FINANCING OPTIONS FOR SMALL AND MEDIUM ENTERPRISES (SMES): EXPLORING NON-BANK FINANCIAL INSTITUTIONS AS AN ALTERNATIVE MEANS OF FINANCING

THE CASE OF NIGERIA.

ESISAL LEMUEL

Masters Degree Thesis in Business Administration
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**ACRONYMS**

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<tr>
<td>SMES</td>
<td>SMALL AND MEDIUM-SIZED ENTERPRISES</td>
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<td>NON BANK FINANCIAL INSTITUTIONS</td>
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ABSTRACT

**TITLE:** FINANCING OPTIONS FOR SMALL AND MEDIUM-SIZED ENTERPRISES (SMES): EXPLORING NON-BANK FINANCIAL INSTITUTIONS AS AN ALTERNATIVE MEANS OF FINANCING.

**AUTHOR:** Esisal Lemuel

**SUPERVISOR:** Stefan Hellmer

**DEPARTMENT:** School of Management, Blekinge Institute of Technology

**COURSE:** Master’s Thesis in Business Administration, 15 credits.

**BACKGROUND AND PROBLEM DISCUSSION:**
Small and medium-sized enterprises are observed as capable instruments to solving the critical problems of development and poverty affecting most developing countries (Kayanula and Quartey 2000; Mead and Liedholm 1998; Fischer 1995), therefore the need for their growth in Nigeria is beyond question. Amidst many other problems, gaining access to bank credits and other financial markets have been identified as a key hindrance to this growth. This thesis tried to review this challenging problem of SMEs financing in Nigeria with a view of identifying alternative financing options besides the traditional banks credit system. It also takes a look at Non-bank financial institutions as one of such alternative options of financing for SMEs.

**PURPOSE:** To review the challenging problem of SMEs financing in Nigeria and secondly to identify other alternative financing options available to SMEs such as the Non-bank financial institutions.

**METHOD:** For the most part of this work, empirical data has been collected from secondary sources. Also, primary data collected was from a conducted survey received from fifteen SMEs within Lagos city in Nigeria.

**KEYWORDS:** Non-Bank Financial Institutions, Financing, Small and Medium-sized Enterprises.
# TABLE OF CONTENTS

ACKNOWLEDGEMENT .................................................................................................................. 6

**CHAPTER 1: INTRODUCTION** ........................................................................................................ 7
1.1 PROBLEM DISCUSSION ON THE NIGERIAN SITUATION ......................................................... 9
1.2 STRUCTURE OF THE SMALL AND MEDIUM-SIZED ENTERPRISES IN NIGERIA ..................... 9
1.3 STRUCTURE OF THE NIGERIAN FINANCIAL SYSTEM ................................................................ 9
1.4 THE RELATIONSHIP BETWEEN THE FINANCIAL SYSTEMS AND SMES IN NIGERIA ........ 10
1.5 PURPOSE AND PROBLEM ......................................................................................................... 12

**CHAPTER 2: METHODOLOGY** .................................................................................................... 13
2.1 DATA COLLECTION .................................................................................................................. 14
2.2 HOW THE ANALYSIS WAS DONE ......................................................................................... 14
2.3 CRITICAL STAND TOWARDS METHOD AND DATA .................................................................. 15
2.4 VALIDITY AND RELIABILITY ................................................................................................. 15

**CHAPTER 3: LITERATURE REVIEW** .......................................................................................... 16
3.1 DEFINITIONS AND SCOPE OF ANALYSIS ............................................................................. 16
3.2 DEMAND FOR SME FINANCE ............................................................................................... 18
3.3 THEORETICAL FRAMEWORK ................................................................................................. 19
3.4 BANK CAPITAL CHANNEL MODEL ...................................................................................... 19
3.5 CAPITAL CONSTRAINT MODEL ............................................................................................... 19
3.6 THE LIFECYCLE APPROACH .................................................................................................. 20
3.7 THE PECKING ORDER THEORY ............................................................................................. 20
3.8 AGENCY THEORY ................................................................................................................... 20

**THE NIGERIAN CASE** ............................................................................................................... 22
3.9 THE NIGERIAN ECONOMY ...................................................................................................... 22
3.10 SMes ECONOMIC SIGNIFICANCE IN NIGERIA ................................................................... 22
3.11 STRUCTURES OF SMES IN NIGERIA .................................................................................... 25
3.12 DEMAND FOR SME FINANCE IN NIGERIA .......................................................................... 26
3.13 REASON FOR THE DIFFICULTY PROBLEM OF BANK FINANCING TO SMES ................ 28
3.14 MACROECONOMIC ENVIRONMENT .................................................................................... 29
3.15 LACK OF INFRASTRUCTURAL FACILITIES .......................................................................... 30
3.16 INTERNAL STRUCTURING PROBLEMS OF SMES ................................................................ 30
3.17 BANK SHORTCOMINGS

CHAPTER 4: SOURCES OF SMES FINANCE

4.1 FINANCE FOR SMES

4.2 INFORMAL SOURCES, PERSONAL FUNDS/ RETAINED EARNINGS

4.3 LEASING

4.3 NON-GOVERNMENTAL GROUPS (NGOS)

4.4 SMES’ ACCESS TO FINANCIAL SERVICES THROUGH NON-BANK FINANCIAL INTERMEDIARIES

4.5 IMPORTANCE OF NBFIS

4.6 INTERNATIONAL PRECEDENT

4.7 EMERGENCE, CHARACTERISTICS AND ROLE OF NBFIS IN NIGERIA

4.8 ACTIVITIES OF NON-BANK FINANCIAL INTERMEDIARIES IN NIGERIA

CHAPTER 5: EMPIRICAL ANALYSIS

5.1 RECENTLY CONDUCTED SURVEYS

5.2 COMPANY PROFILE OF SMES

5.3 AWARENESS OF SMES

5.4 THE BARRIERS FOR FURTHER DEVELOPMENT

5.5 FACTORS FOR GROWTH AND DEVELOPMENT

5.6 FINANCIAL MANAGEMENT: SERVICES TO FACILITATE GROWTH FOR SMES

5.7 REQUESTS FOR ACCESS TO FINANCE AND SERVICE SUPPORT

5.8 PREVIOUSLY CONDUCTED SURVEYS BY OTHER RESEARCHERS

CHAPTER 6: CONCLUSION

6.1 CONCLUSION

6.2 RECOMMENDATIONS

6.3 PROPOSAL FOR FURTHER RESEARCH

APPENDIX 1

APPENDIX 2

REFERENCES
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Esisal Lemuel

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CHAPTER 1

INTRODUCTION
Given the great potential of small and medium sized enterprises to bring about social and economic development, it is of no surprise that the performance of SMEs is of all huge concern to the government of different countries in the world. Small and medium sized enterprises in both developing and developed countries plays important roles in the process of industrialization and economic growth, by significantly contributing to employment generation, income generation and catalyzing development in urban and rural areas (Hallberg, 2000; Olutunla, 2001; OECD, 2004; Williams, 2006).

As affirmed by one estimate, Africa and Asia has the majority of their population living in rural areas where small scale enterprises delivers about 20% - 45% of full-time employment and 30% - 50% of rural household income (Haggblade and Liedholm 1991). Latin America, which is more urbanized, has an estimated 50million micro and small-scale enterprises, employing 120million people (Berger and Guillamon 1996). In Nigeria, according to a report, an estimate of about 70% of the industrial employment is held by SMEs and more than 50% of the Gross Domestic Product (Odeyemi, 2003) is SMEs generated.

Given the seminal role of SMEs to the economy of Nigeria, various regimes of government since independence in the 1960s, have focused on various progammes and spent immense amount of money with the primary goal of developing this sector, these have however not yielded any significant results (Mambula 1997) as evident in the present state of the SMEs in the country. SMEs are generally very susceptible and only a certain number of them manage to survive due to several factors such as difficulty in accessing credits from banks and other financial institutions; harsh economic conditions which results from unstable government policies; gross undercapitalisation, inadequacies resulting from the highly dilapidated state of Infrastructural facilities; astronomically high operating costs; lack of transparency and corruption; and the lack of interest and lasting support for the SMEs sector by government authorities, to mention a few (Oboh 2002; Okpara 2000; Wale-Awe 2000).

Despite the numerous factors that challenge the survival and growth of SMEs in both developing and developed countries, finance has been identified as one of the most important factor (UNCTAD, 1995, 2001; SBA, 2000). Having access to finance gives SMES the chance to develop their businesses and to acquire better technologies for production, therefore ensuring their competiveness, however, there is a huge challenge for SMES globally when it comes to sourcing for initial and expansion capital funds from traditional commercial banks.

Abereijo and Fayomi (2005) notes that the majority of commercial bank loans offered to SMEs are often also limited to a period far too short to pay off any sizeable investment. In addition, banks in many developing
Countries prefers to lend to the government rather than private sector borrowers because the risk involved is lesser and higher returns are offered (Levitsky, 1997), such apathy for the SMES have crowded out most private sector borrowers and increased the cost of capital for them. The situation is equally prevalent in the Nigerian economy where commercial banks often prefer to lend to government, trade in foreign exchange (FOREX), and financing buying and selling. A banker in Nigeria aptly put such preferences that “the banks are not a charity, hence why should they take risks with SMEs when they can make good money elsewhere”. These preferences and tendencies of the commercial banks have worsened the lack of financing for SMEs.

The Financial systems in every country play a key role in the development and growth of the economy, although the ability to play this role effectively and efficiently largely depends on the degree of development of the financial system. The traditional commercial banks which are key players in the financial systems of nearly every economy, have the potential to pull financial resources together to meet the credit needs of SMEs, however, there is still a huge gap between supply capabilities of the banks and the demanding needs of SMEs. In Nigeria, the situation is even more prevalent as noted by Olutunla and Obamuyi (2008).

"There is a huge supply of both equity and loan able funds in the commercial banking sector which the SMEs are not benefiting from. For example, as at the end of the first quarter of 2007, out of N38.2 billion set aside under the scheme by the banks, only N18.1 billion or 47.3% had been assessed by the SMEs (CBN, 2007). Similarly, the Financial Guidelines every year stipulate that banks must dedicate a minimum proportion of their loan portfolio to the SMEs. However, since the 1970s the banks have not met this requirement. On the demand side, the SMEs have been reluctant to seek bank loans despite the various loan schemes being offered by the banks and the government, because of the fear of the business being taken away in case of any problem to meet the agreed terms”

Another important part of the financial systems apart from the traditional commercial bank are the non bank financial institutions (NBFIs), which together with commercial banks, provide a wide range of financial products and services to meet the financial need of businesses, households and the public sector. They include companies such as insurance, leasing, factoring, venture capital companies, as well as mutual funds, pension funds, and investment trusts, which all provide additional and alternative financial services.

NBFIs help in improving the general system-wide access to finance, facilitate longer-term investments and financing, and also provide competition for bank deposits. According to the World Bank 2006 report, NBFIs allow for better risk management while helping to reduce the potential for systemic risk through the aggregation of resources, allocation of risk to those more willing to bear it, and application of portfolio management techniques that spread risk across diversified parts of the financial system. They serve to improve competition
and increase the depth of the financial market. By reducing concentration and providing alternative sources of finance, NBFIs, as former Federal Reserve Chairman Alan Greenspan has said, “enhances the resilience of the financial system to economic shocks by providing it with an effective ‘spare tyre’ in times of need.”

The question therefore arises that if traditional commercial banks are failing in fulfilling the financial needs of SMEs, are NBFIs also doing the same? Is there a possibility that SMEs are not taking full advantage of the services and products of the NBFIs to improve the prevalent problem of access finance? It is the objective of this thesis to review the challenges that SMES face in accessing finance from traditional commercial banks and also investigate other alternative sources for SMEs to access finance such as the NBFIs. Can the NBFIs be the effective ‘spare tyre’ for the SMEs in Nigeria when dealing with issues of financial services?

1.1 PROBLEM DISCUSSION ON THE NIGERIAN SITUATION
In this thesis, both the financial systems and Small and medium-sized enterprises from the perspective of the Nigeria environment will be reviewed here.

