NATIONAL OPEN UNIVERSITY OF NIGERIA
FACULTY OF MANAGEMENT SCIENCES

COURSE CODE: BFN737

COURSE TITLE: MICRO AND SMALL BUSINESS FINANCING

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CONTENTS **PAGE**

INTRODUCTION

BFN 737: Micro and Small Business Financing is a first semester course, two credit units, 700 level core course. It will be available for all students offering postgraduate programme in Banking and Finance in the Faculty of Management Sciences. The course will introduce students to microfinance banking in Nigeria, small and medium scale enterprises and procedures for accessing for and utilisation of funds for business development. In this course, students will be exposed to the rules, regulations, guides towards the operation of small and medium scale enterprises and microfinance banking in Nigeria. Students will also be able to apply the knowledge in this course in a banking setting.

COURSE GUIDE

The course guide tells students briefly what the course is about, what course material will be used, and how you can work your way through the study material. It suggest some general guidelines for the amount of time you are likely to spend on each unit of the course in order to complete it successfully.

The guide also gives you some guidance on your tutor-marked assignments, which will be made available to you in the Study Centre. There are regular tutorial classes that are linked to the course. You are advised to attend these sessions.

WHAT YOU WILL LEARN IN THIS COURSE

The BFN 737 course consists of 14 units. Specifically, the course discusses the following:

- History of Micro-Financing in Nigeria
- Formulation of the National Micro Finance Policy
- Sources of Finance
- Micro Finance Non-Financial Services
- An Overview of Government Financial Assistance for Small and Medium Enterprises
- The Procedure for Accessing Government Financial Assistance for Small and Medium Enterprises
- Financial Analysis of Small Business Income Repayment of Capital
- Financial Analysis of Small Business Income Repayment of Capital and Risk Management
- How Micro-Credit can be effectively Provided
- Leasing and Other Alternate Sources of Finance to Small and Medium Scale Enterprises (SMEs)
- Alternate Sources of Financing for SMES
- The Role of Small Scale Business to the Economy
- The Challenges of Small Scale Business on the Economy
- Sources and Acquisition of Capital by Small Business
- Uses of Capital by Small Business
- Financial Inclusion and Small Scale Enterprises Financing in Nigeria

COURSE AIMS

The aim of this course can be summarised as follows:

It aims to give you an understanding of the concept microfinance banking, small amd medium scale enterprises and the procedures guiding the acquisition and utilisation of finance by small scale businesses in Nigeria. It also aims at facilitating a good knowledge of the microfinance banking operations, financial inclusiveness and other relevant topics.

Finally, you will have an insight into the rules, regulations and practices in the microfinance banking sub-sector and related issues concerning small and medium scale enterprises operations in Nigeria.

COURSE OBJECTIVES

To achieve the aims set out, the course sets overall objectives. Each unit also has specific objectives. The unit objectives are always specified at the beginning of a unit, you should read them before you start working through the unit. You may want to refer to them during your study of the unit to check your progress.

You should always look at the unit objectives after completing a unit. When you do that, you will ensure that you have followed the instructions in the unit. Below are the overall objectives of the course. By meeting these objectives, you should have achieved the aims of the course as a whole. On successful completion of the course, you should be able to:

- Trace the history of Micro-Financing in Nigeria including the formulation of the National Micro Finance Policy, the financial and non-financial services provided by this sub-sector, sources of finance available to small and medium scale enterprises as well as an overview of financial assistance available to this sector from the government.

- Discuss the procedures for accessing Finance by Small and Medium Scale Enterprises, financial analyses for income repayment of capital as well as capital and risk management by small businesses, how micro credit can be effectively provided and leasing and other alternative sources of funding for small scale enterprises.

- State and explain alternate Sources of Financing for SMES, the role of small scale businesses in the economy, the challenges of small scale business in an economy, sources and acquisition of capital by small businesses, uses of capital bu small businesses and financial inclusion and small scale enterprises financing in Nigeria.

WORKING THROUGH THIS COURSE

To complete this course, you are required to read the study units, read set books and read other materials provided by the National Open University of Nigeria (NOUN). Each unit contains assignments which you are required to attempt and submit for assessment

purposes. At the end of the course, there will be a final examination. The course should take you a total of 16 - 17 weeks to complete.
Below, you will find listed all the components of the course. What you have to do and how you should allocate your time to each unit in order to complete the course successfully on time. The list of all the components of the course is as presented.

COURSE MATERIALS

Major components of the course are:
- Course Guide
- Study Units
- Textbooks
- Assignment
- Presentation Schedule

STUDY UNITS

The study units in this course are as follows:

Module 1	**Micro Finance Banking in Nigeria**
Unit 1	History of Micro-Financing in Nigeria
Unit 2	Formulation of the National Micro Finance Policy
Unit 3	Sources of Finance
Unit 4	Micro Finance Non-Financial Services
Unit 5	An Overview of Government Financial Assistance for Small and Medium Enterprises
Module 2	**Procedures for accessing Finance by Small and Medium Scale Enterprises**
Unit 1	The Procedure for Accessing Government Financial Assistance for Small and Medium Enterprises
Unit 2	Financial Analysis of Small Business Income Repayment of Capital
Unit 3	Financial Analysis of Small Business Income Repayment of Capital and Risk Management
Unit 4	How Micro-Credit can be effectively Provided
Unit 5	Leasing and Other Alternate Sources of Finance to Small and Medium Scale Enterprises (SMEs)
Module 3	**Sources of Finance for Small and Medium Scale Enterprises**
Unit 1	Alternate Sources of Financing for SMES
Unit 2	The Role of Small Scale Business to the Economy
Unit 3	The Challenges of Small Scale Business in the Economy
Unit 4	Sources and Acquisition of Capital by Small Business
Unit 5	Uses of Capital by Small Business
Unit 6	Financial Inclusion and Small Scale Enterprises Financing in Nigeria

TEXTBOOKS

At the end of each unit of the course, there are reference materials to which you can refer in order to increase the depth of your knowledge on the course. Please take this seriously.

ASSIGNMENT FILES

A number of assignments have been prepared to help you succeed in this course. They will guide you to have understanding and good grasp of the course.

PRESENTATION SCHEDULE

The presentation schedule included in your course materials also have important dates of the year for the completion of tutor-marked assignments (TMAs) and you're attending to tutorials.

Remember, you are to submit all your assignments by the due date. You should guard against failing behind in your work.

ASSESSMENTS

There are two aspects to the assessment of the course: first are the tutor-marked assignments and a written examination.

In tackling the assignments, you are expected to apply information, knowledge and techniques gathered during the course. The assignments must be submitted to your tutor for formal assessment in accordance with the deadlines stated in the **Presentation Schedule** and the **Assignment File**. The work you submitted to your tutor will count for 30 percent of your total course mark.

At the end of the course, you will need to sit for a final written examination of 'three hours' duration. This examination will also count for 70 percent of your total coursework.

TUTOR-MARKED ASSIGNMENTS (TMAs)

Each of the units in the course material has a tutor-marked assignment (TMA) in this course. You only need to submit five of the eight assignments. You are to answer all the TMAs and compare your answers with those of your course mates. However, you should ensure that you collect four (TMAs) from the Study Centre. It is compulsory for you to answer four (4) TMAs from the Study Centre. Each TMA is allocated a total of 10 marks. However, the best three (3) of the four marks shall be used as your continuous assessment score.

You will be able to complete your assignment from the information and materials contained in your reading, references and study units. However, it is desirable in all degree level education to demonstrate that you have read and researched more widely than the required minimum. Using other references will give you a broader viewpoint and may provide a deeper understanding of the subject.

FINAL EXAMINATION AND GRADING

The final examination for BFN 737 will not be more than three hours' duration and has a value of 70 percent of the total course grade. The examination will consist of questions, which reflect the types of practice exercises and tutor-marked problems you have previously encountered. All areas of the course will be assessed.

Use the time between finishing the last unit and sitting for the examination to revise the entire course. You may find it useful to review your tutor-marked assignments and comments on them before the examination. The final examination covers information from all parts of the course.

COURSE MARKING SCHEME

Table showing the total course marking scheme is shown below:

ASSESSMENT	MARKS
Assignment 4 (TMAs)	Best three marks of the 4 TMAs @ 10 marks is 30 marks of the course = 40%
Final Examination	60% of overall course marks
Total	**100% of course marks**

COURSE OVERVIEW

This table brings together the units and the number of weeks you should spread to complete them and the assignment that follow them are taken into account.

Unit	Title of Work	Week Activity	Assessment (end of unit
	Module 1		
1	History of Micro-Financing in Nigeria	1	Assignment 1
2	Formulation of the National Micro Finance Policy		
3	Sources of Finance	1	Assignment 2
4	Micro Finance Non-Financial Services		
5	An Overview of Government Financial Assistance for Small and Medium Enterprises		
	Module 2		
6	The Procedure for Accessing Government Financial Assistance for Small and Medium Enterprises	1	Assignment 3
7	Financial Analysis of Small Business Income Repayment of Capital		
8	Financial Analysis of Small Business Income Repayment of Capital and Risk Management	1	Assignment 4
9	How Micro-Credit can be effectively Provided		
10	Leasing and Other Alternate Sources of Finance to Small and Medium Scale Enterprises (SMEs)	1	Assignment 5

	Module 3		
11	Alternate Sources of Financing for SMES		
12	The Role of Small Scale Business to the Economy I	1	Assignment 7
13	The Challenges of Small Scale Business in the Economy		
14	Sources and Acquisition of Capital by Small Business		
15	Financial Inclusion and Small Scale Enterprises Financing in Nigeria	1	Assignment 8
16	Uses of Capital by Small Business		
	Revision		
	Total	**16**	

HOW TO GET THE MOST FROM THIS COURSE

In distance learning, the study units replace the university lecturer. This is one of the great advantages of distance education. You can read and work through the specially designed study materials at your own pace, and at a time and place that suits you best. Think of it as you read the lecture notes and that a lecturer might set you some readings to do.

The study unit will tell you when to read your other materials. Jut as a lecturer might give you an in-class exercise, your study units also provide assignments for you to do at appropriate points.

Each of the study units follows a common format. The first item is an introduction to the subject matter of the unit, and how a particular unit is related with the other units and the course as a whole.

Next is a set of learning objectives. These objectives let you know what you should be able to do by the time you have completed the unit. You should use these objectives to guide your study. When you have finished the unit, you must go back and check whether you have achieved the objectives set. If you make a habit of doing this, you will significantly improve your chances of passing the course.

The main body of the unit guides you through the required reading from other sources. This will usually be either from **Reading Section** or some other sources.

Self-tests/assignments are interspersed throughout the end of units. Working through these tests will help you to achieve the objectives of the unit and prepare you for the examinations. You should do each of the assignments as you come to it in the study unit. There will also be numerous examples given in the study units, work through these when you come to them too.

The following is a practical strategy for working through the course. If you run into any trouble, telephone your tutor. When you need help, don’t hesitate to call and ask your tutor to provide it. In summary:

(1) Read this course guide.

(2) Organise a study schedule. Refer to the course overview for more details. Note the time you are expected to spend on each unit and how the assignments relate to the unit. Important information e.g. details of your tutorials and the date of the first day of the semester is available. You need to gather together all information in one place, such as your diary or a wall calendar. Whatever method you choose to use, you should decide on and write in your own dates for working on each unit.

(3) Once you have created your own study schedule, do everything you can to stick to it. The major reason that students fail is that they get behind with their coursework. If you get into difficulty with your schedule, please let your facilitator know before it is too late for help.

(4) Turn to unit 1 and read the introduction and the objectives for the unit.

(5) Assemble the study materials. Information about what you need for a unit is given in the 'Overview' at the beginning of each unit. You will always need both the study unit you are working on and one of your set books, on your desk at the same time.

(6) Work through the unit. The content of the unit itself has been arranged to provide a sequence for you to follow. As you work through this unit, you will be instructed to read sections from your set books or other articles. Use the unit to guide your reading.

(7) Well before the relevant due dates (about 4 weeks before the dates) access the Assignment file on the web and download your next required assignment. Keep in mind that you will learn a lot by doing the assignments carefully. They have been designed to help you meet the objectives of the course and, therefore, will help you pass the examination. Submit all assignments not later than the due dates.

(8) Review the objectives for each study unit to confirm that you have achieved them. If you feel unsure about any of the objectives, review the study material or consult your tutor.

(9) When you are confident that you have achieved a unit's objectives, you can then start on the next unit. Proceed unit by unit through the course and try to pace your study so that you keep yourself on schedule.

(10) When you have submitted an assignment to your tutor for marking, do not wait for its return before starting on the next unit. Keep to your schedule. When the assignment is returned, pay particular attention to your facilitator's comments. Consult your tutor as soon as possible if you have any questions or problems.

(11) After completing the last unit, review the course and prepare yourself for the final examination. Check that you have achieved the unit objectives and the course objectives.

TUTORS AND TUTORIALS

There are thirteen (13) hours of tutorials provided in support of this course. You will be notified of the dates, times and location of these tutorials, together with the names and phone number of your tutor, as soon as you are allocated a tutorial group.

Your tutor will mark and comment on your assignments, keep a close watch on your progress and on any difficulties you might encounter as they would provide assistance to you during the course. You must mail your tutor-marked assignments to your tutor well before the due date (at least two working days are required). They will be marked by your tutor and returned to you as soon as possible. Do not hesitate to contact your tutor by telephone, e-mail, or discussion board if you need help. The following might be circumstances in which you would find help necessary.

Contact your tutor if:

- you do not understand any part of the study units or the assigned readings;
- you have difficulty with the tutor-marked assignments;
- you have a question or problem with an assignment or with your tutor's comments on an assignment or with the grading of an assignment.

You should try your possible best to attend the tutorials. This is the only chance to have face-to-face contact with your tutor and to ask questions which are answered instantly. You can raise any problem encountered in the course of your study during such contact. To gain the maximum benefit from course tutorials, prepare a question list before attending them. You will learn a lot from participating in discussions actively.

SUMMARY

As earlier stated the course BFN 737: Micro and Small Business Financing is designed to introduce you to various techniques, guides, principles and practices relating to the regulations and practices of Microfinance Banking and Small and Medium Scale Enterprises in Nigeria.

We hope you enjoy your acquaintances with the National Open University of Nigeria (NOUN) and wish you every success in the future.

CONTENTS

MODULE 1 MICRO FINANCE BANKING IN NIGERIA

You are welcome to the first module of this course. Following are the units in this module.

UNIT 1 HISTORY OF MICRO-FINANCING IN NIGERIA

CONTENTS

1.0 INTRODUCTION

Welcome to the first unit of the first module in this course. In this course you will be taken through the meaning, history, challenges and prospects of microfinance banking. You will also be introduced to the evolution of micro finance institutions in Nigeria.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Discuss the meaning of microfinance;
- Narrate the history of Microfinance in Nigeria;
- Highlight the challenges of Microfinance in Nigeria;
- Explain the evolution of Microfinance institutions in Nigeria.

3.0 MAIN CONTENT

The major problem facing African nations today is the eradication of poverty which every government has built in as part of its development program. The World Bank Report defined poverty as hunger, lack of shelter and being sick and not being able to go to school, not knowing how to read, not having a job and fear for the future among others. When we speak of absolute poverty, we refer to existence below a reference standard of living. Poverty has been analyzed from five dimensions of deprivation among which are economic deprivation drawn from the lack of access to property, income, assets, factors of production and finance.

Small business firms can be described as the live wire of a developing economy like of Nigeria. Their role in the economic development can be appreciated by fact that they make substantial contributions to the Gross Domestic Product (GDP). Small businesses serve as a reliable revenue source for the government. Government recognized the need to encourage the small enterprises through the provision of credit and this informed policy reforms that brought about the Microfinance bank that the Federal Government of Nigeria introduced during the Obasanjo regime to replace the formal community banks in Nigeria and the policy became operational in 2005.

Microfinance is the form of financial development that has its primary aim to alleviate the poverty of the poor who are generally remained un-served or were offered improper financial service. Banks and other financial institutions are currently estimated to provide services to only 25% of potential client worldwide. It has been opined that only 2% of micro entrepreneurs are being provided service by banks. It is also opined that the size of the unsaved market by existing financial institutions is large. The average banking density in Nigeria is 1 financial institution outlet to 32,700 inhabitants and in rural areas, it is 1-57,000 inhabitants i.e. less than 2% household have access to financial service. Microfinance banks are established to fill the gap created by the formal financial sector by improving the socio-economic condition of the poor income generation. Many researchers, development workers and institution hauled microfinance as a potential solution to alleviation of poverty in which standard of living is one of the indicators. Nigerian government recognized the need to alleviate poverty and encourage small enterprises through the provision of credit and this inform policy reforms with respect to bringing the Microfinance bank under the Central Bank of Nigeria to create enabling environment for access to small loans and the policy became operational in 2005. There are still important gaps to be filled by this institutions in Nigeria, the Microfinance banks have not been able to adequately address the gap in terms of credits, savings and other financial services required by the small scale enterprises like barbing saloons, hair dressing saloon, block making outlets, sachet water making industries.

3.1 Meaning of Microfinance

Microfinance involves the provision of financial services to the poor and the low income segment of society. Worldwide, microfinance has been identified as a potent instrument for promoting financial inclusion and consequently, poverty alleviation. In 2005, the

Central Bank of Nigeria (CBN) formulated the National Micro finance Policy along the objectives of the Millennium Development Goals and the National Economic Empowerment and Development Strategy (NEEDS) and thus was born, the formal microfinance subsector in Nigeria. The CBN had since undertaken a comprehensive review of the Policy to address the identified challenges of the emergent subsector and leverage on its achievements.

Microfinance is defined as the provision of a broad range of financial services including loans, savings, insurance, remittances and transfers to low-income households and their micro enterprises. For the purposes of this work, focus will be made on the services that are most commonly associated with microfinance - loans and savings. The selection of these two services is also in line with the focus on the banking sector; as these are the two services provided by the banks with microfinance operations.

3.2 History of Microfinance in Nigeria

The history of micro financing can be traced back as long to the middle of the 1800s when the theorist, Lysander Spooner was writing over the benefits from small credits to entrepreneurs and farmers as a way getting the people out of poverty. But it was at the end of World War II with the Marshall plan the concept had a big impact.

The today use of the expression micro financing has it roots in the 1970s when organizations, such as Grameen Bank of Bangladesh with the microfinance pioneer Mohammad Yunus, where starting and shaping the modern industry of micro financing. Another pioneer in this sector is Akhtar Hameed Khan. At that time a new wave of microfinance initiatives introduced many new innovations into the sector. Many pioneering enterprises began experimenting with loaning to the underserved people. The main reason why microfinance is dated to the 1970s is that the programs could show that people can be relied on to repay their loans and that it´s possible to provide financial services to poor people through market based enterprises without subsidy. Shore bank was the first microfinance and community development bank founded 1974 in Chicago.

An economic historian at Yale named Timothy Guinnane has been doing some research on Friedrich Wilhelm Raiffeisen´s village bank movement in Germany which started in 1864 and by the year 1901 the bank had reached 2 million rural farmers. Timothy Guinnane means that already then it was proved that microcredit could pass the two tests concerning peoples' payback moral and the possibility to provide the financial service to poor people. Another organization, the caisse populaire movement grounded by Alphone and Dorimène Desjardins in Quebec, was also concerned about the poverty, and passed those two tests. Between 1900 to 1906 when they found the first caisse, they passed a law governing them in the Quebec assembly; they risked their private assets and must have been very sure about the idea about microcredit.

Today, the World Bank estimates that more than 16 million people are served by some 7,000 microfinance institutions all over the world. CGAP experts mean that about 500 million families benefits from these small loans making new business possible. In a gathering at a Microcredit Summit in Washington DC the goal was reaching 100 million of the world´s poorest people by credits from the world leaders and major financial institutions.

The year 2005 was proclaimed as the International year of Microcredit by The Economic and Social Council of the United Nations in a call for the financial and building sector to "fuel" the strong entrepreneurial spirit of the poor people around the world.

The International year of Microcredit consists of five goals:

- Assess and promote the contribution of microfinance to the MFIs;
- Make microfinance more visible for public awareness and understanding as a very important part of the development situation;
- The promotion should be inclusive the financial sector;
- Make a supporting system for sustainable access to financial services;
- Support strategic partnerships by encouraging new partnerships and innovation to build and expand the outreach and success of microfinance for all.

The economics professor Mohammad Yunus and the founder of Grameen Bank were awarded the Nobel Prize 2006 for his efforts. The press release from nobelprize.org states:

> *"The Norwegian Nobel Committee has decided to award the Nobel Peace Prize for 2006, divided into two equal parts, to Muhammad Yunus and Grameen Bank for their efforts to create economic and social development from below. Lasting peace cannot be achieved unless large population groups find ways in which to break out of poverty. Micro-credit is one such means. Development from below also serves to advance democracy and human rights. Muhammad Yunus has shown himself to be a leader who has managed to translate visions into practical action for the benefit of millions of people, not only in Bangladesh, but also in many other countries. Loans to poor people without any financial security had appeared to be an impossible idea. From modest beginnings three decades ago, Yunus has, first and foremost through Grameen Bank, developed micro-credit into an ever more important instrument in the struggle against poverty. Grameen Bank has been a source of ideas and models for the many institutions in the field of micro-credit that have sprung up around the world. Every single individual on earth has both the potential and the right to live a decent life. Across cultures and civilizations, Yunus and Grameen Bank have shown that even the poorest of the poor can work to bring about their own development. Micro-credit has proved to be an important liberating force in societies where women in particular have to struggle against repressive social and economic conditions. Economic growth and political democracy cannot achieve their full potential unless the female half of humanity participates on an equal footing with the male. Yunus's long-term vision is to eliminate poverty in the world. That vision cannot be realised by means of micro-credit alone. But Muhammad Yunus and Grameen Bank have shown that, in the continuing efforts to achieve it, micro-credit must play a major part."*

3.3 The Challenges of Microfinance in Nigeria

The failure of community banking scheme and many previous government's micro financing schemes was predicated on the challenges they faced. Many of these challenges are still bedevilling microfinance banking. This section discusses some of these:

One of the most fundamental difficulties microfinance banks in Nigeria have is the **near absence of basic infrastructure**. This lack of basic infrastructure compounds the operational difficulties of these banks, which ordinarily are faced by high operational costs because of their nature of business. By dealing with many small clients microfinance banks' transaction costs are usually higher than those of conventional banks. Unfortunately, these banks are also forced to incur additional costs to provide themselves with electricity and water. The absence of good roads especially in the rural areas also distorts their outreach. All these work in concert to drive cost of operations up and put them at a very big competitive disadvantage.

The **lack of banking culture in the rural areas and among the urban poor** is another factor militating against the progress of microfinance banks. Traditionally, these people borrow money from friends and relatives and repay the same amount of money borrowed no matter the tenure of such loans. They therefore find it difficult to understand the payment of interest on bank loans.
In the northern part of the country, the issue of frowning at interest on loans takes a religious dimension. This part of the country is populated by mainly Muslims, a religion which abhors usury. This has hampered the development of microfinance banking in that part of the country. This was buttressed by who opined that "conventional micro financing violates Islamic principles by charging interest. This matter is of concern for Muslims due to the consequences of dealing with interest (ribia)". This may account for the lopsided location of microfinance banks in country as over 75% of them are located in the southern part of the country while the northern part with a higher incidence of poverty has less than 25%.

The **failure of many community banks and the withdrawal of the licence of 224 microfinance banks in 2010 have badly damaged public confidence** in these banks. Many microfinance banks established in communities where failed community banks existed are faced with an uphill task of convincing these communities that they will not go through the unfortunate experience of losing money in a bank failure. The sudden withdrawal of the licence of 224 of these banks has fuelled the lack of public confidence which community banks bequeathed them. Many of the customers of these banks have refrained from dealing with them in fearing the same fate would befall them. On the other hand, the Central Bank of Nigeria has constantly assured the public that it will not allow any commercial bank to fail; this, places the microfinance banks at a great disadvantage by tilting public confidence in favour of commercial banks that are normally bigger and stronger.

Another important factor identified to militate against the performance of microfinance banks in Nigeria as identified is **limited support for human and institutional capacity**

building. The paucity of human capacity in the microfinance sub-sector in Nigeria has been an issue from the days of community banking. According to one of the major problems of the microfinance sub-sector is recruitment of effective and appropriate manpower. This he ascribed to the inability of the sector to adequately remunerate staff. Other human resource problems faced by microfinance banks include lack of training opportunities and poor conditions of service. The quality of manpower in these banks is reflected in the poor performance of many of them, inefficiency and high levels of frauds and forgeries. The banks also suffer from high labour turnover a further indication of low staff motivation and poor personnel practices.

Corruption is a cankerworm that has wrecked-havoc in many sectors of the Nigerian economy. The microfinance sub-sector is not left out of the ravages of corruption. This manifests in many ways, such as, corporate governance failures, frauds and forgeries, theft and refusal by customers to repay loans. The standard of corporate governance in many microfinance banks in Nigeria is poor. Board members are known to misuse their positions to obtain facilities way above the regulatory limit for insider related loans and worse still with no intentions of repaying such facilities. They also use their positions to unduly influence and manipulate the recruitment processes in favour of their cronies. Frauds and forgeries by both insiders and outsiders to the banks are rife and people generally obtain loans with no intention to repay.

It is important to note that there is over nine hundred (900) microfinance banks today in Nigeria and they are regulated and supervised by the Central Bank of Nigeria (CBN). The CBN also has the responsibility of supervising commercial banks, development finance institutions, primary mortgage institutions, and bureau de change and credit bureaus. The multiplicity of the institutions and their diverse nature possess a regulatory challenge. This is against the backdrop that since for instance commercial banks and microfinance banks differ in operational method and scope, a regulator trained to inspect/supervise the activities of one may be handicapped in the supervision of another.

