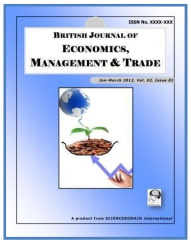

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Issues in the Management of the Supply-side Financing of Micro, Small and Medium Enterprises (MSMEs) in Nigeria

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Authors' contributions

This work was carried out in collaboration between both authors. Both authors read and approved the final manuscript.

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ABSTRACT

Access to financial credit facilities remains top on the list of constraints affecting the development of MSMEs in Nigeria. This state of affairs subsists despite the nation's robust financial sector. Commercial banks loans portfolio to MSMEs as percentage of total credit to the private sector has been dwindling over time, from 27.04 percent in 1992 to less than one percent in 2012. Driven by the desire to effect a positive change, government has initiated policies and programmes which have produced unsatisfactory results. International best practices identify interventions which can substantially contribute to effective and greater efficiency in financial credit system delivery. Such interventions, modified along the line of a developing economy environment are needed as integral part of efforts to initiate, develop and sustain MSMEs in Nigeria.

Keywords: Supply-side financing; MSMEs; credit constrains; collateral; interventions.

1. INTRODUCTION

The working definitions of micro, small and medium enterprises (MSMEs) will be as provided by Small and Medium Enterprises Development Agency of Nigeria (SMEDAN), which coordinates and facilitates the enabling environment in the country. A micro enterprise is one

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which employs a maximum of 10 persons with a turnover of not more than N10 million (circa USD 65,000) and an asset base excluding land and building, not exceeding N5 million (circa USD 32,000). A small enterprise employs between 10-49 persons with a turnover of between N10-100 million (circa 65,000-650,000) and an asset base (excluding land and building) of between N5-50 million (circa USD 32,000-320,000), while the medium enterprise's turnover hovers in the region between N100-500 million (circa USD 650,000-3.2 million) with assets excluding land and building of between N50-199 million (circa USD320,000-1.2 million) and having the capacity to employ 50-199 persons. In the MSMEs sector composition, the micro enterprises occupy the lion share of 98 percent and one percent each shared between the small and medium enterprises [1].

The benefits of MSMEs to the national economy are enormous hence the huge interest among practitioners, researchers, policy makers and advocates. Their relevance to the national economy includes the ease of start which has propped up an amazing population of 17.3 million enterprises in Nigeria employing about 32.5 million persons [2]. These figures may be conservative considering the large Nigerian underground economy. Evidence indicates increasing percentage points of underground economy to the official Nigerian GDP of 57.9; 58.6 and 59.4 percentage points in 2000, 2002 and 2003 respectively[3].

Other benefits of MSMEs include the assurance of a competitive business environment, mobilising local resources, creation of new industries, being a platform for industrialisation, poverty reduction, mitigation of rural-urban migration and the provision of intermediate goods for larger industry use. Indeed, MSMEs represent a nation's economic strength. Advantageously too, the Nigerian MSMEs are known to be distributed along sector lines within the regions therefore creating potential operating and cost synergies. Specifically, MSMEs accounted for 46 percent of Nigeria's GDP in 2010 [2].

However, as assuring as their relevance is, they are endemic hiccups which hinder their development. Frequently mentioned hiccups include weak infrastructures, difficulty in acquiring space, machinery and spares; corruption, low capacity utilisation and lack of capacity building [4]. But, the lack of access to financial credit remains top on the list of operational challenges affecting MSMEs [5,6]. Finance availability for industry use has been categorised by [7] into demand and supply sides. The demand side perspective explains expectation. The supply-side concept emphasises provision but its constraints in financial parlance explains misallocation outside the control of the firm. It portrays an imperfect condition which hinders access to funds in a well-defined environment. The supply-side explanation seems to typify the Nigerian situation hence our interest. Our major objective therefore is to expand the literature in examining the major interventions in the management of the supply-side financing of MSMEs in Nigeria.

