

PROBLEMS AND PROSPECTS OF FINANCING SMALL SCALE BUSINESSES IN NIGERIA

AFOLABI FELIX OLALEKAN

Bursary Department

Osun State College of Education Ilesha

afolabifelix444@gmail.com

&

ADENLE OLUWATIMILEYIN ESTHER

Department of Accounting

Osun State University, Osogbo

ORCID ID: 0000-0002-5914-1882

oluwatimileyin.adenle@uniosun.edu.ng

Abstract

This study examined the problems and prospects of financing small scale businesses in Nigeria. The utmost objective of this study is to examine and assess the various sources of finance opened to small scale industrialists and problem associated with their operation in Nigeria. However, attempt was made to collect relevant data on a selected small scale business Didvet Animal Health and Nutrition small scale enterprises in Osogbo, Osun State, Nigeria. Questionnaire method was utilized to gather the data used for the study and the outcome of the research was analyzed using frequency, Standard deviation, mean, percentages, and chi-square method. The questionnaire was administered on 100 respondents. All hypotheses were tested at degree of freedom 3.841. The result of the findings showed that the percentage contribution by bank loans and overdraft to small scale enterprises is up to 50% with calculated value of 25 which is more than the 3.841 at 1 degree of freedom of 0.05 chi-square table. It also showed that the expansion of small scale business is hindered by finance, management skill, family problems and power supply with calculated value of 9 which is more than 3.841 at 1 degree of freedom of 0.05 chi-square table. The study concluded that banks and other development institutions should further rationalize their functions to cater exclusively for small scale businesses and to enable the small businesses to have access to funds and better management. The study recommends that small scale industry should be given a concessionary interest rate to develop their sector as well as encouraging others to engage in productive ventures.

Keywords: Problems, Entrepreneurs, Funds, Investments, Small scale businesses.

Introduction

The definition of small and medium enterprises (SMEs) varies from country to country, region to region and from agency to agency in today's world. Small and Medium Scale Enterprises (SMEs) are generally the engine of equitable development and economic growth in developing economies.

However, Eze T.C. (2012) revealed in his study of the problems and prospects of management of small-scale business in Nigeria that since 1960 till date, SMEs have been given due recognition in developed nations such as United State, China and Japan and others for playing a vital role towards fostering accelerated economic development and growth and stability within several economies. He also stated that SMEs make up the largest proportion of businesses all over the world and play tremendous role in the provision of goods and services, improving standard of living and contributing to countries Gross domestic products (GDPs). SMEs is regarded as the basis for economic well-being of many developed nations (Aiden J.W. 2013).

The growth in the small and medium scale sector of the economy in Nigeria is necessitated by the unemployment situation in the country coupled with government and private sector entrepreneurs' initiatives to encourage the unemployed and under employed youths to ventured into small and medium scale businesses. Many Nigerians are now venturing into SMEs business ventures in the area of fashion design, health, consultancy, Information Technology, farming, cosmetology, catering and decoration, events planning, entertainment, hair stylist, laundry services, transport services and some other businesses which depend on local raw material and which are not too cost intensive.

The Nigeria government and several Non-governmental bodies in Nigeria has recently created different platforms to create awareness on the importance of SMEs and the need for Nigerians to be a creator of employment rather than being a job seeker. Aiden J.W. (2013) in his studies also attest to these by stating that the Nigeria government plays appreciative role in promoting the survival and growth of small- scale enterprise and also encourages people to establish their own business so as to reduce the problem of unemployment, increase exportation of goods and services and to also reduce the problems associated with importation of goods and services in the country.

In Nigeria, credit has been recognized as an essential tool for promoting small and medium scale enterprises (SMEs), about 70% of the Nigeria population are engaged in the informal sector or in agricultural production. The federal and state governments have recognized that for sustainable growth and development the financial employment of the rural areas is vital, being the repository of the predominantly poor in society and in particular the SMEs. More so, financing of small-scale businesses if given adequate attention by the government and policy makers will enhanced and improve the growth of numerous small scale enterprises that are groaning under the effect of inadequate funding and recognition. There various source of finance available to Small and Medium scale enterprises in Nigeria, the sources of finance are divided into internal source and external source of financing, the SMEs can finance their business internally by using their own personal savings and by seeking assistance from family and friends.