1.2 STRUCTURE OF THE SMALL AND MEDIUM-SIZED ENTERPRISES IN NIGERIA
Small and Medium-sized Enterprises (SMEs) in Nigeria, as defined by Small and Medium Industries Equity Investment Scheme (SMIEIS), are enterprises with a total capital employed not less than N1.5 million, but not exceeding N200 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. In this work, this definition was adopted, however an observation of some of the surveyed SMEs are with a total capital less than N1.5 million and a lower staff strength. They are estimated to generate about 50% of the Gross Domestic Product (Odeyemi, 2003) and employ about 70% of the industrial work force in the country (Adebusuyi, 1997). The SMEs are made up of a mixed blend of businesses ranging from distributive trade which constitute about 50% of the SMEs, 10% in manufacturing, 30% in agriculture and 10% in services all operating in different parts of the country.

1.3 STRUCTURE OF THE NIGERIAN FINANCIAL SYSTEM
The Nigerian financial system is broadly dualistic in nature comprising of both an informal and formal sector. The informal financial system (IFS) is made up of the institutions that are not integrated with the formal financial system and virtually out of the control of the legal framework. They are poorly developed and limited in reach; they include institutions such as the local moneylenders, rotating savings and credit associations. The formal financial system (FFS) on the other hand comprises of the banking sector, non-banking sector and the financial markets that are registered and regulated by the by the Federal Ministry of Finance (FMF), Central Bank of Nigeria (CBN), Nigerian Deposit Insurance Corporation (NDIC), Securities and Exchange Commission (SEC), National Insurance Commission (NIC), Federal Mortgage Bank of Nigeria (FMBN), and the National
The formal financial system structurally consists of the Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC), the Security and Exchange Commission (SEC), the National Insurance Commission (NAICOM), 25 deposit money banks, 6 development banks, 757 community banks, 1 stock exchange, 1 commodity exchange, 5 discount houses, 9 primary mortgage banks, 112 finance companies, 126 bureau de change, 103 insurance companies and 581 stock brokers (CBN, 2005).

The Nonbanking financial sector is described as financial intermediaries that operates in specialist sectors but who are not allowed to combine the traditional retail banking function, insurance marketing services and capital market transactions as their lines of business (CBN Banking Annual Report, 2001). They comprise simply of the following financial institutions; Community Banks; Primary Mortgage Institutions; Finance Companies; Bureaus de Change; Development Finance Institutions; Discount Houses; and Insurance Companies etc. They play a key role of uplifting the economic growth of the country and together with the financial banking system, build up and strengthen the financial system of the country.

1.4 THE RELATIONSHIP BETWEEN THE FINANCIAL SYSTEMS AND SMES IN NIGERIA


As revealed in a study conducted in 2001, the performance of SMES have not been justified by the set up of all these programs, 79% of surveyed enterprises mentioned poor access to finance as the most challenging constraint they face (see Guardian, Nov, 26, 2001). From the records of CBN, it is observed that though traditional commercial banks have been experiencing aggregate growth credit to the domestic economy, the ratio of loans of small-scale enterprises to commercial banks’ total credit to the economy has continued to decrease over the years and it takes only a mandatory enforcement by the government to the commercial bank to get them to loan to SMEs, this is observed in Table 1 where it reveals commercial banks’ credits to SMEs
declining progressively from 25% in 1996 to 2.7% in 2005 when the mandatory bank’s credit allocations of 20% of the total credit from commercial banks to small scale enterprises wholly owned by Nigerians was abolished by the government through CBN directives.

Table 1. Table 1 Ratio of loans to SME’s by Commercial banks\(^4\) \(\{ = N =^{\text{m}} \}\)

<table>
<thead>
<tr>
<th>Year/quarter</th>
<th>Commercial Banks Loans To Small Scale Enterprises ((N^{=}) Million)</th>
<th>Commercial Banks Total Credit ((N^{=}) Million)</th>
<th>Commercial Banks loans to Small Enterprises as Percentage of total credit (%)</th>
<th>CBN prescribe minimum lending %</th>
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<tbody>
<tr>
<td>1992</td>
<td>20,400.0 41,</td>
<td>41,810.0</td>
<td>48.8</td>
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<tr>
<td>1993</td>
<td>15,462.9</td>
<td>48,056.0</td>
<td>32.2</td>
<td>20</td>
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<tr>
<td>1994</td>
<td>20,552.5</td>
<td>92,624.0</td>
<td>22.2</td>
<td>20</td>
</tr>
<tr>
<td>1995</td>
<td>32,374.5</td>
<td>141,149.0</td>
<td>22.9</td>
<td>20</td>
</tr>
<tr>
<td>1996</td>
<td>42,302.1</td>
<td>169,242.0</td>
<td>25.0</td>
<td>20</td>
</tr>
<tr>
<td>1997</td>
<td>40,844.3</td>
<td>240,782.0</td>
<td>17.0</td>
<td>-</td>
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<tr>
<td>1998</td>
<td>42,260.7</td>
<td>272,895.5</td>
<td>15.5</td>
<td>-</td>
</tr>
<tr>
<td>1999</td>
<td>46,824.0</td>
<td>353,081.1</td>
<td>13.3</td>
<td>-</td>
</tr>
<tr>
<td>2000</td>
<td>44,542.3</td>
<td>508,302.2</td>
<td>9.7</td>
<td>-</td>
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<td>2001</td>
<td>52,428.4</td>
<td>796,164.8</td>
<td>6.6</td>
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</tr>
<tr>
<td>2002</td>
<td>82,368.4</td>
<td>954,628.8</td>
<td>8.6</td>
<td>-</td>
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<tr>
<td>2003</td>
<td>90,176.5</td>
<td>1,210,033.1</td>
<td>7.5</td>
<td>-</td>
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<tr>
<td>2004</td>
<td>54,981.2</td>
<td>1,519,242.7</td>
<td>3.6</td>
<td>-</td>
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<tr>
<td>2005</td>
<td>50,672.6</td>
<td>1,899,346.4</td>
<td>2.7</td>
<td>-</td>
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</tbody>
</table>

Source: CBN Statistical Bulletin Volume 13 December 2005
1.5 PURPOSE AND PROBLEM

PURPOSE OF STUDY:

To review the challenging problem of SMEs access to finance from the traditional commercial banks in Nigeria and secondly to investigate if there are other alternative financing options available to SMEs such as the non-bank financial institutions.

PROBLEMS:

1. Are the commercial banks providing access to finance small and medium sized enterprises and if no, why are they not?

2. Can the non-bank financial institutions be an alternative source of financing for SMEs?

RESEARCH HYPOTHESES

The two hypotheses formulated for the study are stated below:
Hypothesis 1: SMES suffer great challenges in accessing financial support from traditional commercial banks in Nigeria.
Hypothesis 2: NBFIs can help in providing access to finance for SMEs
CHAPTER 2

METHODOLOGY

The main objective of this study is to investigate the challenges and problems of accessing finance from the traditional commercial banks by small and medium-sized companies; in addition, the study also looks at identifying other alternative sources of gaining finance for the small and medium-sized enterprises in Nigeria such as the non-bank financial institutions. In this section of the thesis, the methods used in this research are described, detailing the procedure used in collecting data and carrying out analysis in a concise and proper order.

According to Ghauri (2005, page3) — ‘’Research is a process of planning, executing and investigating in order to find answers to our specific questions. In order to get reliable answers to our questions, we need to do this investigation in a systematic manner, so that it is easier for others to understand the logic and believe in our report’’ Three approaches can be used in any research work, and they are the inductive approach, deductive approach and finally a combination of both the inductive and deductive approach called the mixed method (Romano 1989).

The deductive approach is characterized by drawing conclusions through a pattern of logical reasoning, hypothesis are built from existing knowledge and literature and then subjected to empirical scrutiny to draw conclusions (Ghauri, 2005). This is also known as the qualitative approach because it is characterized by more of descriptions instead of numerical data and aim to create a common understanding of the subject being studied.

In the Inductive approach specific observations are made that leads to broader generalizations and theories. The approach is characterized by beginning with specific observations and measures and then goes on to detect patterns and regularities, formulate some tentative hypotheses that can be explored, and finally end up developing some general conclusions or theories, it is also known as the quantitative approach since it is largely based on numerical observations that aims at generalizing a phenomenon through formalized analysis of selected data.

The mixed-method strategy is one in which more than one method of approach is used in data collection and analysis while conducting research (Romano 1989). This approach is similar to what Mikkelsen (1995) and Denzin (1978) described as triangulation.
The multiple-method strategy was adopted for this study to reduce the possibility of personal prejudice by not depending on only one method of approach or response coming from only one firm, writer’s view or sector with the aim to give accuracy to the study. Both the inductive and deductive were used in a variety of ways, relying largely on secondary data from previous literatures that expresses the financial challenges of SMES in the Nigeria and other countries and also overview of detailed survey results conducted. Primary data from Semi-structured interviews based on open-ended, flexible questionnaires were conducted with several groups of people interested or involved with the small business sector in Nigeria, with the aim of obtaining cross-referencing data and some independent confirmation of data, as well as a range of opinions.

The work largely adopts a conceptual analytical framework that employs theoretical and statistical comparative cross-sectional data to analyze the stated objectives.

2:1 DATA COLLECTION

SECONDARY SOURCES:
Mainly used in this research are secondary data obtained from existing literature (both theory and empirical studies) such as journals, journals, articles, research papers, magazines, statistical reports, catalogues and books etc that reflects the challenges that small and mediums sized enterprises encounter in gaining access to finance and that also highlights the role of NBFIs in resolving the problem.

This thesis extensively analyzed relevant studies and surveys that have been conducted by different researchers that reflects and discussed the prevalent finance problem, also used were records and figures from reliable data sources such as the central bank of Nigeria, SMEAN etc.

PRIMARY SOURCES:
Also used in this exploratory study is primary data obtained from a survey conducted in Nigeria which is the reference case environment. A total of fifteen SMEs within Lagos (a typical state in terms of the characteristics of SMES in Nigeria) were surveyed using a comprehensive structured questionnaire that captures data which reflects the challenges and behavior of SMEs towards traditional banks and NBFIs as regards access to finance.

2.2 HOW THE ANALYSIS WAS DONE
In conducting this study, the possibilities of the hypothesis set out in the beginning of this research are tested to verify if they true or false. Therefore an extensive review of other surveys previously made was done to trace the trend of the existing financial challenges of the SMES, In addition, an analysis of the results obtained from the conducted surveyed is done to make comparison between the existing the theories put forward about the problem and the actual fact on ground and then to also see why the problem is there and what possible solutions can be employed to tackle the issue.
2.3 CRITICAL STAND TOWARDS METHOD AND DATA
The largest problem encountered during the data collection process was that some questionnaires were returned with certain key questions unanswered, because the interviewers considered them to be a bit too sensitive, this is an understandable concern and pressure was not put on them and could not be done as it was not a face to face interview which would have provided an opportunity to further buttress the importance of the need for all questions to the answered. Although it would have been great to get the answers to those questions as to further carryout comparison, through other secondary sources the problem of the unanswered was sorted out to some extent.

2.4 VALIDITY AND RELIABILITY
Patton (2001) states that validity and reliability are two features which any qualitative researcher should focus on while designing a study, analyzing the results and judging the quality of the study. Eisner (1991) further confirms this by saying a good qualitative study can help us to understand a situation that would otherwise be enigmatic or confusing; hence a good research work should hold a high degree of reliability and should be valid as well. According to Alexandersson (1994) in a research work, all the rights things must be measured. Care should be taken that the appropriate item is measured (validity); in addition, careful attention should be paid to how the measurement is being made (reliability).

This study therefore took into consideration these two key factors during the course of the research. This work as earlier mentioned adopts a conceptual analytical framework that employs theoretical and statistical comparative cross-sectional data to analyze the stated objectives. This was done because of the paucity of firm level data on the operations of small and medium scale firms in Nigeria. All hypothesis proposed will be tested by the available theoretical analysis and intuitive analysis of the historical evidence on the performance of SMEs within the period under review. Also, the results from the survey conducted will be used to evaluate the validity of the proposed hypothesis and it will also be compared with historical evidence presented in the work of earlier conducted researches.
CHAPTER 3

LITERATURE REVIEW

Several factors contribute to the growth of SMEs, these include, the development of horizontal relationships aimed at improving the market environment for small enterprises, the development of vertical linkages with larger domestic enterprises, principally through subcontracting agreements; or the development of new interfirm networks that increase the small-scale sector’s capacity for dialogue in relation to macro-level policy (for example, export rebates and tax concessions). All which are vital for the development of clusters which is a concentration of suppliers of raw materials and components; specialist organizations providing technical, financial and accounting services and national and international marketing agencies; and the availability of a large pool of skilled, specialized workers, specialist training centers and transport services (Cook, P. 2000).