According to various publications including [8], the country boasts of a vibrant financial sector with 22 commercial, 5 development, 2 merchant, 871 micro finance and one non-interest banking institutions which post huge annual profits. Added to this list are 82 Primary Mortgage institutions, 62 finance companies and many other allied institutions. Interestingly, despite a sizeable bank loan portfolio, there is a negligible support to the MSME sector. Remarkably too, there has been a dwindling commercial banks loan portfolio to small scale enterprises as percentage of total credits from 27.04 percent in 1992 to less than one percent in 2012 [9]. For these two decades, the overall performance has not shown any appreciable improvement despite many interventions. Table 1 shows the ratio of commercial banks' loan to MSMEs as a percentage of total loans for the said period.

Table 1. Ratio of Commercial Banks' Loan to MSMEs, 1992- 2012

Period	Commercial Banks Loans to small scale Enterprises (₦ million)	Commercial Banks Total Credit to private sector (₦ million)	Commercial Banks Loans to Small Scale Enterprises as percent of Total Credit (%)
1992	20,400.0	75,456.3	27.04
1993	15,462.9	88,821.0	17.41
1994	20,552.5	143,516.8	14.32
1995	32,374.5	204,090.6	15.86
1996	42,302.1	254,853.1	16.60
1997	40,844.3	311,358.4	13.12
1998	42,260.7	366,544.1	11.53
1999	46,824.0	449,054.3	10.43
2000	44,542.3	587,999.9	7.58
2001	52,428.4	844,486.2	6.21
2002	82,368.4	948,464.1	8.68
2003	90,176.5	1,203,199.0	7.49
2004	54,981.2	1,519,242.7	3.62
2005	50,672.6	1,991,146.4	2.54
2006	25,713.7	2,609,289.4	0.99
2007	41,100.4	4,820,695.7	0.85
2008	13,512.2	7,799,400.1	0.17
2009	16,366.5	9,667,876.7	0.17
2010	12,550.3	9,198,173.1	0.14
2011	153,284.6	38095845.6	0.40
2012 Q1	14,875.1	9,520,552.0	0.16
Q2	15,065.4	10,048,406.5	0.15
Q3	14,995.8	10,274,095.4	0.15
Q4	13,863.5	10,440,956.3	0.13

**Source: CBN statistical bulletin 2013*

This Nigerian MSMEs situation is further compounded by the fact that the vital role of government in providing an enabling environment (finance, infrastructure, knowledge and policy) is low when compared to fellow African countries like South Africa and Egypt. The total loans as percentage of GDP for example are equally not impressive. The 2006 figure was 19.7 percent compared to Egypt's 53.3 percent and 94 percent of South Africa [10].

Apparently, financial credit constraint is a global phenomenon. This has resulted in credit rationing [11], a situation where borrowers are denied access to financial credit even where such borrowers are ready to pay higher interest rates. Government constraints, imperfect market conditions, difficulty in identifying the good borrower and rising risk with interest rates are some of the identifiable reasons for credit rationing. Certainly, these are common features in all economies. Other reasons alluded include collateral issues, in-explainable exogenous shocks; behavior, distribution and size of borrowers. [12] Have indicated that, the small size firms are the most vulnerably in issues of financial constraints. Larger firms seem to fare better.

Note: One United States Dollar ($) exchanges for about one hundred and sixty-five Nigerian Naira (₦).

It is worth mentioning that certain characteristics, apart from size separate the small from the large businesses in credit rationing. The differences include management and ownership unification in both economic and emotional levels, lack of professional attention to issues, short life expectancy and the fact that private equity affects the risk positioning of the owners [13]. These differences consequently impact on the finance functions and the overall organizational performance.

2. POOR FUNDING EFFECTS ON MSMEs

The business process from conception, the coming forth, growth, maturity and even failure revolve around finance [14]. Researchers have shown that capital requirement and the availability of finance resources affect entrepreneurial propensity [15,16]. Access to this important resource according to [17] is the absence of price and non-price barrier in the use of its services. This does not mean financial availability to all and sundry but that such is based on credit worthiness of the applicant. While finance comes in various forms, types and structures, the two main easily available for most businesses are debts and equity. Whether externally or internally generated, finance goes a long way in the process of accomplishing business objectives [18].