The external sources of financing which are grants from government, bank overdraft, bank loan, venture capital, business angels and trade credit. The SMEs can source for funds from commercial banks, International development agencies, microfinance banks and from the central bank of Nigeria. The biggest source of funds to SMEs across the globe is the

commercial banks. Moreover, many commercial banks are reluctant in financing SMEs because of supposed risks and uncertainties in SMEs business (Gbandik and Amissah, 2014).

This paper therefore takes a look into problems and prospects of financing small scale businesses in Nigeria

Statement of the problem

Small and medium scale enterprises (SMEs) have been considered to be the bulwark for technological advancement and employment generation in Nigeria, the sector on the other hand has had its own fair share of neglect with simultaneous revolting impacts on the economy. According to Basil A.N.O (2005) SMEs in Nigeria are faced with different problems some of which are; inadequate equity capital, poor management practices, high rate of enterprise mortality, low level of entrepreneurial skills, shortages of skilled manpower, lack of access to source of finance and inadequate personal savings attributable to level of poverty and low return on investment, poor infrastructural facilities and lack of access to information to mention but few.

Furthermore, the performance of small medium scale enterprises has a great influence on its access to finance. SMEs with increasing sales and sales turnover have less constraint on accessing funds while poor or non-performing SMEs have been found to have limited access to finance, particularly with formal source like banks (Zarook, Rahma & Khanam, 2013). It is also easy for registered small scale enterprises to get access to external source of financing than the unregistered small scale enterprises. Regardless of the studies conducted by past researchers, little or no effort was made to examine the contribution of bank loan and overdraft to small scale businesses and whether the expansion of the small scale business can be hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw material. This however calls for further investigation of this phenomenon with a view to broadening knowledge in the area of small and medium scale financing. It is from this foregoing that this study examines the problems and prospects of financing small scale businesses in Nigeria using Didvet Animal Health and Nutrition small scale enterprises in Osogbo, Osun State as case study.

Objective of the Study

This study intends to examine the problems and prospects of financing small scale businesses in Nigeria. The study specifically examines:

- i. if the percentage of contribution to the financing of small scale enterprises in Nigeria by bank loan and overdraft is up to 50%
- ii. Whether the expansion of small scale business in Nigeria is hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw materials.

Hypotheses for the Study

The following hypotheses are formulated for the study

- H_{01} : the percentage of contribution to the financing of small scale enterprises in Nigeria by bank loan and overdraft is not up to 50%

H₀₂: the expansion of small scale business in Nigeria is not hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw materials.

Literature Review

Small Scale Businesses in Nigeria

The Nigeria small and medium scale businesses represent about 90% of manufacturing and industrial sector in terms of number of enterprises in Nigeria. Though, the SMEs constitute more than 90% of Nigerian businesses, their contribution to GDP is only about 1% (Oyelarin, 2010). In the industrialized countries like Canada and United State of America, small business is defined in terms of annual turnover and the number of paid employees. The definition of SMEs also varied and is mostly based on the number of employees and the value of assets.

Further, the Nigeria Company and Allied Matter Decree (CAMD) NO. 1 of 1990 section 376 (2) defined small scale business as a company whose annual turnover is not more than #1 million. Also, the Nigeria industrial policy describes small scale industries as those with total investment of between ₦100,000 and ₦2 million, exclusive of land and housing but including working capital. The small scale industries division of the Federal Ministry of Commerce and Industry also defines the industry as the establishment with capital investment holding totaling two hundred and fifty thousand naira (₦250,000) only and have employee of between fifty to one hundred people.

Characteristics of small scale businesses source of finance

Ogujuiba, Ohuche and Adenuga (2004) revealed in their empirical evidences that finance contributes about 25% to the success of small and medium scale businesses. A report by World Bank few years back showed that 39% of small scale firms and 37% of medium scale firms in Nigeria are financially constrained. There are several characteristics of small scale businesses some of which are; little capital outlay, less complex technology, dependency on local raw materials, owner have close contact with customers and workers, they are not quoted on the Nigeria stock exchange, their financial statement does not often reflect the true net worth of profitability, difficulty in borrowing loans from financial institution and absence of formal standardize control.

Sources of finance to small scale businesses (Bank Loan and overdraft)

The formal finance sector is made up of finance institutions such as commercial banks, microfinance banks, international development agencies and so on. Commercial banks and development banks in the formal sector are the most popular source of finance for enterprises. The informal sector that provide funds to small scale enterprises consists of borrowing from personal saving, friends, relatives and cooperatives are also important source of financing SMEs. The relationship between banks and small scale business in Nigeria could be well appreciated. It was however, noted during this research work that bank has been assisting the industrialist of small scale business to develop financially ever before the central bank of Nigeria (CBN) development policy guidelines of 1997. Many small scale owners have to consult commercial banks to obtain loans in order to organize their business well; commercial banks can extend credit facilities to small scale businesses in different ways some of which are through bank loans and overdraft.