Despite the significant role these industrial factors play, a lack of sufficient capital and credit is often a major handicap to the development of SMEs, particularly in their early growth stages. The focus in this chapter is directed at describing the structures of SMEs and the challenges they face with specific focus on their financial challenges. Several theories and previous researches conducted on the subject matter will be explored with the aim of approaching and drawing conclusions that reaches a deeper understanding of the financing problems of SMEs in Nigeria.

3.1 DEFINITIONS AND SCOPE OF ANALYSIS

It is very important to define the precise meaning of the terms used in every analysis so as to avoid ambiguity.

SME (SMALL AND MEDIUM ENTERPRISE)

There is currently no generally agreed or universally applicable definition of SME. In almost all countries and organization diverse factors mostly related to given socio-economic environment, influence the definition of SMEs. Various government ministries, research institutes, agencies, private, sector institutions, etc. use different definitions (see box below box).
Table 2: Definition of SMEs across several groups


Among these definitions, there is the greatest concurrence of opinion when it comes to defining SMES in terms of asset values and the number of people employed. The following are some of the measures for ‘SME’ given in the literature:

- The Organization for Economic Co-operation and Development (OECD 2000) views SMEs as firms with fewer than 500 employees.

- Small and Medium Industries Equity Investment Scheme (SMIEIS), views SMES in Nigeria, as enterprises with a total capital employed not less than N1.5 million, but not exceeding N200. including working capital, but excluding cost of land and/or with a staff strength of not less than 10 and not more than 300

- According to the Nigeria’s national Council on Industry; an SME is defined in terms of employment i.e. as one with between 10 and 300 employees (Udechukwu, 2003).

Given that the focus of this thesis is more related to financial issues, the definition proposed by the Small and Medium Industries Equity Investment Scheme was adopted, however, some of the firms surveyed had capital less than N1.5 million and staff strength lower than 10.

**FINANCE**

This comprises the whole range of financial services to the rural, urban and peri-urban population at large. Financial services include savings facilities, credit, payment and transfer services, insurance and leasing.
FINANCING

The act or process of providing funds for a business venture

NON-BANK FINANCIAL INSTITUTIONS

Non-banking Financial Institutions carry out financing activities but their resources are not directly obtained from the savers as debt. Any institution which is not a bank as defined by legislation but is involved in finance.

3.2 DEMAND FOR SME FINANCE

SMES are very significant to the economic success for most countries and their citizens and in recent times have been observed to employ an increasing proportion of the workforce of most countries. There is a fast growth in the number of privately owned small and medium-sized companies worldwide, however, this category of business is plagued by several issues that deter this growth. A key challenge for most SMEs is the problem financing, according to Da Silva et al (2007), all small firms live under tight liquidity constraints, therefore making finance a major problem for them.

According to Ogujiuba, Ohuche and Adenuga (2004) generating an entrepreneurial idea is one thing but accessing the necessary finance to translate such ideas into reality is another. Many novel entrepreneurial ideas have been known to die simply because their originators could not fund them, and banks could not be convinced that they were worth investing in. Finance, whether owned or borrowed, is needed to expand so as to maximize profit and given the nature of SMES, there is a need for financing. As described by the South African reserve bank (2004) in a report conducted by the Task Group of the Policy Board for Financial Services and Regulation, SMEs generally have four key funding requirements: i) initial infrastructure investments, ii) lumpy operations costs, iii) ‘next-step’ expansions, and iv) unexpected opportunities requiring quick access to funds. Despite what the funding requirement maybe, SMES often prioritize the source of financing from internal (cash flow or entrepreneur’s own capital) to external, according to relative availability and (opportunity) cost (Ogujiuba, Ohuche and Adenuga 2004). This is because for most firms, the internal funds are always insufficient to undertake the required level of transactions for profitable projects hence the call for external finance to fill the finance gap.

Theoretically, a number of analytical paradigms have attempted to explain the complexities and practicalities involved in small-firm financing. As early as the MacMillan Report in 1931, there has been recognition that British small firms suffer from what is termed the ‘finance gap’. In a first-world setting like that in the UK, this situation arises when a firm has grown to a size where the use of short-term finance is maximized, but the firm is not big enough to access capital-market funds. By contrast, in developing countries it is probable that such a
3.3 THEORETICAL FRAMEWORK
The theoretical framework adopted for the paper involved the bank capital channel model and the capital constraint model. Also adopted in this work, is the Lifecycle approach, Pecking-order and the agency framework hypotheses that attempts to explain small-firm financial structuring.

3.4 BANK CAPITAL CHANNEL MODEL
This model considers the lending behaviors of bank to SMES to be affected by a capital adequacy requirement. According to T.M Obamuyi (2007),

“The bank capital channel views a change in interest rate as affecting lending through bank’s capital, particularly when banks’ lending is constrained by a capital adequacy requirement. Thus, an increase in interest rates will raise the cost of banks’ external funding, but reduce banks’ profits and capital. The tendency is for the banks to reduce their supply of loans if the capital constraint becomes binding. However, banks could also become more willing to lend during certain periods because of an improvement in their underlying financial condition.”

This condition as purported by this model, is seen clearly seen in the relationship between banks and SMEs as the SMEs suffers through a lack of financial assistance as a result of this situation.

3.5 CAPITAL CONSTRAINT MODEL
The capital constraint model describes the behavior of banks restrain to gives out loans to SMEs because of the limitation of available financial recourses banks.

According to the work of T.M Obamuyi (2007),

“Basically, banks are subjected to both market- and regulator –imposed capital requirements. For prudential purposes, banks regulators generally require banks to maintain capital at not less than a stated fraction of the bank’s total assets. For instance, banks are expected to meet the capital adequacy requirement of the Basel Accord of ten per cent”

This situation is visible in Nigeria, as banks are expected to maintain a minimum of 40 per cent liquidity ratio of total deposits.
3.6 THE LIFECYCLE APPROACH

The lifecycle approach, as described by Weston and Brigham (1981), was conceived on the premise of rapid growth and lack of access to the capital market. Small firms were seen as starting out by using only the owners’ resources. If these firms survived, the dangers of undercapitalization would soon appear, and they would then be likely to make use of other sources of funds, such as trade credit and short-term loans from banks. Rapid growth could lead to the problem of illiquidity.

‘‘The dynamic small firm would therefore have to choose between reducing its growth to keep pace with its internally generated funds, acquire a costly stock market quotation, or seek that most elusive form of finance – venture capital’’ (Weston, J.F. and E.F. Brigham, Managerial Finance, Hindgale: Dryden Press, 1981)

Thereby indicating a trend in SMES that expanding small firms are likely to experience rising short-term debt and use little or no long-term debt.

3.7 THE PECKING ORDER THEORY

The pecking order theory as propagated by Myers, S (1984)\(^1\) states that firms finance their needs in a hierarchical order, first by using internally available funds, followed by debt and finally, external equity. This practice is more common in Small Firms practice and indicates the negative relationship between profitability and external borrowing by small firms. According to the report by South African reserve bank (2004)

‘‘This hypothesis implies that there tends to be a negative relationship between profitability and external borrowing by small firms. In other words, assuming a zero growth, firms with high profitability would generate higher levels of internal liquidity, reducing the need for borrowing. Older firms, it may then be hypothesized, would make less use of external finance and, instead, would rely on retained funds.’’\(^2\)

3.8 AGENCY THEORY

This theory places emphasis on transaction costs, contracting analysis following the work of Coase (1937)\(^2\) Jensen and Meckling (1976)\(^3\) and most important, Stiglitz and Weiss (1981)\(^4\). The work of these writers all point to the challenges that surround ownership, contractual agreements, management interrelationship, credit

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rationing etc between SMEs and external providers of finance, thereby subjecting firms to the risk of asset substitution which in practice means a change in the firm’s asset structure. For very small and micro-enterprises this asset substitution may well take place between the enterprise and the owner’s household. As described in the report by South African reserve bank (2004)

‘The presence of these problems in small firms may explain the greater use of collateral lending to small firms as a way of dealing with these agency problems. Lenders’ strategies for dealing with these problems also add significantly to the cost of dealing with this sector. For a large enterprise the evaluation of an application for finance may be limited to the assessment of an (audited) set of financial statements and supporting documentation provided by the applicant, while for SMEs the assessment frequently has to go far beyond this, implying a substantially higher transaction cost.” 5

Regardless of all the theories explaining the financial needs of SMEs, it’s clear that the financial needs of SMES in both developing and industrial countries is largely diverse, they differ from region to regions or country to country. As depicted in the table below showing some of the major differences in the finance made available to SMEs both in UK and lower income countries

Table 3: Indicates some of major differences between the UK and lower income countries in respect of the finance made available to SMEs

<table>
<thead>
<tr>
<th>COMPARISON BETWEEN THE UK AND LOWER INCOME COUNTRIES IN RESPECT OF FINANCE FOR SMES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small firms in the UK</td>
</tr>
<tr>
<td>Small firms have a high reliance on short-term financing through the banking sector</td>
</tr>
<tr>
<td>A low proportion of small firms’ assets are financed by shareholders; so debt-to-equity ratios are relatively high compared to larger firms</td>
</tr>
<tr>
<td>Fixed assets are relatively unimportant in the balance sheets of smaller firms.</td>
</tr>
<tr>
<td>Trade credit and trade debt are relatively important.</td>
</tr>
<tr>
<td>In recent years, leasing, hire purchase, and venture capital have become more important.</td>
</tr>
<tr>
<td>Small firms have higher transactions costs than larger firms.</td>
</tr>
<tr>
<td>Small firms have higher/greater information imperfections than larger firms</td>
</tr>
<tr>
<td>Small firms have poor business planning, a lack of interfirm co-operation and higher transactions costs than larger firms</td>
</tr>
<tr>
<td>Small firms have poor relations with financial institutions.</td>
</tr>
</tbody>
</table>

5 With the evident restriction, though, that many potential entrepreneurs from previously disadvantaged backgrounds cannot find sufficient resources among their families and friends to start their firms.
THE NIGERIAN CASE

3.9 THE NIGERIAN ECONOMY

Nigeria being the most populous country in Africa and the eighth most populous country in the world (United States Library of Congress - Nigeria ; 2006) with a population of over 150 million has long envisioned a crucial role for itself as an engine of growth in the African continent (C.C Soludo 2004). Based on its comparative advantages such as its population size, rich petroleum base amongst others, the country aspires to support economic growth, regional integration, and political stability on the continent. However this position of relevance has not be matched by a strong domestic economy especially since the era of military rule and emergence of petroleum as a dominate source of income.

According to a report by USAID-funded Promoting Improved Sustainable Microfinance Services (PRISMS) project, Nigeria is a country with a GDP of about $40 billion, and it is Africa’s second largest economy having a GDP in 2006 and 2007 N18.57 trillion and N22.91 trillion respectively (National Bureau of Statistics NBS). However, 70% of its population lives below the poverty line with an average per capita income of about $300 population density and poverty statistics (USAID 2003a, p.40).

The economy of Nigeria is made up of both the oil and non-oil producing sector with the middle income, oil-producing economy of perhaps five million people having a per capita income of about $2,200 and the rest of the population part of a poor, non-oil producing economy (World Bank 2003, p. 2). Although The agricultural sectors stands out to be the country’s biggest employer, the oil and gas production sector still accounts for 98% of the foreign exchange earnings and 84% of budgetary revenues and majority of Nigerians derive their income from a combination of agricultural activity and operation of a Small and medium enterprise (USAID 2003a, p.40).