Studies including [19,20,21] have identified constrained financial credit as negatively affecting new firm entry into the market and the consequent decreased post-entry growth. Relaxing the constraints on the other hand is believed to positively affect small firms more than they do to larger ones. In their own opinion, [11,22] posit that collateral provision which is the asset pledged to borrow until payback time; long term exclusive relationships and repeat borrowing which are non-common features of MSMEs are some of the fundamentals that tilt the proportion of finance credit in favor of the larger firms. [23,24] have successfully associated lack of finance to firm's growth and innovation impediment, even as [25] have identified its adverse contribution towards firm survival. Equally, lack of funds limit the firm's capacity to replace low quality employees [26,27] have emphasized low firm performance as fall-out of external funds dislocation.

Internally generated funds from profits of MSMEs take long time to accumulate and they have dire consequences on long term plans if they serve as the only source of financing. The inability to capitalize on business opportunities due to paucity of funds has the capacity to hinder competition and thwart growth tendencies. This is because businesses require working capital and long term funds to operationalise activities. Modernisation process will be slow, transition to larger enterprises will be affected and inter-firm and industry linkages will be frustrated. Certainly, the overall effects of MSMEs on national economy will be negatively impacted.

3. BUT, WHAT WERE THE INTERVENTIONS?

Government has played a proactive role in broad areas of regulatory and supervisory frameworks. This role involves licensing requirements, identification and classification of institutions for the promotion of competition, financial infrastructure for the introduction and development of credit reforms and bureaux, registries and business registration procedures. Others are equity investment, direct public intervention like credit guarantee schemes, apex and wholesale funding facilities as well as value-chain organization projects. There is also the informal sector whose role includes money lending between friends, money lenders, family foundations and credit associations. It is however difficult to get information from the informal sector due to weak credit skills and practice. However, some specific public interventions include:

i. National policy on MSMEs which was launched in 2007 by SMEDAN to facilitate the promotion and development of efficient supportive environment. The policy identifies seven key areas of institutional; legal and regulatory framework; human capital development; research and development; extension and support services; marketing; infrastructure and finance. Each identified framework has plans for actualising specific objectives within a time frame. The policy streamlined definitions of MSMEs from a plethora of definitions that bedevil the sector.
ii. Micro finance policy- The existence of a huge market not serviced by financial institutions; poor banking culture and low level of financial literacy; and the need to empower the poor were some of the justifications for this policy which was launched in 2005 and modified in 2011 [28]. The policy objectives include:

    a) A 10 percent annual increase of access to financial services of the economically poor.
    b) Increase of micro credit share as percentage of GDP from 0.2 percent in 2005 to at least 5 percent in 2020.
    c) Participation of all federating States and FCT as well as two thirds (516) of all Local Government Areas in micro finance activities by 2015.
    Nigeria has 871 single-branched microfinance banks (MFBs) which are not evenly distributed across the country with most of them privately owned. Of the number, 82 MFBs service the North-West and North-East geo-political zones which has the highest unbanked rate when compared to the over 500 in the South-West and South-East geo-political zones. The entire MFB network according to [29] serves 3.8 percent of the adult population (3.2 million clients) of which only 14 percent use credit products.
iii. Small and Medium Enterprises Equity Investment Scheme (SMEEIS) was an initiative of the Bankers Committee [30] which required all banks to set aside 10 percent of Profit After Tax for investment and promotion of small and medium enterprises (SME). For the purpose of the scheme, an SME was defined as one with a maximum asset base of N1.5 billion with no lower or upper staff limit. Trading and financial activities were not covered by the scheme. With a single digit interest rate, benefiting enterprises were to surrender part of their ownership structure to the financing bank with a provision of financial and technical services from the bank. Seven years after its inauguration, the scheme was discontinued in 2008.
iv. Bank of Industry (BOI) is the largest project and industrial financing establishment in Nigeria. It commenced operations from the reconstruction of Nigeria's foremost development bank, Nigerian Industrial and Development Bank. It has the mandate to provide assistance to the establishment of large, small and medium enterprises as well as rehabilitation of ailing industries. As a development fund administrator, it receives funds from official entities, developing agencies and State governments. These include N5 billion Dangote's small business development fund, UNDP's USD 4 million access to renewal energy project, N3 billion micro enterprise fund for 9 States; CBN's N500 billion intervention fund; N100 billion cotton, textile and garment industries revival scheme, N10 billion Rice Processing Fund and State government dedicated funds for the benefit of indigenous entrepreneurs in respective States. In fulfillment of its paradigm shift of committing 85 percent of its resources in support of SMEs while 15 percent goes to large enterprises, statistics shows disbursed funds to SMEs increased by 35 percent, 85 percent and 96 percent in 2001, 2006 and

