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# Capacity of SMEs in Nigeria to Access Institutional Equity Finance

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**Abstract:** The objective of this study was to examine the capacity of SMEs in Nigeria to access the funds accumulated under the Small and Medium Enterprises Equity Investment Scheme. Data used was from the database created by the Central Bank of Nigeria which sponsored a baseline economic survey of all small and medium scale industries in Nigeria in 2004. The data base contained information on the characteristics of a total of 6,663 small and medium industrial firms across the seven Zones of the country. The study revealed that only a small percentage of the SMEs succeeded in accessing the funds. Only about 45% were aware of the scheme even though the management capacity of the firms was high and the scheme was given mass media coverage. On the basis of legal status criteria, only 36% of the firms indeed qualified to access the funds. The study recommends the establishment if Management Information desks by banks in Nigeria to facilitate the SMEs access to the funds.

**Key words:** Venture capital, government policy, regulation

## INTRODUCTION

There is a huge and increasingly accumulating fund for equity investment in SMEs in Nigeria from the Small and Medium Enterprises Equity Investment Scheme (SMEEIS) which was introduced in 2001. As at June 2005, the total amount accumulated was N31.0 billion. The total amount of the funds invested by banks in SMEs was N10.3 billion representing 33.2% of the funds set aside (Chukwuma, 2005). This slow rate of adoption, utilization calls for concern, both by government and all stakeholders in the scheme.

Many reasons have been adduced for the inability of SMEs to access funds from financial institutions in Nigeria. These include poor attitude towards external financing by Nigeria entrepreneurs, poor quality of project proposal presented by the SMEs to financial institutions, unreliable and outdated database and inability to access the database of the SMEs by financial institutions.

The aim of this study was to account for the inability of SMEs in Nigeria to access the funds accumulated under the scheme specifically, the study analysed the level of awareness of the scheme by operators of SMEs, their readiness and capacity to access and utilize the funds.

SMEs in Nigeria account for about 95% of the total number of industrial enterprises in the country. It is the expectation of government that the SMEs would accelerate job creation, ensure increase in production of goods and services, facilitate technology transfer, create more opportunities for entrepreneurs and in particular, increase the local content component of the giant multinational companies in Nigeria.

SMEs in Nigeria have not been able to meet these expectations, the common reason adduced being their lack of access to credit facilities. One of the major factors is the credit worthiness of the SMEs

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and the perception of banks about the credit standing of the SMEs. According to Fraser *et al*. (2001), banks make most of their money from lending which also accounts for most of their risks. Banks seek to reduce their credit risk by adopting a variety of strategies including:

- Avoidance of very high-risk loans by raising credit standards.
- Reduction of risk by evaluating the credit worthiness of borrowers, by obtaining collateral and by obtaining guarantees.
- Monitor the behavior of the borrowers after the loan has been made to ensure compliance with the loans agreement.
- Transfer credit risk to other parties, by selling standardized loans by hedging in futures, options or swaps.
- Diversify the loans portfolio. In this context, it involves making loans to a variety of firms whose returns are not perfectly positively correlated and avoiding undue concentration.

Various interventions have been made in different countries to cater for the peculiar needs of SMEs. These interventions include institutional support, training in the relevant skills, tax concessions, technological acquisition and liberalized access to credit and innovation schemes (Obadan and Agba, 2006).

In Malaysia, the Small and Medium Industries Development Corporation (SMIDEC) was established in 1996 with the responsibilities for complementing, coordinating and monitoring assistance to the SMEs in areas of soft loan, grants and as venture capital financing. (www.smidec.nny/smedevelopmentprogrammes).

South Korea established the Korean Federation of Small Business (KESB) to provide guidance in various areas to SMEs. The Industrial Bank of Korea (IBK) provides technical guidance in finance and information technology in collaboration with research institutions. The Citizens National Bank (CBN) was also established to provide adequate financing for SMEs while the Korea Credit Guarantee Fund (KCGF) was created to support operational SMEs and those that are yet to get over capital fund problem (www.korea.sme.org).