3.10 SMES' ECONOMIC SIGNIFICANCE IN NIGERIA

There is no doubt that SMEs have been credited with massive contribution to the growth of developed economics of the world, they afford the platform on which any country’s economic growth and stability lies. According to the SBA Report (2000), the American economy which is arguably the largest economy of the world depends largely on the success of SMES for “innovation, productivity, job growth and stability” (D.Ojukwu, 2006), according to the report, SMEs represent about 99% of all employers, employ 51% of private-sector workers, employ 38% of workers in high-tech occupations, provide about 75% of new jobs of the private sector output and represent 96% of all goods exporters” (Twist, 2000).
This account is also true for economies of several countries, such as the United Kingdom where a report in 2002 indicated that SMEs accounted for 99.8% of all businesses, 55.6% of employment and 52.0% of turnover (ODPM, 2005).

In Canada also, the SMEs deliver 60% of the country’s economic output, generate 80% of national employment and 85% of new jobs (Net Impact Study Canada, 2002).

In addition, it could that the rapid transformation of the “Asian Tiger” countries of India, Malaysia, Indonesia, Taiwan and Hong Kong, was largely due to the development of the SMES of these countries, thereby hailing the proof that SMEs are major catalysts to economic development.

In developing countries like Nigeria, the role of SMEs is equally of strategic importance as they facilitate Indigenous entrepreneurship, reduce poverty and provide employment for a large number of people amongst other important roles that they play.

Although there are no clear statistics on the number, geographical distribution, and activities of the SME sector and the available statistics could be very partial and highly unreliable. The best estimates available suggests that SMEs comprise 87% of all firms operating in Nigeria, although the total number of registered firms in Nigeria is also unknown (World Bank 2002a, p.127). In another study conducted in Nigeria by the Federal Office of Statistics, it is estimated that over 97% of all businesses in Nigeria employ less than 100 employees. This therefore means that about 97% of all businesses in Nigeria are SMEs (Ariyo, 2000)

In 1996, FOS poverty statistics indicated that 55.8 million were below the poverty line and that there are approximately five persons per household. A conservative assumption is that 75% of the total number of poor households (or 8.4 million) depend on a farm or non-farm SME for their livelihood.

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6 This percentage quoted in the World Bank report was reported as being from the Corporate Affairs Commission (CAC) in Abuja, Nigeria. It is also consistent to the best of our knowledge with earlier, similar estimates (87%) provided by earlier World Bank reports.
This estimate is supported by an earlier CBN report that estimated the total number of micro and small-scale enterprises at seven million (ACCIOM International 2003, p.8)

Due to the lack of available statistics, to estimate the exact number of SMEs segregated by size in the country is an impossible thing, but it can be reasonably estimated to comprise of microenterprises which makes up about
80% of the total number of potential MSMEs (approximately 6.7 million), small businesses account for 15% of the total (about 1.3 million), and medium enterprises may comprise 5% of the total MSMEs (around 420,000).

3.11 STRUCTURES OF SMES IN NIGERIA

The characteristic of SMEs in Nigeria differs based on the size of the business and a review of their several attributes is useful to inform discussion of their demand for and the supply of financial and non-financial services; the table below describes the various attributes of the structure of SMEs in Nigeria.

Table 4: Characteristic of SMEs in Nigeria based on several factors.

<table>
<thead>
<tr>
<th>MSME Characteristics</th>
<th>Microenterprises</th>
<th>Small Businesses</th>
<th>Medium Enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skills</td>
<td>Low: uneducated but dynamic. Sole ownership</td>
<td>Medium: have technology competence, engage in training and invest in apprenticeship system. Basic education at the very least high school leaving certificate or trade technical certificate</td>
<td>High: undertake technology upgrading, design adaptations in response to market. Highly educated, often with a university degree or higher</td>
</tr>
<tr>
<td>Technology</td>
<td>None to low</td>
<td>Low to medium</td>
<td>Medium to high</td>
</tr>
<tr>
<td>Competition</td>
<td>Medium to high</td>
<td>High</td>
<td>Medium to high</td>
</tr>
<tr>
<td>Products</td>
<td>Retail, arts and crafts, textiles, services, e.g., Salons, tailoring</td>
<td>Manufacturing, chemicals and Pharmaceuticals, organized retail</td>
<td>Telecom, IT, specialized Retail service e.g. restaurants, entertainment</td>
</tr>
<tr>
<td>Markets</td>
<td>Local</td>
<td>Local, national, regional</td>
<td>Local, national, regional</td>
</tr>
<tr>
<td>Links with BDS</td>
<td>Very limited: few links with donor sponsored Providers</td>
<td>Limited: some links with donor and private sector providers complemented by in-house technical Training, accounting and some routine functions, e.g. legal, management and technical consultancy</td>
<td>Extensive</td>
</tr>
<tr>
<td>providers and other</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>support institutions</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

SOURCE: ADAPTED FROM WORLD BANK 2002B.

According to USAID / PRISMS (2004), the main trade carried by SMEs may be segregated by size of enterprise, for instance, microenterprise operations tend to be “low tech” and focused on retailing, and services such as salons, tailoring, etc. Small businesses make more use of various technologies as they grow to scale and simply be larger versions of microenterprises or be engaged in different businesses that require more employees (5-25) to produce a product. Examples of these kinds of small businesses include small-scale manufacturing (e.g. furniture), chemicals and Pharmaceuticals, and organized retailers such as clothing outlets, shoe stores, etc. Medium-sized business are less apt to be larger versions still of typical microenterprise-type operations and more likely to larger versions of small enterprises or other types of businesses that require more advanced technology or additional employees. Examples of medium-scale enterprises include telecom providers and specialized retailers such as restaurants and entertainment establishments.
Furthermore, statistics indicates that majority of SMES especially the large ones are clustered around population centers such as Lagos, Port Harcourt, and the Federal Capital Territory (FCT), however, many micro and small enterprises can be found operating at the village level throughout the country as well. Locations of most micro and small enterprises appear to be along secondary, tertiary, and quaternary roads, in, and around market centers (USAID / PRISMS, 2004)

3.12 DEMAND FOR SME FINANCE IN NIGERIA
As much as SMEs are of strategic importance to the economy of a country so also are the financial systems in that country, because of the fundamental role they play in the development and growth of the economy. The Nigerian financial system is broadly dualistic in nature comprising of both an informal and formal sector, with the formal sector largely dominated by the deposit money banks in Nigeria in terms of total deposits, credit and total assets T.M Obamuyi (2007).

In attempt to make the banking sector sound, stable, reliable, dependable and internationally competitive, the Central Bank of Nigeria (CBN) announced on July 6, 2004, that with effect from January 1, 2006, the minimum paid up capital should be N25 billion. As a result of this policy, the banks embarked on mergers, acquisitions and consolidations with a turnout of 25 groups of bank from a previous existing 89 commercial banks and 14 banks going into liquidation.

The hope for the consolidation was that, banks would be able to mobilize a large amount of funds to provide loan-able funds to the productive sector, which is dominated by the small and medium enterprises. This is with the goal to enable SMEs to grow into large and conglomerate firms, this has however not been achieved as SMEs are still plagued with the challenge of accessing the necessary fund they need to develop.

According to a report by the CGAP, despite the large percentage of SMEs operating in the country, only about 5 percent of them get access to loans from banks despite the fact that 80 percent of them seek financing (CGAP: Access to finance in Nigeria report, 2009). Although several constraints are responsible for the slow growth of SMEs in the country, topping the list are electricity shortage, low access to finance and the poor transportation network, in order of importance this is according to a recent World Bank Investment Climate Assessment (ICA) study (2008). The need for eliminating these bottlenecks to their growth cannot be over emphasized. The figure below depicts the extent to which access to and cost of financing are a problem for Nigerian firms, according to a report from an ICA study in 2008.
According to the study conducted by ICA in 2008, it was clear that only around 10 percent of the surveyed SMEs applied for a loan or a line of credit and about 70 percent of them saw their application rejected. However, 80 percent of SMEs that did not apply for financing would like to have a loan/line of credit, compared to only 20 percent of large firms (ICA Report, 2008)
This trend when compared to relevant countries globally indicates that Nigeria’s results exceed those of Brazil but lag behind results for India, China, South Africa, and Indonesia (see Figure).

**FIG 4: Difficulty of Access to Finance: International Comparison**
(Percentage of firms reporting access to finance and cost of debt as a problem)

![Graph showing difficulty of access to finance and cost of debt as a problem for Nigeria, Brazil, Indonesia, South Africa, India, and China over different years.](image)


### 3.13 REASON FOR THE DIFFICULTY PROBLEM OF BANK FINANCING TO SMES

The problem of bank financing to SMEs has been persistent for many years in the country with both parties actively responsible for the lack of SMES financing: SMES because of their shortfalls in meeting the classic requirements of the banking sector and banks because they could mobilize more resources in order to penetrate the SMES segment, basically both parties share the blame of the problem as both groups show real weaknesses in their capacity to respect the requirements and practices of the other. In Nigeria, the banks have traditionally dominated the financial systems, leaving little leeway for SMEs seeking alternative financing to bank loans; hence a close look at the problem focus on the banks and points to reveals a number of reasons explaining the
behavior from the bank. For the purpose of this thesis, these will be categorized under three major broad heading.

- A poor macroeconomic environment
- Lack of basic infrastructure facilities.
- Internal structuring problems of SMEs

3.14 MACROECONOMIC ENVIRONMENT
The Nigerian macroeconomic environment considered to be relatively unstable especially for a number of factors, high interest rates, exchange rate disparity, unavailability, and dominance of the government sector in the economy. E.g. deficit financing and budgetary distortions etc (Ogujiuba, Ohuche and Adenuga, 2004)

- **Interest Rates:**
Interest rates in Nigeria are officially as high as 23.6 %, making it very discouraging for the small and medium scale industries to obtain credit from the banks, high interest rates are not encouraging to investors in the sense that the cost of funds could undermine profits, and cause a loss of the investment. This situation is even worse for the manufacturing sector that sees interest rates from the bank go as far up as 36% or more. According to a World Bank survey; 2001, banks offers lower interest rates to bigger firms

- **Exchange Rates:**
Disparity in the management of the foreign Exchange Rates system greatly affects the business the environment and this has been the case in Nigeria for a while now, making it a huge challenge for the small and medium scale industries to procure raw materials from abroad and equally constrains the availability of trade credits for SMEs by banks.

- **Inconsistency in government industrial policies and a weak legal apparatus:**
Inconsistency in government policies is a major problem affecting the growth of small and medium scale industries. The inability of the government to execute budgets on time is a major restriction on the ability of manufacturing firms to factor tariff measures into their trade decisions also affecting the availability of trade credits for SMEs by banks ( Njoku , 2002).

In addition, weaknesses in the legal framework of the country (for instance, in terms of guarantees’ enforcement) makes it extremely difficult to recover bad loans. These difficulties reduce interest in SME financing further still and, at the same time, lead banks to impose stiffer conditions for their financing.
3.15 LACK OF INFRASTRUCTURAL FACILITIES
The poor state of infrastructure in Nigeria is a key excuse given by many banks for their inability to fund SMEs. According to Olanrewaju (2001), the low performance of public utilities such as electricity generation is unstable and inadequate; new roads are neither constructed nor old roads maintained; water supply is not sustainable etc, all make up factors that pose as threats for fund managers. For banks to extend credit to SMEs, all these factors must be considered. At the end, it is realized that the cost of doing business is so high that the ability of the banks to recoup their investment is uncertain.

3.16 INTERNAL STRUCTURING PROBLEMS OF SMES
Other concerns of the banks aside the external factors are the internal problems that exists within the structures of the SMEs themselves and these includes the lack of organization in SMEs, particularly in terms of human resources, accounting, administrative management and control functions. Most SMEs are often owned by a family and the business leaders even in the biggest SMEs – are oftentimes the sole decision-makers in their firms, and this modest, often fledgling, structure creates a breeding ground for errors, fraud and works against the regularity of processes. This can be particularly prejudicial for firms in the manufacturing sector, and notably for exporting firms. There is usually too little reflections prior to action yet such reflection could help ensure the stability of manufacturing and marketing processes. Control, both internal and by auditors, is pushed into the back seat which makes it difficult to swiftly detect a firm’s weaknesses. This can also encourage inclinations towards non-transparency on the part of promoters and can cause banks to lose their equanimity towards SMEs (Paul Derreumaux, SME financing in Sub-Saharan Africa, page17, 2009)

In addition, the business leaders oftentimes lack good management skills to drive the organization yet they still lead the group. This can only lead to failure in the organization that the banks fears are too risky for them to put their money.