2010 respectively in proportion of 65 percent 15 percent and 4 percent to large enterprises in the same period [31].

v National Economic Reconstruction Fund (NERFUND) was set up in 1989 to provide needed medium to long term credit facility to viable SMEs, especially those of the manufacturing, mining and agro-allied sectors. Loan facility is in two categories; the less than N5 million micro loans and the over N5 million SME loan. The agency's treasury was boosted in 2010 with a stimulation package of N200 billion. Information from the agency's website [32] showed that between March, 2010 and May 2013, of the 8215 loan applications valued at N25.7 billion, only 1497 projects valued at N5 billion were approved.

vi. Commercial Agricultural Credit Scheme (CACS). The objectives include:
   a) To develop the agricultural sector by providing credit facilities to agro-allied entrepreneurs at a single digit interest rate.
   b) To enhance national food security.
   c) To reduce cost of credit in agricultural production.
   d) To produce input for industrial sector on a sustainable basis.

4. INTERVENTION OUTCOMES AND CONSTRAINTS

Despite the afore-mentioned interventions and many other public sector initiatives, the overall penetration level is exceedingly low. According to [33], 73 percent of Nigerians expressed concerns about getting a loan [31] identified some fundamental flaws in past and existing intervention programmes in the supply-side management. Finance lending institutions were known not to be favourably disposed to advancing financial resources to micro enterprises despite apparent clarity in the definitions of MSMEs. The definitions are often used loosely enthroning different eligibility criteria for enterprises applying for financing. Larger enterprises and the high yielding government debts are preferred for their high returns and as risk avoiding mechanism than lending to MSMEs. Supporting the above claim is the high cost of lending to MSMEs since the administrative costs are relatively constant to the small loans. Additionally, Nigeria has a weak capital market and a few development banks. Most other banks rely on short term liabilities for lending to avoid mismatch in maturities of assets and liabilities. The global financial crises with corresponding international finance architectural redesigning caused lesser linkages in the flow of long term funds.

Negatively too, Nigeria has a weak data base resulting from the poor data collection, storage, analysis and retrieval [34]. The country lacks a reliable identification system, has no developed collateral administration system and operates a nascent credit documentation databank. It is worth adding that some of the operating enterprises are not officially registered and many also without audited and recorded financial history. These challenges inhibit the potential for lending based on financial records. Equally identified as worrisome was the mentality of micro finance institutions behaving as 'mini' commercial banks awaiting full commercial banking operating license. This mentality has therefore disenfranchised many in the target group. But, the biggest challenges of MFBs are high refinancing costs compounded by low focus on deposits, high operating expenses and low staff capacity, leading to poor asset portfolio. Certainly, the vast majority of MFBs lack the scale and operating capacity to have a strong impact on the target group.