The **emergence of miracle or magic banks from time to time** has done a lot of disservice to the image of microfinance banks. These banks spring up without any license, promise to pay outlandish interest on deposits, mobilize deposits from the uninformed and/or greedy and disappear. Most of the victims of these scams are customers that microfinance banks should service but become skeptical about banking after the miracle bank experience. Many others do not see any difference between those magic banks and the licensed microfinance banks.

Another prevalent problem among microfinance banks is the **copying, competing and mimicking the practices of commercial banks**. Many microfinance bank managers and other management staff were commercial banks' staff who were either retired or sacked by their former employers. To these staff microfinance banking is just an extension of the commercial banking they know. They also come with their organizational orientation, philosophy and culture. They refuse to understand that microfinance is not micro-commercial banking but a different kind of banking requiring a different approach, philosophy and client base. This may be why many microfinance banks spend colossal sums on office complex, exotic cars and the wardrobe of their staff. They also engage in inordinate competition with the commercial banks. This class of staff lack orientation as to the essence of microfinance.

3.4 Prospects of Microfinance in Nigeria

That a lot of opportunities exist in the microfinance subsector in Nigeria is unarguable. Scholars are unanimous in their agreement that there exist a large untapped market for microfinance banks. Buttresses this by pointing out that about 70% of the Nigerian population is engaged in the informal sector or agricultural production. Going by the country's population of over one hundred and fifty million people we can deduce that about one hundred and five million are in this sector. The scenario above is indicative of an enormous market which microfinance banks can take advantage of. This large untapped market in the microfinance subsector is further enhanced by the fact that over 65% of the entire population of Nigeria has no access to banking services. To say that this leaves a lot of room for existing microfinance banks to expand their scope of operations and for new ones to enter will be stating the obvious.

Government's renewed interest and improved regulatory environment in the microfinance sub-sector also enhances the prospects for development and success of microfinance banks. One indication of this is the implementation of training programmes for regulators, promoters and practitioners by the Central Bank of Nigeria (CBN). The CBN has even gone ahead to adapt the suggestion of that it subsidizes the training of practitioners in the sector to reduce the burden on the banks. Today the CBN pays 60 per cent of the cost of training the management staff of these banks, this is aimed at improving capacity in the industry. The programme which the CBN runs in collaboration with Nigerian Deposit Insurance Corporation (NDIC) will culminate in these managers passing a certification examination set by the Chartered Institute of Bankers of Nigeria (CIBN). The regulators are taking this certification/human capacity building programme so seriously that they have issued a guideline that only certified persons will qualify to manage microfinance banks in the near future.

Another sign of regulatory will to ensure vibrancy in the micro-financing banking subsector is the inclusion of microfinance banks' deposits in the deposit insurance scheme. This has improved public confidence in the sub-sector. Furthermore, the review of the deposit insurance limit from one hundred thousand (N100,000.00) naira as stipulated by the NDIC Act of 2006 to two hundred thousand (N200,000.00) naira is a further sign of regulatory intention to build confidence in these banks.

3.5 The Evolution of Microfinance institutions in Nigeria

With the huge shortage of funds in the banking industry, failure of the established community banks and other government programs in financing micro-enterprises in Nigeria, gave rise to the idea of transforming existing microfinance NGOs into microfinance banks. In the past years, microfinance institutions were informal in nature. They were characterized by different mechanism such as ability of the members of these microfinance institutions to have credit support from other members which could be used in expanding their businesses mainly in the agricultural sector.

For almost three decades it has been a challenge for governments to provide micro-credit to the poor people who are operating micro and medium enterprises. It is known that in every country around the world, over 90% of the businesses are micro and small businesses (Jenkins, 2009).

In Nigeria, there used to be people who go round taking money from other people in their job places. These kinds of people serve like village banks, where they accept the money as deposit and save it for the people. This kind of agreement between the inhabitants of the respected area and the people going round to collect their money establishes a trust between them. Although it differs between community to community, the whole idea is the same which is deposit taking and saving, but what remains interesting here is that in some cases, these people that agree to save, form group amongst themselves, and one or two people among them borrow the money after it has been accumulated. They usually gather the money for six to twelve months. The members who collect the money usually use it to invest in their businesses but they also know that they are required to return the money back to the depositors. This way other members will also have a chance to borrow. This is one of the interesting cases as it gives us an insight on how the financial sector operates in Nigerian villages and towns.

This process of formation of own borrowing groups was not only common in Nigeria, but it was experienced around the world. An empirical evidence in Ghana (Owusu and Tetteh, 1982), Zimbabwe (Bratton, 1986) and Dominican Republic (Desai, 1983) shows that local conditions have influenced the ideal size of membership and that below or above the ideal size of membership correlates negatively with cohesiveness and joint accountability.

Anyanwu (2004) conducted a study on micro-finance institutions in Nigeria, their policy practice and potential. In this study, he analyzed at that time, the ten major micro-finance institutions in Nigeria with respect to their location. These micro-finance institutions were Farmers' Development Union (FADU), in Ibadan; Community Women and Development (COWAD), in Ibadan; Country Women Association of Nigeria (COWAN), in Akure; Lift Above Poverty (LPO), in Benin; Justice Development and Peace Commission (JDPC), in Ijebu-Ode; Women Development Initiative (WDI), in Kano; Development Education Centre (DEC ENUGU), in Enugu; Development Exchange Centre (DEC BAUCHI), in Bauchi; Outreach Foundation (OF), in Lagos; and Nsukka Area Leaders of Thought United Self-Help Organization (NLTNUSHO), in Nsukka.

4.0 CONCLUSION

Microfinance is the form of financial development that has its primary aim to alleviate the poverty of the poor who are generally remained un-served or were offered improper financial service. Banks and other financial institutions are currently estimated to provide services to only 25% of potential client worldwide. It is noted that the size of the unsaved market by existing financial institutions is large. The average banking density in Nigeria is 1 financial institution outlet to 32,700 inhabitants and in rural areas, it is 1-57,000 inhabitants i.e. less than 2% household have access to financial service.

Microfinance involves the provision of financial services to the poor and the low income segment of society. Worldwide, microfinance has been identified as a potent instrument for promoting financial inclusion and consequently, poverty alleviation. In 2005, the Central Bank of Nigeria (CBN) formulated the National Micro finance Policy along the objectives of the Millennium Development Goals and the National Economic Empowerment and Development Strategy (NEEDS) and thus was born, the formal microfinance subsector in Nigeria. Microfinance banks are established to fill the gap created by the formal financial sector by improving the socio-economic condition of the poor income generation. There should be faithful and diligent implementation of the Revised Microfinance Policy and other reform initiatives already put in place in order to guarantee socioeconomic development through the viability of small and medium scale enterprises.

5.0 SUMMARY

In this unit, you learnt the meaning of microfinance, the European origin of microfinance, the African origins of microfinance and the emergence of microfinance banks in Nigeria. You also learnt how the formulation of the national microfinance policy by the Central Bank of Nigeria led to the establishment of microfinance subsector in the economy.

In the next unit, we shall examine another unit titled: formulation of national microfinance policy in Nigeria.

6.0 TUTOR MARKED ASSIGNMENT

1. Trace the emergence of Microfinance banks in Nigeria.
2. Reasons for the Formulation of the National Microfinance Policy

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UNIT 2 FORMULATION OF THE NATIONAL MICRO FINANCE POLICY

CONTENTS

1.0 INTRODUCTION

In the preceding unit we learnt the meaning of the meaning of microfinance, the European origin of microfinance and the African origin of microfinance. You also learnt how the formulation of the national microfinance policy by the Central Bank of Nigeria led to the establishment of microfinance subsector in the economy.

In this unit, we shall delve extensively on the national microfinance policy and how it was formulated to guide the operations and practices of the microfinance banking Nigeria.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Trace the African origins of microfinance;
- Give reasons for the formulation of the national microfinance policy;
- Explain the objectives of the microfinance policy.

3.0 MAIN CONTENT

3.1 African Origins of Microfinance

Turning now to another world of microfinance, our journey back in history takes us to Nigeria: to a microfinance revolution, centuries ago. The earliest evidence of financial institutions in Africa dates back to the 16thcentury: to esusu, a rotating savings and credit association (RoSCA) among the Yoruba. As a form of social capital, the esusu as a financial self-help group was transported during the slave trade to the Caribbean islands

(Bascom 1952:69), where both the institution and the term still exist today and are now carried by a new wave of migrants to major American cities. Its origin were probably rotating work associations, in which labour as a scarce commodity was accumulated and allocated to one member at a time; and then, with the spreading of commercial transactions, replaced by money, such as cowries, pounds and Naira.

Nigeria is one of the countries where informal financial institutions continue to play an important role. There may be only few Nigerians who are not a member in one or several of them. Numerous adaptations and innovations have sprung from the RoSCAs: one is the transformation into non-rotating savings associations with a permanent loan fund. Both the name, esusu, and the institution have spread as far as Liberia as the only effective financial institutions existing in the countryside (Seibel 1970; Seibel & Massing 1974) and Congo, or Zaire. The other one is daily deposit collection at doorsteps or market stalls. It seems to have originated among the Yoruba (where it is known as ajo) from where it has spread all over West Africa during the past 50 years. These informal financial institutions are immensely popular in Nigeria. Virtually every ethnic group has its own institutions and proper names (adashi, in Hausa, perhaps the best-known besides esusu); and most adults are members in one or several. Yet their importance and potential have been controversially discussed.

In 1934 C.F. Strickland, a British cooperative expert, examined the esusu as a possible basis for modern cooperative societies in Western Nigeria. Having previously worked on the rotating chit funds in India, he speculated that the <u>esusu</u> must have been imported from India at some unknown time, found them “improvident” and “fraudulent”, and concluded that he was “not hopeful of the reform of the esusu.” (Strickland, 1934:14). The consequences of his judgment were far-reaching: the Co-operative Societies Ordinance, introduced in 1935 and modeled after British-Indian cooperatives, became the blueprint for the British colonies in Africa. However, informal financial institutions of various types continued to be rediscovered in Nigeria by scholars (e.g, Green, 1947/64; Bascom, 1952; Ardener, 1953, 1964; Isong, 1958; Seibel, 1967; Seibel & Marx, 1984; Ottenberg, 1968, 1973; Okorie & Miller, 1976; Chukwu, 1976) and practitioners, who were intrigued by their development potential.

At various times, two approaches were tested:

(i) upgrading informal rotating or non-rotating savings and credit associations to registered cooperatives and linking them to banks; and
(ii) transforming indigenous savings and credit associations into cooperatives.

In Eastern Nigeria, in the 1940s, colonial officers with an anthropological background recommended the transformation of esusu or isusu (the Igbo term) to financial cooperatives as well as the continuation of isusu practices within modern cooperatives (i.e., those registered under cooperative law). In 1954, the Eastern Region Cooperative Department (1954) stated in its annual report: Financial institutions accumulate scarce resources and make them available in lump sums: either as one’s savings at the end of a period of depositing small amounts; or as a loan at the beginning of a period of (usually) small payments; or as a mixture of both, savings and credit, somewhere during that period. In the process, financial institutions manage risks; decrease the costs of transaction between individuals, and increase efficiency.

Historically, labour has been a scarce resource in Africa. Rotating group work has been one of the forms of accumulating and allocating that scarce resource. With the emergence of a cash economy, money was gradually substituted for labour: a process which is still going on in some countries. (Seibel & Damachi, 1982). “The Isusu (Esusu, Susu, Osusu) is a widespread indigenous system of thrift and credit... On the whole, the Esusu seems to be fairly well managed; although in some areas... the Isusu has degenerated into a notorious money-lender-controlled ‘racket’. There are vast numbers of Isusu Clubs in the region and the total amount of money involved must be very large. Some local Government Bodies have recently instituted a system of registration of Isusu Clubs.”

During the 1950s, when self-government was introduced, definitions of what constitutes “development” changed; and so did attitudes to local culture and institutions. This is indicated by the “modernization” of one esusu in Ondo Province initiated in 1952 by a Nigerian civil servant, J.T. Caxton-Idowu. He prepared bye-laws, “regularized” its activity, imparted cooperative education, and registered the esusu as a proper cooperative society. At that time, there existed four Cooperative Thrift & Credit Societies of the type imported by the British, to which the esusu was added as a fifth cooperative, but of indigenous origin. Within a ten-year period, the number of such cooperatives grew from 5 in 1952 to 94 in 1962, including converted esusu. Their proportion in terms of number of cooperatives had risen from 20% in 1952 to 44% in 1962; their working capital and savings from 20% to 52%, and their membership from 23% to 58%. Adeyeye (1970), a learned observer, concluded: “the Ondo experiment has demonstrated... that the ‘Esusu’ may yet represent a source of immeasurable strength... With the renewed pride in our traditional heritage, we in the developing nations will definitely find the idea of institutional adaptation a most welcome experiment. It will offer opportunities to modernize without necessarily destroying the essentially indigenous character.”

In the early 1980s, donor countries realized that capital transfer through development banks had failed to bring about the desired modernization and shifted their interest to the domestic resource mobilization. As a contribution to the Third International Symposium on the Mobilization of Personal Savings in Developing Countries, 1984 in Yaoundé, the Federal Ministry of Economic Cooperation (BMZ) commissioned a study of modern cooperatives as well as indigenous savings and credit associations in Nigeria. At the time, cooperatives in Nigeria had 1.6 million members. There were no figures on the membership in esusu-type groups; but membership was conservatively estimated at 12-25 million.

At a time when Nigeria had a differentiated banking sector and a booming oil industry, the question came up again whether traditional and modern cooperatives had a major role to play in financial sector development; and what had happened to the earlier approach of converting indigenous to modern cooperatives. Was it a thing of the past, or did it still have promise? In Eastern Nigeria, it was estimated at the same that approximately 40%

of all cooperatives had been established on the basis of pre-existing esusu, the majority of which had previously evolved from rotating to non-rotating associations with permanent loan funds. In 1984, Seibel & Marx studied a total of 64 cooperatives in five states in Nigeria: Anambra, Imo, Cross River, Oyo and Benue, comparing cooperatives with and without esusu origin. The case studies are not statistically representatives; and the results can only be indicative. There are two striking results: one concerning the difference between cooperatives with and without an indigenous esusu origin; the other concerning the difference between cooperatives and unconverted esusu.

3.2 European Origin of Microfinance

Revolutions in rural and microfinance seem to be recurrent events. One such revolution started in the 1970s, when Shaw and McKinnon (1973) at Stanford University propagated, pertaining to financial systems, the crucial importance of Money and Capital in Economic Development; and a group of scholars around Dale Adams (1984) at Ohio State University, pertaining to rural financial systems, exposed the dangers of Undermining Rural Development with Cheap Credit. An earlier revolution, truly in microfinance, urban and rural, started in Germany some 150-200 years ago from small informal beginnings as part of an emerging self-help movement: with the first thrift society established in Hamburg in 1778; the first community bank in 1801; and the first urban and rural cooperative credit associations in 1850 and 1864, respectively. The provision of legal status, prudential regulation and effectively delegated supervision played a crucial role in their further development, starting with the Prussian Savings Banks Decree in 1838 and the Cooperative Act of the German Reich in 1889, the first cooperative law in the world. Their success has been spectacular. With 39,000 branches, these two types of (micro-) finance institutions now comprise 51.5% of all banking assets in Germany (Dec. 1997 data) and seem far healthier than the big national banks. (Seibel, 2003a).

The story of Germany is preceded by the earlier, but sadder, story of the Irish charities which emerged in the 1720s in response to a tremendous increase in poverty. They started with interest-free loans from donated resources. After a century of slow growth, a boom was initiated a special law in 1823, which turned the charities into financial intermediaries by allowing them to collect interest-bearing deposits and to charge interest on loans. Around 1840, around 300 funds had emerged as self-reliant and sustainable institutions, with high interest rates on deposits and loans. They were so successful that they became a threat to the commercial banks, which acted with financial repression: getting the government to put a cap on interest rates in 1843. The Loan Funds lost thus their competitive advantage, which caused their gradual decline, until they finally disappeared in the 1950s. (Seibel, 2003a).

Microfinance is thus not a recent development, and it is not just a temporary solution for poor countries. Every now developed country has its own history of microfinance. It is important to recognize this because it presents a view different from that of many in the microfinance community who associate microfinance with credit NGOs and believe that microfinance was invented in Bangladesh some 20 years ago. Attributing the origin of microfinance to recent initiatives misses not only the historical depth and scale of microfinance, but also centuries of experience, which means: learning from trial and error, failure and success. The beginnings in Europe and Africa, notably in Nigeria, were all informal and small-scale. What distinguishes a country like Germany from many developing countries is not the prevalence of self-help and informal finance at an earlier time. Community- and member-based as well as other informal financial institutions are exceedingly widespread throughout the world. The major difference seems to be the legal recognition given to informal finance in Germany and the protection of the institutions through prudential regulation and effective supervision: an issue which is still controversial in the microfinance community.

3.3 Reasons for the Formulation of the National Microfinance Policy

The apex bank gave the following reasons for the formulation of the National Microfinance Policy:

i. Weak Institutional and Network Capacity: The prolonged sub optimal performance of many erstwhile community banks, microfinance and development finance institutions is as a result of incompetent management, weak internal controls and lack of deposit insurance schemes. Other factors include poor corporate governance, lack of well defined operations and restrictive regulatory / supervisory requirements.

ii. Weak Capital Base: The weak capital base of the existing microfinance institutions could not adequately provide a cushion for the risk of lending to micro enterprises.

iii. The Existence of a Huge Un-served Market: The size of the un-served market by the existing financial institutions is large. For instance in 2005, the aggregate microcredit facilities in Nigeria accounted for about 0.2 percent of Gross Domestic Product (GDP) and less than one percent of total credit to the economy. This revealed the existence of a huge gap in the provision of financial services to a large number of the active poor and low income groups.

iv. Poor Banking Culture and Low level of Financial Literacy: The primary target of microfinance initiative includes people who have never had any banking relationship in their lives either due to poor financial literacy, remoteness from bank locations or complete ignorance of what banking entail. Most of these people equate microfinance with micro credit see banks and other fund providers not as partners in business but mere sources of loans and advances.

v. Economic Empowerment of the Poor: Globally, micro small and medium enterprises (MSMEs) are known to contribute to poverty alleviation through their employment generating potentials. As people become gainfully employed they are able to earn some income from which basic needs of life are met. In Nigeria, however, the employment generation potentials of small businesses have been seriously constrained by lack of access to finance either to start, expand or re-engineer their present scope of economic activities in order to generate employment.

vi. The increasing interest of local and international investors in Microfinance: Many local and international investors have expressed interest in investing in the country's microfinance sector.

vii. Urban Bias in Banking Services: Most of the existing banks are located in urban centres and several attempts in the past at encouraging them to open branches in the rural areas did not produce the desired results .With a high proportion of the Nigerian population still living in the rural areas, it has become absolutely imperative to develop an institutional framework to reach the hitherto un served population with banking services..

3.4 Objectives of the Microfinance Policy

The main objectives of the Microfinance Policy are:

i. Provision of diversified affordable and dependable financial services to the economically poor which otherwise would have been excluded in a timely and constructive to enable them undertake and develop long term sustainable entrepreneurial activities.

ii. Creation of employment opportunities and increase in the productivity of the active poor in the country thereby enhancing their individual household income and uplifting their standard of living.

iii. Promotion of synergy and mainstreaming of the informal Microfinance subsector into the formal financial system, thereby ensuring effective systematic and focused participation of the poor in socio economic development and resource allocation.

iv. Enhancement of service delivery by all microfinance institutions to MSMEs and rendering of specialized services such as payment of salaries , gratuities and pensions licensed by the CBN.

v. Mobilization of savings for intermediation and contribution to rural transformation.

vi. Promotion of linkage programmes between MFIs on one hand and DMBs, DFIs and specialized funding institutions on the other.

vii. Provision of sustainable avenues for the administration of the micro credit programmes of government and high net worth individuals on a non recourse basis, and promotion of an enabling platform for microfinance service providers to network and exchange views and experiences on their products and processes.

3.5 Reform of the Microfinance Subsector in Nigeria

Efforts to reform and reposition the subsector for enhanced service delivery include:

i. Withdrawal of the operating licenses of 103 MFBs in 2010.

ii. Proposed criminal prosecution of errant directors and management staff found culpable for the mismanagement of the affected banks.
iii. Intensified on site routine examination.
iv. Continuous sanitization/revocation of licences of failed MFBs.
v. Zero tolerance for regulatory infractions.
vi. Implementation of stiffer sanctions and penalty regime.
vii. The review of the Microfinance Policy framework.

4.0 CONCLUSION

We have been able to trace the history of the emergence of microfinance banking in Europe, African continent and Nigeria.

We also considered the reasons for formulating a policy for national microfinance, the objectives of the policy and why reform of the subsector was undertaken in Nigeria.

5.0 SUMMARY

The objectives of the microfinance policy, reasons for its formulation, the operational challenges of microfinance banks in Nigeria and reform of the microfinance bank sub-sector in Nigeria were examined in this unit.

In the next unit, we will consider the sources of finance available to firms in Nigeria.

6.0 TUTOR-MARKED ASSIGNMENT

1. How did the microfinance banking originate in Europe?
2. Trace the history of the emergence of microfinance banking in the African continent.
3. Enumerate the reasons for the Formulation of the National Microfinance Policy.
4. List the objectives of the Microfinance Policy.

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UNIT 3 SOURCES OF FINANCE TO FIRMS

CONTENTS

1.0 INTRODUCTION

The objectives of the microfinance policy, reasons for its formulation, the operational challenges of microfinance banks in Nigeria and reform of the microfinance bank sub-sector in Nigeria were examined in this unit.

In this unit, we will consider the sources of finance available to firms in Nigeria.

2.0 OBJECTIVES

The aim of this unit is to enable students understand the major sources of finance available to a business and how businesses get money to finance growth, also to overcome problems such as working capital and cash flow issues. Other objectives are to understand:

i. the various sources of finance for a business;
ii. how firms acquire funds in order to acquire assets for their businesses.

3.0 MAIN CONTENT

The financial needs of a business varies from firm to firm, and it is influenced by a firm's size, form of ownership, type of technology being used within the firm, the relationship between capital and labour, the length of credit periods (taken and allowed), and the age of the firm's assets. For example, processing businesses are usually capital intensive, requiring large amounts of capital while retail businesses usually require less capital. Every business needs finance to start and hump it up to profitability.

3.1 Sources of Finance available to Firms

There are several sources to consider when looking for start-up financing. The main questions managers have to answer are:

i. How much finance is needed?

ii. Whether the finance can be obtained internally.
iii. Whether the finance should be borrowed temporarily, with a view to paying back, or obtained as permanent (e.g. share) capital.
iv. If the finance is borrowed, whether the loan is for short (up to one year), medium (1–5 years) or long term.

Sources of funds available to business organizations could be classified into two main categories:

1. Short-term sources
2. Long-term sources

These categories have different types of sources, that is a firm can generate funds internally or externally to finance its activities. External sources could also be short-term or long-term. This unit will focus on how firms acquire funds in order to acquire assets to grow their businesses.

3.2 Short-term Sources of Finance

Short-term fund means financing for a period of less than 1 year. They represent short-term obligations. Since they are supposed to be settled by cash, they represent cash payments which must be settled as at when due. The need for short-term finance arises to finance the current assets of a business like an inventory of raw material and finished goods, debtors, minimum cash and bank balance etc. Short term financing is also named as working capital financing. Short term finances are available in the form of:

1. *Owner's Equity*: The owner contributes as owner/shareholder who bears the risk of the business.

2. *Bank Overdraft*: The source of overdraft is commercial banks, and they grant this to creditworthy firms. Funds could be advanced to such firms within a period ranging between one day and one year. These loans are supposed to be repaid on self-liquidating basis.

3. *Account Payable*: This is trade credit. A firm can buy something on credit. Supplies could be made on credit, and they give rise to trade credits.

4. *Bill Finance*: This is bill is a promissory note. But there are different types of bills and complexity exists in their meanings. In our case, a bill is a trade bill of exchange which could be domestic or foreign. If a bill of exchange (inland) is accepted from discounting operations.

5. *Deferred Tax Payment*: Tax payment could be looked at from two perspectives: Self-imposed (a firm will not pay when it is supposed to pay and that becomes a source) and Late assessment.

6. *Factoring: Debt could be factored*: This is another source of short-term funds. Factoring involves handing over of account receivable or any other debt to factors for collection with or without recourse.

7. *Hire Purchase Finance Arrangement*: This is a form of installment credit. Hire purchase is similar to leasing, with the exception that ownership of the goods passes to the hire purchase customer on payment of the final credit installment, whereas a lessee never becomes the owner of the goods. Hire purchase agreements usually involve a finance house.

   i) The supplier sells the goods to the finance house.
   ii) The supplier delivers the goods to the customer who will eventually purchase them.
   iii) The hire purchase arrangement exists between the finance house and the customer.

   The finance house will always insist that the hirer should pay a deposit towards the purchase price. The size of the deposit will depend on the finance company's policy and its assessment of the hirer. This is in contrast to a finance lease, where the lessee might not be required to make any large initial payment.

8. *Stock Finance*: Stocks could be used to raise short-term funds in a number of ways. They could be used as collaterals for secured loans from commercial or merchant banks. Raw materials could be financed en route by means of trade bills and/or warehouse receipt. This represents another type of secured loans on the value of stock of raw materials. The bill could become negotiable if endorsed by a reputable commercial house or bank, and could thereafter be sold outright or used as collateral for a loan.

3.2 Long-term Sources of Finance

A long-term source of finance means capital requirements for a period of more than 5 years to say, 10, 15, 20 years or more depending on other factors. Capital expenditures in fixed assets like plant and machinery, land and building etc. of a business are funded using long-term sources of finance. Part of working capital which permanently stays with the business is also financed with long-term sources of finance. Two major external sources of long-term funds are:

- Financial institutions (including lease finance companies), and
- Capital market.