According to Ogujiuba, Ohuche and Adenuga (2004), inadequacy of financial resources to recruit skilled manpower naturally restrains expansion and limits productivity and growth and the problem of financial indiscipline on the side the SMEs as Firms are most likely to divert funds meant for the business in funding other projects are also key Obstacles affecting the bank’s lending attitude to the SMEs.

3.17 BANK SHORTCOMINGS
Despite the faults with the Nigerian macroeconomic environment and the SMEs internal issues, the banks also contribute to the problem of financing SMEs as most of them display apathy towards the SMEs, preferring to offer their services to larger multinational firms. The banks on their own part have at least two significant shortcomings.
• **Weakness in Supervision.**

SMEs are understandably fragile in nature in terms of terms of organization and forward-looking vision; hence bankers ought to closely follow-up firms’ day-to-day running and the relevance of their investments and the difficulties they meet, however, banks lack behind in performing this role. According to Paul Derreumaux, This lack of supervision on the part of banks can be explained by several factors such the lack of time due to the sheer number of extremely varied SME files to deal with, and the low level of profitability of this supervision compared to other activities. This nonetheless, creates a vicious circle, since this lack of supervision actually causes files to deteriorate which in turn makes banks even more averse to SMEs (Paul Derreumaux, SME financing in Sub-Saharan Africa, page17, 2009)

• **Lack of reference framework to manage SMEs**

Banking teams according to Paul Derreumaux, lack a specific reference framework based on in-depth experience of SME financing. The diversity of SMEs – in size, sectors, characteristics or in terms of support required – is, of course, at the root of this situation and explains the difficulties encountered when developing solutions. In most cases, banks continue to suffer from a lack of departments specialized in SMEs, a lack of procedures adapted to the limited available financial information and supervision indicators, limited innovation capacities in terms of acceptable guarantees and a total absence of specific training in SME financing for credit analysts and client advisors. These are all factors that prevent banks from having any greater interest in SMEs.
CHAPTER 4

SOURCES OF SMES FINANCE

The focus of this chapter is to look at the various sources of finance for SMEs and the non-banks intermediaries as financial service providers and role they currently play and are capable of performing in providing access to financial service required by SMEs.

4.1 FINANCE FOR SMES

Since bank lending to SMEs Firms in Nigeria is relatively low say about (1% of firms), SMEs tend to depend a lot on retained earnings and their own fund (70% of firms) for financing, this is according to a report conducted by ICA Survey in 2008. Supplier credit is also low, accounting for only a quarter of SME financing. They also seek financial assistance from other informal and formal sources that are necessarily commercial banks. The table below gives a description of this trend.

Table 5: Sources of SME Finance in Nigeria

<table>
<thead>
<tr>
<th>PERCENTAGE OF FINANCING FROM:</th>
<th>TOTAL</th>
<th>SMALL</th>
<th>MED.</th>
<th>LARGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own Funds/ Retained Earnings</td>
<td>70%</td>
<td>70%</td>
<td>71%</td>
<td>61%</td>
</tr>
<tr>
<td>Borrowed from banks and other financial Institutions</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Purchases on credit from suppliers and advances from customers</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
<td>35%</td>
</tr>
<tr>
<td>Borrowed from family, friends and other informal Sources</td>
<td>4%</td>
<td>4%</td>
<td>2%</td>
<td>1%</td>
</tr>
</tbody>
</table>


4.2 INFORMAL SOURCES, PERSONAL FUNDS/ RETAINED EARNINGS

Most SMEs in Nigeria are observed to get funding from personal savings, informal lending schemes known as “esusu”, savings collectors, and moneylenders, rotating savings and credit associations and family members. This is further confirmed in a survey by USAID (demand survey; 2005) where 24 percent of the surveyed respondents agreed to use informal finance services in a report conducted by the EFInA FinScope survey.

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7 It is to be noted that this table refers only to short-term financing. For long-term financing, firms, supplier credit is not an option, so firms tend to rely on own funds over 90 percent of the time.
4.3 LEASING

A creative financing alternative for SMEs that is seemingly more popular in Nigeria is known as equipment leasing. The equipment needs of SMEs are increasing being met through this unique form of financing.

Equipment leasing is described as a contractual accord between two parties known as the equipment owner “the lessor” and the user of the asset a “lessee” whereby the lessee remits to the lessor a periodic rental fee as compensation for the usage of the equipment. The two major types of leasing are known as finance lease and operating lease. In the Finance lease, the lessee is transferred all the risks and benefits of ownership, while the lessor retains the title of the equipment. The lease is usually non-cancelable by either party before the expiration of the primary tenor and payments are sufficient in total to amortize the capital outlay of the lessor and to provide for the lessor’s cost of funds plus a desired return. In operating lease, the asset is not fully amortized during the primary tenor. The lease is therefore usually shorter than the estimated useful life of the asset and can be leased out on a secondary lease.

Between 2003 and 2007, the Equipment Leasing Association of Nigeria (ELAN) recorded a quadrupling of leasing volumes granted by its members in Nigeria, however only a number of Small independent financial and leasing companies provide support for the SME industry. The commercial banks tend to serve larger companies (predominantly for oil and gas) with bigger leasing amounts. An estimate of 33 leasing companies out of the 250 in Nigeria, are non-financial companies that do not accept deposits (and are not regulated by the CBN). These companies typically face high costs of funds, as they borrow at commercial rates from the banking system. According to ELAN most leasing companies are able to access loans from the financial system at rates between 22 and 30 percent per annum. With such margins, the final cost to the SME customer is between 35 and 50 percent. The fact that such leasing is growing in spite of the high costs involved is a clear indication of the lack of financing alternatives.

4.3 NON-GOVERNMENTAL GROUPS (NGOS)

According a report in 2008 conducted by ICA in Nigeria, Non-governmental groups’ microcredit programs in Nigeria date back at least as far as the late 1980s or early 1990s. There are currently five major microfinance NGOs in Nigeria and they include COWAN, LAPO, SEAP, DEC and FADU and they serve an approximate of 550,000 borrowers and manage a total loan portfolio of NGN 4.9 billion (US$ 40.6 million). Though the number of viable microcredit NGOs is small, these successful organizations play an important demonstration role in Nigeria. They are perceived to have developed a viable model of making very small loans to rural populations, particularly women. Most NGOs use a version of the Grameen solidarity model to provide small loans to SMEs groups.
4.4 SMES’ ACCESS TO FINANCIAL SERVICES THROUGH NON-BANK FINANCIAL INTERMEDIARIES

Traditionally the commercial banks in Nigeria functions as the ‘caretaker of the nation’s money-transmission system’ and they operate within corporate cultures that are hardly the most fertile breeding ground for the level of innovation and of risk taking that is required for the development of effective finance products for SMEs. As described in earlier chapters, the history of Nigerian banks’ involvement in small business finance indicates the resistance of the banks to becoming involved in SME finance, which is likely to hold true until other non-banks intermediaries lead the way into this sector. For the achievement of an increase in the amount of finance and the financial products available to the SME sector, there should be more financial service providers that are willing to take risk and be more innovative. Access to credit supplied by non-bank financial institutions (such as retailers and micro-lenders) is an important source of finance for SMEs. A well diversified financial sector with sound banks as well as non-bank financial institutions (NBFIs) are necessities to supporting the articulated development objectives of increased economic growth, greater job creation, and a better standard of living set by the Nigerian government. Banks and NBFIs are both key elements of a healthy and stable financial system that complement each other and offer synergies. However, at present, Nigerian’s financial services industry continues to be dominated by banks – with nearly 80% of financial system assets (in 2005) in banks. The rest of the financial sector – including insurance, Finance Companies, Bureau de Change, pensions, mutual fund, Community Banks, Development Finance Institutions, leasing, factoring, and venture capital companies etc is still small, with less than 15 per cent of GDP in assets combined.

4.5 IMPORTANCE OF NBFIS

As commercial banks generally continue to increase in their direct competition with other international banks, it is avoidable that they will continue to eliminate ‘marginal’ product lines and reduce their retail branch network (South African reserve bank 2004)

This observation is further confirmed in the Wallis Report by this statement ‘the process of rationalisation, including closure of bank branches, is likely to occur irrespective of regulatory changes, since it is driven by the fundamental competitive forces unleashed by new technologies and other factors.’ Furthermore, ‘certain services may become unaffordable for some sections of the community, including low-income groups or those in remote areas.’
This trend makes it unlikely for commercial banks in worldwide including Nigeria to provide meaningful finance for SMEs in the future, except they do so profitably. Hence, the need for Non-bank financial institutions to step in and render the much needed financial support to SMES.

4.6 INTERNATIONAL PRECEDENT

In a report by World Bank (Unlocking Indonesia’s Domestic Financial Resources: World Bank; December 2006) the relevance of NBFIs in Indonesia’s economy shows that these institutions cannot be neglected as they have continuously aided in the growth of the small and medium enterprises.

NBFIs helps to broaden and deepen the financial market of any economy which turns facilitate savings mobilization by offering both individual and institutional savers and investors additional instruments and channels for placement of their funds at more attractive returns than are available on bank deposits. In addition, it also boosts access to finance and offers additional instruments and channels to individuals, firms, institutional savers and investors placement of their funds at more attractive returns than are available on bank deposits (Unlocking Indonesia’s Domestic Financial Resources: World Bank; December 2006).

Also similar experience in Latin America demonstrates the role that NBFIs play in expanding access to enterprise finance (Christen, Op. cit., p. 16) For example, in Paraguay small finance companies dominated the commercialization of micro (enterprise) credit, and anecdotal evidence suggests that there is a considerable crossover from consumer finance into micro (enterprise) credit.

In Malaysia, NBFIs are identified as the key players in the development of capital and also in complementing the facilities offered by the commercial banks and as pointed out by Alan Greenspan (1999) the impact of the currency crisis in Thailand might have been significantly less severe if some of the risks borne by the Thai banks had instead been borne by the NBFIs. NBFIs are identified to keep the financial sector complete and enhance the overall growth of the economy of the country (The Efficiency of Non-Bank Financial Institutions (Fadzlan Sufian; 2006).

As stated by Fadzlan Sufian in his research on the Malaysian economy, the development of NBFIs such as insurance companies, pension funds, and mutual funds broadens the range of products available for people and companies with resources to invest. These institutions also provide competition for bank deposits, thereby mobilizing long-term funds necessary for the development of equity and corporate debt markets, municipal bond markets, infrastructure finance, mortgage bond markets, leasing, factoring and venture capital.
Thus, countries have a lot to gain from deep and broad financial markets and a mature financial services industry. NBFIs improve general system-wide access to finance by providing additional and alternative financial services. Longer-term investments and financing which is often a challenge in the early stages of bank-oriented financial sector development are facilitated by these institutions. This development paradigm is increasingly recognized around the world (The Efficiency of Non-Bank Financial Institutions (Fadzlan Sufian; 2006).

4.7 EMERGENCE, CHARACTERISTICS AND ROLE OF NBFIS IN NIGERIA.

According to E.A. Esezobor (CIBN 2003), with the adoption of universal banking in Nigeria from January, 2001, non-bank financial institutions are identified as financial intermediaries in specialist sectors but who are not allowed to combine the traditional retail banking function, insurance marketing services and capital market transactions as their lines of business. As stated by Nwankwo G. O (1985), non-bank financial institutions are described as non-bank financial intermediaries with distinguished characteristic and these are:

- They are specialist lenders in the different sectors of the economy e.g. primary mortgage institutions lend for owner-occupied properties while finance companies and community banks lend for consumer credits structured on installmental repayment
- Unlike banks which have short-term deposits repayable on demand, these intermediaries have nearly all their deposit liabilities fixed for specified periods.
- Most of the non-bank financial institutions do not operate current accounts. Customers are therefore expected to, first of all, withdraw their funds, a process called purification, before making payment unlike the privilege of issuing cheques in a current account in conventional banks.
- Unlike banks that enjoy free funds in current account, all the deposits of non-bank financial institutions attract interest.
- While banks maintain the liquidity principle in banking, the non-bank financial institutions must match their credits against their deposit profile.
- Banks, especially commercial banks, offer retail banking through a network of branches while non-bank financial institutions maintain unit offices or limited branch offices and concentrate on corporate customers in their wholesale services.
- Largely, the non-bank financial institutions do not operate current accounts. Customers are therefore expected to; first withdraw their funds, a process called purification, before making payment unlike the privilege of issuing cheques in a current account in conventional banks.