The venture capital and private equity industry is novel and almost not in existence, perhaps the foundation for SMEEIS' failure. SMEEIS failed to meet its objectives hence its discontinuance [30]. Enterprises were not willing to accept banks as equity partners as the latter were seen as not having the skills in equity investment. Asides, the programme was against the prevailing culture of absolute ownership of business by their owners [35]. This resulted in the clash of confidence as social perceptions and administrative attitudes did not align. In all cases of banks providing credit, stringent collateral conditions were paramount. The lack of collateral would therefore naturally compound lending possibilities as it remained a major drawback preventing banks from lending. In [36], 80 percent of banks were known to have difficulties in this regard. Moreover, the operative environment of weak property rights and poor contract enforcement processes remain unattended to and legal issues take long time to incomplete resolve at the courts of law.

Consequently, [37] as represented in Fig 1 identified specific constraints and the levels of effect on the overall finance supply side environment. Collateral conditions occupied an enviable 42 percent. Collateral is an asset pledged to borrow, redeemable when repayments are completed. It gives banks a fall-back position in times of loan default. Most MSMEs could not afford it and banks were hindered from financing their projects. Loan applications occupied 13 percent, poor credit history 10 percent, insufficient profitability 6 percent and other objections, 29 percent. From the above, the constraints can broadly be categorised as collateral-based; financial illiteracy, information gap and insufficient profitability.

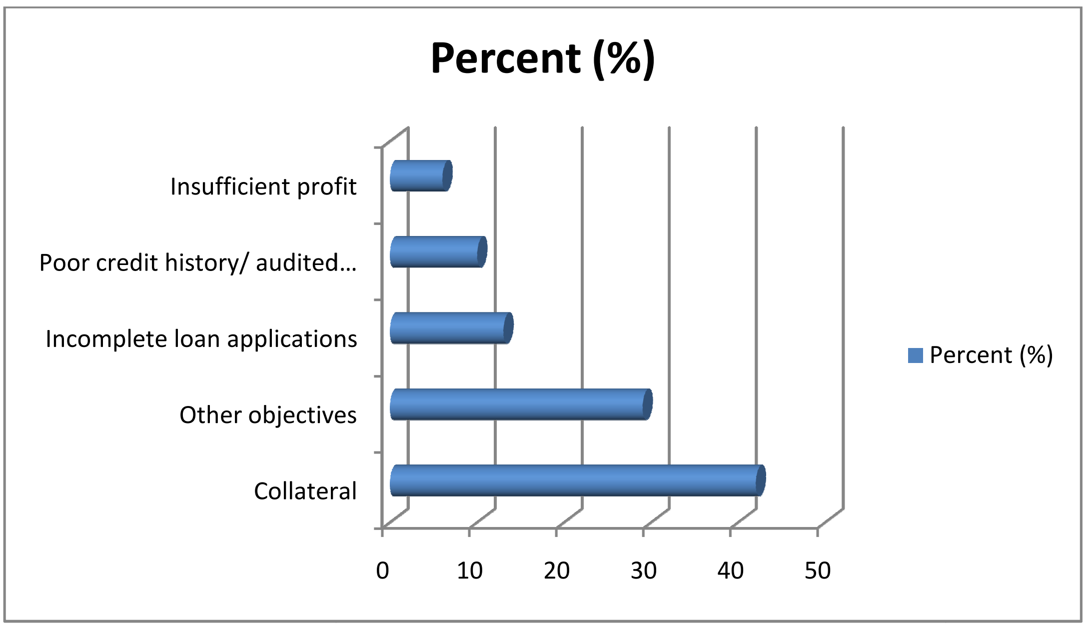

Fig. 1. Supply-side loan constraints
**Source: World Bank (2012b)*

5. THE WAY OUT

The malaise of finance to MSMEs is not peculiar to developing economies. The need for recalibration of strategies for better outcome can better be captured in the words of the European Commission Vice President Antonio Tajani, who is Commissioner for Industry and Entrepreneurship [38]. While acknowledging the finance capital insufficiency for European SMEs, definite plans capable of shrinking the finance gulf for remarkable and measurable results were suggested.