Capital market is classified into: Organized and Unorganized. The organized capital market will be our focus because it is the capital market that will assess the performance of the firm. Firms raise money from the capital market by: Issuing common stock (C/S); and issuing instruments of debt (long-term liabilities). Note that a firm cannot issue debt instruments if it has no common stock. Long term financing sources can be in form of any of the following:

1. **Common Stock:** Equity shares, common stock and ordinary shares, all mean the same thing, but a stock is a group of shares, that is, a stock is made up of shares. Ordinary shares could be issued by firms which have been quoted on the stock exchange. Ordinary shares constitute the equity base of a firm, and represent ownership of the firm on pro-rata basis. This implies that an individual investment is a small proportion of total investment. Each equity shareholder is entitled to a proportionate part of the firm's residual profit and asset. The capital contributed by the shareholders is, therefore, known as risk capital. But they have some compensation like voting rights.

2. **Preference Shares:** The next class of shares which ranks above equity shares are the preference shares. They are also known as preference stocks. Preference shares occupy an intermediate position between common stock and debenture stocks. Preference shareholders are entitled to fixed dividend payment as different from equity shareholders which are entitled to variable dividend payments. They are imperfect creditors because tax is paid before fixed dividend is paid to them; they are not creditors and they are not the owners of the firm. They do not normally have voting rights unless otherwise stipulated in the terms of the issue.

   There are various types of preference shares:

   (i) Cumulative preference shares
   (ii) Participating Non-Cumulative shares
   (iii) Participating Cumulative shares
   (iv) Redeemable and irredeemable Preference shares
   (v) Convertible Preference shares

   i. *Cumulative Preference Shares* - Preference shares could be cumulative or non-cumulative. Cumulative preference shares allow for dividend payment to be deferred if a firm does not make adequate profit to pay such dividend. Therefore, such firms are normally required to pay such dividends in arrears before dividend could be paid to common shareholders. Non-cumulative preference shares do not allow for any form of deferment of dividend payment.

   ii. *Participating Non-Cumulative Preference Shares* - This class of shareholders is entitled to a non-cumulative dividend at a fixed rate but without a right to participate in the residual profit of a firm after the equity shareholders has been paid.

   iii. *Participating Cumulative Preference Shares* - This class of shareholders is entitled to participate in the residual profit of a firm in addition to the cumulative fixed dividend rate (i.e. they combine the features of cumulative and participating).

iv. *Redeemable and Non-Redeemable/Irredeemable Preference Shares* - Preference shares could be redeemable or irredeemable. Redeemable preference shares are normally redeemed after a fixed period of time. We can say that this class of preference shares has a definite maturity period while irredeemable preference shares do not have definite maturity period (but it could be sold at the security market – an artificial maturity

v. *Convertible Preference Shares* - Convertible preference shares convey upon the holders the right to convert these shares into equity shares in accordance with the terms of issues. This is an issue with speculative features. These shares are corporate fixed-income securities that the investor can choose to turn into a certain number of shares of the company's ordinary shares after a predetermined time span or on a specific date. The fixed income component offers a steady income stream and some protection of the investors' capital. However, the option to convert these securities into stock gives the investor the opportunity to gain from a rise in share price. It can be summarized that convertible preference shares give the assurance of a fixed rate of return plus the opportunity for capital appreciation.

Some of the advantages of preference shares are:

i. Dividends do not have to be paid in a year in which profits are poor, while this is not the case with interest payments on long term debt (loans or debentures).

ii. Since they do not carry voting rights, preference shares avoid diluting the control of existing shareholders while an issue of equity shares would not.

iii. Unless they are redeemable, issuing preference shares will lower the company's gearing. Redeemable preference shares are normally treated as debt when gearing is calculated.

iv. The issue of preference shares does not restrict the company's borrowing power, at least in the sense that preference share capital is not secured against assets in the business.

v. The non-payment of dividend does not give the preference shareholders the right to appoint a receiver, a right which is normally given to debenture holders.

However, dividend payments on preference shares are not tax deductible in the way that interest payments on debt are. Furthermore, for preference shares to be attractive to investors, the level of payment needs to be higher than for interest on debt to compensate for the additional risks.

Preference shares are less attractive than loan stock because:

i. They cannot be secured on the company's assets.

ii. The dividend yield traditionally offered on preference dividends has been much too low to provide an attractive investment compared with the interest yields on loan stock in view of the additional risk involved.

3. **Loan Stocks:** Loan stock is long-term debt capital raised by a company for which interest is paid, usually half yearly and at a fixed rate. Holders of loan stock are therefore long-term creditors of the company. Loan stocks has a nominal value, which is the debt owed by the company, and interest is paid at a stated "coupon yield" on this amount. For example, if a company issues 10% loan stocky the coupon yield will be 10% of the nominal value of the stock, so that N100 of stock will receive N10 interest each year. The rate quoted is the gross rate, before tax. Debentures are a form of loan stock, legally defined as the written acknowledgement of a debt incurred by a company, normally containing provisions about the payment of interest and the eventual repayment of capital. Loan stocks and debentures are usually redeemable. They are issued for a term of ten years or more, and perhaps 25 to 30 years. At the end of this period, they will "mature" and become redeemable (at par or possibly at a value above par). Loan stock and debentures will often be secured. Security may take the form of either a fixed charge or a floating charge.

   a) *Fixed charge*: Security would be related to a specific asset or group of assets, typically land and buildings. The company would be unable to dispose of the asset without providing a substitute asset for security, or without the lender's consent.

   b) *Floating charge*: With a floating charge on certain assets of the company (for example, stocks and debtors), the lender's security in the event of a default payment is whatever assets of the appropriate class the company then owns (provided that another lender does not have a prior charge on the assets). The company would be able, however, to dispose of its assets as it chose until a default took place. In the event of a default, the lender would probably appoint a receiver to run the company rather than lay claim to a particular asset.

4. **Lease Financing:** This is an important source of long-term funds. It is an agreement between two parties, the "lessor" and the "lessee". The lessor owns a capital asset, but allows the lessee to use it. The lessee makes payments under the terms of the lease to the lessor, for a specified period of time. It may be used as a source of financing company expansion or for modernization of the productive apparatus of the firm. Thus, through leasing, a company may make use of equipment without actually owning it. The main objective of leasing is to put at the disposal of a firm a plant or any fixed asset which serve the productive need of such a firm. The firm, in making use of that equipment, is obliged to pay to the lessor adequate sum of money which constitutes cost on the part of the firm. There are two basic forms of lease: "operating leases" and "finance leases".

   1. *Operating Lease*: Operating lease is a rental agreement between the lessor and the lessee whereby:
      a) The lessor supplies the equipment to the lessee;

b) The lessor is responsible for servicing and maintaining the leased equipment;

c) The period of the lease is fairly short, less than the economic life of the asset, so that at the end of the lease agreement, the lessor can either;
   - Lease the equipment to someone else, and obtain a good rent for it, or
   - Sell the equipment secondhand.

2. *Finance lease*: A finance lease is a lease agreement between the user of the leased asset (the lessee) and a provider of finance (the lessor) for most, or all, of the asset's expected useful life. Other important characteristics of a finance lease are:

   i. The lessee is responsible for the upkeep, servicing and maintenance of the asset. The lessor is not involved in this at all.

   ii. The lease has a primary period, which covers all or most of the economic life of the asset. At the end of the lease, the lessor would not be able to lease the asset to someone else, as the asset would be worn out. The lessor must, therefore, ensure that the lease payments during the primary period pay for the full cost of the asset as well as providing the lessor with a suitable return on his investment.

   iii. It is usual at the end of the primary lease period to allow the lessee to continue to lease the asset for an indefinite secondary period, in return for a very low nominal rent. Alternatively, the lessee might be allowed to sell the asset on the lessor's behalf (since the lessor is the owner) and to keep most of the sale proceeds, paying only a small percentage (perhaps 10%) to the lessor.

5. **Bonds:** Bonds may be used to raise financing for a specific activity. They are a special type of debt financing because the debt instrument is issued by the company. Bonds are different from other debt financing instruments because the company specifies the interest rate and when the company will pay back the principal (maturity date). Also, the company does not have to make any payments on the principal (and may not make any interest payments) until the specified maturity date. The price paid for the bond at the time it is issued is called its face value.

   When a company issues a bond it guarantees to pay back the principal (face value) plus interest. From a financing perspective, issuing a bond offers the company the opportunity to access financing without having to pay it back until it has successfully applied the funds. The risk for the investor is that the company will default or go bankrupt before the maturity date. However, because bonds are a debt instrument, they are ahead of equity holders for company assets.

4.0 CONCLUSION

A firm can source for funds to finance its activities. These sources could be short-term or long-term, and the funds so acquired are used in turn to acquire assets. Both short and long term sources of funds have their own advantages and disadvantages and degrees of risk attached.

5.0 SUMMARY

In this unit, we have been able to classify the sources of finance for a firm, enumerate and discuss the various short-term and long-term sources of finance available to firms in Nigeria.

In the next unit, we shall examine the non-financial services offered by microfinance banks in Nigeria.

6.0 TUTOR-MARKED ASSIGNMENT

1. List three long-term sources of finance for a firm.
2. List and explain six short-term sources of finance for a firm or business.
3. Discuss the various types of Preference shares.
4. What is Lease financing? Discuss the types of Lease financing

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UNIT 4 MICROFINANCE NON-FINANCIAL SERVICES

CONTENTS

1.0 INTRODUCTION

In the last unit, we classified the sources of finance for a firm, enumerated and discussed the various short-term and long-term sources of finance available to firms in Nigeria.

In this unit, we shall examine the non-financial services offered by microfinance banks in Nigeria.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Explain Integrated Microfinance programme;
- Describe the three models of integration of non-financial services with microfinance;
- Enumerate the number of factors explaining why MFIs are proposing non-financial services with regards to portfolio quality.

3.0 MAIN CONTENT

Traditionally, poverty has been conceptualized in terms of income, with the poor defined as anybody living below a given income level. But, poverty is now being increasingly recognised as a multidimensional phenomenon that encompasses not simply low income, but also lack of assets, skills, resources, opportunities, services, and the power to influence decisions that can affect an individual's daily life. By providing small loans and savings facilities to people who are excluded from commercial financial services, microfinance has become a strategy for reducing poverty. Access to credit and deposit services is a way to provide poor women and men with opportunities to take an active role in their respective economies through entrepreneurship and building income, bargaining power, and social empowerment.

With the seeming success of microfinancing, a clarion call has been made that microfinance banks are not complete without integrating non-financial services along with the financial services. A lot of non-financial services exist in the microfinance industry which includes: business education also known as financial intelligence, health education where people are encouraged to at least check for vital signs, pre-loan training, group membership and cross guarantee ship.

3.1 Microfinance Services

Like many other development instruments, microfinance has generated various debates about its capacity to fight poverty. Many practitioners argue that microfinance per se needs to be combined with other actions to effectively improve the living conditions of its beneficiaries. That is, Microfinance institutions should provide both financial and non-financial services. Based on this principle, a number of microfinance institutions (MFIs) with a strong pro-poor positioning promoted the idea of comprehensive microfinance services (Hickson, 1999).

3.1.1 Financial Services

Under this approach, MFIs provide beneficiaries with financial services (credit, savings, insurance). CBN (2012) listed the following as services an MFB shall be allowed to engage in to its clients:

a. Acceptance of various types of deposits including savings, time, target and demand from individuals, groups and associations; except public sector deposits;
b. Provision of credit to its customers, including formal and informal self-help groups, individuals and associations;
c. Issuance of redeemable debentures to interested parties to raise funds from members of the public with the prior approval of the CBN;
d. Collection of money or proceeds of banking instruments on behalf of its customers including clearing of cheques through correspondent banks;
e. Act as agent for the provision of mobile banking and micro insurance services to its clients.
f. Provision of payment services such as salary, gratuity, pension for employees of the various tiers of government;
g. Provision of loan disbursement services for the delivery of the credit programme of government, agencies, groups and individual for poverty alleviation on non-recourse basis;
h. Provision of ancillary banking services to its customers such as domestic remittance of funds and safe custody;
i. Maintenance and operation of various types of account with other banks in Nigeria;
j. Investment of its surplus funds in suitable instruments including placing such funds with correspondent banks and in Treasury Bills;
k. Pay and receive interests as may be agreed upon between the MFB and its clients in accordance with existing guidelines;
l. Operation of micro leasing facilities, microfinance related hire purchase and arrangement of consortium lending as well as supervision of credit schemes to ensure access of microfinance customers to inputs for their economic activities;

m. Receiving of refinancing or other funds from CBN and other sources, private or public, on terms mutually acceptable to both the provider of the funds and the recipient MFBs;
n. Provision of microfinance related guarantees for its customers to enable them have better access to credit and other resources;
o. Buying, selling and supplying industrial and agricultural inputs, livestock, machinery and industrial raw materials to low-income persons on credit and to act as agent for any association for the sale of such goods or livestock;
p. Investment in shares or equity of a body corporate, the objective of which is to provide microfinance services to low-income persons;
q. Investment in cottage industries and income generating projects for low-income persons as may be prescribed by the CBN;
r. Provision of services and facilities to customers to hedge various risks relating to microfinance activities;
s. Mobilize and provide financial and technical assistance and training to micro-enterprises;
t. Provision of loans to microfinance clients for home improvement, housing microfinance and consumer credits; and

3.1.2 Non-financial Services (primarily education, but also health services, practical training, and technical assistance)

These aim at improving the borrowers' capacities to develop sustainable income-generating activities. Organizations and projects that typically share a broader mission of poverty alleviation and offer services that include microfinance or microenterprise development among many other activities. Since these organizations use an integrated approach to poverty alleviation, microfinance is just one of a package of services - their activities are less bound by the rigid financial sustainability criteria that govern most MFIs (Flores and Serres, 2009). Other non-financial services that can be provided by MFIs include the following as stipulated by CBN (2012).
a. Promotion and monitoring of loan usage among its customers by providing ancillary capacity building in areas such as record keeping and small business management;
b. Provision of professional advice to low-income persons regarding investments in small businesses; rendering managerial, marketing, technical and administrative advice to customers and assisting them in obtaining services in such fields;
c. Provision of technical services and training to microenterprises;
d. Performance of non-banking functions that relate to microfinance business development services such as co-operatives and group formation activities, rural industrialization and other support services needed by micro enterprises.

3.2 Integrated Microfinance Programme

In many cases, microfinance practitioners have not limited their activities to the financial arena. They have been implementing integrated programs where microcredit is linked to education, health, nutrition and other non-financial services (NFS). Delivered in conjunction with microfinance products, these programs are widely heterogeneous. A simplified categorization classifies them in social related services which include, among others, health education, maternal and child healthcare, literacy, language training, legal advice and different kinds of personal mentoring, and micro-entrepreneurial development services, involving financial, business or technical skills training. Practitioners with strong pro-poor positioning, mostly operating group lending methodologies, such as ProMujer, FINCA (Foundation for International Community Assistance) or BRAC (Bangladesh Rural Advancement Committee) have been implementing successful integrated programs where credit is linked to education and other non-financial services (NFS) for the past few decades (Biosca, Lenton and Mosley, 2011).

3.2.1 Models of Integration

There are three main models of integration of non-financial services with microfinance, leading to different results in terms of performance and management: the linked, the parallel and the unified models.

1. The linked model: services are provided by two independent organizations. The MFI does not directly provide non-financial services but establishes a partnership with another entity to do so. This may be very appropriate for schemes including specialized non-financial skills that cannot be found within the MFI, like health services or technical assistance for agriculture. This model also allows to know the exact cost of non-financial services and to decide how to better handle it. However, one of its weaknesses is that the MFI has little control on the quality of its partner's services.

2. The parallel model: often applied by multiservice organizations, as opposed to fully-fledged MFIs. Here, financial and non-financial services are offered by the same organization under different programs and are managed by separate, specialized personnel who share the same brand. For example, FUNDAP in Guatemala, or Interactuar in Colombia, have strong training and microcredit programs, provided by different departments to clients who are not necessarily beneficiaries of both services. This model allows to employ specialized staff and to have direct control on each program. However, managing each program separately generates a significant financial and administrative burden on the organization. Also, the comprehensive approach is not really implemented since financial and non-financial services are offered to different beneficiaries.

3. The unified model: seeks complementarity between financial and non-financial services by embedding them in a hybrid product to be provided by the same staff. In this scheme, unlike the two other models, non-financial services are generally compulsory for the beneficiary of financial services. Services usually involve education activities, which occur during regular group meetings. A well-known example is the Credit with Education model developed by Freedom From Hunger1. It is based upon a village banking methodology, whereby groups of 15 to 25 women meet every week to receive financial services from a loan officer, who then gives a 10 to 20 minutes education session on issues such as health, nutrition, business and financial literacy. If well integrated, this model can be cheaper for MFIs than the two

others: apart from management costs (for training materials, training of trainers, etc.) it only requires extra time at the end of each meeting. However, measuring this extra cost is challenging, since all services are provided by the same staff.

3.2.2 Factors for proposing Integrated Microfinance programme

With regards to portfolio quality, a number of factors explain why MFIs proposing non-financial services show relatively good results:

- Portfolio monitoring is very tight, involving regular weekly or bi-weekly meetings with the loan officers, during which both financial and non-financial services are rendered
- Eligibility for credit services of each borrower is based on community selection. Peer pressure is exercised all along the credit cycle to ensure repayments, and in some cases it can lead to the exclusion of defaulting borrowers.
- Health, business and financial education services improve the living conditions of clients, hence their capacity to repay loans and access other financial services
- Non-financial services can lead to increased loyalty of clients.

4.0 CONCLUSION

Overall, this unit suggests that implementing non-financial services along with typical microfinance services is possible and can even lead to sustainability, good portfolio quality, while achieving the primary goal of fighting against poverty. Choosing the right delivery model, integrating it in the most cost-effective way with financial products, adjusting pricing and training staff are prerequisites for a successful comprehensive scheme. All MFIs may not be interested in developing non-financial products. But those which support this approach have a legitimate reason to do it as long as they respect some basic implementation rules.

5.0 SUMMARY

In this unit, the different types of services rendered by Microfinance banks were discussed with emphasis on non-financial services. The Integrated Microfinance programme was also discussed pointing out the models of integration and factors to consider in proposing the Integrated Microfinance programme.

In the next unit, we shall discuss an overview of government financial assistance for small and medium enterprises in Nigeria.

6.0 TUTOR-MARKED ASSIGNMENT

1. With regards to portfolio quality, mention the factors that explain why MFIs proposing non-financial services show relatively good results.
2. From your own perspective, mention and explain non-financial services that will be useful to microfinance clients in Nigeria.
3. Explain microfinance services available in microfinance banks.

4. List the financial and non-financial services provided by MFBs
5. Differentiate between the three models of integration

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UNIT 5 AN OVERVIEW OF GOVERNMENT FINANCIAL ASSISTANCE FOR SMALL AND MEDIUM ENTERPRISES

CONTENTS

1.0 INTRODUCTION

In this unit, the different types of services rendered by Microfinance banks were discussed with emphasis on non-financial services. The Integrated Microfinance programme was also discussed pointing out the models of integration and factors to consider in proposing the Integrated Microfinance programme.

In the next unit, we shall discuss an overview of government financial assistance for small and medium enterprises in Nigeria.

2.0 OBJECTIVES

After studying this unit, you should be able to:

i. State the objectives of the Fund;
ii. Outline the activities to be covered under the intervention fund;
iii. Outline the types of facilities available under the intervention fund;
iv. State the criteria for eligibility of borrowers

3.0 MAIN CONTENT

The high rate of unemployment in Nigeria has continuously posed a problem to the increasing number of graduates who seek for white collar jobs. Touring the route of entrepreneurship seem to be the way out of such economic strangulation. However, starting or growing a small business can be very challenging. Even though experts generally agree that finance is not the biggest problem facing Nigerian Entrepreneurs, many of them still believe that it still ranks among the first five. So, it is normal for small businesses to solicit for all the help they can find, especially if it comes from the government.

Unfortunately, many small businesses seeking for government's support become confused by the vast array of initiatives and eventually give up looking for help.

3.1 Finance of Small and Medium Enterprises (SMEs)

SMEs are critical to the development of any economy as they possess great potentials for employment generation, improvement of local technology, output diversification, development of indigenous entrepreneurship and forward integration with large-scale industries. In Nigeria, there has been gross under performance of the SMEs sub-sector and this has undermined its contribution to economic growth and development. The key issues affecting the SMEs in Nigeria can be grouped into four namely: unfriendly business environment; poor funding; low managerial skills and lack of access to modern technology (FSS 2020 SME Sector Report, 2007).

Among these, shortage of finance occupies a very central position. Globally, commercial banks which remain the biggest source of funds to SMEs have in most cases, shied way because of the perceived risks and uncertainties. In Nigeria, the fragile economic environment and absence of requisite infrastructure has rendered SME practice costly and inefficient, thereby worsening their credit competitiveness.

To improve access to finance by SMEs, the Central Bank of Nigeria has approved the investment of the sum of N500 billion debenture stock to be issued by the Bank of Industry (BOI) with effect from May, 2010. In the first instance, the sum of N300 billion will be applied to power projects and N200 billion to the refinancing/restructuring of banks existing loan portfolios to Nigerian SME/manufacturing sector.

3.2 The Objectives of the Fund

The objectives of the fund are to:

1. Fast-track the development of the manufacturing sector of the Nigerian economy by improving access to credit to manufacturers;
2. Improve the financial position of the Deposit Money Banks;
3. Increase output, generate employment, diversify the revenue base, increase foreign exchange earnings and provide inputs for the industrial sector on sustainable basis.

3.3 Activities to be covered under the Fund

The activities to be covered under the fund are manufacturing activities. Any entity is adjudged to be a "Manufacturer" if it:

1. Is involved in the production and processing of tangible goods;

2. Fabricates, deploys plants, machinery or equipment to deliver goods or provide infrastructure to facilitate economic activities in the real sector; and

3. Does not involve in the financial services industry.

The manufactures include Small and Medium Scale Enterprises defined as an entities with an asset base (excluding land) of between N5 million to N500 million with labour force between eleven (11) to three hundred (300) persons. Trading activities are not covered by the fund.

3.4 Types of Facilities available under the Fund

The facilities available under the fund are:

(i) Long term loan for acquisition of plant and machinery;
(ii) Refinancing of existing loans;
(iii) Resuscitation of ailing industries;
(iv) Refinancing of existing lease;
(v) Working capital

3.5 Criteria for Eligible Borrowers

For any borrower to be eligible for this facility, the following criteria must be met:
(i) Any entity falling within the definition of an SME and/or manufacturer;

(ii) An entity wholly-owned and managed by Nigeria private limited company registered under the Companies and Allied Matters Act of 1990;

(iii) A legal business operated as a sole proprietorship;

(iv) Be a member of the relevant Organised Private Sector Associations such as Manufacturers' Association of Nigeria (MAN), National Association of Small and Medium Scale Enterprises (NASME), National Association of Chambers of Commerce, Industry, Mines and Agriculture (NACCIMA), National Association of Small Scale Industry (NASSI) etc.

(v) Any entity as defined above with an existing facility on the books of the participating banks. Participating banks are all the deposit money bank and development finance institutions excluding the Bank of Industry.

4.0 CONCLUSION

Obtaining government funding for your small business is extremely hard unless you happen to perfectly fit a narrow niche. After all, it wouldn't make good sense if the government started funding private ventures - which are practically gambling - with taxpayer money. It's due to this stigma that the government will only fund businesses which are deemed productive to a community, and sharing some similar characteristics with non-profit organizations.

5.0 SUMMARY

In this unit, we discussed government financial assistance for small and medium enterprises. To improve access to finance by SMEs, the Central Bank of Nigeria has approved the investment of the sum of N500 billion debenture stocks to be issued by the Bank of Industry (BOI) with effect from May, 2010. In the first instance, the sum of N300 billion will be applied to power projects and N200 billion to the refinancing/restructuring of banks existing loan portfolios to Nigerian SME/manufacturing sector. Hence, in this unit, we discussed the objectives of the fund, activities covered under the fund, types of facilities available under the fund, and the criteria for eligible borrower.

By this development, we have come to the end of the first module of this course.

6.0 TUTOR MARKED ASSIGNMENT (TMA)

1. What are the objectives of the N200 billion Intervention Fund for Re-financing and Restructuring of Bank's Loan to Nigeria SMEs?

2. Outline the criteria for eligible borrowers of the N200 billion Intervention Fund for Re-financing and Restructuring of Bank's Loan to Nigeria SMEs.

7.0 REFERENCES/FURTHER READING

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MODULE 2 PROCEDURES FOR ACCESSING FINANCE BY SMALL AND MEDIUM SCALE ENTERPRISES

Welcome to the second module of this course. This module has the following units for your study:

UNIT 1 THE PROCEDURE FOR ACCESSING GOVERNMENT FINANCIAL ASSISTANCE FOR SMALL AND MEDIUM ENTERPRISES

CONTENTS

1.0 INTRODUCTION

Welcome to the first unit of the second module of this course.

In this unit, we shall discuss the procedures for accessing government financial assistance for small and medium scale enterprises.

2.0 OBJECTIVES

After studying this unit, the student should be able to:

(i) Enumerate the procedure for refinancing and restructuring of the fund;
(ii) Outline the guideline for verifying and monitoring projects; and
(iii) State the responsibilities of various stakeholders in the administration of the fund.