4.8 ACTIVITIES OF NON-BANK FINANCIAL INTERMEDIARIES IN NIGERIA

The following are a number of NBFIs that exist within the Nigeria, their modes of operation and roles which they play. They are Community Banks, Primary Mortgage Institutions, Finance Companies, Bureau de Change,
Development Finance Institutions, Discount Houses, mutual funds, Insurance Companies, and pension funds, savings collectors, cooperative societies, moneylenders, rotating savings and credit associations.

- **Finance Companies**
  These companies focus on short-term, non-bank financial intermediation by mobilizing monetary resources from the investing public in form of borrowing and provide, among others, facilities for Local Purchase Order (LPO) and project financing, equipment leasing and debt factoring. They are under the direct control and supervision of the CBN.

- **Bureau de Change (BDC)**
  These are institutions that perform the vital functions of broaden the foreign exchange market and improve access to foreign exchange, especially for small users. They were authorized in Nigeria since 1989. A total of 240-bureau de changes have been licensed and they are supervised by CBN.

**Insurance Companies**

- **The insurance companies**
  The Nigerian insurance industry was mandated to operate under the act of 1991 and have since grown tremendously over the years. It is made up of insurance companies that offer both life and non-life insurance and also reinsurance firms. Their investments are mainly in government securities and mortgage industry and they mobilize relatively long-term funds and act as financial intermediaries. Their funds are sourced mainly through reduction in outgoing and other assets which together account for 80.8 per cent of total funds. The National Insurance Commission was established to provide insurance cover for insurance companies. All registered insurance companies in Nigeria are required to reinsure 20% of premium collected with the National Insurance Commission.

- **Development finance institutions (DFIS)**
  Specialized banks or development finance institutions (DFIs) were established to contribute to the development of specific sectors of the economy. In order to enhance their operations and make their efforts felt in the economy, most of the former DFIs in the country have been merged and restructured. The DFIs from the merger and restructuring are the Bank of Industry (BOI) and the Nigerian Agricultural Co-operative and Rural Development Bank (NACRDB). The two banks provide soft loans to industrialists and those engaged in agro-allied ventures. Other existing DFI's are Federal Mortgage Bank (FMB), Urban Development Bank (UDB) and Education Bank (EB) to cater for the sectors reflected in their names.
• **Community Banks.**
The GoN introduced the Community Bank (CB) license in the early 1990s to promote the growth of banks dedicated to rural areas and lower income groups, a community bank in Nigeria is a self-sustaining financial institution owned and managed within a community to provide financial services to that community. The National Board for Community Banks (NBCB) processes applications for the establishment of community banks. The first community bank commenced operation in December 1990. Since then, NBCB has issued provisional licenses to 1,366 community banks and are expected to be issued final licenses by the CBN after operating for two years.

• **Discount Houses:**
A discount house is a special, non-bank financial institution that intervenes in mobilizing funds for investments in securities in response to the liquidity of the system. It does this by providing discount/rediscounting facilities in government short-term securities. In the process of shifting the financial system from direct market-based monetary control, discount houses were established to serve as financial intermediaries between the CBN, licensed banks and other financial institutions. Some of the discount houses currently in operation in Nigeria include First Securities Discount House Limited, Express Discount House Limited, Associated Discount House Limited, Kakawa Discount House Limited and Consolidated Discount House Limited.

• **Primary Mortgage Institutions**
Primary mortgage institutions operate within the framework of Act No. 53 of 1989. PMIs mobilize savings for the development of the housing sector. Their total assets/liabilities rose to N7248.2 million in 1999. In reaction to distress in the sector, the Federal Mortgage Bank of Nigeria tightened its surveillance of the institutions by issuing “clean bill of health” to 116 mortgage institutions. The share capital requirement for new primary mortgage institutions has been raised to N20 Million.

• **Mutual funds and venture capital companies**
These two types of institutions are the latest additions to NBFIs, due to the current growth of pension funds and other contractual savings institution, the importance of these institutions cannot be overlooked.

The main characteristics of Venture capital companies (VCCs) is that they offer both equity and debt finance and take a more active and specialist interest in the management of the ventures they support. Their main function is the financing of small firms and new ventures, although they have gradually progressed to financing infrastructure and other major projects that governments delegate to the private sector for more efficient construction and management.
Mutual funds investing in equities or bonds exist as means of conferring to small individual investors the benefits of professional fund management and efficient risk diversification. Their number has increased in recent years, especially in the financial systems of high income countries. Currently there are now mutual funds specializing by sector or by country or region as well as mutual funds following active investment management policies or passive ones using published indices of various types of securities.

Employing the service of established and successful mutual funds is an economically viable and efficient alternative to pension funds and other institutional investors that clearly lack the specialist skills needed to invest in particular economic sectors or in particular regions or countries. Venture capital companies and mutual funds are not very advanced in the Nigeria although they exist in one form or another. Their prospects is very promising, especially if sound macro financial policies continue to be pursued in the countries concerned and if successful reforms can be are done in the contractual savings sectors, social security and pension systems.
EMPIRICAL ANALYSIS

Access to sufficient funds to grow and further develop their activities is a huge challenge faced by many SMEs in Nigeria as described in the previous chapters, no doubt emphasis on improving the access to finance of the SMEs is extremely critical in fostering entrepreneurship, competition, innovation and growth. From previous chapters, it’s also clear that the challenge of access to finance is made even worse by the attitude of many financial Providers who consider SMEs financing to be as a high-risk activity that generates high transaction costs and/or low returns on investment, additionally the SMEs have the task of adapting to the changing financial environment and to the increasing complexity and extent of financial reporting and management. The focus of the surveys below is to capture these issues and present them with a view to making recommendations to help change the situation.

This Chapter will focus on the collected data both from previously conducted surveys by other researchers and a small survey conducted on by this researcher on some SMEs using questionnaires, also focus is placed on the presentation of highlights from all the surveys. This is to help provide answers to the questions and hypothesis stated in chapter one.

5.1 RECENTLY CONDUCTED SURVEYS

Sample Characteristics and Profile of the Participants

In considering sample size, Saunders et al. (2003), suggested that a minimum number of thirty (30) for statistical analyses provide a useful rule of thumb (Ugwushi B; 2009), however, the researcher chose a sample size of forty (40) questionnaires but has responses from about 15 respondents, therefore the number of SMEs captured in this survey is fifteen (15). Due to the distance and the limited time available, it was rather difficult to conduct a face-to-face interview, hence primary data had to be collected by the use of questionnaire surveys. However, this was rather challenging as well, because the responses were not coming as promptly as they should, constant follow-up was done to get the response. In addition, responses on some questions were not given as the respondents did not want to disclose those information and some lacked understanding of the questions. A total of 15 respondents was therefore used although, a higher number of responses would have been better.

The study was focused some SMEs in Lagos State, being a typical state in terms of the characteristics of SMEs, availability of physical and financial infrastructure as well as economic resources.
Since there was no comprehensive listing of the SMEs in the state, a random selection of some SMEs was done with the guide that these SMEs meet the required criteria for selection, in addition, a listing of firms that have requested one form of service or the other from a recognized bank used.

5.2 COMPANY PROFILE OF SMES

Data from this section describes the characteristic of the sampled SMEs which is a reflection of most SMEs within the country.

**Table 6: AGE OF COMPANY**

<table>
<thead>
<tr>
<th>Number in years</th>
<th>&lt; 3 years</th>
<th>3 years</th>
<th>5 years</th>
<th>&gt;6 years till 9years</th>
<th>10 years &lt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total No. Responses</td>
<td>6</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

- This table depicts the characteristic of the sampled SMEs in terms of their duration of existence. This shows that Most of the SMEs have been in operation for less than three (3) years and only a few get past the age mark of ten (10) years. An indication that majority of them go out of operations due to several challenges especially financial challenges that they encounter, so survival is very difficult.

**Table 7: NUMBER OF EMPLOYEES**

<table>
<thead>
<tr>
<th>Number in years</th>
<th>&lt;10</th>
<th>10-99</th>
<th>100-199</th>
<th>200-499</th>
<th>&gt;500</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total No. Responses</td>
<td>14</td>
<td>1</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Table 7 describes the staff strength of SMEs

It is indicative that the staff strength is relatively low with an indication of about fourteen (14) SMEs having less than ten (10) employees and only one (1) SMEs having more than ten (10) employees.

**Table 8: BUSINESS INVOLVEMENT**

<table>
<thead>
<tr>
<th>Category of Occupation</th>
<th>Manufacturing</th>
<th>Service Provider</th>
<th>Commerce &amp; trade</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total No. Responses</td>
<td>1</td>
<td>6</td>
<td>5</td>
<td>3</td>
</tr>
</tbody>
</table>

Table 8 describes the business activities involved in by of the sampled SMS

- Majority of SMEs are involved in a service providing and commerce and trade occupation, only a few can get into the manufacturing sector as the capital required is very challenging for them to access. Therefore an indication that there is a need for provision of assistance to the SMEs if they are to play the role of employment providers.
The following other variables were also covered in this survey

5.3 AWARENESS OF SMES:
This section describes how knowledgeable SMEs are about the policies and groups that support their growth.

Table 9: PUBLIC POLICY

<table>
<thead>
<tr>
<th>AWARENESS OF PUBLIC</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>NO. SMES RESPONSES</td>
<td>4</td>
<td>11</td>
</tr>
</tbody>
</table>

Only four (4) respondents from the total fifteen (15) are aware of the existence of any government-implemented policies to support SMEs.

Table 10: GROUPS THAT SUPPORT SMES

<table>
<thead>
<tr>
<th>GROUPS THAT SUPPORT</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
<th>F</th>
<th>G</th>
<th>H</th>
<th>I</th>
<th>J</th>
<th>K</th>
<th>L</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL OF RESPONSES</td>
<td>5</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>NIL</td>
<td>1</td>
<td>NIL</td>
<td>5</td>
<td>NIL</td>
<td>1</td>
<td>NIL</td>
</tr>
</tbody>
</table>

This table depicts that most sampled SMEs are only aware of the banks and national government as the groups that can provide support for them.

For the purpose of this study, A to L represents the following in this section
A. national government
B. large state companies
C. local administration
D. large foreign companies
E. International donors
F. consulting companies and Agencies
G. associations of entrepreneurs
H. insurance companies
I. banks
J. service centers
K. chambers of commerce
L. Others (Please specify)
Deductions from this section indicate that most SMEs are unaware of the policies in place to promote and support their growth, with such ignorance SMEs are stuck to themselves and can barely grow.

In addition, majority of them see only the banks and national government as the only groups that can provide support for them. This has a very negative effect on their growth, because these groups alone cannot give the required support that they need and with a lack of awareness of other groups that can give them support, they cannot develop.

5.4 THE BARRIERS FOR FURTHER DEVELOPMENT
14 respondents out of 15 said that the major barrier to the growth and development of their business is the challenge they face in accessing credit, also 8 of them confirmed that they suffer from a lack of qualified human resources and a number of other respondents attributed this barrier to inadequate support from local authorities.

