Financing options available to small and medium scale enterprises (SMEs) in Nigeria: a critique

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Key Words
Small and Medium Scale Enterprises, Formal and Informal Financing Option, Risk-sharing, Sustainable Economic Development, international trade.

Abstract
This study critically looks at the financing options available to Small and Medium Scale Enterprises (SMEs) in Nigeria, using Benue and Nasarawa States as case study. Mean scores and standard deviation were used to present and analyze the primary data obtained via questionnaires. Correlation was used to substantiate whether there is similarity in the inherent identified problems of each financing option. Simple percentages combined with mean scores were used to test hypothesis one while Chi-square was used to test hypothesis two. The result shows that SMEs are significantly financed by informal sources of finance than the formal sources of finance. Small and Medium Scale Enterprises Equity Investment Scheme (SMEEIS) which is a major formal financing option has not made any significant impact towards SMEs growth in Nigeria. The conditions for accessing its funds were beyond the reach of the predominant SMEs in Nigeria. This situation has a negative effect on Nigeria's ability to be effectively involved in international trade. The major recommendations are a legislation for financing of SMEs be put in place which will last for a long time and that both the government and the banking sector should mutually agree on a credit guaranteed scheme strategy that will incorporate a risk-sharing arrangement as a way of encouraging the banks to channel funds to the SMEs sub sector for their growth and development which would translate into the national economic growth and sustainable economic development of Nigeria.

Introduction
Generally, the United Nation's Millennium Development Goals (MDGs) are being pursued in Nigeria in line with the need to enhance the process of development in the country by making all the basic amenities of life at the disposal of the masses. Specifically, the present administration of Dr. Goodluck Ebele Jonathan is of the vision that, by the year 2020, Nigeria would be one among the first 20 largest economies of the world. This is achievable if it is premised on a sound and committed economic policies implementation in the country. It must be emphasized that it is while attending to small matters that bigger things are created (Sule, 1986). Vision 2020, for example, is economically a big and remarkable thing, but unless Nigeria attends to smaller economic matters, she cannot achieve it. There is, therefore, the need to assess the country's stand now to see if she is heading to the right direction in actualizing her dreams.

Small and Medium Enterprises (SMEs) play important roles in the economic growth and sustainable development of any economy (Ariyo, 2005). They may look small or inconsequential but are actually the foundation of any economically stable nation. The potential benefits of SMEs to any economy include contribution to the economy in terms of output of goods and services; creation of jobs at relatively low capital cost; provision of a vehicle for reducing income disparities; development of a pool of skilled and semi-skilled workers as a basis for future industrial expansion, among others.

A country that is not economically stable cannot be a candidate for international trade. It should be emphasized that international trade has a lot of economic benefits to a nation. A key developmental issue like SMEs has proven to enhance various economies. It is there fore a paramount issue to be addressed in an attempt to see if a given nation is worth interacting at the international arena in trade and other economic issues. According to NCI (2003), a small-scale industry is an enterprise with total cost (including working capital but excluding cost of land) above N1.5 million but not exceeding N50 million, with a labour size of between 11 and 100 workers, while the medium-scale industry has a total cost (including working capital but excluding cost of land) above N50 million but not exceeding N200 million, with a labour size of between 101 and 300 workers. On the other hand, the revised Operational Guidelines of SMEEIS (2005) defines a small and medium enterprise as an enterprise with a maximum assets base of five hundred million naira (N500m)(excluding land and working capital), and with no lower or upper limit of staff.

In Nigeria, there is no clear definition that distinguishes Small and Medium Enterprises (Abiodun, 2011). Small and Medium Enterprises Credit Guarantee Scheme (SMECGS) as the name appears did not differentiate Small and Medium enterprises in its definition. It is however opined that a distinction would be more appropriate especially when financing is emphasized. Start-ups could be those enterprises operational for three years, growing enterprises should be ones in operation between three to five years and successful ones should be those operational between five years and above. This will help diversify financial support for them. For the purpose of this paper, Small enterprises are those with staff less than ten and assets not more than three hundred thousand naira. Medium enterprises are those with staff more than ten and assets not more than one million naira. They are both considered together because they have similar financing problems.