3.0 MAIN CONTENT

Government funds are not gifts given to people without meeting certain laid out conditions. A lot of people are excited when they hear of the availability of government's fund. This is because sometimes, there is the subconscious notion that government funds are mere share of national cake. Consequently, some people do not give it the required commitment and sincerity in paying back the loan or using the fund for what it is expected to be used for. Therefore, there must be a laid down procedure that would protect the fund from being abused. In this chapter, we shall be discussing the procedure put in place by the Federal Government of Nigeria to manage the N200 billion intervention fund for re-financing and restructuring of banks' loans to Small and Medium Enterprises.

3.1 Mechanism for Refinancing/Restructuring for the Fund

According to the provision of the guideline on the N200 billion intervention fund for restructuring/refinancing of banks' loan to Nigeria SMEs, the procedure for accessing the loan by banks are listed below:

1. The process starts by Bank of Industry (BOI) sending out notice to all Deposit Money Banks (DMBs) and Development Finance Institutions (DFIs) for submission of refinancing/restructuring requests.

2. Banks are required to submit requests in the prescribed format within 14days of the notice from BOI.

3. Each request must be accompanied by the following documents:

   (a) Request from the customer seeking for such refinancing and/or restructuring;
   (b) Latest financials of the obligor (management accounts will be acceptable in lieu of updated accounts);
   (c) Copies of duly executed offer documents between the bank and the loan obligor evidencing existence of a facility;
   (d) 6 months account statements showing the current exposure;
   (e) An abridged business plan or feasibility study of the underlying project for which the facility was initially approved. The plan must include the projects cash flow projections detailing the repayment schedule;
   (f) Certificate of Incorporation evidencing the incorporation of the Company with the Corporate Affairs Commission; and
   (g) A letter of commitment indicating that the requesting bank shall on or before 31st December 2010, book new loans to the manufacturing / SME sectors in an amount not less than50% of the amount accessed under the Fund.

4. All applications for refinancing/restructuring facilities can be made directly or by way of syndication, club arrangement or any other means involving two (2) or more banks on the books of a bank.

5. Within 7days of the receipt of the banks' requests, BOI shall inform the banks of the status of their application and also advice each bank of the amount of its facility that shall be refinanced / restructured under the Fund.

6. An on-lending agreement shall be signed between BOI and each bank at this time.

7. Within receipt of funds from the CBN, BOI shall require each bank, to pledge securities with face value of not less than 100% of its specified refinanced amount to BOI through the Discount office of the CBN. Eligible securities shall include the following:
   i. Nigerian Treasury Bills;
   ii. Federal Government of Nigeria Bonds;
   iii. Other Bonds Backed by the guarantee of the Federal Government; and
   iv. Any other securities acceptable to the Central Bank Nigeria.

8. BOI shall within 24hours of receipt of the pledge (vide a pledge writer duly acknowledged by the discount office), credit each bank with the amount allocated to them – and not exceeding the face value of government instruments pledged.

9. The recipient banks are expected to apply the funds by restructuring and/or refinancing the stated accounts in line with the terms and conditions of their requests (especially as it relates to tenor and interest rates) within 48hours of receipt of funds from BOI.

10. In the event a bank fails to meet its obligations, the BOI shall give 30daysnotice of its intention to liquidate the securities.

11. As a result of pledging of securities for this fund, the following prudential treatment shall be accorded throughout the tenor of the loan.
   i. The amount disbursed shall be treated as a Term Loan.
   ii. The Term Loan shall not form part of the bank's deposit liabilities for the purpose of liquidity and cash reserve ratio computations.
   iii. The Term Loan shall not be liable for NDIC premium charges.
   iv. The securities pledged shall continue to count as part of the bank's liquid assets for the purpose of Liquidity Ratio Computation.

3.2 Verification/Monitoring of Projects

The guideline requires the projects to be verified and monitored according to the following procedure:

(i) Projects under the Fund shall be subject to verification by the BOI. Acceptance or rejection of an application for refinancing/restructuring by the BOI shall be communicated to the Participating Banks and the borrower within 14 working days after verification.

(ii) The project shall be subject to monitoring by the Bank of Industry, the Central Bank of Nigeria and the Participating Bank during the loan period.

(iii) The BOI has the right to reject a request from any Participating bank that contravenes any section of the Guidelines.

3.3 Responsibilities of Stakeholders

For the effective implementation of the Fund and for it to achieve the desired objectives, the responsibilities of the stakeholders shall include:

a. The Central Bank of Nigeria (CBN)

The CBN shall:

(i) Articulate clear guidelines for the implementation of the Fund;
(ii) Provide Fund for the Intervention;
(iii) Determine the limits of the Fund;
(iv) Specify the rate at which BOI and Participating Banks will lend under the Fund;
(v) Carry out verification/monitoring of projects under the Fund;
(vi) Monitor the implementation of the Fund and publish periodic reports on its performance;
(vii) Request BOI to render periodic returns as may be specified from time to time;
(viii) Build capacity of stakeholders;
(ix) Review the Fund guidelines as may be necessary from time to time

b. The Organised Private Sector Associations (for example MAN, NASME, etc)

The Organised Private Sector Associations shall:

i. Accredit would-be beneficiaries of the Fund;
ii. Ensure prompt repayment of loans by members;

c. Bank of Industry

The BOI shall:

i. Issue debenture covering the funds to be invested by the CBN;
ii. Lend the proceeds of debenture to Participating Banks at 1%;
iii. Put in place appropriate institutional arrangements for disbursing, monitoring and recovering the amount obtained under the Fund;
iv. Render periodic returns on the participation of Banks under the Fund to the Central Bank of Nigeria

d. The Participating Banks (PB[s])

The PB(s) shall:

i. Grant credit facilities to Manufacturers at a rate of 7% p.a.;

ii. Approve requests under the Fund based on normal business consideration and exercising appropriate due diligence;
iii. Render periodic returns under the Fund as may be specified by the CBN and BOI from time to time;
iv. Monitor the projects during the loan period.
v. Collaborate with Organised Private Sector Associations to ensure efficient utilization and prompt repayment of funds; and
vi. Comply with the guidelines of the Fund.

e. Borrower

The borrower shall:

i. Utilise the funds for the purpose for which it was granted;
ii. Insure the project being financed;
iii. Adhere strictly to the terms and conditions of the Fund;
iv. Make the project and records available for inspection/verification bythe CBN and BOI.
v. Comply with the guidelines of the Fund.

4.0 CONCLUSION

There cannot be any form of economic growth in any country if the citizenry are not ready to make effort in creating progressive economic activities. The issue of unemployment cannot be tackled if there are no increasing viable economic organisations that would minimize the rate of unemployment to the barest minimum. It is the responsibility of the private sector to embark on various viable ventures that would build the economy strength of the country while the role of the government is to provide necessary condition that would ensure the success of small and medium enterprises.

5.0 SUMMARY

In this unit, we discussed the procedure for accessing government financial support for small and medium enterprises. We discussed the mechanism for Refinancing/ Restructuring of the Fund, Verification and Monitoring of Projects, and the Responsibilities of Stakeholders in the administration of the fund.

In the next unit, we shall be examining an important unit whose title is: Financial analysis of small business income and repayment of capital.

6.0 TUTOR MARKED ASSIGNMENT

1. State the responsibilities of the Central Bank of Nigeria and Bank of Industry in administration of the N200 billion intervention fund for re-financing and restructuring of banks' loans to Small and Medium Enterprises.

2. List the documents that are required to be attached to the request application form from the banks.

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UNIT 2 FINANCIAL ANALYSIS OF SMALL BUSINESS INCOME REPAYMENT OF CAPITAL

CONTENTS

1.0 INTRODUCTION

In the last unit, we discussed the procedure for accessing government financial support for small and medium enterprises. We discussed the mechanism for Refinancing/ Restructuring of the Fund, Verification and Monitoring of Projects, and the Responsibilities of Stakeholders in the administration of the fund.

In this unit, we shall examine an important unit whose title is: Financial analysis of small business income and repayment of capital. This discussion will lead to explanation of financial performance, concept of financial ratio and different types of financial ratios.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Explain financial performance
- Discuss the concept of financial ratio
- Identify and explain different types of financial ratios

3.0 MAIN CONTENT

In the financial analysis of the income of small business, some financial ratios are to be employed because financial analysis measures financial performance of such business based on relevant information obtained from past operations. Basically, there are numerous ratios that can be employed to measure the performance of the small business in relation to the income from operations. Hence, prospects of the future loan repayment by the small business can be determined through the measurement and analysis of the performance such quantitative approach. The figures (or values) that are normally used in calculating financial ratios are derived from income statement, balance sheet, and statement of cash flows. In this study unit, therefore, we shall discuss the relevant ratios that can be derived from the income of small business with which to assess the repayment of loans and advances being used to run the operations.

3.1 Conceptualization of Financial Performance

The Business Dictionary (2017) states that financial performance portrays the results of a firm’s policies and operations in monetary terms, and such results are reflected in the firm's return on investment and return on assets, among others.

Financial performance involves the degree to which financial objectives are being or have been accomplished. Essentially, it constitutes an important aspect of **financial risk management**. The financial performance is also regarded as a process of measuring the outcomes (or results) of a firm's policies and operations embedded in monetary terms. Therefore, it involves the measurement of firm's overall financial strength over some years, which can also be employed to compare similar firms across the same industry or to compare industries or sectors in aggregation (Eshna, 2012).

In most cases, firms and their managers, shareholders, creditors, and tax authorities are always interested in the financial health of the firm. And the financial performance which portrays the results of a firm's policies and operations in monetary terms in terms of the firm's return on investment and return on assets is very useful to such stakeholders of the firm.

In essence, financial analysis involves the use of financial statements in getting clearer picture of the firm’s performance. This involves the use of a financial statement, which is a collection of data as organized on the basis of logical and consistent accounting procedures. The essence is to convey an understanding of some financial aspects of a business firm. In the case of balance sheet, it shows the firm’s position during a given period of time, and in the case of income statement, it reveals a series of financial activities over a given period of time (Eshna, 2012).

Furthermore, financial performance analysis includes analysis and interpretation of financial statements thereby undertaking full diagnosis of the profitability and financial soundness of the business. The areas of performance analysis include the firm's production and productivity performance (total business performance), profitability performance, liquidity performance, working capital performance, fixed assets performance, fund flow performance and social performance (Eshna, 2012). These are elements of performance being used financial ratios to measure.

3.2 Meaning of Financial Ratio

A financial ratio (or accounting ratio) refers to a relative magnitude calculated using two selected numerical values extracted from the financial statements of a business. The financial ratio is often used in accounting and finance in evaluating the overall financial condition of the firm. Financial ratios can be employed to assess the ability of the firm such as the small business to meet the repayment of its capital funds. Furthermore, the market price of the firm's shares is also used in calculation of some financial ratios when such shares are traded in the financial market (Groppelli and Nikbakht, 2000),

The income statement alone cannot provide all the necessary information with which to calculate the relevant ratios in measuring the financial performance of small business. We also need the statement of affairs, which is commonly known as balance sheet of the business. While the income statement shows the outcome of operations in terms of profitability, the statement of affairs exposes to us the assets and liabilities of the business.

The relevant ratios derivable from the statement of affairs, income statement and statement of cash flows of the business are usually categorized into four areas such as Activity ratios, Liquidity ratios, Solvency ratios and Profitability ratios.

3.3 Different Types of Financial Ratios

In this section of the unit, we shall discuss the relevant ratios that can be calculated in relation to the income of a business. The various ratios are identified on the basis of their respective groups.

3.3.1 Activity or Efficiency Ratios,

There are two common efficiency ratios that are calculated under this group such as follows:

a) Inventory Turnover $= \dfrac{\text{Cost of goods sold}}{\text{Inventory}}$

b) Accounts Receivables Turnover $= \dfrac{\text{Credit sales}}{\text{Accounts receivable}}$

c) Accounts Payable Turnover $= \dfrac{\text{Credit Purchases}}{\text{Average Payables}}$

d) Asset Turnover $= \dfrac{\text{Net Revenues}}{\text{Average Total Assets}}$

A high inventory turnover ratio from the company figures implies that the firm succeeds in converting its inventory into sales. And the receivables turnover ratio is used to monitor the company's outstanding credit sales. A high accounts receivable turnover means that the business is successful in collecting its outstanding credit balances. A higher turnover than the industry average means that inventory is sold at a faster rate and effective inventory management. Accounts Payables turnover measures how quickly a company pays off the money owed to suppliers. Asset turnover measures how efficiently a company uses its total assets to generate revenues.

3.3.2 Liquidity Ratios

a) Liquidity ratio/Current ratio $= \dfrac{\text{Current assets}}{\text{Current liabilities}}$

b) Quick ratio/Acid Test ratio $= \dfrac{\text{Current assets–Stock}}{\text{Current liabilities}}$

c) Cash Ratio $= \dfrac{\text{Cash And Short-Term Marketable Securities}}{\text{Current Liabilities}}$

These ratios indicate a company's ability to pay its short-term bills. A ratio of greater than one is usually a minimum because anything less than one means the company has more liabilities than assets. A high ratio indicates more of a safety cushion, which increases flexibility because some of the inventory items and receivable balances may not be easily convertible to cash. The most conservative liquidity ratio is the cash ratio. Cash and short-term marketable securities represent the most liquid assets of a firm with which payments for short claims can be met.

3.3.3 Solvency Ratios

a) Debt-to-Asset $= \dfrac{\text{Total debts}}{\text{Total assets}}$

b) Debt-to-Equity $= \dfrac{\text{Total debts}}{\text{Shareholders' Equity}}$

c) Debt-to-Capital $= \dfrac{\text{Total Debts}}{\text{Capital}}$

d) Interest Coverage Ratio $= \dfrac{\text{EBIT}}{\text{Interest Payments}}$

EBIT = Earnings before Interest and Taxes

The interest coverage ratio, also known as times interest earned, measures a company’s cash flows generated compared to its interest payments. In the case of a higher quotient from the calculation, the implication is that there a less chance that the business can fail in meeting its debt repayment obligations. It also means that the business is generating strong earnings compared to its interest obligations.

The debt-to-capital ratio is very similar, measuring the amount of a company’s total capital (liabilities plus equity) that is provided by debt (interesting bearing notes and short- and long-term debt).

The debt-to-equity ratio is the ratio of total debt to shareholders' equity. The shareholders equity is the difference between total assets and total liabilities.

The ratios measure the percentage of the total assets financed through total debts and the percentage of total debts in relative to the shareholders equity.

3.3.4 Profitability Ratios

a) Gross profit margin $= \dfrac{\text{Gross profit}}{\text{Sales}}$

b) Operating income margin $= \dfrac{\text{Operating Profits}}{\text{Sales}}$

d) Net income margin $= \dfrac{\text{Net Income}}{\text{Sales}}$

c) Return-on-Asset ratio $= \dfrac{\text{Net Income}}{\text{Total Assets}}$

d) Return-on-Investment ratio $= \dfrac{\text{Net Income}}{\text{Total Assets}}$

e) Return on Equity (ROE) $= \dfrac{\text{Net Income}}{\text{Owners Capital}}$

This ratio measures the level of income attributed to the owners in relation to the investment that shareholders put into the business. It normally accounts the total debts. Note that position of small business is not comparable to that of companies.

The gross profit is equal to sales minus cost of goods sold. The operating profit is equal to the gross profit minus operating expenses, while the net income is equal to the operating profit minus interest and taxes. The return on total assets measures a company's effectiveness in deploying its assets to generate profits. The return-on-investment ratio, which is the ratio of net income to shareholders' equity, indicates a company's ability to generate a return for its owners.

Profitability ratios indicate management's ability to convert sales dollars into profits and cash flow. The common ratios under this group include the following.

4.0 CONCLUSION

Financial performance refers to the degree to which financial objectives are being or have been accomplished, and it constitutes an important aspect of **finance risk management** in business. Such performance of a business can be determined through the calculation of financial ratios derivable from the income of operations. A financial ratio (or accounting ratio) refers to a relative magnitude calculated using two selected numerical values extracted from the financial statements of a business. The various ratios that can be calculated from income of a business include Activity ratios, Liquidity ratios, Solvency ratios and Profitability ratios.

5.0 SUMMARY

In this study unit, we have discussed issues in relation to conceptualization of financial performance, meaning of financial ratio, and different types of ratios. We also identified and explain various ratios that can be calculated from the income of a business. Such ratios have been discussed under their groupings in respect of activity or efficiency ratios, liquidity ratios, solvency ratios, and profitability ratios. In the next study unit, we shall discuss the financial analysis of small business income repayment of capital and risk management.

In the next unit, we shall consider another important unit titled: Financial Analysis of Small Business Income Repayment of Capital and Risk Management.

6.0 TUTOR-MARKED ASSIGNMENTS

1. What is financial performance?
2. Explain the concept of financial ratio.
3. Mention and explain various ratios that can be calculated from income of a business.
4. Explain the concept of financial performance.
5. Explain the concept of financial ratio.
6. Mention and explain various ratios that can be calculated from income of a business.

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UNIT 3 FINANCIAL ANALYSIS OF SMALL BUSINESS INCOME REPAYMENT OF CAPITAL AND RISK MANAGEMENT

CONTENTS

1.0 INTRODUCTION

The preceding study unit has been used to discuss how the financial ratios can be used to determine the income repayment of capital in a small business. This unit follows the discussion due to the fact that it is related to it.

In essence, this study unit is used to discuss the management of risk that may arise from the operations of the business, which can jeopardize the repayment of the capital funds of the business, especially the debt capital. In analyzing the income of a business using ratios, it exposes the risks involved in the operations of the business and the measures to put in place to forestall them. This is the focus of this study unit.

In this unit, we shall consider Financial Analysis of Small Business Income Repayment of Capital and Risk Management.

The discussion in this unit will concern definition and explanation of the concept of risk, identification and discussion of external risks of business and how financial ratio analysis can be used to manage risk affecting repayment of capital funds.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Explain the concept of risk;
- Identify and explain external risks of business;
- Discuss how financial ratio analysis can be used to manage risk affecting repayment of capital funds.

3.0 MAIN CONTENT

3.1 Conceptualization of Risk in Operation of a Business

Risk refers to the variation in respect of the outcomes of operational activities of a business, which can affect the expected results in terms of income that is necessary towards the payment of capital funds.

The impact of a risk can affect the very existence of the enterprise, its operational resources, the products and services, and the customers. The occurrence of a risk can also impact negatively on markets, the society and the environment generally (Hubbard, 2009). This implies that risk management involves instituting a mechanism in connection with planning, organizing and controlling resources and operational activities of business towards effective reduction or elimination of risk and by extension, the adverse effects of risks (Ayodele and Alabi, 2014).

3.2 Types of Risk in Business Operations

These risks are associated with the dictates of the external environment that are beyond the control of the firm. These types of risk are as identified and discussed below.

3.2.1 External Risks in Business Operations

i) Financial Risk

It is the type of risk which arises as a result of external obligations. It is associated with the possibility that the business may not have enough funds to meet its financial obligations. Such obligations include debt repayments, dividend payments, payments of taxes, settlement of financial transactions. The risk also encompasses the possibility that external sources of finance may not be available when needed.

ii) Systematic Risk

This is the type of risk that cannot be abridged or predicted in any approach. Therefore, it becomes almost impracticable to protect the business entity against it. Some examples of these risks are interest rate fluctuation, changes in government legislation, and environmental upheavals.

iii) Speculative risk

This type of risk arises as a result of committing funds in high risk investment such as funds used to speculate on oil business and capital market investment. In the case of capital market investment, some firms in the country took loans to invest in shares during the initial public offer. This was purely speculative in nature. When the bubble in the Nigerian capital market burst, the investments in shares were lost.

iv) **Exchange Rate Risk**

This type of risk arises from the fluctuations in foreign exchange rates. This can affect investment in other countries and transactions on imports and exports.

The fluctuations in foreign exchange rate, particularly a constant rise in the value of other currencies compared with the value in currency of the home country cause for home industries. The situation would erode the value of the purchasing power of the firms when related to the payment to be made for foreign supplies for production. In terms of oversea investment, in the event of exchange rate risk being high, the value of the home currency may be less than the foreign currency. This may erode a significant amount of earnings of the foreign investment.

v) **Market Risk**

This type of risk is associated with the price fluctuations or volatility in the market for a firm's products or services. In the event of persistent fall in the market price for the firm's products, the expected revenue would fall and the firm might not be in a position to meet its obligations in operations.

vi) **Political Risk**

This type of risk involves the risk associated with investment of funds in another country where the political environment is unstable. The risk can crop up as a result of a major change in the political setup. It implies that the political risk or country risk as the case may be, could devalue the investment and reduce its overall return. Hence, this type of risk is usually associated with emerging or developing countries that are characterized by unstable political or economic scenarios.

3.2.2 Internal Risks in Business Operations

These risks are associated with the internal intricacies of a firm's operations. These types of risk are as identified and discussed below.

a) **Strategic Risk**

This type of risk, according to The Institute of Risk Management, is said to be future oriented and can arise when: a new competitor enters a firm's industry; two businesses in the industry merge to create a power house; the firm faces decisions about creating new products; the firm faces decisions about entering new markets; and the firm is considering the location of a disaster recovery site in relation to the main centre of operations. It is risky when the recovery site is too close to the main centre of operations due to the possibility of the two structures being consumed in an inferno. It is also problematic when the site is far away from the main centre of operations due to communication and logistic bottlenecks.

b) **Unsystematic Risk**

This type of risk is inherent in or specific to the nature of the assets. In some cases, such risks can be eliminated or guided against through a process called diversification. Some examples of this type of risk are strikes by workers and changes in management decisions.

c) Liquidity Risk
This is the type of risk which may arise from the fact that the firm may find it difficult to generate enough quanta of funds with which to meet its short-term financial obligations. The expected illiquidity position is associated with the use of obsolete items of operational equipment which may break down. Hence, the firm would not be able to compete with other firms in meeting market conditions.

d) Operational Risk
The operational risk is conceptualized as the risk of loss arising from failed processes, people and systems, as well as external events. In other words, operational risk refers to the possibility that transactions or processes can fail as a result of poor design, inadequately trained personnel and external disruptions. Operational risk also incorporates the risk of frauds and the possibility that the business can fail to meet the contractual obligations of a transaction arising from operational hiccups.

e) Compliance Risk
This type of risk arises from the possibility that the firm might not comply with laws and regulations within the jurisdictions where it operates, which could spell some enormous costs and thereby affects its fortunes. This type of risk can also arise as a result of the possibility that the firm might violate the obligations of a legally binding contract entered into in the course of business transactions. The consequences of such violation are in areas of court cases, costs of legal processes, seizure of operational equipment, etc.

f) Business Risk
This type of risk is inherent in the uncertainty of income caused by the nature of the firm's business. The uncertainty in income generation can arise from problems associated with company's products, ownership structure, composition of the board, management quality and behaviour, and market position.

3.3 Using Financial Analysis to Manage Risk of Repayment of Capital Funds in Small Business

1. *Managing the Activity or Efficiency Risk* - In the event that there is a low inventory turnover ratio from the company figures policy should be adopted to increase the conversion its inventory into sales. And policies should also be instituted manage receivables outstanding from creditors, and that inventory is sold at a faster rate for effective inventory management. Payments for credits can be deliberately delayed towards using the funds to transact other businesses. This also affects the asset turnover which should be done to ensure efficient management of the inventory to add value to the business assets.

2. *Managing the Liquidity Risk* - Since the liquidity ratios indicate the company's ability to pay its short-term bills, policies are usually put in place to ensure that all the value of current assets is geared up to be more in quantum than the current liabilities. The cash available cash balances at bank and at hand should be improved upon to ensure adequate funding of the various claims by the external parties on daily basis. Above all, more or excess current liabilities than current assets must be avoided since it is normally portrayed by the financial ratio analysis based o past income.

   This implies that maintaining a higher amount of cash balances can serve as a safety cushion, which increases flexibility because some of the inventory items and receivable balances may not be easily convertible to cash. More so, the most conservative liquidity asset of the business is the cash balance. In essence, therefore, reasonable amount of cash and short-term marketable securities (like treasury bills and treasury certificates) represent the most liquid assets of the business with which to meet payments for short claims on the business.

3. *Managing Solvency Risk* - Generally, policies are to be instituted with which to ensure that the business cash flows generated from operations are more than enough to cover the interest payments. In order to manage the solvency risk effectively, a higher quotient from calculations of relevant ratios must be maintained or ensured. This is to ensure that there a less chance that the business can fail in meeting repayment of its debt capital. It is necessary to ensure that the business is generating strong earnings compared to its interest obligations.

   Furthermore, the amount of debt capital to the total capital (debt-to-capital ratio) should be kept at minimum level so as not to jeopardize the earnings available to the owners of the business. It is also necessary for the business to be able to service and repay the debt capital with relative ease.

   The debt-to-equity ratio as the ratio of total debt to shareholders' equity should be kept at minimum level. Trying to trade in equity by using more debt capital than the shareholders equity can create structural problem for the shareholders, which should be avoided at all cost. Appropriate policies should be put in place not allow amount of debt capital to be more that 50 percent of the total capital funds of the business.

4. *Managing Profitability Risk* - In using the financial ratio analysis, the business can determine the level of income attributable to the owners in relation to the investment that shareholders put into the business. In order for this income not to be depleted by the debt capital, such external obligations must kept at minimum.

   By consciously improving on sales volume of the business through aggressive promotion, the position of gross profit will improve as well. This has the effect of improving the returns on total assets, investment, and shareholders equity generally.

4.0 CONCLUSION

Risk refers to the variation in respect of the outcomes of operational activities of a business, which can affect the expected results in terms of income that is necessary towards the payment of capital funds.

The impact of a risk can affect the very existence of the enterprise, its operational resources, the products and services, and the customers, and above all, its ability to repay the funds of the capital. Risks of business are in two types such as internal and external risks. The financial ratio analysis can be used to manage the risks inherent in the repayment of capital funds in small business.