Table 11: Depicts the various barriers mitigating further development of SMEs according to the responses of the respondent.
<table>
<thead>
<tr>
<th>Factors affecting growth of SMEs</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unstable legal environment</td>
<td>2</td>
</tr>
<tr>
<td>Uncompetitive products</td>
<td>0</td>
</tr>
<tr>
<td>High level of taxation</td>
<td>3</td>
</tr>
<tr>
<td>Low purchasing power of the population</td>
<td>4</td>
</tr>
<tr>
<td>Insufficient support from local authorities</td>
<td>9</td>
</tr>
<tr>
<td>Negative image of the entrepreneurs</td>
<td>4</td>
</tr>
<tr>
<td>Procedural difficulties in starting a company</td>
<td>3</td>
</tr>
<tr>
<td>Difficulty in accessing to credit</td>
<td>14</td>
</tr>
<tr>
<td>Low coordination between organizations supporting SMEs</td>
<td>2</td>
</tr>
<tr>
<td>lack of qualified human resources</td>
<td>8</td>
</tr>
<tr>
<td>Lack of clear government SMES program</td>
<td>8</td>
</tr>
<tr>
<td>lack of market information</td>
<td>2</td>
</tr>
<tr>
<td>lack of management skills</td>
<td>1</td>
</tr>
<tr>
<td>too high cost of money</td>
<td>1</td>
</tr>
<tr>
<td>lack of proper marketing skills</td>
<td>4</td>
</tr>
<tr>
<td>Others (Please specify)</td>
<td>0</td>
</tr>
</tbody>
</table>

5.5 FACTORS FOR GROWTH AND DEVELOPMENT
For the purpose of this study, A to L represents the following in this section
Table 12: Depicts the various factors that will enhance further development of SMEs according to the responses of the respondent.

<table>
<thead>
<tr>
<th>Factors for growth &amp; Development of SMEs</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Simplify the registration of new companies</td>
<td>7</td>
</tr>
<tr>
<td>Based on existing agencies for SMEs support</td>
<td>7</td>
</tr>
<tr>
<td>Facilitate access to financing (creation of SMEs funds, etc)</td>
<td>14</td>
</tr>
<tr>
<td>Decrease the amount of taxes</td>
<td>4</td>
</tr>
<tr>
<td>Decrease the number of taxes and simplify the tax system</td>
<td>5</td>
</tr>
<tr>
<td>Simplify the system of reporting (currently, many reports to different organizations)</td>
<td>7</td>
</tr>
<tr>
<td>Decrease taxes for SMEs exporters and promote « SMEs-made</td>
<td>3</td>
</tr>
<tr>
<td>Give priority to women-entrepreneurs and create program of support of businesswomen</td>
<td>4</td>
</tr>
<tr>
<td>Determine laws more concretely and exactly</td>
<td>4</td>
</tr>
<tr>
<td>Create more penalties for SMEs that do not pay taxes</td>
<td>6</td>
</tr>
<tr>
<td>Publish more information for small business</td>
<td>7</td>
</tr>
<tr>
<td>Help to create « business incubators » or « technology parks » for new companies where they can be based for first 1-2 years</td>
<td>13</td>
</tr>
<tr>
<td>Create special funds for business-skilled staff</td>
<td>3</td>
</tr>
<tr>
<td>Support innovative technological companies</td>
<td>10</td>
</tr>
<tr>
<td>Others (please specify)</td>
<td>4</td>
</tr>
</tbody>
</table>

As table 12 indicates, 93% of the total respondents suggest that a major factor that will facilitate the growth of their personal business and other businesses in general is better access to financing (i.e. creation of SMES funds, etc). In addition, majority of the respondents, attribute this to the creation of business incubators and technology parks where the businesses can grow especially at the initial stages of the companies.

5.6 FINANCIAL MANAGEMENT: SERVICES TO FACILITATE GROWTH FOR SMES

Table 13

<table>
<thead>
<tr>
<th>INFORMATION SERVICES</th>
<th>RESPONSES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Providing basic information on foreign companies searching for partners in SMEs</td>
<td>6</td>
</tr>
<tr>
<td>Information on SMEs law</td>
<td>3</td>
</tr>
<tr>
<td>Information about fiscal incentives and policies</td>
<td>5</td>
</tr>
<tr>
<td>Information for start-up entrepreneurs</td>
<td>4</td>
</tr>
<tr>
<td>Providing package of information for company registration</td>
<td>2</td>
</tr>
<tr>
<td>Others</td>
<td>0</td>
</tr>
<tr>
<td>TOTAL RESPONSES</td>
<td>20</td>
</tr>
</tbody>
</table>
Apart from the measures that should be taken to support and promote growth of their business, SMEs require some services to be implemented to help facilitate this growth, and the deductions here indicate that:

- Most of them considers availability of information on the foreign companies searching for partners in SMEs as a key factor and regards information services to be fundamental to their continuous growth.
- Also, 100% of all them agreed to the need for training services especially in the area of production and technological advancement. In the consulting services category, not many see the importance of this service, however, the few that recognizes the necessity of this service category highlights the need for SMEs to learn more efficient ways to present their business plans to the banks or investors.
5.7 REQUESTS FOR ACCESS TO FINANCE AND SERVICE SUPPORT

Table 16: Service support

<table>
<thead>
<tr>
<th>Requested access to Finance</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>8</td>
</tr>
<tr>
<td>No</td>
<td>7</td>
</tr>
</tbody>
</table>

Table 17: This depicts the various sources from which request for service support was made.

<table>
<thead>
<tr>
<th>Sources</th>
<th>RESPONSES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Law Firms</td>
<td>3</td>
</tr>
<tr>
<td>Private consulting Firms</td>
<td>1</td>
</tr>
<tr>
<td>Training service providers</td>
<td>2</td>
</tr>
<tr>
<td>Talent market/employment agency</td>
<td>0</td>
</tr>
<tr>
<td>Banks and financial institutions</td>
<td>8</td>
</tr>
<tr>
<td>SMES Service Centers</td>
<td>0</td>
</tr>
<tr>
<td>Accountant/auditors</td>
<td>3</td>
</tr>
<tr>
<td>Advertising and promotion service providers</td>
<td>1</td>
</tr>
<tr>
<td>Others (Please specify)</td>
<td>3</td>
</tr>
</tbody>
</table>

Table 18: This depicts what growth Stage SMEs usually make request for support.

<table>
<thead>
<tr>
<th>Time of request</th>
<th>RESPONSES</th>
</tr>
</thead>
<tbody>
<tr>
<td>before creating a company</td>
<td>8</td>
</tr>
<tr>
<td>during the process of company set up</td>
<td>7</td>
</tr>
<tr>
<td>when my company started to grow</td>
<td>4</td>
</tr>
<tr>
<td>when my company started to have problems</td>
<td>0</td>
</tr>
<tr>
<td>Others (Please specify)</td>
<td>0</td>
</tr>
</tbody>
</table>
Table 19: This depicts the number of times SMEs made request for financial support

<table>
<thead>
<tr>
<th>Requested access to Finance</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>8</td>
</tr>
<tr>
<td>No</td>
<td>7</td>
</tr>
</tbody>
</table>

Table 19 shows, the vast majority of the SMEs surveyed had not recently made a request for a service and financial support for their company’s activities i.e. 7 out of 15 – indicating a cautious attitude due to experiences of refusal from the banks.

Table 20: This depicts the number various sources that finance was requested from by the SMEs.

<table>
<thead>
<tr>
<th>Sources</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>A friend or relative of the business owners</td>
<td>3</td>
</tr>
<tr>
<td>An employee of the business</td>
<td>0</td>
</tr>
<tr>
<td>A private investor from outside the firm who was unrelated to the firm and its owners (i.e. angels)</td>
<td>3</td>
</tr>
<tr>
<td>A venture capital firm</td>
<td>1</td>
</tr>
<tr>
<td>A government institution</td>
<td>1</td>
</tr>
<tr>
<td>Other, please specify the type of institution</td>
<td>0</td>
</tr>
</tbody>
</table>

This illustrates that most SMEs go to a friend or relative of the business owners and private investor from outside the firm who was unrelated to the firm and its owners (i.e. angels) for this support

Table 21: Granted financial support

<table>
<thead>
<tr>
<th>Granted Support</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>3</td>
</tr>
<tr>
<td>NO</td>
<td>5</td>
</tr>
</tbody>
</table>

Table 21 shows the aspects of gaining access to service and financial support by, and as illustrated, most SMEs that have made a request for either or both service support and financial support have not received it; some were
given refusals due to one reason or the other. It’s also observed that, most go to a friend or relative of the business owners and also private investor from outside the firm who was unrelated to the firm and its owners (i.e. angels) for this support because they prefer the terms given, as one respondent put it;

“The interest rate are better and they genuinely want our business to grow”

Finally, it is also observed that most of the SMEs usually request for this support at the point before the creation of the company while for others, it’s during the process of company being set up. They said that this is the most crucial point where they need the help of the government and other investors and sadly they do most times do not receive it.

5.8 PREVIOUSLY CONDUCTED SURVEYS BY OTHER RESEARCHERS

Previously conducted researches on the issue of SMEs access to funding and service support, points out that both the banks and SMEs contributes to the situation, nonetheless, it is still very obvious that SMEs are really faced with the challenge of access to financial and other required services that are very key to their growth. An example of one of such researches is the work of T. M. Obamuyi, tagged an ‘exploratory study of loan delinquency among small and medium enterprises (SMEs) in Ondo state of SMEs’. He drew his results based the analysis of interview in 2004 with the managers of 9 commercial banks and 115 SMEs that have been borrowers or currently have active loans from the banks. His findings revealed a poor lending practice of banks towards the SMEs due o several factors principal of which are poor credit worthiness, lack of collateral security and the constraint Imposed on banks’ capital by regulation
CHAPTER 6

6.1 CONCLUSION

The purpose of this thesis has been to review the challenging problem of SMEs access to finance from the traditional commercial banks in SMEs in Nigeria and secondly to investigate if there are other alternative financing options available to SMEs such as the non-bank financial institutions. The gathered data and observations from this analysis lead to the following conclusions:

- The research and surveys confirmed that small and medium scale firms are not favored by the Commercial banks in the provision of medium to long-term loan facilities. This situation is as a result of both external factors and internals affecting both banks and SMEs.

- Furthermore, it is clear that the majority of the employed populations are engaged in SMEs in Nigeria, therefore, if meaningful development is to be attained in the economy of the country, there has to be sustainable funding for the SMEs.

- The existence of Non-Bank Financial Institutions that offer a wide range of financial services and perform transactions that are needed by the under banked population is very important to the economy and a well-developed NBFI system can play a major role in achieving the developmental goals of Nigeria. However, these institutions are not really helping the SMEs because they are also not as developed as found in the Western countries where they provide support to the banking system in the provision of funding for businesses especially small and medium enterprises.

- In addition, it is obvious that SMEs require more than financial support, they also need leadership and management skills development. Most importantly, the government has to improve the conditions and infrastructural inadequacy hindering the commercial banks from investing in the growth and development of the SMEs sector in Nigeria.

6.2 RECOMMENDATIONS

- The findings of the research agrees that there is a clear challenge of SMEs been limited in their growth due to inadequate capital occasioned by the reluctance of the government should formulate policies that will encourage commercial banks to relax their restrictive regulations and operations which discourage borrowing and offer more credit facilities for SMEs. In addition, the development of the non banks
financial institutions should be encouraged and supported as a combination of both the commercial banks and the NBFI will go a long way in aiding the development of the SMEs sector.

- Finally, there should be empowerment of SMEs to access not just financial support but entrepreneurial education that gives an effective and enduring strategy for solving the capital problems of small-scale businesses.

### 6.3 PROPOSAL FOR FURTHER RESEARCH

Future research in this field should be carried out in discovering how NBFI can be developed in Nigeria so they can assist in providing the much needed support that they are acclaimed to offer especially in the western World.
APPENDIX 1

COVER LETTER

Dear respondents,

I am a student of the School of Management **Blekinge Institute of Technology Sweden** writing my masters’ thesis on the topic: **Exploring non-bank financial institutions as an alternative means of financing for small and medium scale enterprises (SMEs)**

Find attached here, a copy of the questionnaire I have designed to get your response on issues related to this topic. I will really appreciate it if you spend a few minutes of your time filling this questionnaire.

Your response is important and will enable me to make a proper analysis of my research. Your response shall be treated confidentially and anonymously. I kindly request you to complete this questionnaire honestly.

Thank you for your assistance as I anticipate your response.

Esisal Lemuel

CONTACT DETAILS:
STUDENT
ESISAL LEMUEL
ESISAL@YAHOO.COM
+46736319485

THESIS ADVISOR:
DR. STEFAN HELLMER (PH.D)
STEFAN.HELLMER@BTH.SE
0457-385629
APPENDIX 2
THE SMES SURVEY QUESTIONNAIRE

Kindly indicate your answer by highlighting your choice /choices and please also include your comments by typing in the spaces provided, use the space tab to get more space to type in your comments.