Kpelai (2009) asserts that SMEs are the engine room for the growth of any developing economy, because they form the bulk of business activities in developed and developing economies like Nigeria. Many economies like Canada, Croatia, etc have acknowledged that SMEs are crucial for industrial restructuring and have formulated national SME financing policies, targeted at developing the sub-sector. However, the small business' contribution to macro-economic development is inhibited by the fact that they have no, or only overpriced, access to finance institutions and other services (Schneider-Barthold, 2002). More so the accessibility to funds and the cost of raising them have remained issues limiting the in-capitalisation requirement leading to premature collapse of SMEs (Mambula, 2002).Funding has therefore remained one of the key managerial problems that keep confronting business enterprises in Nigeria today.

The two fundamental financing concepts of SMEs, the formal and informal forms of financing, have been identified by previous researchers, scholars and practitioners (Gelinas, 1998; Aruwa, 2004a). The formal forms of financing are the ones regulated by the government, while the informal forms of financing are not so regulated by the government. To Gelinas (1998) and Aruwa (2004a) among the most popular of the formal sources of financing, are the commercial banks and development banks for enterprises. The informal sources on the other hand comprise borrowing from friends and relatives, and cooperative credits. With the availability of these identified financing options SMEs still have problem of financing.

The problem of SME financing has received the most tremendous research efforts from researchers. Some notable works in this respect include Aernold (1998), Anic and Paus (1998), Inang and Ukpong (2002) and Aruwa (2004b). In their findings, four problems in financing SMEs have become recurrent: the cost of capital; risk; the inappropriate terms on bank loans; and the shortage of equity capital. Over the years government has enacted various policies and introduced schemes aimed at financing SMEs. However it is worrisome to note that SMEs up till date are starved of funds and the financing problems keeps reoccurring. The question which this research wishes to answer is; why this recurrent financing problems of SMEs in the face of the formal and informal financing options available?

SMEEIS is a product of formal financial institutions put in place to finance SMEs through a venture capital financing. This initiative is seemingly attractive as a reliable formal source of financing for SMEs since it involves all the banks in Nigeria and the Central Bank of Nigeria monitors the banks to enhance compliance. There is serious doubt as to the success of SMEEIS as regards accessibility of its funds. Nigeria's vision 20-20-20 as explained above is achievable only if SME sub sector is well developed. The researcher's motivation to research in this area is to emphasize this point with probable recommendations as a way of contributing to the delivery of this vision.

The aim of this paper is to assess the financing options available to SMEs in Nigeria and to examine the factors militating against accessing the SMEEIS funds by SMEs in Nigeria. This is premised on the notion that an international interaction amongst economies is a function of their national economic stability without which it is impossible. The hypotheses tested in the study are stated in the null form as follows: HO1 SMEs in Nigeria are funded significantly by formal sources rather than informal sources. HO2: Conditions for accessing SMEEIS funds are beyond the reach of most SMEs in Nigeria. The paper is arranged into sections one through five, with Introduction, theoretical framework and literature review, methodology, data presentation analysis and interpretation and finally conclusion and recommendations respectively.

Theoretical frame-work and literature review

A well functioning financial system is a key enabler of economic growth. SMEs are an important part of Nigeria's economic growth and development and bank lending is the primary source of external finance for SMEs. Therefore, it is important that the banking sector responds efficiently and effectively to the needs of SMEs. According to Ohanga (2005) there are a number of features of lending generally which potentially could affect the efficiency of the market for lending.

Information Asymmetry is a situation where business owners or managers know more about the prospects for, and risks facing their business than do lenders. Where information asymmetries exist, bank lending theory predicts that lenders may respond by increasing lending margins to levels in excess of that which the inherent risks would require. Bank lending theory also suggests that banks may also curtail the extent of lending – credit rationing – even when SMEs would have been willing to pay a fair risk-adjusted cost of capital. The implication of raising interest rates and/or curtailing lending is that firms will not be able to finance as many projects as otherwise would have been the case. Information asymmetry is more acute in case of SMEs because their relative size makes them economically unattractive to banks since they are unable to accurately gauge the level of risk involved in lending to SMEs (Ohanga, 2005).