5.0 SUMMARY

In this study unit we discussed issues such Conceptualization of Risk in Operation of a Business Types of Risk in Business Operations; External Risks in Business Operations; Internal Risks in Business Operations; and Using Financial Analysis to Manage Risk of Repayment of Capital Funds in Small Business.

In the next unit, we shall consider the unit titled: how to effectively provide micro credit.

6.0 TUTR MARKED ASSIGNMENT

1. Explain in simple terms the concept of risk in business operations.
2. Mention and discuss various external risks confronting business operations.
3. Discuss how the financial ratio analysis can be used to manage the risk of repayment of capital funds.
4. Explain in simple terms the concept of risk in business operations.
5. Mention and discuss various external risks confronting business operations.
6. Mention and discuss various internal risks confronting business operations.
7. Discuss how the financial ratio analysis can be used to manage the risk of repayment of capital funds.

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UNIT 4 HOW TO EFFECTIVELY PROVIDE MICRO-CREDIT

CONTENTS

1.0 INTRODUCTION

In our previous units, we discussed issues such Conceptualization of Risk in Operation of a Business Types of Risk in Business Operations; External Risks in Business Operations; Internal Risks in Business Operations; and Using Financial Analysis to Manage Risk of Repayment of Capital Funds in Small Business.

In this unit, we shall consider the unit titled: how to effectively provide micro credit. The discussion will centre on the provision of micro-credit targeted at difficult-to-reach clients and the poorest of the poor by informal and formal financial institutions with emphasis on the development of MFIs' activities nationwide.

The focus of this unit is to address the ways and means of channeling micro-credits to small entrepreneurs and low income household to expand and modernize their operations in an orderly and cost-effective manner. The development of microenterprises plays a crucial role for sustainable economic development. The two words microfinance and micro-credit can be used interchangeably which means provision of financial services to those living in poverty and excluded from the financial system.

Three features distinguish microfinance from other formal financial products. They are: smallness of loans and savings; absence or reduced emphasis on collateral, and simplicity of operations.

2.0 OBJECTIVES

After going through this unit, the student should be able to:

* Explain the meaning of micro-credit.
* Identify informal sources of micro-credit
* Describe the functions of microfinance institutions
* Explain the policy objectives of Microfinance Banks.
* Distinguish between financial and non-financial institutions providing micro-credit.
* Describe the role of Stakeholders in the Micro Finance landscape.
* Describe management process in micro, small and medium scale Enterprises (MSMEs).

3.0 MAIN CONTENT

From the appraisal of existing microfinance – oriented institutions in Nigeria, it has become evident that steps taken by the authority to strengthen their institutional capacity will enhance the flow of micro-credit and other financial services to Micro, Small and Medium scale Enterprises (MSMEs) operating in Nigeria. The key areas to be addressed include:

3.1 The Microfinance Policy

To ensure the effective provision of micro-credit to MSMEs especially those managed by the economically active poor and the low-income households, the specific objectives of the revised 2005 microfinance policy of government must be met.

1. Easy access to micro-credit by MSMEs by the provision of timely, diversified, affordable and dependable financial services to the rural poor.

2. Provision of micro-credit can be said to be effective when it results in increased employment opportunities, increase in productivity and household income of the active poor in the country, thereby enhancing their standard of living.

3. The promotion of synergy and mainstreaming of the informal Microfinance sub-sector into the formal financial system will enhance access and quality of micro-credits in the country.

4. The encouragement of linkage programme between microfinance institutions (MFIs), Deposit Money Banks (DMBs), Development Financial Institutions (DFIs), Donor Agencies and specialized funding institutions will enable MFIs source for wholesale funds and re-financing facilities for on-lending to their clients.

5. The elimination of gender disparity will ensure that more women can access micro-credit facility nationwide.

3.2 Informal Financial Institutions

Before the emergence of Microfinance Banks (MFBs) people who were un-served or under-served by formal financial institutions usually found succor in the informal financial institutions such as the non-governmental organization – microfinance institutions (NGO-MFIs), moneylenders, friends, relatives, credit unions, Donors etc. These informal sources of funds have helped to partially fill a critical void, in-spite of the fact that their activities were neither regulated nor supervised by the Central Bank of Nigeria. They have become key players in the Nigerian microfinance landscape and so the government can supervise them for a more effective microcredit delivery.

3.3 Microfinance Banks (MFBs)

Under Microfinance Banks, diversified, affordable and dependable financial services are given to the active poor in a timely and competitive manner. Small Enterprises, undertaken by this category of people will develop into long term sustainable entrepreneurial activities. However, for MFBs to effectively play their role, the Government must continue to revise the existing Microfinance Policy Framework to take care of the following areas.

3.3.1 Stakeholders

Increased awareness among stakeholders in the microfinance landscape of their individual and collective roles and responsibilities is importance. Stakeholders include the Government, the CBN, the Public Sector Poverty Alleviation Agencies, Donor Agencies and Development Partners. If government can set aside one (1) percent of its annual budgets at Federal, State and Local Government levels for microcredit initiatives, more number of those who hitherto were unable to have access to small loans or microcredit would be able to do so.

3.3.2 Distribution of MFBs

The spread of Microfinance banks in Nigeria are concentrated in a particular section of the country, which investors perceive to possess high volume and profitability. A deliberate policy by CBN to ensure a more even distribution of microcredit institutions will increase the volume of micro-credit to low-income clients.

3.3.3 Institutional Capacity of MFIs

The sub-optimal performance of micro-finance providers over the years has been due to incompetent management, weak internal control and lack of deposit insurance schemes. Other factors are poor corporate governance, restrictive supervisory requirement and lack of well defined operations. Once these drawbacks are addressed by the quality and size of financial services delivery will improve. There is need, therefore, for training and re-training of staff of the microfinance institutions in order to sharpen their operational knowledge and skills in micro-financing.

3.3.4 Weak Capital Base

The weak capital base of existing microfinance institutions cannot adequately provide cushion for risk of lending micro-credit to clients. Therefore, any policy framework aimed at increasing both the authorized and paid-up capital of these institutions will enable them give more micro-credit to their clients.

3.3.5 Savings Opportunity

Savings have continued to grow at a very low rate particularly in the rural areas of Nigeria. Most poor people keep their resources in kind or simply under their pillows. If their resources can be mobilized by MFIs and channeled to deficit areas of the economy, especially the rural clients, savings and micro-credit level in the economy will improve leading to adequate funds being made available for intermediation.

3.3.6 Institutional Linkages

The CBN is to work our modalities for fostering linkages between universal banks, specialized finance institutions and microfinance banks to enable the latter source for wholesale funds and re-financing facilities for on-lending to their clients. This will increase flow of micro-credit.

3.3.7 Microfinance Development Fund

As an incentive for MFBs, Microfinance Development Fund will be established by Government, CBN and other stakeholders to support the MFBs in rendering efficient financial services to their clients on a sustainable basis. The Fund shall comprise two windows: Commercial and Social.

3.4 A Few Aspects of the Management Process in MSMEs

An entrepreneur managing a small enterprise is confronted by factors that necessitate a different management approach. This means that planning, organizing, leading and control should be approached differently in a small enterprise as compared to a large one. The entrepreneur is the production factor that mobilizes the other production factors to satisfy the needs of society. Micro, Small and Medium Entrepreneurs (MSMEs) are of major importance in the development of a country. The entrepreneurially-driven small and medium sized business is the main creator of job opportunities and throughout the world, steps are being taken to promote its development. Entrepreneurs managing small businesses will need to apply the following few aspects of management process if they are to successfully manage the micro-credits or small loans extended to them by microfinance institutions on a sustainable basis.

3.4.1 Planning in small enterprises

Planning is very important in small and medium-sized enterprises, but the planning context of a small enterprise is far simpler than that of large-scale enterprises; the planning environment is smaller and usually simpler, it has few or fewer regulations to conform to, its marketing environment is easier to identify and its planning horizon is much shorter. A small business can also be far more flexible in revising and adapting plans to meet specific conditions.

3.4.2 Organizing in the small enterprise

Few entrepreneurs possess the skills necessary for the successful functioning of an enterprise. When a small business therefore begins to grow, the choice is often to appoint people to execute specialized tasks such as keeping the accounts, managing information and doing computer work, marketing, production and even human resource management. If a small enterprise contracts consultants or external specialists, however, this does not imply that the organizational design, the skills needed to help the organization succeed and the affordability of the necessary skills can simply be ignored.

3.4.3 Leading in the Small Enterprise

The entrepreneur takes initiative in establishing a small enterprise, but this does not imply that he automatically qualifies as a good leader. Entrepreneurs in small businesses should realize that their employees also have personal objectives that must be satisfied. Entrepreneurs should communicate the organization’s objectives and plans clearly to subordinates. Leaders of small businesses must realize that individuals and groups behave in a certain way and that this behavior needs to be managed if the organization is to attain its objectives. Small businesses have a particular need for management education in the area of leadership.

3.4.4 Control in the Small Enterprise

Control is another management activity that is neglected in small enterprise because of the typical entrepreneur’s aversion to systems and figures. Such people fail to see that control is simply the process in which their actions, as well as those of their employees, are evaluated in terms of their predetermined plans and objectives. In this regard, financial control is crucial, since few small entrepreneurs can afford the luxury of a second chance. Of special importance is the budget, which is not only an instrument of control but also of planning.

It is clear from the above discussion of management process that management education can significantly contribute to the functioning of the small, entrepreneurially-driven enterprise.

4.0 CONCLUSION

To ensure an effective flow of micro-credit and other financial services to clients, any effort by major stakeholders like the Government and CBN to strengthen the institutional framework of the Micro Finance Institutions (MFIs) will enhance the quality and continuous flow of micro-credit on a sustainable basis. Micro, Small and Medium Entrepreneurs (MSMEs) that emerge from the small loans or micro-credit must learn the basic rudiments of management process if the envisioned future for small business development in Nigeria is to be attained. The entrepreneurially-driven small and medium-sized business is the main creator of job opportunities and throughout the world; steps are taken to promote its development.

Finally, for micro-credit extended to MSMEs to be effective, the cardinal objectives of Government in the areas of economic empowerment of the poor, poverty alleviation, employment generation and overall growth in the economy must be substantially realized.

5.0 SUMMARY

In this unit, we considered the unit titled: how to effectively provide micro credit. The discussion centred on the provision of micro-credit targeted at difficult-to-reach clients and the poorest of the poor by informal and formal financial institutions with emphasis on the development of MFIs' activities nationwide.

In the next unit, we will discuss another important unit titled: leasing and other alternate sources of finance to small and medium scale enterprises (SMEs).

6.0 TUTOR MARKED ASSIGNMENT

1. Enumerate the key result areas that the authority must focus on to increase the flow of micro-credit to the active poor in Nigeria.
2. What are the basic rudiments of management process that Micro, Small and Medium-sized Enterprises (MSMEs) must embrace to Effectively manage micro-credit.
3. Describe the specific objectives of the revised microfinance policy.
4. Discuss the specific objectives of the Federal Government microfinance policy.
5. What must the Government do to enhance the rendering of efficient microfinance services to the rural poor?
6. Discuss a few aspects of management process in Micro, Small and Medium-size Enterprises (MSMEs).

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UNIT 5 LEASING AND OTHER ALTERNATE SOURCES OF FINANCE TO SMALL AND MEDIUM SCALE ENTERPRISES (SMEs)

CONTENTS

1.0 INTRODUCTION

In this unit, we considered the unit titled: how to effectively provide micro credit. The discussion centred on the provision of micro-credit targeted at difficult-to-reach clients and the poorest of the poor by informal and formal financial institutions with emphasis on the development of MFIs’ activities nationwide.

In this unit, we will discuss another important unit titled: leasing and other alternate sources of finance to small and medium scale enterprises (SMEs). Embarking on entrepreneurial activities as a part of running one's business in many cases requires the engagement of resources well beyond the capabilities of micro, small and medium-sized businesses. In particular this refers to financial resources and leads to the necessity to use external sources of funding. One of the options in this case is leasing, which allows the enterprise to obtain fixed assets without the necessity of making the purchase. Such a form of financing may be attractive to numerous micro, small and medium-sized companies, becoming a basis for their investment and innovative activities of an entrepreneurial character.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Understand the meaning of leasing
- Differentiate between Finance lease and operating lease
- Draw a relationship between Leasing, factoring and Hire purchase

- State the characteristics of leasing transaction
- State the important functions of leasing

3.1 What is Leasing?

Leasing is a possibility for SMEs to expand their access to short- and medium-term financing. From an economic perspective, leasing can be defined as "a contract between two parties where one party (the lessor) provides an asset for usage to another party (the lessee) for a specified period of time, in return for specified payments" (Fletcher et. al., 2005). This is also reflected in accounting-related definitions: According to the Accounting Standard IAS 17 "a lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time" (see e.g. European Commission, 2012).

Leasing is referred to as asset based financing. As lessors retain ownership of the assets they lease throughout the life of the contract, these leased assets are therefore an inherent form of collateral in such contracts (compared to traditional bank lending which will either be unsecured or make use of different types of collateral and typically not physical assets such as equipment which are inherent in leases). Conventional bank lending focuses on the loan repayment by the borrower from two sources: a primary source, the cash flow generation, and a secondary source, credit enhancements and collateral (if any). Leasing is focused on the lessee's ability to generate cash flows from the business operations to service the lease payments (Gallardo, 1997), as the lessor retains legal ownership of the asset. Hence, leasing separates the legal ownership of an asset from its economic use. Ownership of the asset may or may not pass to the customer at the end of the lease contract. Contracts, where legal ownership of the asset passes directly to the customer at the start of the agreement, are not considered to be leases.

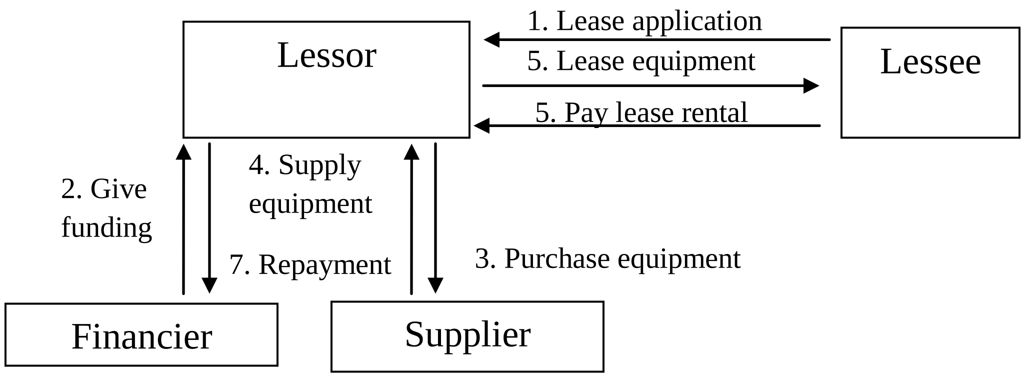
Based on contractual arrangements, the lessee is allowed to use an asset which is owned by the lessor; the lessee pays specified periodic rentals. The lessor relies on the lessee's ability to generate sufficient cash flows to pay the lease rentals (rather than to rely on the lessee's other assets or track record/credit history). Leasing enables also borrowers with limited track record / credit histories and collateral to access the use of capital equipment, often even in cases where they would not qualify for traditional commercial bank lending.

3.2 Finance Lease versus Operating Lease

In a “finance lease”, typically substantially all the risks and rewards of ownership of the asset are transferred to the lessee (while the lessor remains owner).[3] In comparison, an "operating lease" is essentially a rental contract for the temporary use of an asset by the lessee. Typically, the risks associated with the ownership of the asset (e.g. maintenance and insurance responsibilities) remain with the lessor.

Organisationally and technically, leasing companies have to be able to assess the value of the physical assets being leased in order to sell on the secondary market, or lease again the assets that have not been eventually purchased by their customer.

Figure 1: The Leasing Mechanisms



Source: Based on Izumi (2006)

3.3 Relationship between Leasing, Hire Purchase and Factoring

In many statistics, leasing is combined with hire-purchase and factoring. The term hire-purchase covers different types of contracts from country to country. In some cases, hire purchase involves the transfer of ownership of the asset at the end of the contract, either automatically or through the exercise of a purchase option. These types of hire purchase contracts are therefore leases (i.e. in the UK, Germany, Poland and the Netherlands). However, in cases where ownership transfers at the beginning of the contract, these types of contracts are closer to an installment credit contract than a lease. Factoring is typically an arrangement under which a financial intermediary (the factor) collects the debts of its client in return for a service charge in the form of discount or rebate (or to describe it the other way round: the company sells its receivables to the factor at a discount). The factor eliminates the company's risk of bad debts by taking over the responsibility of book debts due to the client.

3.4 Determinants of Choice and Market Imperfections

Before we analyse recent empirical evidence and survey results in chapter 3, we have a look at what academic literature tells us about leasing. Simply speaking, the economic rationale for the decision between leasing and purchasing is, whether the cost of ownership and operation is higher or lower than the lease rate offered by the lessor (Sloffy, 2009). Originally, finance literature assumed that mainly tax-related incentives lead to the decision of buying or leasing and that the real operating cash flows associated with leasing or buying are invariant to the contracts chosen! However the tax-argument is too single sided and cannot alone explain the strong position of leasing in many markets (Chemmanur and Van, 2000). Also non-monetary items have to be considered, i.e. the fact that leasing contracts are flexible towards customer needs (Slotty, 2009), like the variety of contractual provisions (option to cancel the lease before maturity of contract, possibility to renew for additional periods, option to buy the asset at termination, etc.) (Chemmanur and Van, 2000). Lease payments by the client can also be tailored to the cash flow generation pattern of the lessee.' However, in contrast to the purchase of an asset, leasing also means that certain expenses are due over a longer period (fixed component in P&L) without ownership of the asset.

Up-front cash down-payments (or required security deposits) in a lease contract are typically lower than the equity component in conventional bank financing (Gallardo, 1997). One of the advantages of leasing over traditional lending is the fact that a lessee can finance up to 100% of the purchase price of an asset and no additional collateral/security is needed - collateral for the transaction is provided by the asset itself. Moreover, the leased goods might be of higher quality than purchased goods - because of the distribution of payments the lessee might be able or willing to lease more expensive goods (Hendel and Lizzeri, 1998). Lasfer and Levis (1998) have found (based on a data set from the UK) that the reasons for using leasing depend on the size of the company and that in small firms the leasing decision is driven more by growth opportunities than by taxation considerations, the latter being one of the main reasons that larger companies chose leasing. The results also show that leasing allows smaller companies to survive, as small less profitable companies are more likely to lease than cash generating firms. As we show later, recent empirical evidence for Europe suggests that there is not one dominant reason for the choice of leasing, but leasing is attractive for SMEs in many diverse circumstances for different reasons.

Leasing is often seen as substitute for medium to long term credit, but the answer to the question whether leasing and debt are substitutes or complements is not trivial and has in financial literature not resulted in a clear conclusion. In traditional corporate finance the decision of buying versus leasing is mostly discussed in the context of the Modigliani and Miller (1958) world of perfect capital markets (where in general the capital structure is irrelevant for the determination of the firm value). But in real financial markets, there are market imperfections.

The reasons for a market failure relate to insufficient supply of capital (debt or equity) and inadequacies on the demand side. This market failure is mainly based on asymmetric information (in the case of debt: information gap between lender and borrower), combined with uncertainty, which causes agency problems that affect debt providers' behavior.

Information asymmetries can be reduced via three ways: a firm's ability to signal its credit worthiness (incl. on institutional assessment or rating by an independent agency and the provision of collateral), a strong relationship between lender and borrower, and through due diligence/lenders' examination (screening). However, this means on the other hand that new or young firms, with a lack of collateral and by definition without track record, are the ones with greatest degree of difficulty accessing debt capital.

Low-rated firms with poor estimated credit quality (and resulting high costs of external financing) show higher volumes of leasing than highly-rated companies since they can reduce their financing costs by means of leasing. Yan (2002) examined the impact of asymmetric information, agency costs and taxes on the substitutability of leases and debt and concluded that they are more likely to be used as substitutes by firms facing more severe asymmetric information and agency problems. It was analysed that enterprises (i.e. SMEs), for which the problem of information asymmetries are severe, lease a greater share of their assets. The analysis concluded that the "descriptive and empirical evidence seems to support the theory that firms which are more likely to suffer from problems of asymmetric information have a greater exigency to leasing". Moreover, lessee firms with higher information asymmetry rely more on lease financing; furthermore they stress that leasing mitigates underinvestment problems by enabling capital expenditures and reducing the sensitivity of investment expenditures to availability of internal funds.

This refers especially to situations of (from the bankers' perspective rational but) de facto unjustified credit rationing: the real creditworthiness of the SME can be better than the perceived quality (i.e. if a financial institution's decision to lend is based on collateral and track record, rather than the economic viability of the business. Consequently, leasing is also a tool to mitigate market weaknesses in SME lending.

3.5 To what extent do SMEs use Leasing?

SMEs finance themselves to a great extent by internal sources, both from the business owner and through retained profit. Many SMEs also use external sources of finance, informal sources (such as family and friends, and some types of business angel investment) and formal sources, such as bank loans, leasing, trade credits, factoring and more "formal" Venture Capital, which is important for a select group of high potential SMEs (EIM, 2009). Nevertheless, as mentioned above, SMEs have usually more difficulties in accessing external financing than large enterprises.

3.6 SMEs' Reasons to Use Leasing

SMEs on average have a variety of reasons for their decision to lease an asset. However, the main reason seems to be price considerations (price of leasing relative to other financing forms). The importance of different reasons for using leasing becomes clearer when looking at different SME size classes. For example, medium-sized enterprises seem to lease due to price considerations, better cashflow management and the absence of the need to provide collateral. In contrast, micro-enterprises stated tax benefits next to price considerations as main reasons to use leasing. Interestingly, the absence of collateral requirements seems to be less important for micro-enterprises than for small or medium-sized firms.

Reasons for leasing vary more over countries than over sectors. This could be due to different tax and regulatory environments. For instance, collateral considerations were most important in France and Italy, while tax benefits were mainly stated in the UK.

3.7 Characteristics of Leasing Transaction

The object of leasing may be both movable and immovable goods, and one can distinguish several common characteristics applicable to leasing transactions. These have to do with the:

- o legal ownership of the object, which is the subject of leasing, remains with the lessor for the duration of the contract
- o the period of leasing is specifically stated,
- o the lessor cannot take back the object of leasing for the duration of the contract (with the exception of the lessee not meeting their contractual obligations).

3.8 Classification of Leasing Transaction

Leasing transactions can be classified in a variety of ways, applying various criteria of division. Among the examples one can list the following.

1. The number of entities, which is the basis for division into direct leasing, indirect leasing and leaseback.
2. The duration of the contract, which is the basis for division into short-term leasing, medium-term leasing and long-term leasing.
3. The obligations of the parties involved and the parties being burdened with additional input. In this case one can distinguish net leasing and full leasing.
4. The scope of additional services, taking these into account one can distinguish wet lease and dry lease.
5. The scope in terms of territory, which allows to distinguish national and international leasing.
6. The entity financing the purchase of the good. One can distinguish manufacturer's leasing (direct) and lease by a leasing company (indirect.
7. The method of issuing foreign currency payments, allowing one to distinguish leasing in Polish zlotys and foreign currency leasing.

3.9 Important Functions of Leasing

Leasing has many important functions in the economic practice. First of all it is a financing instrument suitable for a number of investment needs of a company, with the minimum engagement of own funds and substantial, one-off investment. It supports the development of entrepreneurial attitudes and activities by increasing the flexibility of actions, innovativeness and competitiveness of the enterprise. It positively influences the financial liquidity and does not result in increase of company's liabilities, hence it does not restrict access to other forms of financing. It is also beneficial from the point of view of the balance sheet and taxes, due to the direct translation of all or part of the leasing rates to tax deductible expenses.

It is very often the case that access to leasing for micro, small and medium-sized enterprises is easier than accessing a bank credit. This stems from the fact, tithe leasing institutions needs to be provided with far less security than it is in the case of credit. Moreover leasing is very often the only possibility to finance investment by young entrepreneurs, who need financial support in their initial stages of operation as leasing companies can offer services to a business owner who has been operational for 3-6 months.

The use of leasing in practice is related to establishing_cooperation with the leasing company and preparation of required documentation however the procedures and requested documents may differ, depending on the leasing company, as well as the asset being leased and its value. What should be underlined is the fact, that the number of parties involved in the leasing transaction can differ. In extreme situations there may be two to six parties involved, depending on the type of leasing, as well as the values of the asset subject to the contract. The following parties usually participate in the execution of the leasing transaction: the funding entity (lessor), the beneficiary (lessee), the supplier of the asset being leased, the institution funding the purchase and the company insuring the transaction.

3.9.1 Stages of Lease Transaction

The first stage of the transaction is the selection of the leased asset including the price, conditions of payment and the deadline for the asset's delivery. In the next step, the necessary documents (legal and financial) must be provided to the leasing company. In most cases these are company's registration documents. In the following stages of the procedure the leasing company verifies the following:

- Authenticity of the documents provided and of the information about the lessee by cross-checking with the databases.

- The supplier and the selected asset to be leased, from the point of view of its origin, the level of suggested price, or the possibility of further resale.

Having thoroughly checked the authenticity of all the parties involved and all of the elements of the transaction it is possible to sign the lease contract. It contains: the asset subjected to lease, the duration of lease, the amount of leasing rate, the currency used in transactions, as well as the allocation of responsibilities in case of the repair of a damaged asset. The legible signatures of both parties as well as the date on which the transaction took place are also the necessary elements. When the final decision is being made as to whether or not to hand over the asset, additional conditions may be imposed, such as e.g. the necessity to provide additional security against the asset, additional documents being provided or a higher initial payment to be made. At this stage it is necessary to issue the payment of deposit against the first rate payment, which is the initial rent.