1 COMPANY PROFILE

a Number of employees
A. <10 B. 10-99 C. 100-199 D. 200-499 E. >500

b Age of company

c Type of activity done
A. manufacturing B. Service C. commerce & trade D. Others (Please specify)

2 SME PUBLIC POLICY
1 Are you aware of any SMEs public policies?
Yes □ No □

2 If yes, please list any/ several of the SMEs public policies that you know.

3 IN YOUR OPINION, WHICH OF THE FOLLOWING ORGANIZATIONS SUPPORT SMES IN NIGERIA?
(Several answers possible)
A. national government B. large state companies
C. local administration D. large foreign companies
E. international donors F. consulting companies and Agencies
G. associations of entrepreneurs H. insurance companies
I. banks J. service centers
K. chambers of commerce L. Others (Please specify) ___________________________

3a REGARDING YOUR OWN COMPANY/ORGANIZATION WHAT DO YOU BELIEVE ARE THE MAIN BARRIERS FOR FURTHER DEVELOPMENT OF YOUR BUSINESS (SEVERAL ANSWERS POSSIBLE)

A. unstable legal environment
B. uncompetitive products
C. high level of taxation
D. low purchasing power of the population
E. insufficient support from local authorities
F. negative image of the entrepreneurs
G. procedural difficulties in starting a company
H. Difficulty in accessing to credit
I. low coordination between organizations supporting SMEs
J. lack of qualified human resources
K. Lack of clear government SME program
L. lack of market information
M. lack of management skills
3b IN YOUR OPINION, WHAT ARE THE BARRIERS TO THE DEVELOPMENT OF THE SMALL BUSINESS IN NIGERIA in general (SEVERAL ANSWERS POSSIBLE)
A. unstable legal environment
B. uncompetitive products
C. high level of taxation
D. low purchasing power of the population
E. insufficient support from local authorities
F. negative image of the entrepreneurs
G. procedural difficulties in starting a company
H. Difficulty in accessing to credit
I. low coordination between organizations supporting SMEs
J. lack of qualified human resources
K. Lack of clear government SME program
L. lack of market information
M. lack of management skills
N. too high cost of money
O. lack of proper marketing skills
P. Others (Please specify) ______________________________________

4a IN YOUR OPINION regarding your own company/organization, WHAT MEASURES SHOULD BE TAKEN AT GOVERNMENTAL LEVEL TO SUPPORT THE CREATION AND further DEVELOPMENT OF your BUSINESS?
(Several answers possible)
A. simplify the registration of new companies
B. help to create the « one-stop shop » for SMEs based on existing agencies for SME support
C. facilitate access to financing (creation of SME funds, etc)
D. decrease the amount of taxes
E. decrease the number of taxes and simplify the tax system
F. simplify the system of reporting (currently, many reports to different organizations)
G. decrease taxes for Nigerian exporters and promote « Nigerian-made »
H. give priority to women-entrepreneurs and create program of support of business-women
I. determine laws more concretely and exactly
J. create more penalties for SMEs which do not pay taxes
K. publish more information for small business
L. help to create « business incubators » or « technology parks » for new companies where they can be based for first 1-2 years
M. create special funds for business-skilled staff
N. support innovative technological companies
O. Others (Please specify) ________________________________

4b IN YOUR OPINION, WHAT MEASURES SHOULD BE TAKEN AT GOVERNMENTAL LEVEL TO SUPPORT THE CREATION AND DEVELOPMENT OF SMALL BUSINESS IN NIGERIA in general?(Several answers possible)
A. Simplify the registration of new companies
B. Help to create the « one-stop shop » for smes based on existing agencies for sme support
C. Facilitate access to financing (creation of sme funds, etc)
D. Decrease the amount of taxes
E. Decrease the number of taxes and simplify the tax system
F. Simplify the system of reporting (currently, many reports to different organizations)
G. Decrease taxes for Nigerian exporters and promote « Nigerian-made »
H. Give priority to women-entrepreneurs and create program of support of business-women
I. Determine laws more concretely and exactly
J. Create more penalties for smes which do not pay taxes
K. Publish more information for small business
L. Help to create « business incubators » or « technology parks » for new companies where they can be based for first 1-2 years
M. Create special funds for business-skilled staff
N. Support innovative technological companies
O. Others (please specify) ______________________________

5 SME SUPPORT
5a HAVE YOU EVER requested SUPPORT FROM ANY OF THE FOLLOWING BUSINESS SERVICE PROVIDERS? (IF YES, PLEASE CIRCLE THE CORRESPONDING LETTERS, Several answers possible)
A. Law Firms
B. Private consulting Firms
C. Training service providers
D. Talent market/employment agency
E. Banks and financial institutions
F. SME Service Centers
G. Accountant/auditors
H. Advertising and promotion service providers
I. Others (Please specify) ______________________________

5b IF YES, AT WHAT STAGE HAVE YOU ASKED FOR SME SUPPORT?
A. before creating a company
B. during the process of company set up
C. when my company started to grow
D. when my company started to have problems
E. Others (Please specify) ______________________________

5c. FOR WHAT TYPE OF SERVICES?
A. information on company creation
B. search for partner/distributor
C. search for information about other Nigerian or foreign companies
D. information about Nigerian legislation
E. training
F. business consulting
G. business planning
H. information for access to financing
I. Others (Please specify) ______________________________

6 The Services
6a REGARDING YOUR OWN COMPANY/ORGANIZATION, PLEASE TELL ME IN YOUR OPINION WHAT SERVICES ARE THE MOST IMPORTANT FOR THE FURTHER DEVELOPMENT OF YOUR OWN BUSINESS? (SEVERAL ANSWERS POSSIBLE)

□ INFORMATION SERVICES
A. providing basic information on foreign companies searching for partners in Nigeria (example: their addresses and their offers)
B. information on Nigerian law
C. information about fiscal incentives and policies
D. information for start-up entrepreneurs
E. providing package of information for company registration
F. Others (please specify) ______________________________

□ CONSULTING SERVICES
A. business planning for SMEs (to be presented to the bank or investors)
B. help with the presentation of business plan to the banks
C. search for a potential investor using the business plan
D. market research/marketing
E. Banking and credit financing
F. Seminars and exhibitions for SMEs on specific subjects (international services)
G. SME law (lawsuit, enterprise law)
H. Accounting and book-keeping
I. Credit assessment (Loan application)
J. Employment (Recruitment)
K. Others (Please specify) _________________________________________________

□ TRAINING SERVICES

1. MARKETING
A. Marketing plan
B. Marketing research
C. Product promotion
D. Marketing strategy
E. Advertising

□ Accounting
A. Cash flow
B. Book keeping
C. Audit
D. Taxation
E. Business planning

□ Human resources Management
A. Management skills
B. Motivation of staff
C. Performance appraisal
D. Technology

□ Production/technology
A. Product design
B. Production management system
C. Software development (IT)
5. Others (please specify) _________________________________________________

6b THE SERVICES REGARDING THE GENERAL BUSINESS CONDITIONS IN NIGERIA, PLEASE TELL ME IN YOUR OPINION WHAT SERVICES ARE THE MOST IMPORTANT FOR FURTHER DEVELOPMENT? (SEVERAL ANSWERS POSSIBLE)

□ INFORMATION SERVICES
A. providing basic information on foreign companies searching for partners in Nigeria (example: their addresses and their offers)
B. information on Nigerian law
C. information about fiscal incentives and policies
D. information for start-up entrepreneurs
E. providing package of information for company registration
F. Others (please specify) _________________________________________________

□ CONSULTING SERVICES
A. business planning for SMEs (to be presented to the bank or investors)
B. help with the presentation of business plan to the banks
C. search for a potential investor using the business plan
D. market research/marketing
E. Banking and credit financing
F. Seminars and exhibitions for SMEs on specific subjects (international services)
G. SME law (lawsuit, enterprise law)
H. Accounting and book-keeping
I. Credit assessment (Loan application)
J. Employment (Recruitment)
K. Others (Please specify) ____________________________________________________

□ TRAINING SERVICES

1. MARKETING
   A. Marketing plan
   B. Marketing research
   C. Product promotion
   D. Marketing strategy
   E. Advertising

□ Accounting
   A. Cash flow
   B. Book keeping
   C. Audit
   D. Taxation
   E. Business planning

□ Human resources Management
   A. Management skills
   B. Motivation of staff
   C. Performance appraisal
   D. Technology

□ Production/technology
   A. Product design
   B. Production management system
   C. Software development (IT)

5. Others (please specify) ___________________________________________________

7. FINANCE

7a DURING THE PERIOD FROM 2003 AND 2009, DID THE BUSINESS OR ITS OWNERS APPROACH ANY TYPE OF CREDIT SUPPLIER REQUEST NEW OR ADDITIONAL CREDIT SUPPORT FOR BUSINESS PURPOSES? THIS COULD INCLUDE ANY REQUEST FOR A NEW TERM LOAN, LOAN, LINE OF CREDIT, OR ANY REQUEST FOR AN INCREASE TO EXISTING CREDIT LIMITS.

A. □ yes □ no

7b WHAT TYPE OF FINANCIAL INSTITUTION OR CREDIT SUPPLIER DID THE BUSINESS APPROACH TO REQUEST NEW OR ADDITIONAL CREDIT? PLEASE STATE BELOW.

________________________________________________________

7c DURING THE PERIOD FROM 2003 AND 2009, DID THE BUSINESS REQUEST ANY EQUITY FINANCING? THIS COULD INCLUDE ANY REQUEST FOR NEW OR ADDITIONAL FINANCING FROM AN INVESTOR, VENTURE CAPITAL SUPPLIER, OR FRIEND OR FAMILY MEMBER IN EXCHANGE FOR A SHARE OF THE OWNERSHIP OF THE BUSINESS.
PROMPT: EQUITY FINANCING IS THE EXCHANGE OF OWNERSHIP IN A COMPANY FOR FINANCING.

A. ☐ yes B. ☐ no

7d IF YES KINDLY SPECIFY THE CATEGORY BY CLICKING OR CIRCLING THE GROUP/ GROUPS.
1= A FRIEND OR RELATIVE OF THE BUSINESS OWNERS
2= AN EMPLOYEE OF THE BUSINESS
3= A PRIVATE INVESTOR FROM OUTSIDE THE FIRM WHO WAS UNRELATED TO THE FIRM AND ITS OWNERS (I.E. ANGELS)
4= A VENTURE CAPITAL FIRM
5= A GOVERNMENT INSTITUTION
6= OTHER, Please SPECIFY THE TYPE OF INSTITUTION __________________

7f WAS AN INVESTMENT OR FUND PROVIDED AS A RESULT OF THIS REQUEST?
A. ☐ yes B. ☐ no

7g WERE YOU CONTENT WITH THE CONDITIONS GIVEN FOR THE AUTHORIZATION OF THE LOAN, CREDIT, OR REQUEST FOR INVESTMENTS.
A. ☐ yes B. ☐ no
If yes please say why __________________________

7g WHAT WAS THE INTEREST RATE AND TERM FOR THE CREDIT AUTHORIZED?

<table>
<thead>
<tr>
<th>Financing instrument ( type of credit/ loan requested for)</th>
<th>Amount authorized</th>
<th>Fixed rate (%)</th>
<th>Interest term( in months)</th>
<th>Variable rates.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tr>
</tbody>
</table>

8 BASED ON YOUR ANSWER TO QUESTION 7D ABOVE, WHY DO YOU PREFER TO SEEK FINANCIAL SUPPORT FROM THIS GROUP OR GROUPS.
a. Favorable interest terms
b. Genuine interest in the growth of small business
c. Personal Concern for the leaders of the organization.
d. Others (please specify) __________________________________________________________

9. PLEASE STATE THE ANNUAL TURNOVER FOR YOUR BUSINESS
___________________________________________________________________________

10. PLEASE STATE THE ASSET VALUE FOR YOUR BUSINESS
___________________________________________________________________________

Thank you very much for your time
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