepreneurial development.

Finally, efforts should be intensified to enlighten entrepreneurs about various credit opportunities which are cheaper and entrepreneur friendly. Activities of organisations like Small and Medium Scale Enterprises Agency (SMEDAN) should be more vigorous particularly at the local government levels.

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