The next step is the purchase of the asset from the supplier, who issues the invoice and then sends it to the lessor, attaching all the documents necessary to transfer the ownership and execute the contract. The lessee, based on the written consent, may then receive the asset leased. A hand-over protocol is signed and the final formalities take place.

The fact that a lease contract is signed results in a number of obligations being imposed on the lessee, the most important of which is paying the leasing rates in accordance to the clauses agreed to in the contract. The payments, which must be made also include the initial payments and where necessary the so called premium resulting from the lessor's increased risk. All of these costs contribute to the total cost of leasing, which also includes initial rent and the amount to be paid to repurchase the asset. Should the lessee fall behind with the payments. the leasing company is entitled to issue a demand for payment. In case of the payments being further overdue the subject of leasing the leasing companies often suggest insurance related to their offer, which may be taken away and a demand to issue all overdue payments resulting from the contract signed may be issued. In order to make the process of collecting overdue payments more efficient, the leasing institutions create vindication departments, employees of which are very effective in collecting the debt outstanding.

The lessee is also under the obligation to use the asset properly, according to its economic purpose. Despite a significant freedom in the selection of the fixed asset, such a decision should be taken after thorough analysis as many lessors transfer onto their customers all of the rights with regards to the guarantee as well as warranty. This practice results in the fact, that in case of faulty or damaged equipment the lessee has to execute their rights directly with the manufacturer

The responsibility for selecting the asset to be leased is entirely on the lessee. In case of overdue delivery the leasing company is not to be held responsible. The case is similar when it comes to the insurance, where all of the obligations are on the lessee's side, yet in such a situation simplifies the signing of the contract and is also often quite attractive when it comes to price. Insurance to cover the leased asset is necessary as per the obligations each party has under the contract. The loss of the fixed asset does not in this case relieve one from the duty of making regular leasing rate payments, which have been agreed to in the contract.

Should one compare the procedure of applying for leasing and applying for a bank loan, some similarities can be found. Both types of contracts are signed for a specific duration, the liabilities as expressed in financial terms, and similar securities may be in place in the form of guarantee or a guarantee fund. Therefore both leasing as well as credit are often treated as alternative sources of funding for micro, small and medium-sized enterprises and in both cases the company must prove its capability to pay back. However the cooperation with a leasing company may be more beneficial, as such entities are more willing to cooperate with SME sector companies, may provide the assets quicken, and in some cases cheaper than the banks.

4.0 CONCLUSION

In this unit, we have seen that an important element of SME finance is not directly provided by banks through traditional loans but rather by leasing or factoring companies. Various surveys on access to finance show that bank loans and overdrafts are the most widespread debt financing tools for SMEs, but also those alternative sources like leasing and factoring are of high relevance. The concept of leasing is based on the assumption that profits are generated by the lessee through the use of assets, rather than from the ownership. Different to a loan there is no cash made available from a finance company to the client, but only an asset.

5.0 SUMMARY

In this unit, you have learnt the meaning of Leasing, the difference between Finance Lease and Operating Lease, the Relationship between Leasing, Hire Purchase and Factoring. You have also been taught the Determinants of Choice and Market Imperfections, the extent to which SMEs use Leasing, SMEs' Reasons for using Leasing, the Characteristics of Leasing Transaction, the Classification of Leasing Transaction as well as the Important Functions of Leasing

By this arrangement, we have come to the end of module two of this course.

6.0 TUTOR MARKED ASSIGNMENT

1. Define Leasing according to Accounting standard IAS 17
2. State three characteristics of Leasing transition

7.0 REFERENCES/FURTHER READINGS

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MODULE 3 SOURCES OF FINANCE FOR SMALL AND MEDIUM SCALE ENTERPRISES

You welcome to the third module of this course. This module consists of the following units:

UNIT 1 ALTERNATE SOURCES OF FINANCING FOR SMES

CONTENTS

1.0 INTRODUCTION

Welcome to the first unit of module three. In this unit, we shall consider sources of finance available to small and medium scale enterprises.

A number of sources of capital exist but many of them may not be accessible for companies with small and medium sizes. These sources can be grouped into two, namely: Debt and Equity groups.

2.0 OBJECTIVES

At the end of this unit, you should be able to :

- Understand the alternate sources of funding to SMEs;
- Understand the different sources of SMEs funding classified as debt;
- Understand the different sources of SMEs funding classified as Equity.

3.1 Debt

This can take the forms of assistance from friends and relatives, banks, business suppliers, etc. These are explained below.

3.1.1 Friends and Relatives

Loans and contributions from friends and relatives are common source of funds, especially for new business since the financial institutions are reluctant to providing funding for start-up business because of the risk involve. This source of funds, however, bears a potentially dangerous price. Many friends' relatives find it very difficult to stay as passive creditors or investors. They usually try to interfere with policy and operational issues. As a remedy to this problem, it is recommended that such loans be treated like bank loans by putting in writing all the terms including interest rates and payment schedule.

3.1.2 Banks

Banks be it commercial, merchant or development constitute the most widely used source of debt financing for small companies. This assertion is also supported by various scholars. Again commercial banks loans to small companies are mostly short-term loans, though some do offer long-term loans to small and medium size companies. Also commercial banks usually provide loans for working capital or for the purchase of fixed assets. They demand evidence of a company's ability to pay the interest and principal as scheduled. This evidence is usually in the form of cash flows statements. They also demand some form of security. Collaterals are the most widely used form of security demanded by commercial banks.

3.1.3 Business Suppliers

Companies can enjoy some form of credit from their business suppliers. This is a very important source of credit, especially for SMEs. The suppliers allow the company some time to pay for the supplies. The credit periods varies from a few days to several years. Credit from business suppliers may be trade credit or equipment loans and leases.

(i) ***Trade Credit***: Basically it involves the purchase of goods and services from a supplier on credit. The purchasing firm is given a few days, usually between 30 and 120 days, to settle the debt. This type of credit is very important to SMEs for a number of reasons:

    That suppliers are more flexible in dealing with SMEs than the banks. Suppliers may only check the credit standing of an SME whereas a bank is likely to demand financial statement and cash flow budgets before extending a credit facility. Generally, suppliers are very eager to add to their customers (irrespective of the size of firm) and thereby increase their sales hence they are more willing to assume greater risk.

- Suppliers are more flexible regarding adherence to terms of credit. Banks required strict adherence to loan terms and monitor borrowers more closely than suppliers do.
- The amount of trade credit granted may be readily increased just as the volume of a company's purchases increases. It may not take a lot of negotiations to make this possible. Banks are less willing to substantially increase the amount of credit they grant to customers, especially small and medium scale companies.

Trade credit, however is not cost- free. The cost associated with trade credit may not be explicit as interest on bank loans, for instance. Suppliers incur costs by supplying goods on credit and they must recover cost. They usually pass the costs on implicitly as part of the purchase price of the merchandise. Trade credit may come with an offer of cash discount. A cash discount may be quoted as 3/12 net 40. This means that the customer has 40 days to pay the full amount but can enjoy a 3 percent discount if payment is done within 12 days. Failing to take cash discount may constitute an opportunity cost of trade. In the above quote, for example, failing to utilize such discount implies borrowing the amount for 28 days (i.e. 40-12) days at 3 percent. Therefore it is important to compare the cost of forgoing a trade discount and the cost of other available short-term credit facilities before decision is made.

(ii) ***Equipment Loans and Leases:*** Many SMEs find it very difficult to raise funds for outright purchase of certain equipments and machinery. They resort to purchasing such equipment on installment basis. Payment of about 25 and 30 percent of the price of the respective equipment are usually made initially. The remainder may be amortized over 3 to 5 years. This practice is referred to as equipment loans. An alternative to this is equipment leasing. This arrangement allows firms greater investment flexibility; and smaller amounts of capital are required by the firm at any given time. However, the total cost involved in equipment leasing is usually higher than the cost of outright purchase. On the other hand, in a situation where continuous specialized maintenance and protection against obsolescence are required, leasing may be more suitable.

3.2 Equity

Equity takes the form of personal resources and other individuals known business angels. Also in this group is joint venture, venture capital, etc.

3.2.1 Personal Resources

Personal savings of the owners and partners of business constitutes an important source of funds, particularly in the formative stages of a firm. Personal contributions also help to raise additional funds from other sources.

Significant financial commitments made by owners of a company tend to build a lot of confidence among potential savings. These include borrowing, using one's personal assets such as house and bonds as collateral.

3.2.2 Other Individuals (Business Angels).

There is a category of private individuals who invest in business ventures. These individuals are referred to as 'business angels'. Many of such individual investors tend to have some experience in business and/or are affluent professionals, who may have a lot of money to invest. Business angels constitute the informal capital source. They are said to represent the informal capital because there is no formal market place where their investment transactions are carried out. They are usually contacted through dealmakers such as business associates, accountants and lawyers

3.2.3 Venture Capital

Venture capital, according to Stevenson et al (1999), is a pool of equity capital contributed by wealthy individuals, as limited partners, and professionally managed by general partners for a fee and a percentage of the gain on investments. Thus venture capital firms are investment firms. Owing to the highly risky nature of the investments they undertake, venture capitalists.

Demand very high returns on their investments, owing to their high expected returns, venture capital companies usually target companies that have prospects of rapid growth and above average profitability. The targeted companies must also have the prospects of rapid growth and above average profitability. The targeted companies must also have the prospect of going public in the foreseeable future- usually within five to seven years. Venture capital firms aim to capitalize on initial public offerings (IPOs) and cash in on their investments if prices are substantially above their initial investments in the respective companies.

Apart from the provision of capital for very promising business ventures, venture capital firms also provide useful advice to these young enterprises, having acquired much more experience in business. They also provide additional financial assistance in the future if a firm they have invested in runs into financial difficulties. It will not be considered prudent to stand aside and watch their investments go to waste with a firm for lack of cash provided throwing in more cash will not amount to reckless investment. Therefore, "future availability of funds can be an enormous boost to achieving boost to achieving long-term strategic goals".

3.2.4 Joint Venture

Various forms of strategic alliances have become important and common practice in business today. One such important form of strategic alliances is joint ventures. A joint venture typically involves two or more companies coming together to form a new entity. The main objective of joint venture formation is to gain competitive advantage and become more profitable. Combining the resources of the firms involved in a joint venture most often leads to the attainment of synergy. The new company may be able to perform a service more efficiently, produce a product at a less cost or utilize a facility or funds more effectively. This ultimately results in greater profits for the firms involved than they would have achieved as separate business entities. Financing is also a common goal of joint venture. Smaller firms in particular tend to benefit from the usually better financial positions of larger firms. In addition, joint venture stand a better chance of obtaining credit or raising more equity as creditors and investors confidence in the new firm is often greater. As a joint entity, they provide better guarantee for creditors fund as their assets base is widened.

4.0 CONCLUSION

We have seen the two broad categories of alternate sources of funding available to SMEs, these different sources of SMEs funding are classified as debt and those sources of SMEs funding known as Equity. Efforts were made to discuss each classification very extensively for easy understanding.

5.0 SUMMARY

In this unit, you have learnt that a number of sources of capital exist but many of them may not be accessible to companies of small and medium sizes. These alternate sources can be grouped into two major groups: Debt and Equity.

In this next unit, we shall consider the role small and medium scale enterprises play in the economic development of a nation.

6.0 TUTOR MARKED ASSIGNMENT

1. List the different sources of funding available to SMEs under the Equity sub group
2. What is Venture Capital, according to Stevenson et al (1999)?

7.0 REFERENCES/FURTHER READINGS

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UNIT 2 THE ROLE OF SMALL SCALE BUSINESS TO THE ECONOMY

CONTENTS

1.0 INTRODUCTION

In the last unit, you have learnt that a number of sources of capital exist but many of them may not be accessible to companies of small and medium sizes. These alternate sources can be grouped into two major groups: Debt and Equity.

In this unit, we shall consider the role small and medium scale enterprises play in the economic development of a nation.

2.0 OBJECTIVES

At the end of the study you should be able to:

1. ascertain the effectiveness of small scale manufacturing firms contribution to employment generation
2. know the extent small scale manufacturing firms are promoting entrepreneurship.
3. ascertain whether the role of developing and increasing export trades by small scale manufacturing firms are possible.

3.0 MAIN CONTENT

Small Scale business has attracted a lot of attention from Nigerian Economists, management consultants; the government etc., who are interested in the transition of this country to an industrialised state. Though there is phenomenal growth in the large-scale, small firms are known in playing a very important role in developing economies, Schafer and Talavera (2006).

Extensive work on development and importance of small-scale businesses started about three decades ago. However, the roles small and medium scale enterprises (SMES) can play, in the process of economic development are many and varied, (Nzewi U.C. and Ozo E.O, 1985) are of the view that economic development cannot exist without economic growth is increased in small-scale industries in our economy.

3.1 Employment Generation

Small-scale business is regarded as a veritable tool for employment generation. It is clear that employment generation is assured through SSI as that sector cannot fully afford automated machines like the large corporation does. Their activities are mostly based on human labour, hence they are said to be labour intensive. As well this is obtainable with developed economies where relatively the society is richer than the developing countries, their mainstay in production is more of labour intensive than automated.

This role of SSI in employment generation is evident in the works of Daniels & Ngwira, (1993); Gallagher & Robson, (1995). They say, it is estimated that small and medium scale enterprises employs 22% of the adult population in developing countries. If Small and Medium Enterprise, SME's can employ up to this proportion of the population, it show enormous the growth and development they could contribute to the economy.

The most outstanding role in this employment generating capability is the issue of offering job opportunities to rural dwellers. Because small scale firms are established at every nook and cranny of the country, it makes it possible for rural dwellers to enjoy being employed without drifting to the urban areas for jobs. So the problem associated with rural urban migration is minimized, the living standard of this rural dwellers will improve and most importantly the desired industrialisation is brought to the grass root.

3.2 Industrial Initiatives and Entrepreneurship

Promoting industrial initiatives and entrepreneurship among the people is a prospect from small-scale firms that is worth mentioning. Small scale firms as a concept encourage especially the dynamic and vibrant youths to go into its establishment as it is relatively, cheap. Though, this is only for the ones with requisite skill who can move with tide of constant innovation and entrepreneurship so therein. However the industrial initiative as well as entrepreneurship is being promoted as business is always changing. It is only with skill that one can succeed and maintain success in his enterprise. Hence they say change is an inevitable concept. The special edition of Business Week (1992) stresses it the more that change can no longer be an occasional episode in the life of a corporation, companies with rigid structures will be swept away. For one to feel that he is managing a small scale firm without adaptability and flexibility in this regard definitely is at the risk of running his business aground. This dynamics surely is as a result of businesses being very sensitive to change constantly.

The goal of any enterprise is to achieve success continually, which is only possible with proper industrial initiative and entrepreneurship ability of the proprietors. There are people who through small scale industry developed their industrial initiative and took it up as an entrepreneur, today that is yielding tremendous profit. Take the instance of most inventors like Thomas Alva Edison, the American inventor, Henry Ford, the auto maker, Innoson Group, the great industrialist, Wilson Nigeria Limited, the entrepreneur to mention but a few. All these achieved their success as a result of industrial initiative and entrepreneurship. These made their dreams come true and not only that, through their initiative and entrepreneurial skill had taken their establishment to the level they are today.

Quality management is an area of management that industrial initiative and entrepreneurship can foster. For instance the export oriented model adopted by the Asian Tigers encouraged the manufacturers to dwell so much on quality as their products are targeted onto those highly industrialised nations; without which it will be difficult to market their products there. When small-scale firms imbibe the culture of quality management the result will always be tremendous if they meet the quality standards of the potential buyers. Of course there is no doubt that their products would be acceptable by the countries of their destination. McDonalds and the Burger King and here in Nigeria Mr. Biggs, the fast foods franchise, are today the toast of patronage because of the qualitative products and services they provide. Mercedes cars enjoy are wide range of customer demand both from middle and high class due to quality they deliver. And a whole lot enviable firms in the world today. It is so with the entire known world organization today.

No wonder Anyaoku (2010) posits that no nation in the world has ever advanced in development without laying its fortresses on quality education. And this industrial initiative and entrepreneurship is sharpened through education. The constant innovation by manufacturers to avert being edged out of business as a result of competition is another good example of how industrial initiative and entrepreneurship can play a vital role. Saikou and Wen-Chi (2009), opine that entrepreneurship is a source of innovation and change, and as such spurs improvements in productivity and economic competitiveness; and therefore, activities to convert ideas into economic opportunities is eat the very heart of entrepreneurship.

This issue of maintaining economic opportunities has gotten to the point that most of industrial goods today are being modified before anybody would have thought it necessary just to keep competition at bay. In the motor industry for instance they churn out motor vehicles of different and wonderful designs almost on yearly basis, and so are with other industrial goods. Nwachukwu, (1988) says that any organisation that fails to recognize the inevitability of change is doomed to failure.

Change is inevitably too necessary for an organisation to keep being on track. Opening up to change brings positive innovation and hence the opportunity of exploring better avenues that firm can leverage on to keep being at a competitive advantage. And these innovations are borne out of industrial initiative and entrepreneurship

4.0 CONCLUSION

In the area of employment generation, small scale firms' contribution to industrialisation in any given society cannot be over emphasized. Though in our own case one might say that small firm's impact on employment is not yet significant, it is still generating an employment within the populace. The instance of some of these firms employing regularly is non-existent. Some of them say that they started with only one employee and after some years have up to fifteen and some more employees on their payroll.

Small Scale Firms do not Promote Industrial Initiative and Entrepreneurship among the populace in Nigeria significantly. It has been found that entrepreneurs in this area are highly risk averse. It is observed too that the proprietors relatively are slow in embracing the dynamism found in today's technology because various reasons like cost, acquisition, maintenance and training. While another issue is environmental factors which includes basic infrastructure problems, government policies, that pose a great challenge and of course funding which is evident how expensive it is in taking up an idea, midwife that idea and commercialize it is, so says our respondents

3. Increment and Development of export trade is not affected significantly. The study reveals that even though small scale firms have not affected it is expected, it is still within the minds of entrepreneurs within Enugu. They are of the opinion that if the issue of technological equipment is addressed definitely most of them will think export. So encouragement and support are needed here to help out.

In conclusion, it has been identified that the small scale firms could be used as a tool that can help in advancing the pace of industrialisation in Enugu State. Though this role is bedevilled with the problem in Nigeria and the way Nigerians go about their business.

5.0 SUMMARY

In this unit, we have considered the role small and medium scale enterprises play in the economic development of a nation. These roles concerns employment generation, industrial initiatives and entrepreneurship.

In the next unit, we shall consider the challenges faced by small and medium scale enterprises in the economy of a nation.

6.0 TUTOR MARKED ASSIGNMENTS

1. How do small-scale businesses boost generation of employment opportunities?
2. How has industrial initiative and entrepreneurship among the populace been promoted through small-scale firms?
3. To what extent is export trade increased and developed by the instrument of small-scale firms?

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UNIT 3 THE CHALLENGES OF SMALL SCALE BUSINESS IN THE ECONOMY

CONTENTS

1.0 INTRODUCTION

In the last, we considered the role small and medium scale enterprises play in the economic development of a nation. These roles concerns employment generation, industrial initiatives and entrepreneurship. In spite of these noble roles played in the economy, there are still some problems and challenges faced by this sector of the economy.

In this unit, we shall consider these problems and challenges faced by small and medium scale enterprises in the economy of Nigeria.

2.0 OBJECTIVES

At the end of the study you should be able to highlight and discuss the challenges of small scale businesses in the economy of Nigeria compared to that of Taiwan.

3.0 MAIN CONTENT

As stated above, the small scale business sector plays a vital role in the growth of any nation's economy the world over; and is considered to be the engine of growth in most countries. If that sector of any economy has the largest share of the population, then anything that happens to the sector positively or otherwise will definitely be of either great gain or great consequences to the nation.

3.1 Problems and Challenges of Small Scale Businesses in Taiwan

The problems and challenges faced by small scale business sector in the economy of Taiwan will be discussed under several subheads listed below.

1. Funding
2. Infrastructure facilities

3.1.1 Funding

Funding which is widely known to be a very difficult issue for investors everywhere, was as well threatening the growth of small-scale firms in Taiwan. Tai Li (1983) in enumerating the challenges facing the small scale firms in Taiwan puts funding among other challenges as it affects the growth of small scale firms in that country. Then it was the same story when they started their industrialisation process. The people of the country were able to surmount the obstacle of raising funds.

Some of these ways and means through which they got about this challenge of funding are stated below:

1. *Grain Mutual Credit Aid*: As the name of the association suggests, it is a group of people who came together to help each other financially as there is the need. Because the cost of establishing a small scale firm is not too high the members of society engaged themselves in this type of association where one can borrow money to run his firm. This was a veritable source of funding because most of small scale entrepreneurs do not register their firm before going into operation, while on the other hand it’s an avenue for acquiring cheap loan; which cannot easily be obtained from a bank without registration. What we are saying is that one cannot walk into any bank to seek loan nor get cheaper capital from bank without first of all registering the business. Therefore, most people resort to borrowing through the mutual credit aid. How does it work one may ask?

   Grain mutual credit aid through a convener rallies those who are interested and they will decide on how much to contribute, say one thousand kilogram worth of grain. After the contribution they bid on who will take the contribution, the person in turn pays an interest for collecting the contribution. By this arrangement the proprietors of small scale factories could raise up money easily and at cheap rate too.

2. *Family Inheritance*: Some would-be small firm owners are from a family with relatively rich background. People in this category do not have to worry too much as the family inheritance can support their take off. It’s all about using the person’s inheritance to raise money, like selling landed property.

3. *Personal Savings*: there are those that were able to make some reasonable savings that could help him or her take off. These are the people of working class, who can raise their own money through savings. And finally,

4. *Through Banks*: There are those that have access to bank loan that is, being able to provide all requirements for the bank to grant them such loan. These category of investors are those who before their take off gets their firm duly registered.

3.1.2 Infrastructural Problems in small scale industries (SSI) in Taiwan

Provision of infrastructures like electricity, good road network, housing accommodation, portable water and effective and functional communication network and so on, in any given society is and had always been a Herculean task. For individuals, it would be impossible, that is why it is an exclusive task left for the government. However the government of every country is striving to make available functional basic infrastructures that are affordable by her citizens even when the task is enormous. Due to this difficulty in meeting the expectation of man in the area of infrastructural demand, that becomes a serious threat to national development. So any industrialised nation is one that can cater for the aforementioned basic infrastructures to her citizens at least to a reasonable degree.

In a developing economy like Taiwan the issue of availability of infrastructures was never easy for the small scale manufacturers. Hence, most of the small scale manufacturers established their factories in their various farm houses (Tai-Li, 1983).

The second problem that a potential investor in small scale industry faces is how to provide electricity for his intended factory, though available but very expensive for small scale firms. Their greatest headache was access to supply of electricity. The need for electricity is so much as no industrial machinery can run without it. And getting subsidy, from government requires registration and most of them starts first without registering.

Because of this most of the proprietors had no option but to establish their firms in the hinterland farm houses where they will pay no bill for accommodation, and make use of available electricity no matter how to avert exorbitant bills from industrial electricity charges. This then turned out to be a great challenge to small firm owners, for the survival of small scale industry within the country largely depends on these infrastructures.

3.2 Problems and Challenges facing Small Scale Firms in Nigeria

There are problems and challenges that face small enterprises which affects the growth of Small scale industries (SSI) the world over. Here under are the challenges of Funds and Infrastructure as experienced in Taiwan to show that this is a problem encountered by developing countries.

In Nigeria Awolowo (1986), says in spite of the oil wealth and its ever bold industrialisation programmes, little have been achieved in the way of economic development. According to him, our per capita real income remains as low as ever, poverty, disease and ignorance are evident everywhere, particularly in the rural areas. Unfortunately, this statement credited to one time elder statesman, Chief Obafemi Awolowo back in 1986 is still, or better said, is even truer today than ever after twenty-six years of such warning. Boapeah (1993, as cited in Umeania, 2004) points out that there are so many problems that hinder the growth of small scale enterprises in developing countries of which some of them are lack of credit, competition from large-scale firms, over-liberalization of the economy, and difficulty in access to advisory services and research findings. It is unfortunate that all these are factors that could be controlled if managed properly to ensure tremendous growth of the sector which will help industrialisation of the country in a country like Nigeria. Some of these are the problems that are posing as serious challenge to small scale businesses in Nigeria:

3.1.1 Funding

Funding, as we know is one, actually, the major problem that is facing the small-scale firms in Nigeria and in particular Enugu State. Some say the reason could be traced to wrong utilization of fund if granted to most of the small scale industrialists. When the issue of funding comes up they are of the view that some people might be ready to help but they are afraid of diversion. To some, it will be time to take in a new wife, some will take to buying new vehicles and to some, taking chieftaincy titles rather than using the money for its original purpose. It is even most worrisome to find out that this act is also being perpetrated by those who had laboured to establish a small scale industry, and subsequently they would allow their labour to get wasted. Abdulkadir (1984, as cited by Ile, 2003) says, both loans obtained from government, banks and individuals are used to promote personal aggrandizement instead of the corporate objective of the business and hence failure to repay the loan including the interest.