Overdraft: This is one of the ways open to small-scale industries to get funds for the development of their business. more so, the bank thus allows the industrialists that are customers to the bank with regular banking operation (of not less than six (6) months) to withdraw an excess amount for the up-keeping of their firms which is between ₦20,000 to areasonably inexpensive amount and it is repayable in a specific given time duration.

Bank Loans: These are forms of loans by commercial banks to small-scale business. They are credit facilities of fixed sums and for fixed periods placed to credit of a customer account and interest is charged on this fixed sum, unlike overdraft forms of loans usually made on a secured basis. The CBN (2010) statistics show that commercial banks advances to SMEs have been on the decline over the years. Commercial bank loans to SMEs as a percentage of total credits decreased from 48.79% in 1992 to 0.15% in 2010 (Luper, 2012).

Problems involved in financing small scale enterprises

Despite all various available sources of finance to small scale business in Nigeria there are still some problems that are encountered in the process of financing and these problems affect the development of the nation's economy sector. The lack of adequate funding for the SMEs is traceable to among other reasons the reluctance of banks to extend credits to them for the following reasons; weak demand for the products of SMEs as a result of the dwindling purchasing power of Nigerians, lack of patronage of locally produced goods, undercapitalization, inadequate collateral securities, poor management practices by SMEs operators (Gbandi E.C. & Amissah G., 2014). Other problems faced by small scale businesses in Nigeria are; questionable integrity of the promoters and the use of unrealistic financial projection.

Solutions to the problems of small scale business financing in Nigeria

Assisting small scale businesses meet the requirements of formal financing and making the financial system more accessible to small scale businesses are some of the solutions to the problems of small scale business financing in Nigeria, others as suggested by Kauffman (2004) are increasing SMEs access to finance, intensifying the supply of funding through the non-financial private sector and improving business conditions which should lead to proper information, impartial legal system, clear accounting standards and favorable tax policies.

Prospects of small scale business in Nigeria

There are a lot of prospect of financing small scale business in Nigeria. Small scale industries play a significant role in the development of any country especially here in Nigeria. Among which are: provision of employment opportunities, help to spread productive industrial activity, help to promote economic development and they are effective for mobilizing scarce resources of capital and entrepreneurial skills that may otherwise remain unutilized in the country.

Theoretical framework

This research study is anchored on active learning model of Erickson and Pakes (1995) which states that an organization explores its economic environment actively and invests to enhance its growth under competitive pressure from both within and outside the firm. However, this theory states that owners small and medium scale enterprises could raise their productivity

through formal education and training that upsurges their endowments while government may support their activities through the creation of the enabling environment. This implies that SMEs in Nigeria have prospects of experiencing growth and they also contribute to employment generation only when appropriate investments are made into them by all the stakeholders. This could be achieved by government intervention through the provision of social infrastructures, capacity building of SME operators, financial assistance and favorable taxation policies (Agwu & Emeti, 2014).

Empirical review

Fatoki (2014) examined the traditional and innovative financing options available to new SMEs in South Africa. The analysis included the traditional sources of capital equity and debt such as business angels, venture capitalists, commercial banks, trade credit, and government agencies. He found that SMEs had limited access to external finance despite the existence of various financial market sources of equity and debt to new SMEs.

Luu and Nguyen (2013) also investigated factors that affected SMEs' business financing strategies for new investment projects that included banking sector and informal credit sources in Vietnam using a sample size of 2200 SMEs with 7900 observations from the manufacturing sector in Vietnam for the period 2005, 2007, and 2009. Their findings provided insight into the current supply and demand variance in Vietnam capital market.

Evbuomwan, Ikpi, Okoruwa and Akinyosoye (2013) conducted a study on sources of finance for micro, small and medium enterprises in Nigeria. Analysis carried out in their study showed that commercial banks loans constituted over 90 percent of sources of funds to MSMEs in Nigeria and their loans and advances to agriculture and manufacturing sectors combined.