In South Africa, the Industrial Development Corporation (IDC), provides capital support, while the National Empowerment Fund (NEP) supports firms with venture capital sources. Other agencies provide capital support to SMEs at various stages of development as well as managing a dedicated equity fund (Ntsika, 2001).

Attempts made to address the problem of SMEs in Nigeria include direct lending by various financial institutions, specification of credit guidelines by the Centra Bank of Nigeria to banks lending to SMEs, the establishment of rural banking programmes and indirect lending to SMEs at concessionary rates through participating banks (Inang and Ukpong, 1992; Inegbenebor, 2006).

Other schemes include the establishment of the Second-tier Securities market, the merger of the Nigerian Bank for Commerce and Industry, the Nigerian Industrial Development Banks and the National Economic Reconstruction Fund into the Bank of Industry to provide cheap financial and business support services to SMEs. All these have not been as successful as anticipated. Studies on lending experience of five major banks in Nigeria from 1991-1993 showed that non-performing loans and advances range from 40-50% among commercial banks. The poor attitude of Nigerians to loan repayment led to unwillingness of the banks to lend to the real sector in preference for the trade sector (Feese, 1994; Inegbenebor, 2006).

The latest attempt by the Central Bank of Nigeria and the Banker's Committee to tackle the financial problems of SMEs is the establishment of Small and Medium Enterprises Equity Investment Scheme (SMEEIS). The Scheme requires all banks in Nigeria to set aside 10% of their profit before tax annually for equity investment in small and medium enterprises operating in the productive sector of the economy. The scheme commenced in June 2001 and is aimed at:

- Facilitating the flow of funds from banks for the establishment of new viable small medium industry projects
- Stimulating economic growth
- Developing local technology
- Promoting indigenous entrepreneurship
- Generating employment (UBA, 2001)

To be eligible for funds under the SMEEIS, the beneficiary company should meet the following requirements;

- A maximum asset base of N200 million, excluding land and working capital
- Staff strength of not less than ten (10) and not more than three hundred (300)
- Incorporation as a limited liability company and compliance with all relevant regulations of the Companies and Allied Matters Act (1990) such as filing of annual returns, including audited financial statements

Compliance with applicable tax laws and rending of regular returns to the appropriate authorities. The scheme covers the real sector of the economy.

## MATERIALS AND METHODS

Data used for this study were sourced from the Central Bank of Nigeria-sponsored baseline economic survey of Small and Medium Scale Industries (SMIs) in the seven Economic Zones of Nigeria. The survey was carried out in the first quarter of 2004. The zones are: North- West, North-East, North-central, South-West, Lagos axis, South-South and South-East. The survey generated information on the characteristics of 6,663 SMIs in the following sub sectors of the economy:

- Food-beverage and tobacco
- Textile-wearing apparel, foot wear and leather productions
- Wood and wood products
- Pulp-paper and paper products
- Chemical pharmaceutical
- Non-metallic mineral products
- Plastic and rubber products
- Electrical and electronics
- Basic iron and steel and fabricated products
- Motor vehicle and miscellany assembly
- Information and Communication Technology (ICT)
- Solid mineral mining/processing and
- Others

Data were collected to cover information that are relevant to investors, banker, financial analysts, government and the larger society.

## RESULTS

Most of the responding SMIs (94.1%) were small and medium scale and the rest (5.9%) were in the medium scale category.