Another area of thought is the vulnerability of small scale firms. Some of the institutions are of the view that small scale industry (SSI) is too vulnerable and advancing loan to them will only compound issue for the sponsors, they may never pay back and it is difficult for small scale firm owners to provide security for their loans and hence their refusal. Bigsten et al (1999, as cited in Umeania, 2004) said that about 90% of small firms are refused loans when they applied from the formal financial intermediaries, due to their inability to fulfill conditions such as collateral for security. There had been myriad of suggestions to help in finding solution to the problem having realized the importance of the sector. Insuring one's business is most paramount on the list of solutions proffered. But the dynamics of insurance business is still too difficult for entrepreneurs at this level to understand. Even those few that know the importance of insurance are not thinking in that direction due to cost. Banks that could train their clients and help them grow in this area of investment are not interested as well due to cost on their own side. Even with the claim that Small and Medium Scale Equity Investment Scheme designed by Bankers Committee to help in this regard for this scale of investors are not making appreciable impact. The Scheme is bedevilled with bottlenecks that investors find it too difficult towing the line of acquiring loan through them, unless one is connected with the issuing bank or appropriate authority. Though there is government support programmes and is supposed to be enough, they are marred by corruption. Most often, one discovers that the wrong people are either the ones that get the financial support from the government because it is not available to all-unless those that have the link. The bank loan, which most banks are not ready to keep their word about Bankers Committee's provision of ten percent for Small and Medium Scale Enterprises Equity Investment Scheme (SMEEIS), is another worrisome trend. Financing any organization had never been a cheap and easy process. However, for a country like Nigeria to be within the level of development so desired, there should be an urgent attention to this. Considering the fact that this is an area predominantly occupied by low income earners, it is ever made difficult tackling this problem headlong. Against this backdrop, the government on realizing how important the development of this sector is, had in the past created a lot of programmes to help entrepreneurs in this regard.

On the 246th meeting of the Bankers' Committee held on 21st December,1999, it was agreed that banks would set aside 10 percent of their profit before tax as a fund to finance small and medium scale enterprises. Anaro and Akpan (2007) reports that the total Banks loan to the real sector is about 51.52 trillion naira between 1999 and 2007. And only about 1.18 percent of this sum was given to small and medium scale enterprises within the corresponding period. They continued by explaining that the loan to the real sector improved tremendously by 1,087.4 %, i.e. from N1.27 trillion in 1999 to N15.08 trillion, in the year 2007, while the loan for small and medium scale enterprises (SME) was increased conservatively by 68.03%, i.e. from N46.82 billion naira in 1999 to N78.66 billion naira in 2007. This of course is not adequate to spark off the needed growth in the economy as expected. If the talk about funding is for the whole SME's, then what would be the share given to small scale firms: that is small scale manufacturing? To worsen the issue, Momoh and Alawode (2007), report that the Central Bank of Nigeria (CBN) governor says that participating on the small and medium equity investment scheme should be optional.

Against this back drop, Garba Ibrahim Gusau, on the same report, warns that this directive is counter productive. He advised the Federal Government to raise bond specifically for SME. He further said that many countries and regions have developed various financing models for their SME programme. This means that there mustn't be only one way of financing the SME programme as one model might work at a particular place while it may not work somewhere else. CBN Governor's directive means that the federal Government is loosing sight of the reason behind establishment of the scheme. The Governor should realize that no organization no matter how highly placed would be ready to dole out their hard earned money. This really needs the intervention of the government to compel the banks to comply with the scheme's disbursement requirements. Mahmood (2003), stresses government was preparing a project document that will establish a National Credit Guarantee Scheme for small and medium firms. He continued by saying, that this scheme will be a private/public sector joint venture with a capacity to guarantee about N20 billion loans to Small and Medium Firms SMI then. While the vision of the Ministry of Trade and Investment is to increase the contribution of SMEs to the nation's Gross Domestic Product from 10 per cent to 30 per cent and increase export earnings through SMEs from three percent to 25 percent within the life-time of this administration (Aganga, 2012).

To be able to achieve this, we have identified commercial banks and development financial institutions and we are partnering with them to come up with SME-friendly products or re-design existing products to enhance access to finance by SMEs. This policy issue from the Hon. Minister requires urgent attention and implementation. Mere saying it to attract peoples ovation will not do us any good as we know that a serious support is a must for us to achieve a meaningful development in this sector.

3.1.2 Basic Infrastructure

Basic Infrastructure is another area of concern that is threatening the development of Small-Scale business. No economy can thrive well under poor infrastructures like epileptic power supply, bad road network, lack of portable water, poor communication network, etc. The instance of power is a very terrible monster that is posing a stumbling block to development in this country let alone Enugu. Though the small scale manufacturing sector is known to be labour intensive, it still relies heavily on availability of power to continue growing. Without power there is no way some production can be done using machines. The Manufacturers Association of Nigeria (MAN) president notes, as cited by Adeyemi (2009), the lessons of the past few years have shown that if local manufacturers are to survive in a globalize world, the provision of energy cannot be compromised, particularly in our peculiar situation where the upgrading of energy production had suffered almost thirty years of neglect. It is only with this type of automation and leveraging on the availability of cheap labour that a production firm can boast of cheaper output, thereby the hope for effective competition can be possible.

If an imported good is cheaper than locally produced one, the local industry will definitely suffer in the face of competition. Take a situation of firm that runs a 50KVA generating set for hours for some days in a week, what will be the cost of maintaining the power generator i.e. servicing, fuelling and spare parts? The cost alone will have a ripple effect on the price of the produced goods. Nigeria today is celebrating power generation capacity of 4,800MW when a country like South Africa produces an average of 45,000MW of electricity. Nigeria is over three times more populated than South Africa. Nigeria’s population estimate is 158,423,182 (World Bank, 2010) while that of South Africa is estimated to be 49,991,300 (Statistics South Africa, 2010). The question is wouldn’t it had been three times their production level that Nigeria should be celebrating? The poor state of Nigeria road network is a case that cries for attention. By every calculation there is no way the development of small scale firms in Enugu State can be achieved without the rural areas. And without a befitting road network, accessing the villages in this state would be difficult and vice versa.

3.1.3 Attitude of Entrepreneur

The people of this state, Enugu have attitudinal problems. In various fields of life one finds the same unpatriotic attitude being manifested. Most proprietors are only interested in using their establishment to collect either grant or whatever from the Government. Meaning that, there are lots of fake proprietors in Nigeria, in the name of investors in small scale enterprises. Because the federal government is doing her best in providing support and incentives, many do not have the intention to establish any industry as a venture with propensity to grow. They use same as means of collecting these supporting packages and incentives for their own selfish reasons. Abdulkadir (1984, as cited by Ile, 2003) posits that loans obtained from government, banks and individuals are used to promote personal aggrandizement instead of the corporate objective of the business and hence, failure to repay the loan including the interest. This attitudinal problem is fraudulent. Individuals are not interested in the corporate objective of their business but to use it to defraud the government in the name of collecting incentives as a proprietor in SME sector. Just imagine what kind of entrepreneurs the persons with this attitude would be, a fraudster of course. If somebody had come into the industry with the intention to invest surely there is no way this kind of attitude would be exhibited. Obviously, this is a fraudulent behaviour which a real entrepreneur would like not to be associated with. It is pertinent to say that confronting these unpatriotic attitudinal problems of so-called business owners is very necessary. And the only way out is to change or face the consequence. So if change is made possible we will have less of the fraudulent practices that are inherent in our society. While only the genuine entrepreneurs will be within the sector which without them, achieving the desired growth in the economy will definitely be impossible.

3.1.4 Inability to plan

Some lack planning culture, they believe planning is a waste of time, effort and money. The unfortunate thing here is that these small firm owners believe that they can get along without planning. It is very evident that failure to plan is planning to fail. Ojiako (1987, as cited by Ile, 2003), states that one of the problems small or medium scale businesses has, is lack of strategic planning. They not only need planning to succeed but a long term strategic planning to survive on the long run. Nwachukwu (1988) says that many indigenous businessmen are often too preoccupied by the day-to-day operation of their businesses with the result that they have no time set aside to reflect on the future of their enterprise. In his definition of the term planning, he says that planning is a thought process concerning a proposed course of action. It is important to remind them, he continues, that it is like somebody who wants to embark on a journey. Surely, such person must sit down to make necessary preparation before he embarks on the journey.

The pertinent questions like what is the purpose of this journey, what am I expected to go with, what is the financial involvement and so on must be answered if he hopes to succeed, otherwise getting stranded on the way and probably frustrated, awaits him. In continuation that failure to plan gives rise to inefficiency and lack of direction. Why is planning so important? It is primarily for the singular reason of any investment, to succeed. So, if planning is done as at when due, because planning is a continuous process, so many problems would be taken care of on the course of doing business and success will be a possibility.

3.1.5 Lack of Information

There exists the problem of communication by the owners. Most proprietors of small scale firm have problem of keeping secret to the detriment of their establishment. They rather not divulge any information, forgetting that not everything should be kept secret. When information flows as it should, the chances are that one will be better equipped to face challenges but most do not want to communicate either to or from their immediate environment. And it is very important to note here that the more one communicate the better informed he is. But lack of exchange of information on their business, the strategies needed for growth will as well lack and subsequently the threat of failure settles in. As the saying goes dialogue brings about the chances of achieving a desired and needed result. What should be the practice is to keep advancing on competitive strategies. There is always a unique capability which every individual or business has against the other that will be of advantage. And what proprietors should do is exploiting this advantage optimally through communication.

3.1.6 Lack of proper Training

Another problem is the poor education and lack of requisite skills most business owners have. Many people see business from the point of getting money and dabbling into a business venture. It does not matter to them whether they are trained or educated properly on the requisite skill be it in production, technical services or other enterprise. All they want to know is that they have seen somebody doing very well in that area of business and surely their case will not be different. Of course there is no business without a secret, that is, the nitty-gritty of that business must be known before success can be achieved in there. There is no production that does not require the technical know-how. And if one is jumping into an area of production without the technical background needed for the production, definitely success cannot be achieved. They lack the patience needed to learn and acquire the requisite knowledge and without this training or apprenticeship there is no way success can be guaranteed.

3.1.6 Lack of Motivation by the Entrepreneurs:

Nwachukwu (1988) says that motivation is that energizing force that induces or compels and maintains behaviour. Motivation is an internal psychological process whose presence or absence is inferred from observed performance. When motivation is absent the very workforce of any organization will be lacking in optimum output. And probably at the risk of that establishment going out of existence, there is no way a firm can operate without vibrant and motivated workforce. Ezigbo (2007) says that motivation is one of the key ingredients in employee performance and productivity. No firm can boast of effective and efficient performance without proper motivation for the workforce. Consider any business that is conducted by human beings with the aim of achieving their basic needs as non-existence or dead if proper motivation is not given to the workforce.

There must be a motive behind any action and anyone who undertakes a job with any firm must think towards that goal. This motive which is also known as driver is, what keeps someone on a persistent track for achievement. Until this is achieved, motivation will continue to be sustained. Udeze (2000), puts it that man is a wanting animal and man is also part physiological and part psychological, if any is lacking it brings about discontentment in the being. In either case, a deficiency in each triggers off an impulse which can be emotionally charged, compelling behaviour or act that can help supply the deficit to restore normalcy. These forces can be triggered of internally or externally. Here we are concerned with these impulses that are triggered off by these forces or drivers. Most entrepreneurs or proprietors lack in the ability to motivate their workers so as to elicit their optimal performance. To them it is the attitude of a dictator and his subjects. The workers must as a matter of compulsion carry out their duty with or without their satisfaction. If performance evaluation is to be conducted in most of our small scale firms, what one would get is not even average performance but virtually low performance.

Very many of the workers are carrying on the job because of non-availability of alternative. Suffice to say that given the opportunity, the worker would quit. And of course you will agree with me that this kind of worker will never give in his best to the business establishment. Citing Ile (1999) an unmotivated employee has these problems as:

1. Child characteristics.
2. Dependency syndrome
3. Erratic behaviour and
4. Shallow interest in what he does.

When all these become the characteristics of workers in a company what more does anyone expect.

3.1.7 Policy Issue

Government Policy is another area of concern. Policy formulation and policy implementation by the government or appropriate authority is always at cross roads. Since the federal government’s intention to develop the small and medium scale enterprises, very sound policies had always been formulated. The establishment of Nigeria Development Bank, NIDB in the fifties, was to help in the development and growth of SMEs. Ayozie (2006) says that great attempt to develop the small-scale firms in the 1970s was evident during the days of oil boom. In this period both monetary and fiscal policies were formulated to help in the national development of small and medium enterprises which included:

1. Industrial development and national integration through industrial dispersal
2. Provision of greater employment opportunities
3. Increased production of manufactured exports
4. The development of indigenous technology
5. Increasing local content of industrial output (use of local raw materials to promote greater linkages and backward integration to raise general level of economic activity.

Again, the policy of indigenization Decree of 1972 and later on Nigeria Enterprises Promotion Act of 1977, which helped in creating, chances for Nigerians and in particular indigenes of Enugu State who were interested in manufacturing and other small scale businesses. The establishment of Industrial Development Centres, National Economic Reconstruction Fund (NERFUND), Peoples Bank in the 1980s, the National Directorate of Employment NDE, Nigerian Agricultural Co-operative and Rural Development Bank in the nineties, Nigerian Bank for Commerce and Industry (NBCI) which was merged with the Nigeria Industrial Development Bank (NIDB) and restructured to become the Bank of Industry (BOI).

4.0 CONCLUSION

In conclusion, it has been identified that the small scale firms could be used as a tool that can help in advancing the pace of industrialisation in Enugu State. Though this role is bedevilled with the problem in Nigeria and the way Nigerians go about their business. Let these identified roles be fully exploited in the face of this problem of industrialisation.

5.0 SUMMARY

In this unit, we have been able to identify the problems and challenges bedevilling the growth of small scale enterprises in Nigeria. It was noted that the challenges are many that undermine the growth of small scale businesses, but the sector is trying their best amidst these challenges. Irrespective of these challenges, one would see the level of small scale firms' establishments within Nigeria is seriously on the rise.

In the next unit, we shall examine the sources and acquisition of capital available to small scale businesses in Nigeria.

6.0 TUTOR MARKED ASSIGNMENTS

1. To what extent have the identified challenges militate against the industrialisation in Nigeria?
2. Explain the various challenges you know that affect the growth of small businesses in Nigeria.
3. Using a developing country like Nigeria, draw an illustration to show that small scale businesses are really facing challenges.

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UNIT 4 SOURCES AND ACQUISITION OF CAPITAL BY SMALL BUSINESS

CONTENTS

1.0 INTRODUCTION

In the last unit, we examined and identified the problems and challenges bedevilling the growth of small scale enterprises in Nigeria. It was noted that the challenges are many that undermine the growth of small scale businesses, but the sector is trying their best amidst these challenges. Irrespective of these challenges, one would see the level of small scale firms' establishments within Nigeria is seriously on the rise.

In this unit, we shall consider the sources and acquisition of capital available to small scale businesses in Nigeria.

2.0 OBJECTIVES

At the end of this Unit, you should be able to:

- Say what business capital means;
- Give a proper definition and explain what small business means;
- Analyse the sources and acquisition of capital by small business.

3.0 MAIN CONTENT

Capital is the money or wealth needed to produce goods and services. In Economics, these are factors of production that are used to create goods and services and are not themselves in the process. It can be seen as wealth in the form of money or assets, taken as a sign of the financial strength of an individual, organisation, or a nation, and assumed to be available for development or investment. However, in the most basic terms, it is money. All businesses (including small businesses) must have capital in order to produce assets and maintain their operations.

We shall look at mainly what small business is, and the forms of business capital which are debt and equity available to them for viability and sustenance.

3.1 What is Small Business?

A business is a concern, an enterprise, or organisation set up by an individual or group of individuals for the purpose of making profits from operations of the concerns. Olagunju (2008) defines business as an enterprise that engages in the production of goods and services that provide satisfaction for consumers. Businesses in Nigeria range from micro, small and medium to large ones. However, our concentration here is on the small ones. The definition of small business differs from country to country and from industry to industry. Each country tends to derive its own definition based on the role small businesses are expected to perform in the development of the country. Definitions change over a period of time with respect to price levels, levels of technology as well as other considerations.

Small businesses are synonymous with small and medium scale enterprises (SMEs). SMEs are usually referred to as small businesses in developed countries as well as in developing countries.

Generally, a small business is an enterprise or an organisation that is privately owned and operated with a small number of employees and relatively low volume of sales. Olagunju (2008) defines small business as those business concerns with a total capital investment of not more than N2 million (N2, 000,000), with the number of employees not more than 50. In Nigeria, small businesses are commonly found in small shops, hairdressers, trade men, photographers and others. The owner of the business is referred to as an entrepreneur. He or she provides the capital required for the running of the business in most cases. He/she is the chief coordinator, controller and organizer of the business.

3.2 Sources and Acquisition of Capital by Small Business

There are two ways to externally fund a business: debt and equity. When debt is used, the investor receives a note for his/her cash. The note spells out the terms of repayment, including timing and interest. The benefit of using debt is that the entrepreneur retains ownership of the company. The downside is that he has obligation to repay. If he fails to repay his commitment, the lender, under certain circumstances, can force the company into liquidation.

In the case of equity, an owner who uses it (equity) to fund a business turns over an ownership stake to an investor in return for the latter's cash. The benefit is that there is no obligation to repay the investor. The downside is that the owner has to give-up a part of the ownership of his business, which can entail losing some control over the company. The different sources of equity and debt include the following:

3.2.1 Equity

i) *Bootstrapping* - Here, the business funds itself. As the business grows, it throws off cash that enables further growth.

ii) *Self- funding* - Many entrepreneurs fund their businesses themselves. They use savings or personal debt such as a second mortgage. Alternatively, they sell assets to generate cash.

iii) *Family and Friends* - Family and friends can provide either equity or debt funding. While this may initially seem like a good source, one has to be careful about selling part of the business to this group. Unfortunately, businesses fail. The loss of capital can then cause hurt feelings, ruins friendships and make for unpleasant family gatherings. Be sure that your investors know the true risks.

iv) *Angel Investors* - These people are typically affluent individuals willing to invest in businesses. Increasingly, angel investors are forming investment groups to spread risk, and to pool research.

v) *Cloud funding* - -There are a number of groups that will allow you to pitch your ideas to investors through the internet. Typically, when this type of funding is successful, multiple investors will contribute funds to the idea. Be aware that there are restrictions on how cloud funders can operate.

vi) *Partners* - Taking a partner can be a source of funding. The partner may or may not become an employee of the business. Strategic partners can benefit the business by aligning resources. For example, a property management company might make a strategic investment in a property maintenance company because it could eventually feed-work to the maintenance group.

vii) *Venture Capital* - These firms provide early-stage funding, but are typically looking to make relatively large investments and take a significant share of the company – often a controlling interest.

viii) *Crowd funding* - These are primarily web-based projects and allow individuals with a business, idea or project to reach out to thousands of potential investors through various platforms. Investments can be debt, equity or rewards-based.

3.2.2 Debt

i) *Small Business Lenders* - Many organisations are interested in lending to small businesses.

ii) *Banks* - Traditional banks make small business loans. However, they typically require a track record and will want the loans secured with assets.

3.3 Equity versus Debt Financing

We have known that small businesses can get through “equity financing” or “debt financing”. What are the differences between the two concepts? Surbhi (2015) posits that capital is the basic requirement of every business organization, to fulfill the long term and short term financial needs. To raise capital, an enterprise either used owned sources or borrowed ones.

According to him, **Equity financing** often means issuing additional shares of common stock to an investor. With more shares of common stock issued and outstanding, the previous stockholders' percentage of ownership decreases. **Debt financing** means borrowing money and not giving up ownership. He also stated that Equity refers to the stock, indicating the ownership interest in the company. On the contrary, Debt is the sum of money borrowed by the company from bank or external parties that required to be repaid after certain years, along with interest.

We will discuss the difference between debt and equity financing, to help you understand which one is appropriate for your business type.

- Comparison Chart
- Definition
- Key differences
- Conclusion

S/N	Basis for Comparison	Debt	Equity
1.	Meaning	Funds owed by the company towards another party is known as debt.	Funds raised by the company by issuing shares is known as equity.
2.	What is it?	Loan funds	Own funds
3.	Reflects	Obligation	Ownership
4.	Term	Comparatively short term	Long term
5.	Status of holders	Lenders	Proprietors
6.	Risk	Less	High
7.	Types	Term loan, debentures, bonds, etc.	Shares and stocks
8.	Return	Interest	Dividend
9.	Nature of return	Fixed and regular	Variable and irregular
10.	Collateral	Essential to secure loans, but funds can be raised otherwise also.	Not required

Definition of Debt – money raised by the company in the form of borrowed capital is known as Debt. It represents that the company owes money towards another person or entity. They are the cheapest source of finance as their cost of capital is lower than the cost of equity and preference shares. Funds raised through debt financing are to be repaid after the expiry of the specific term.

Debt can be in the form of term loans, debentures or bonds. Term loans are obtained from financial institutions or banks while debentures and bonds are issued to the general public. Credit Rating is mandatory for issuing debentures publicly. They carry fixed interest, which requires timely payments. The interest is tax deductible in nature, so, the benefit of tax is also available. However, the presence of debt in the capital structure of the company can lead to financial leverage

Debt can be secured or unsecured. Secured debt requires pledging of an asset as security so that if the money is not paid back within a reasonable time, the lender can forfeit the asset and recover the money. In the case of unsecured debt, there is no obligation to pledge as asset for getting the funds.
Definition of Equity – in finance, equity refers to the Net Worth of the company. It is the source of permanent capital. It is the owner's funds which are divided into some shares. By investing in equity, an investor gets an equal portion of ownership in the company, in which he has invested his money. The investment in equity costs higher than investing in debt.

Equity comprises of ordinary shares, preference shares, and reserve and surplus. The dividend is to be paid to the equity holders as a return on their investment. The dividend on ordinary shares (equity shares) is neither fixed nor periodic whereas preference shares enjoy fixed returns on their investment, but they are also irregular in nature. Although the dividend is not tax deductible in nature.

Investment in equity shares is the risky one as in the event of winding up of the company; they will be paid at the end after the debt of all the other stakeholders is discharged. There are no committed payments in equity shareholders i.e. the payment of dividend is voluntary. Apart from that, equity shareholders will be paid off only at the time of liquidation while the preference shares are redeemed after a specific period.

Key differences between Debt and Equity - The differences between debt and equity capital, are represented in detail, in the following points:
1. Debt is the company's liability which needs to be paid off after a specific period. Money raised by the company by issuing shares to the general public, which can be kept for a long period is known as Equity.
2. Debt is the borrowed fund while Equity is owned fund.
3. Debt reflects money owed by the company towards another person or entity. Conversely, Equity reflects the capital owned by the company.
4. Debt can be kept for a limited period and should be repaid back after the expiry of that term. On the other hand, Equity can be kept for a long period.
5. Debt holders are the credits whereas Equity holders are the owners of the company.
6. Debt carries low risk as compared to Equity.
7. Debt can be in the form of term loans, debentures, and bonds, but Equity can be in the form of shares and stock.
8. Return on debt is known as interest which is a charge against profit. In contrast, the return on equity is called dividend which is an appropriation of profit.
9. Return on debt is fixed and regular, but it is just opposite in the case of return on equity.\
10. Debt can be secured or unsecured, whereas Equity is always unsecured.

In conclusion, it is essential for all the companies to maintain a balance between debt and equity funds. The ideal debt-equity ratio is 2:1 i.e. equity should always be twice of the debt, only then it can be assumed that the company can cover its losses effectively.

4.0 CONCLUSION

Relative to small and medium scale enterprises (small businesses) and sources of financing, we can conclude that finance, according to Muktar (2009), is a precondition to the growth of enterprises. The sources of finance available to small businesses are as follows:

i) The owner-savings and his/her associates including family and friends who may or may not be partners or shareholders in the venture.
ii) Partners and shareholders in the venture.
iii) Banks and lending institutions.
iv) The small business administration and financial assistance programme.
v) Small business administration licensed small business investment companies.
vi) Members of the trade, including suppliers of materials such as manufacturers and wholesalers, and in some instances, customers who prepay their contracts.
vii) Other businesses.

5.0 SUMMARY

In this Unit, we have been able to see small business as an enterprise or an organisation that is privately owned and operated with a small number of employees and relatively low volume of sales. We also considered the sources and acquisition of capital for small businesses in general terms as well as its relativity to the Nigerian situation. The common financing sources for Nigerian small businesses include the entrepreneur, family and friends, banks plus trade credit.

Another important unit that would be considered in this next unit of this course is the uses to which small businesses utilise the capital sourced.

6.0 TUTOR-MARKED ASSIGNMENT

1. Differentiate between equity and debt financing of small businesses.
2. Discuss the common financing sources of small businesses relative to the Nigerian environment.
3. What is small business in Nigeria?
4. Discuss the ways to externally fund a small business in Nigeria.

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UNIT 15 USES OF CAPITAL BY SMALL BUSINESS

CONTENTS

1.0 INTRODUCTION

In the previous unit, we had dealt with the sources and acquisition of capital for small business. A sources and uses analysis provides a summary where the capital used to fund an acquisition will come from (the sources), and what this capital will purchase (the uses). The sources and uses will equal each other, and they must total the total purchase price plus transaction costs. In this Unit, therefore, we shall be concerned with the uses of capital by small business.

In this unit, we shall consider the uses to which small businesses utilise the capital sourced.

2.0 OBJECTIVES

At the end of this unit, you will be expected to:

- Mention the typical uses of capital;
- Discuss these typical uses one by one;
- Differentiate between capital asset and working capital.

3.0 MAIN CONTENT

3.1 What is Capital?

Capital is the money or wealth needed to acquire fixed (e.g. land, building, machinery, equipment, etc. and current assets e.g. raw materials, spare parts, consumables, etc. to produce goods and services. In other words, this is the money all businesses must have capital in order to purchase assets and maintain their operations. Capital also refers to fixed assets employed as a means of generating income, generally, the one on which depreciation is claimed. It equally refers to as asset that will be useful to your business over a long period of time and costs more than your usual day-to-day running expenses.

3.2 Typical Uses of Capital

We shall consider typical uses of capital to include the following:

- Capital asset
- Working capital
- Goodwill
- Transaction costs

Each and every one of these typical uses will have to be explored.