Pecking order theory/hypothesis of lending

Ohanga (2005) asserts that, from the borrower's perspective, if faced with a cost of lending that is above the true risk-adjusted cost, the borrower will have incentives to seek out alternative sources of funding. Bank lending theory suggests that, where information asymmetry and moral hazard are prevalent, firms are likely to fund themselves firstly from retained earnings and then from bank debt rather than issuing equity. This is referred to as the pecking order theory/hypothesis. The theory further suggests that the mix of debt and equity should be the cumulative result of hierarchical financing decisions over time. SMEs do not issue equity but this theory applies because if their retained earnings are not enough to fund them then debt is supposed to be the next option.

Evidence around the world indicates that small scale enterprises provide an effective means of stimulating indigenous entrepreneurship, enhancing greater employment opportunities per unit of capital invested and aiding the development of local technology (Sule, 1986: World Bank 1995). Through their wide dispersal, they provide an effective means of mitigating rural-urban migration and resource utilization. Furthermore, by producing intermediate products for use in large scale enterprises, SMEs contribute to the strengthening of industrial linkages. These explain the increased interest which developing countries have shown in the promotion SMEs since the 1970s (Ekpenyong and Nyong, 1992).

Akabueze (2002) asserts that the significance of finance in the drive for economic growth is fairly well established and generally accepted. For instance, the take-off and efficient performance of any industrial enterprises, be it small or large, will require the provision of funds for its capitalization, working capital and rehabilitation needs, as well as for the creation of new investments. Apart from entrepreneurship, funds are required to bring together the other factors of production – land, labour and capital – before production can take place. Provision of funds to the industrial sector, particularly, for the SMEs has, therefore, been of prime interest to policy-makers in both the public and private sectors. Aladekomo (2003) notes that successive governments in Nigeria have, since the last three decades, shown great interest in financing of SMEs, by establishing specialized banks and other credit agencies/schemes to provide customized funding to the sub-sector to enhance growth and stability. In addition to these, programmes like the National Directorate of Employment (NDE), Better Life for Rural Women, Family Support Programme, Child Care Trust, People's Bank, National Poverty Eradication Programme (NAPEP), to mention a few, have been introduced.

The impact of all existing credit schemes to SMEs, in terms of providing funds for meaningful and sustained development among the SMEs, had hardly been noticeable. These credit schemes either have a direct or indirect link with banks. The banks by their nature and position in the economy, therefore, remain the known formal source of finance for enterprises (Agumagu, 2006). It is disheartening to know that a 2001 World Bank survey on Nigerian firms showed that although 85% of the firms had relationships with banks, most of them had no access to their credit. This explains why SMEs in Nigeria represent about 90% of firms in the Nigerian industrial sector on numerical basis but regrettably contribute as low as one percent to GDP in contrast to countries like Indonesia, Thailand and India where SMEs contribute almost 40% to GDP (HPACI, 2002).
The failure of most of the schemes and the need for a sustainable source of financing SMEs, therefore, necessitated the Central Bank of Nigeria (CBN) inspired Banker's Committee initiative which is aimed at committing the banking industry to the provision of finance and other ancillary support to the sub-sector via an equity participation scheme.

Bank lending and SMEs development in Nigeria

SMEs are crucial catalysts for economic development (Aruwa, 2006). Banks provide a nation with a function of pooling scattered resources from surplus to deficit units so as to promote investment innovation, productivity and consequently growth and development. The banking industry in Nigeria dominates the financial system (Agusto, 2000). Berger et al (2001) maintains that a well functioning financial system contributes to investment and economic growth. Every enterprise at its onset, before standing firm on its feet, needs borrowing. The first place that they need to go and borrow at those times is the banks.

According to elementary corporate finance theory, an investment project should be undertaken whenever its net present value is positive. This assumes that the capital outlay is not exhaustive. Firms do any volume of investment, and so where the firms do not have adequate capital to embark on any level of investment, there is need for capital borrowing (Mainoma, 2005). This shows that even if an enterprise is strong and firmly rooted, it still does not stop borrowing, because it can embark on a very large scale investment more than it currently does, if it can get the required capital. When funding becomes a major problem for such enterprises, nothing else works. This is because other problems which emerge later in an enterprise's lives that are being tackled as natural problems which come after its funding. This in turn hinders the growth and development of the economy.