Table 1: Readiness of SME operators to access SMEEIS funds

| | |
|---|---|
| Awareness | 45.0% |
| Legal status | |
| Sole proprietor | 44.9% |
| Partnership | 11.6% |
| Limited liability | 36.3% |
| Cooperative | 7.2% |
| Maintenance of bank account | 92.5% |
| Record keeping | 88.0 % |
| Source of funds | |
| Personal savings | 67.0% |
| Loans from friends | 20.0% |
| Loans from banks | 10.0% |
| Loans from govt. agencies | 5.0% |
| Loans from SMEEIS | 3.0% |
| Equipment leasing | 2.0% |
| Loans from cooperatives | 5.0% |
| New investment sources | |
| Retained earning | 61.0% |
| Loans from friends | 5.5% |
| Loans from banks | 11.5% |
| Loans from govt. agencies | 6.5% |
| Funds from SMEEIS | 4.5% |

About 40% of small scale industries and 51% of Medium Scale Industries operators claimed to be aware of the existence of scheme. Together, about 45% of respondents across the country were aware of the existence of SMEEIS. There was however disparity in the level of awareness of the scheme between the Northern and Southern States with SME operators in the Southern states reporting significantly higher level of awareness of the scheme.

Data on the factors used to determine readiness of SME operators to access funds from the scheme are shown Table 1.

The Table 1 shows that 44.9% of the firms were sole proprietorships, 11.6% are partnerships, 36.3% are limited liability companies and the remaining 7.2% were cooperatives. These statistics show clearly that only 36.3% of SMEs in the country could access and utilize the SMEEIS funds, given the eligibility criteria that only incorporated companies are qualified to access the funds.

The Table 1 shows that a high percentage (92.5%) of responding firms maintained bank account. It is only in a few cases and across lines of business, that there were cases where firms did not maintain bank account. This suggests that a high percentage of responding firms have had dealings with banks.

About 88% of the responding firms in all the zones claimed that they kept financial records.

In all the zones, 67% of the capital invested by the firms, irrespective of size and line of business, were from personal savings of the entrepreneurs. Other relatively important sources were loans from friends and relations, loans from banks, government agencies and loans from co-operatives. The result showed that only 3% of the SMIs utilized SMEEIS as source of capital. Even though the level of awareness of SMEEIS was about 45%, only a small percentage utilized the funds.

The responding SMIs firms in different lines of business, which undertook new investment, were further requested to state their source of new investment funds. The study showed that in the zones, SMIs relied on three main sources to finance their new investments. The three sources were: retained earnings, loans from friends and relatives and loans from banks. Responding firms were further asked to rank their source of funds in order of importance. The study revealed that source of investable funds, in order of importance were retained earnings, loans from banks, loans from friends and relations, loans from government agencies, funds from SMEEIS, loans from co-operative and other sources. SMEEIS was not a significant source of investment for SMI as could be seen in the Table 1.

In both small and medium scale industries the enterprises were owned and managed mostly by Nigerians. In the Southern Zones, management staff were mostly graduates of tertiary institutions in the Southern zones while in the Northern zone of the country management staff were mostly non-graduates. Most of the managers were male and have had considerable number of years in the management position of the enterprises.

SMEs in Nigeria would be unattractive to venture capital operations such as the SMEEIS. The potential for rapid growth of the SMEs targeted by the scheme is low and only a small percentage of firms will ever be able to access funds by the scheme. Hence dependence by government on SMEEIS as a panacea for rapid growth of the sub-sector needs to be carefully studied.

## CONCLUSION

In all the zones covered by the study, most operators of SMEs are aware of the existence of the SMEEIS, as there was enough media coverage of the scheme. Only a small proportion of the firms are eligible given the criteria stipulated by the Central Bank of Nigeria. Also very few of the firms have accessed the funds. Even though the readiness of the firms to access the funds is fair, their capacity to do so is low.

Most of the respondents indicated their wiliness to accept other people or banks to co-finance or acquire shares in the enterprises; the result did not show this trend. This implies that in actual practice Nigerians prefer to own and control their enterprises alone (Aregbeyen, 1999).

Government and the Central Bank of Nigeria now have opportunity to turn this around with the recapitalization of the banks in Nigeria. There is need for a holistic review of the system now that banks have enough liquidity to spare and are willing and seeking for investment opportunities. The banks should set up SMIs desks in their various branches to nurture and provide support services to SMEs.

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