3.2.1 Capital Asset

Capital asset refers to fixed assets employed as a means of generating income, generally, the one on which depreciation is claimed. It also refers to an asset that will be useful to your business over a long period of time and costs more than your usual day-to-day running expenses. Thus, a capital asset is an asset that will be useful to the business over a long period of time (usually more than two years). It could be a piece of equipment, or an investment.

A capital asset is defined to include property of any kind held by the assessee, whether connected with the business or profession or not connected with the business or profession. It includes all kinds of property, movable or immovable, tangible or intangible, fixed or circulating. Examples include computer, camera (for a photographer), a patent (for a software company), and a high-value domain name (intangible asset).

Capital assets are also sometimes referred to as fixed assets. They can be equipment, computers or cars, or anything else that has quite a high cost and is going to be used in your business for more than a year. When your business buys a capital asset, it must spread the value of that asset over the time during which it is expected to be useful to the business. This is called its useful life. For example, a computer's expected useful life might be 3 years, because at the end of 3 years the computer would probably be obsolete and need to be replaced. A car's useful life should be longer.

The capital asset's value is spread across the time it is going to be used in your business, which is called its useful life. A proportion of the asset's value is shown as a day-to-day cost, reducing your business' profit, for each year it will be useful to the business. This is called 'depreciation' for a tangible asset or 'amortisation' for an intangible asset.

3.2.2 Working Capital

It is fair to say that every business has at least one thing in common: the goal to make money. What they do not have in common, however, is how they choose to go about bringing in that money.

Many businesses fail to achieve their most important goal. Why? Most often, it is not due to lack of customers, but a lack of strong working capital management skills.

Working capital is defined as the amount of capital needed to carry on a business or your current assets less the current liabilities. Working capital can also be seen as the cash available for day-to-day operations of an organisation. Strictly speaking, one borrows cash (and not working capital) to be able to buy assets or to pay for obligations. It can be called current capital.

In accounting, working capital is net liquid assets computed by deducting current liabilities from current assets. The amount of available working capital is a measure of the firm's ability to meet its short-term obligations.

Sources of working capital include the following:

- Net income
- Long-term loans
- Sale of capital assets
- Injection of funds by stockholders

Ample working capital allows management to take advantage of unexpected opportunities, and to qualify for bank loans and favourable trade credit terms.

By calculating your working capital, you are able to understand something much deeper: your liquidity. With this measurement, you can make fairly accurate assumptions on the efficiency and financial stability of your company (something every business owner can benefit from, small and large).

But why is working capital important to a business? Besides the fact that understanding your working capital needs can provide you with great insight on your company's financial health, strong working capital management can enable you to propel your business forward.

When you are able to maintain a certain level of working capital, you cannot only successfully pay-off your short-term expenses and debts, but you can also pick and choose the right amount of money to set aside for investing in your future.

We can summarise by saying that working capital is defined as being the capital of a business which is used in its day-to-day operations. It is net of current assets minus current liabilities. Working capital ensures whether or not a business organisation has sufficient cash flow in order to meet its short-term obligations and expenses.

Working capital is used for day-to-day requirement of funds for a business. A business needs certain amount of cash for meeting routine payments, providing unforeseen events or purchasing raw materials for its production. Managing working capital includes managing cash, inventories, accounts receivables and accounts payable in an effective manner. In this way, a working capital is equal to the raw materials, work-in-progress, finished goods inventories and accounts receivables less account payable.

3.2.3 Goodwill

Goodwill, in commerce, refers to an intangible, salable asset arising from the reputation of a business and its relations with its customers, distinct from the value of its stock and other tangible assets. We can also see goodwill as assumed of the attractive force that generates sales revenue in a business, and adds value to its assets.

Goodwill is an intangible but saleable asset, almost indestructible except by indiscretion. It is built painstakingly over the years generally with:

i) Heavy and continuous expenditure in promotion;
ii) Creation and maintenance of durable customer and supplier relationships;
iii) High quality of goods and services;
iv) High quality and conduct of management and employees.

Goodwill includes the worth of corporate identity, and is enhanced by corporate image and a proper location. Its value is not recognized in account books but is realized when the business is sold, and is reflected in the firm's selling price by the amount in excess over the firm's net worth.

3.2.4 Transaction Costs

These refer to the cost associated with exchange of goods and services, and incurred in overcoming market imperfections. Transaction costs cover a wide range: communication charges, legal fees, informational cost of finding the price, quality and durability, etc, and may also include transportation costs. Transactions costs are critical factors in deciding whether to make a product or buy it.

Also called frictional cost, transaction costs are expenses incurred when buying or selling a good or service. Transaction costs represent the labour to bring a good or service to market, giving rise to entire industries dedicated to facilitating exchanges.

4.0 CONCLUSION

Capital is the money or wealth needed to produce goods and services. This is the money all businesses must have capital in order to purchase assets and maintain their operations.

5.0 SUMMARY

In this unit, we have been able to consider typical uses of capital to include the following:

- Capital asset
- Working capital
- Goodwill
- Transaction costs

The last and final unit of module three of this course will consider the topic: financial inclusion and small scale enterprises financing in Nigeria.

6.0 TUTOR-MARKED ASSIGNMENT

1. What is the difference between capital assets and working capital?
2. What is goodwill relative to the typical uses of capital, and how does it differ from the transaction costs?

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UNIT 16 FINANCIAL INCLUSION AND SMALL SCALE ENTERPRISES FINANCING IN NIGERIA

CONTENTS

1.0 INTRODUCTION

In this unit, we have been able to consider typical uses of capital to include the following:

- Capital asset
- Working capital
- Goodwill
- Transaction costs

In the last and final unit of the module of this course, we will consider the topic: financial inclusion and small scale enterprises financing in Nigeria.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- Discuss the meaning of financial inclusion
- The benefits of financial inclusion
- Highlight the challenges of Financial inclusion in Nigeria
- Explain the overview of financial inclusion in Nigeria

3.0 CONTENTS

Financial inclusion or inclusive financing is the delivery of financial services at affordable costs to sections of disadvantaged and low-income segments of society. It involves access and usage of a broad range of affordable, quality financial services and products, in a manner convenient to the financially excluded, unbanked and under-banked; in an appropriate but simple and dignified manner with the requisite consideration to client protection. Financial access facilitates day-to-day living, and helps families and businesses plan for everything from long-term goals to unexpected emergencies. As account holders, people are more likely to use other financial services, such as credit and insurance, to start and expand businesses, invest in education or health, manage risk, and weather financial shocks, which can improve the overall quality of their lives. Financial inclusion is becoming a priority for policymakers, regulators and development agencies globally. It has been identified as an enabler for 7 of the 17 Sustainable Development Goals. The G20 committed to advance financial inclusion worldwide and reaffirmed its commitment to implement the G20 High-Level Principles for Digital Financial Inclusion. The World Bank Group considers financial inclusion a key enabler to reduce extreme poverty and boost shared prosperity, and has put forward an ambitious global goal to reach Universal Financial Access (UFA) by 2020.

Mehrotra et'al (2009), emphasised that access to financial services allows the poor to save money outside the house safety, and helps in mitigating the risks that the poor faces as a result of economic shocks. Hence, providing access to financial services is increasingly becoming an area of concern for every policymaker for the obvious reason that it has far reaching economic and social implications. Financial inclusion has therefore become an explicit strategy for accelerated economic growth and is considered to be critical for achieving inclusive growth in a country. This realisation, in the recent past, was the major impetus for the adoption of policies and measures aimed at growing global financial inclusion as a means of promoting world economic prosperity.

Atkinson (2006) stressed that apart from the regular form of financial intermediation, financial inclusion takes care of:

- Basic no frills banking account for making and receiving payments;
- Savings products suited to the pattern of cash flows of a poor household;
- Money transfer facilities; and
- Insurance (life and non-life).

3.1 Principles Underlying the Banking Industry's Working Definition of Financial Inclusion:

The main goal of financial inclusion is to improve the range, quality and availability of financial services and products to the unserved, under-served and financially excluded. The definition of Financial Inclusion should embrace certain key principles which is critical for delivering a broad range of quality financial services and products to the most vulnerable in our society who comprise both the unbanked and the under-banked. These key principles are:

Access **-** The availability of affordable and appropriate financial products, services and delivery channels to the target market to facilitate universal access.

Affordability **-** Products and services provided at affordable cost. The continuum of financial institutions should strive to reduce cost-to-client and the cost-to-serve in order to ensure that the price of products and services is in line with the target markets' ability to pay for them.

***Appropriateness* -** Product should address the needs of clients and ensure their protection and dignity, taking cognisance of regulatory and language barriers.

***Usage* -** The act of employing or utilising a financial service or product. Access is of no use if the targeted persons are not using the product or service therefore real inclusion should be accompanied by usage.

***Quality* -** Describes how financial services are provided. Quality financial inclusion includes the following traits: affordability, simplicity, convenience, product-fit, safety, dignity of treatment, and client protection. Quality refers to product design and delivery traits that enhance the value of services to clients.

***Consumer Financial Education* -** The provision of consumer financial education on the use of financial services is important if the previously disadvantaged are to use these services in a productive and responsible manner that will not cause them harm.

***Innovation and Diversification* -** Embrace innovative product design, delivery channels and new technologies, keeping in mind that inclusion will be driven by diverse institutions on the financial services continuum.

***Simplicity* -** The ease of use and understanding of the product and services, simple language and channels that are used to deliver them.

3.2 The Benefits of Financial Inclusion

Being included in the formal financial system helps people:

- Make day-to-day transactions, including sending and receiving money;
- Safeguard savings, which can help households manage cash flow spikes, smooth consumption and build working capital;
- Finance small businesses or microenterprises, helping owners invest in assets and grow their businesses;
- Plan and pay for recurring expenses, such as school fees;
- Mitigate shocks and manage expenses related to unexpected events such as medical emergencies, a death in the family, theft, or natural disasters; and
- Improve their overall welfare.

3.3 Overview of Financial Inclusion in Nigeria

World Bank (2012) observed that while there has been progress toward financial inclusion, significant challenges remain as follows:

- An estimated 2 billion adults worldwide don't have a basic account.
- Globally, 59% of adults without an account cite a lack of enough money as a key reason, which implies that financial services aren't yet affordable or designed to fit low income users. Other barriers to account-opening include distance from a financial

service provider, lack of necessary documentation papers, lack of trust in financial service providers, and religion.

- More than 200 million formal and informal micro, small and medium-sized enterprises (MSMEs) in emerging economies lack adequate financing to thrive and grow.
- Small scale enterprises operators cite a lack of collateral and credit history, and business informality as main reasons for not having an account.
- Some groups are more financially excluded than others: Women, rural poor, and other remote or hard-to-reach populations, as well as informal micro and small firms are most affected. For example, the gender gap in developing countries is estimated at 9 percentage points: 59% of men reported having an account in 2014, while only 50% of women did.
- The forcibly displaced populations present one of the most pressing financial inclusion challenges as almost 80% in adults in Fragile and Conflict-Affected States are outside the formal financial system.

Okoduwa (2012) maintained that as countries have accelerated efforts toward financial inclusion, it has become apparent that they face similar hurdles which impede their progress. These include:

- Ensure financial access and services extend to hard-to-reach populations, including women and the rural poor
- Increase citizens' financial literacy and capability so they understand different financial services and products
- Make sure everyone has valid identification documents, and a low-cost, accessible means for them to be authenticated
- Devise useful and relevant financial products, tailored to consumer needs
- Establish robust financial consumer protection frameworks, and adapt relevant regulatory and supervisory authorities, including by utilizing technology to improve supervision.

3.4 Overview of Financial Inclusion in Nigeria

Financial exclusion has manifested prominently in Nigeria with the bulk of the money in the economy staying outside the banking system. The issue of financial exclusion has therefore been a major economic challenge that has received the attention of the various governments over the past four decades.

Prior to the recent efforts to promote financial inclusion, the Nigerian economy was largely a cash-based economy with significant proportion of the narrow money stock in the form of currency outside the banking system. Although the average ratio of the currency outside the banking sector (COBs) to narrow money supply (M1) trended downward from 61.1 per cent in the 1960s to 44.3 percent in the 1970s and later to 40.9 per cent in the 1980s, the value, in nominal terms, was still high considering the growth in the level of narrow money in the economy. The decline in the ratio was attributable to a combination of developments, including increased literacy and government policies directed at encouraging financial sector growth. The CBN, during this period, initiated rural banking programme directing banks to open branches in the rural areas, encouraging Nigerians to use financial institutions and products more.

The crisis in the banking industry during the 1990s eroded the confidence of the populace in the industry. The problem was aggravated by the excessive spending of the political class leading to the increase in the level currency outside the banking system. The ratio of currency outside the banking system moved up to 47.7 per cent by end of the 1990s. To forestall the damaging effect of the banking industry distress in the 1990s, government implemented various policies which not only involved economic reforms to improve the general wellbeing of the populace in terms of employment and income earning capacity but also included measures (particularly the bank consolidation programme of 2004) that increased deepening of the financial sector. The stimulated use of the financial services pushed down the ratio of currency outside the banking system to 38.2 per cent by the end of 2000.

Government hoped that the rural banking scheme would help achieve the transformation through the following:

- Provide a platform for the mobilisation of savings in the rural areas through the diffused network of branches in all parts of the society;
- Encourage banking habits among the largely agrarian rural population;
- Provide credit for the growth of the small scale industries and entrepreneurs; and
- Promote balanced development and eventual reduction in the rural-urban migration (Okorie, 1990).

3.5 Financial Inclusion in Nigeria: Issues and Challenges

Anecdotal evidence has shown that only 46 per cent of the world adults as having access to financial services. Improving the global average level of financial inclusion has, therefore, become a global challenge. According to (Moghalu, 2011), the dearth of access to financial services by billions of adults all over the world poses serious challenges to global economic growth and development.
The challenge of inadequate financial inclusion is not just for the developing economies alone, from the emerging to high-income countries, government conceive and implement policies that seek to ensure majority of the population become financially included. "Beyond the non- robustness and inefficiencies of the financial system which contributes to the act of being excluded or included, the more fundamental issue of sub- optimal macroeconomic environment in the form of low income capacity and pervasive poverty level among the populace has played a more critical role of eroding the eligibility of the bulk of the financially excluded" (Moghalu, 2011). Specifically, he noted that the major challenges within the general economic conditions have manifested in the forms of:

- A major challenge in the financial inclusion process is how to ensure that the poor rural dwellers are carried along considering the lack of financial sophistication among this segment of the Nigerian society due to the general low level of financial literacy. Majority of the estimated 40 million financially excluded Nigerians lack knowledge of the services and benefits derivable from accessing financial services, while staff of the service providers often display lack of adequate understanding of the services and so unable to educate effectively. In fact sub-optimal outcome from attempts to increase customer awareness is reflected in the lack of appreciable progress in the literacy level of the populace. This has remained a major impediment to the progress of the financial inclusion as a result process.

- Another major challenge, especially from the part of growing saving is the inability of the populace to save as a result of double digit inflation in the economy, with its attendant effects on real interest rate and continuous loss of money value. The disincentive negative real interest rates obviously have made potential savers remain with other non-bank avenues for savings.

- There is also the challenge of increasing poverty. Though the economy has been reported to have grown at an average of 7.0 per cent between 2009 and 2011, unemployment rate continue to increase while progress on many of the poverty- reducing Millennium Development Goals has been slow.

- The uncompetitive wage levels, particularly in the public sector where a large number belong to the low-cadre means that these groups are excluded financially. Though their salaries are paid into the bank but the personnel only visit the bank once in a month to collect their salaries with little or nothing to save.

3.6 The Way Forward and Conclusion

The clear fallout of the latest global economic and financial crises of 2007-2008 together with the danger of another crisis, arising from the impending threat of the protracting Eurozone debt crisis has called for concerted efforts around the globe towards fortifying the financial markets. Financial inclusion has emerged as one major approach by policy makers to strengthen the financial sector and improve its ability to successfully ward-off and reduce the possible effects of any subsequent financial crisis.

It is believed that increased financial inclusion will expand the capacity of the financial markets and thus, make it able to withstand any local, regional or global economic shocks. In view of the intricacies and expertise required, financial inclusion strategies should now focus more on instituting a systematic approach, which aligns roles and responsibilities with institutions and frameworks to guarantee continuity, sustainability and efficiency.

3.6.1 The Role of Financial Regulator:

Financial literacy and consumer protection are targeted at ensuring that users of financial services are not unduly exposed to extortion and abuse. Improved literacy level among consumers and a strong consumer protection system reduces greatly, distortions in the market information available to consumers. This will consequently lead to healthy competition, increased transparency and improved access in retail financial markets. The regulator, especially in developing countries like Nigeria, will do well to embrace not only coordination and constant consultation with private partners and financial institutions, but also actively engage more frequently in implementation. Such pragmatic role should include cross-cutting initiatives, ranging from information campaigns like creation of virtual web; inclusion of financial literacy in school curriculum and training of school instructors as well as tight disclosure policy and robust dispute resolution framework. These activities, as an integral part of the financial literacy programme, should span several departments, agencies in the financial markets and ministries, including the informal sector. The Consumer Protection and Financial Policy and Regulation Department in the CBN should provide the strategic lead on financial inclusion issues. In addition, the relevant Departments should be saddled with the responsibility of investing heavily on research programmes that would help improve financial education and protection. Other activities that should be specifically under the purview of regulators include the setting-up and owning of the financial inclusion strategy document and implementation of the reforms, regulation and promotion of microfinance institutions and activities that would promote rural finance in the country.

3.6.2 Role of Banks

The role for banks in the financial inclusion process is pivotal and cannot be overemphasised. In fact, there is the general believe that financial inclusion process is not possible without the banks. There are views also that only an inclusive financial system will promote financial inclusion while the banks remain the critical agent of achieving this through the provision of efficient and key financial services. Hence, most countries today formulate their financial inclusion strategies in a manner that growth in rural areas should be facilitated by banks. It is therefore pertinent that the banks should take steps to properly play their roles in the financial inclusion process. Banks in Nigeria are therefore expected to build capacity in order to adequately support and propel the growth of financial inclusion in the country. Building capacity will include training and equipping of staff with the necessary skills, particularly in the area of rural development financing. Other processes of building bank's capacity to support and enhance financial inclusion include the use of grants and special funding to seek for innovative ways of getting services to customer so as to reduce transaction costs, improve and optimize the use of existing infrastructure and delivery structures rather than creating new and costly ones. Banks should seek to adapt or introduce new financial products, and where appropriate, invest well in technological research, especially in areas of financial transaction dynamics and needs of the rural areas/informal sector.

3.6.3 The Role of Government

A favourable legal environment for lending may enable banks to operate more profitably through lending and grow eventually leading to expansion of banking services. Government role is more of creating the enabling environment for the operators and the consumers to relate and interact in a mutually beneficial way. Specifically, working through the regulatory organ, the government needs to strengthen land and property registries as well as enhance the transparency and efficiency of court systems. Other specific steps the government eed to implement include government's continued payment of interest rate subsidies for agricultural lending in favour of the agricultural sector, and promotion of investment in communications, physical infrastructure, and services, particularly power and education. The creation of commercial courts to handle banking related cases, particularly loans, for easy dispensation of justices would be a welcome development as such cases are currently unduly delayed in the conventional courts.

3.6.4 The Role of the Informal Sector

The peculiarities and characteristics of the target population for financial inclusion has shown over the years that the structures and platforms of the conventional banks and non-bank financial institutions are inappropriate and inadequate to successfully capture the financial needs of the financially excluded low-income and rural group. The informal sector could be a range of voluntary organisations, including community groups, private clubs, faith groups and tenant or resident groups and could also take the form of mutual, community interest groups, trade organisations, industrial and provident societies and charitable organisations.

In most part of the emerging economies like the BRICS and even in the conservative developed economies, voluntary organisations, community groups and social enterprises are fighting inequality, creating a better environment for people to live and making people's lives better. These institutions have clearly become veritable agents of social and economic regeneration. They are known to help the financially excluded have free access not only to funding but also to the advices they require and in the way that suits them. The informal sector, as an aggregation of the common people (the majority poor) and the government (as an organ of the society responsible for guaranteeing social and economic welfare of the entire populace), both share common interest in some areas and this has further accentuated the need for partnership between the two.Indeed, the informal sector:

- Provides an opportunity for the common man to have a say in the issues that affect their lives and this is in agreement with the objective of the government, especially in a democratic dispensation to support a vibrant and civic society, enabling people to better participate in solving local and national issues;

- Is made of groups that come together and thrive largely on volunteering and self-help and this helps to build a closely knitted and strong community life. This complements the government's objective of promoting greater number of levels of shared actions within the community and amongst diverse sections of the society; and

- Provides social enterprises such as poverty self-help groups, trade associations, and market groups etc. all of which have helped in recent times to create new ways of delivering social and environmental benefits through business approaches. Their activities have helped to deliver financing and economic empowerment as a public good in line with the government objective of ensuring equity and equality among the populace in terms of equal access to economic opportunities and social welfare. Government therefore has a critical role to set out measures that will not only promote the value of these social enterprises and improve the provision of information and advice to social enterprises, but also enable access of these social enterprises and groups to finance for their effectiveness. Some of the specific steps needed to achieve this include legal reforms that will ease and promote the establishment of such groups and simplify their regulations. It is important that the government, policy makers and regulators put in place measures in the form of a new framework that will grow this partnership between the informal sector and government. Such relationship will definitely go a long way not only to give opportunity to improve the society, sustain the environment and establish new forms of enterprise but also assist in building and strengthening a prosperous, stronger and equitable society.

3.6.5 Role of Technology

The ability of banks and other financial institutions to take advantage of the huge untapped potential in the smaller towns and cities and provide them with the required type and form of financial services poses a big challenge. Banks should make it a priority first to deploy core banking solution (CBS) that will support the volume and form of services required to capture the low income and rural population. The next step would then be not just to deploy but also sustain a multi-channel approach using handheld devices, mobiles, cards, micro-ATMs, branches and kiosks, with appropriate structures to ensure seamless integration with the banks' CBS. On the part of the government, appropriate policies should be implemented to encourage and facilitate technological research and innovation that will make financial services not just easily accessible but also cheaply available. In a related development, Government and banks would need to move away from the attitude of viewing the objective behind financial inclusion as a national social responsibility or charity activity, but should begin to look at it more as a profitable business opportunity and an enabler of development.

There is global consensus on the importance of financial inclusion due to its key role of bringing integrity and stability into an economy's financial system as well as its role in fighting poverty in a sustainable manner. It is more pertinent in the case of Nigeria as a developing nation to use financial inclusion as a platform not just for growing the financial sector but more as an engine for driving an inclusive economic growth.

Greater financial inclusion is achieved when every economic activities, geographical region and segments of the society have access to financial information, financial assistance, financial services and financing with ease and at minimum cost. This helps to promote balanced growth through its process of facilitating savings and investment and thus causing efficient resource allocation from surplus sector/segments (unproductive) of the society to deficit sectors/segments (productive) of the society. By this process, financial transaction is made easy, income level and growth increases with equity, poverty is eliminated, while the economy becomes insulated from external shock.

It is important to note that as indicated in the various country experiences, the nature, form and challenges of financial inclusion differ between jurisdictions and as such cannot be addressed by a single product or technological innovation. The policy makers will have to realise that there is not a single pre-determined recipe for improving financial inclusion, and developing country policy makers are in the best position to evaluate their unique institutional, socio-economic, financial and political circumstances and pursue the strategy that best fits. In addition, from the varying country experiences, it is clear that a first major step towards ensuring financial inclusion is the political will of the government encapsulated in the creation of institutional and legal framework required for adoption and successful implementation of financial inclusion policy in any economy. It is on the basis of this framework that financial service providers evolve, compete and thrive.

4.0 CONCLUSION

Financial inclusion or inclusive financing is the delivery of financial services at affordable costs to sections of disadvantaged and low-income segments of society. It involves access and usage of a broad range of affordable, quality financial services and products, in a manner convenient to the financially excluded, unbanked and under-banked; in an appropriate but simple and dignified manner with the requisite consideration to client protection. Financial access facilitates day-to-day living, and helps families and businesses plan for everything from long-term goals to unexpected emergencies.

The key principles for financial inclusion or inclusive financing are: access, affordability, appropriateness, usage, quality, consumer financial education, innovation and diversification as well as simplicity.

The benefits of being included in the formal financial system facilitates day-to-day transactions; safeguard savings; finance small businesses or micro-enterprises; plan and pay for recurring expenses; mitigate shocks and manage expenses related to unexpected events; and improve their overall welfare.

The major challenges within the general economic conditions have manifested in the forms of: ensuring that the poor rural dwellers are carried along considering the lack of financial sophistication among this segment of the Nigerian society due to the general low level of financial literacy; inability of the populace to save as a result of double digit inflation in the economy, with its attendant effects on real interest rate and continuous loss of money value; increasing poverty thus reducing the process of Millennium Development Goals; uncompetitive wage levels, particularly in the public sector where a large number belong to the low-cadre means that these groups are excluded financially.

Financial inclusion strategies should now focus more on instituting a systematic approach, which aligns roles and responsibilities with institutions and frameworks to guarantee continuity, sustainability and efficiency. This will involve all segments of the nation's economy including the financial regulator, the banks, and the government at all levels, the informal sector and improved technology.

5.0 SUMMARY

By this development, we have come to the end of the course. We hope you had a rewarding experience and advise that you study the material very well employing the referenced textbooks to improve the depth of the course. We also advise that you should attempt the four TMAs and submit same to your tutor for assessment. Use the assessment comments to guide your study. We wish you every luck in your examination.

6.0 TUTOR MARKED ASSIGNMENT

1. Discuss the challenges of financial inclusion in Nigeria?
2. What are the ways forward?

7.0 REFERENCES AND FURTHER READING

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