However, Agwu and Emeti (2014) in their study of the issues, challenges and prospects of small and medium scale enterprises in Port Harcourt city, Nigeria. They adopted descriptive research design using 120 randomly selected registered operators of SMEs in Port Harcourt City. Data collected were analyzed using descriptive statistics while formulated hypotheses were tested using z-test. The result of their findings revealed that inadequate social infrastructures, poor financing, multiple taxation and lack of managerial skills were the major challenges confronting SMEs in the State.

Gbandi E.C. & Amissah G., 2014 conducted an investigation on financing options for small and medium enterprises in Nigeria. Their findings revealed that funding of SMEs in Nigeria is very critical if they are to perform their role of growth and development of the nation's economy.

Methodology

The study adopted survey research design method. A structured questionnaire was designed for a randomly selected sample of one hundred and twenty (100) respondents from Didvet Animal health and nutrition. The total of one hundred responses received from respondents were analyzed using simple statistical tools such as frequencies and percentages. The hypotheses of the study were tested using Chi-square method. A representative sample

selected from the respondents of the sample comprises of 20 top management, 35 middle level management and 45 lower level management.

Results and Discussions

Objective 1: the percentage of contribution to the financing of small scale enterprises in Nigeria by bank loan and overdraft is up to 50%

Table 1: Bank loan and overdraft is up to 50%

	Frequency	Percent %	Cum. Percent
Yes	25	25	25
No	75	75	100
Total	100	100	

Source: Author's Conceptualization, 2021.

The result from the table above shows that 25% of the respondents attested that the percentage contribution of bank loan and overdraft to small scale businesses is up to 50%. While 75% disagree that the percentage contribution of bank loan and overdraft to small scale businesses is up to 50%. Therefore, majority of the respondent agreed that it is true that the percentage contribution of bank loan and overdraft to small scale businesses is not up to 50%. This result is in line with the CBN (2010) statistics which shows that commercial banks advances to SMEs have been on the decline over the years.

Objective 2: To determine whether the expansion of small scale business in Nigeria is not hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw materials.

Table 2: The expansion of small scale business in Nigeria isnot hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw materials.

	Frequency	Percentage %	Cum. Percent
Yes	35	35	35
No	65	65	100
Total	100	100	

Source: Author's Conceptualization, 2021.

The result from the table above shows that 35% of the respondents attested that the expansion of small scale business in Nigeria is not hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw materials. While 65% disagree that the expansion of small scale business in Nigeria is not hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw materials. However, majority of the respondents disagreed by stating that the expansion of small scale business in Nigeria is hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw materials. This result is in line with the CBN (2010) statistics which shows that commercial banks advances to SMEs have been on the decline over the years.

Hypotheses Testing

Hypotheses testing provide relevant data for validating or rejecting the null hypothesis

Hypothesis one

H₀₁: the percentage of contribution to the financing of small scale enterprises in Nigeria by bank loan and overdraft is not up to 50%

Table 3

Response option	O _i	E _i	O _i – E _i	(O _i – E _i) ²	$\frac{(O_i - E_i)^2}{E_i}$
Yes	25	50	-25	625	12.5
No	75	50	25	625	12.5
Total					25

Authors computation, 2021.

Degree of Freedom = (n-1) (n-1)

DOF= (2-1) (2-1) = 1x1 = 1

Decision rule

The calculated value is 25 while the critical value X^2 for 1 degree of freedom at 0.05 chi-square table is 3.841. the calculated value is more than the $X_{0.05}$ value. Therefore, the null hypothesis is to be rejected while we accept the alternate hypothesis. The results of this study revealed that the percentage of contribution to the financing of small scale enterprises in Nigeria by bank loan and overdraft is up to 50%.

Hypothesis Two

H₀₂: the expansion of small scale business in Nigeria is not hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw materials.

Table 4

Response option	O _i	E _i	O _i – E _i	(O _i – E _i) ²	$\frac{(O_i - E_i)^2}{E_i}$
Yes	35	50	-15	225	4.5
No	65	50	15	225	4.5
Total					9

Author's computation, 2021

Degree of Freedom = (n-1) (n-1)

DOF= (2-1) (2-1) = 1x1 = 1

Decision rule

The calculated value is 9 while the critical value X^2 for 1 degree of freedom at 0.05 chi-square table is 3.841. the calculated value is more than the $X_{0.05}$ value. Therefore, the null hypothesis is to be accepted while we reject the alternate hypothesis. However, based on the decision the null hypothesis is rejected while we accept the alternate hypothesis which states that the

expansion of small scale business in Nigeria is hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw materials.