Access to finance of SMEs remains difficult and is one of the main reasons for the current economic downturn. Therefore we intend to enlarge our loan guarantees to SMEs under the new COSME programme as of 2014. Each euro dedicated to our guarantees has the power to stimulate - on average – 30 Euros in bank loans. This is crucial to help Europe's jobs engine, our small enterprises, to run smoothly again. It is they who create 85 percent of all new jobs.

Bridging the 'financing gap' is so important to national economies considering the vital role of MSMEs. It is even more important for the developing economies with a very high poverty profile without social safety nets with the attendant consequences. Such 'redemption'' plans must appraise existing programmes and policies to identify loose links for necessary attention in line with the weak structures. Information dissemination plays a vital role and activities of financing institutions must be highlighted. Studies have shown exceeding Nigerian banks interest in the less risky government bonds at the expense of loaning to the MSMEs. Indicators of domestic credit to the private sector as a percentage of GDP have not shown tremendous improvement. There was a yearly average of about 13.4 percent between 2000 and 2006, which grew to 25.33 percent in 2007; 33.91 percent in 2008 and reached its peak of 38.59 percent in 2009 but dropped precipitously to 20.9 percent by January 2011 [39]. Based on the above, we have made the following recommendations:

i. There should be legalised and enforceable definitions of MSMEs as these will help in better planning and standardisation of funding criteria and programmes.
ii. The informal and private sectors-driven lending institutions should be encouraged and integrated into the mainstream MSMEs funding programmes
iii. MSMEs unit should be established in banks with staffs adequately and specifically trained in the core-functional area.
iv. There should be more information on financial opportunities to MSMEs
v. Incentives should be given to commercial banks as motivation for lending to the MSMEs sector
vi. Banks should allocate certain percentage of their domestic credits to MSMEs. A policy encouraging banks to apportion a specified yearly allocation to MSMEs as loans should be envisaged.
vii. There should be a review of collateral requirements in favour of credit scoring [40] where the information from tax authorities could be relied upon. Credit scoring is a statistical method used in analyzing historical data on borrowers to predict possible loan default in future.
viii. An accounting standard specific to MSMEs should be developed in line with International Finance Reporting Standards. The conventional accounting methods appear to be specified to the large corporate organizations.
ix. The development of a functional and reliable data base for easy information retrieval is of great essence.
x. Efforts should be made towards simplifying loan procedures and documentations.
xi. The use of Mutual Guarantee Institution, a form of group lending in which banks lend to a group rather than a individual should be encouraged. Such lending promises a joint responsibility of honouring the liability. This will mitigate informational asymmetries as the members can easily screen, monitor and relate with each other than as would be done by the lending institutions.
xii. Disputes resolution process should reflect the peculiar needs of the sector. This is because conventional courts take longer time to resolve issues; this does not auger well for a firm's health.

6. SUMMARY AND CONCLUSION

We have placed on record the ubiquitous nature of constrained finance credit as a global concern [11,20] and paid particular attention to its supply-side management within the Nigerian MSMEs sub sector [37,31,10,2]. Though a universal problem, the Nigerian situation is unacceptable given the available resources, opportunities and inherent potentials. The various policies and programmes having not yielded the expected beneficial results suggest a wide gap between their formulation and implementation. Government, organisations and agencies must take responsibility. Fundamental issues like collateral and loan application challenges are areas that banks can deal with. Banks have a role to play. They should re-strategise, enlarge the markets and simplify rules of engagement. But, these must be done in collaboration with others since some of the associated issues are outside the banks' control. They include weak public structures [31], poor data management [34] and issues relating to culture [35]. These known fundamentals play a big role in bringing out the negative symptoms. Addressing the abysmal performance along the line of peculiar environmental issues raised would certainly promise a future. Our suggestions which are specific can positively alter and deepen the loan penetration within the studied sub-sector. The result will be a better national economy. Certainly, it is worth mentioning that, the vividly noticeable exponential fall in credit provision to MSMEs in Nigeria suggests a robust research thrust to interested scientists.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

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