Discussion of Findings

The results of hypothesis one of this study revealed that the percentage of contribution to the financing of small scale enterprises in Nigeria by bank loan and overdraft is up to 50%. Evbuomwan, Ikpi, Okoruwa and Akinyosoye (2013) also attested to the result of this study in their study of SMEs financing which showed that commercial banks loans constituted over 90% of sources of funds to SMEs.

Furthermore, the result of hypothesis two of this study revealed that the expansion of small scale business in Nigeria is hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw materials. To buttressed this Agwu and Emeti (2014) also supported the result of hypothesis two by stating in their study of the issues, challenges and prospects of small and medium scale enterprises that inadequate social infrastructures, poor financing, multiple taxation and lack of managerial skills were the major challenges confronting SMEs in the Nigeria.

Conclusion and Recommendations

From the study, it has been concluded that percentage of contribution to the financing of small scale enterprises in Nigeria by bank loan and overdraft is up to 50% and also that expansion of small scale businesses in Nigeria is hindered by finance, management skill, family problem, power supply, government regulation and non-availability of raw materials.

However, the study also concluded that banks and other financial institutions should further rationalize their functions to cater exclusively for small scale businesses and to enable the small scale businesses to have access to funds and better management. It is therefore recommended that small scale industry should be given a concessionary interest rate to develop their sector as well as encouraging others in Nigeria to engage in productive ventures. More so, Nigeria government should provide necessary infrastructures facilities, regular power supply, trade credit initiatives, and also to encourage small scale businesses owners by giving them loans and tax incentives.

References

- Agwu & Emeti (2014). Issues, challenges and prospects of small and medium scale enterprises (SMEs) in Port-Harcourt City, Nigeria. *European Journal of Sustainable Development*.3 (1) 101-114
- Aiden J. W. (2013). Problems and prospects of establishing small scale enterprises in Nigeria: A case study of selected bakeries in Enugu urban area. A project submitted to the department of business administration Caritas University, Enugu, Nigeria.
- Basil A.N.O. (2005). Small and medium enterprises (SMEs) in Nigeria: problems and prospects: A dissertation submitted to St. Clements University, Nigeria.
- CBN (2010). SMEs financing in Nigeria. Retrieved on the 11th of January, 2011 from <http://www.cenbank.org> issues, challenges and prospects. Retrieved 12th of January from

- Ericson, R., and A. Pakes (1995). Markov-Perfect industry dynamics: a framework for empirical work", *Review of Economic Studies*, 62(1): 53-82.
- Evbuomwan, G.O., Ikpi, A.E., Okoruwa, V.O. & Akinyosoye, V.O. (2013). Sources of finance for micro, small and medium enterprises in Nigeria. *19th International Farm Management Congress*, SGGW, Warsaw, Poland
- Eze T.C. (2012). The problems and prospects of management of small scale businesses in Nigeria. A dissertation submitted to the department of management, University of Nigeria, Enugu Campus.
- Fatoki, O. (2014). The financing options for new small and medium enterprises in South Africa. *Mediterranean Journal of Social Sciences*, 5, 748-755. doi:10.5901/mjss.2014.v5n20p748
- Gbandi E.C. & Amisah G. (2014). Financing options for small and medium enterprises in Nigeria. *European scientific journal*. 10 (1).
- Kauffman, C. (2004). Financing SMEs in Africa. Retrieve the 30th of August from www.oecd.org/dev/54908457.pdf
- Luper, I. (2002). Does bank size matter to SMEs financing in Nigeria? *International Journal of Business and management tomorrow* 2(3) 2-5
- Luu, N., & Nguyen, N. (2013). Determinants of financing pattern and access to formal informal credit: The case of small and medium-sized enterprises in Viet Nam. *Journal of Management Research*, 5, 240-259. doi:10.5296/jmr.v5i2.3266
- Ogujuiba, K. K., Ohuche, F. K. & Adenuga, A. O. (2004). Credit availability to small and medium scale enterprises in Nigeria: The importance of new capital base for banks-working paper Retrieved on the 23 of June 2011 from www.valuefronteraonline.com/publication.jsp?
- Oyelaran-oyeyinka, B. (2010). FSS 2020: international conference on SME: <http://www.cenbank.org/fss/wed/sme>.
- Zarook, T., Rahman, M.M and Khanam, R. (2013). Does the Financial Performance Matter in Accessing to Finance for Libya's SMEs? *International Journal of Economics and Finance*, 5(6), 11-19.