Njoku (2007) postulates that to forestall the imminent capital flight from the real sector to the banking sector, banks should begin to take second look at the industrial sector in terms of lending operations. He continues that banks should plough back a large proportion of the money available to them to the real sector of the economy as long-term loans at rates not exceeding 5%. This he said will encourage industrialists not only to remain in their present businesses but also to achieve their business expansion targets.

Small and medium scale enterprises dominate the private sector of the Nigerian economy, but almost all of them are starved of funds (Mambula, 2002). The persistent lack of finance, for establishment and operation of SMEs occasioned by the inability or unwillingness of the deposit money banks to grant long term credit to operators of the real sector of the economy, led to the establishment of development finance institutions and the Introduction of numerous funding programmes for the development of SMEs in Nigeria. In spite of these institutions and funding programmes, there continues to be a persistent cry against inadequate finance for the development of the SMEs in the country.

The CBN (2008) shows that commercial and merchant banks loans and advances to SMEs have been decreasing over the years. The statistics show thus; commercial bank's loans to SMEs as a percentage of total credit decreased from 48.8% in 1992 to 22.22% in 1994. The trend increased marginally to 22.9% and to 25.5% in 1995 and 1996, respectively. There was a sharp reduction from 25% to 17% in 1997, and the decrease continued till it reached 0.2% in the year 2010. Similarly, merchant banks loans to SMEs as a percentage of total credits reduced from 31.2% in 1992 to 9.0% in 2000 (Akabueze, 2002). The continuous decrease in commercial and merchant bank's loans to small scale enterprises can be attributed to lack of collateral from the SMEs to secure the loans and the high lending rates from the banks.

Approaches of SMEs Financing in Other Countries

Since 1961, the Government of Canada has supported small businesses in Canada via a strategic partnership with financial institutions. This strategic partnership exists in the form of the Small Business Loans Act (SBLA), which allows financial institutions and the government to "share the risks inherent in extending credit" where they exist. In its 37 years of operation, the SBLA has facilitated the financing, creation and/or improvement of more than 500,000 businesses. During this time, financial institutions have been able to provide small and medium-sized enterprises with more than $20 billion in financing. Loans guaranteed during 1997-98 totaled $1.9 billion in Canada and more than $145 million in Atlantic Canada (Canadian Bankers Association, 1997). While the Export Development Corporation (EDC) provides support to SMEs in the form of insurance services, loans are typically not issued directly to Canadian companies but rather are provided to foreign purchasers of Canadian exports. This financing is important, as it allows Canadian SMEs to successfully bid on and finance export sales opportunities (Canadian Bankers Association, 1997).

In EU countries, Gamser (1998) notes that SME financing can be broken down into three major categories: (i) credit guarantees; (ii) loans/equity investments; and (iii) grants. All these instruments exist in EU and OECD countries. Credit guarantees enable SMEs with sound investment proposals to borrow from commercial banking institutions at reasonable rates. They encourage the private financial sector to act, to raise the profile of the SME market and to be flexible on security.

Starmans (1998) emphasizes that SME support is not just about giving away money. The lesson of the advanced market economies shows that an enabling legislative framework has to be created prior to giving loans to SMEs. It is a government task to increase the supply of credit facilities to the SME sector in order to provide funding for its economic expansion. Government support can be provided in the following forms: (i) promoting the granting of credit to SMEs through targeted guarantee schemes; and (ii) supporting merchant banks in a general sense (through tax incentives, legislation, subsidies, liquidity guarantees, etc.).

Anic and Paus (1998) identify major barriers to the development of SMEs as insufficient support by the Government, low access to loans, lack of information on new technological developments, and insufficient investment in education. The Croatian Guarantee Agency (CGA) provides guarantees of up to 80% of the total amount of the loan. Guarantees are provided for (i) small businesses; (ii) business activities of SMEs in areas of special importance to the country; and (iii) start-ups. Small loans are available up to 50,000 Dutch Mark (DM) with an interest rate of between 1 to 9%. Start-ups may obtain up to DM 100,000 and existing businesses up to DM 300,000 at interest rates of between 7 and 12 % with a repayment period of between 5 and 8 years (Anic and Paus, 1998).

Main Sources of Financing SMEs in Nigeria

The importance of finance to business organisation cannot be over-emphasised. Business finance is however, not easy to come by especially in respect of SMEs. Yet they require funds from every source available to meet their asset needs, working capital needs, and for expansion. According to Ekpenyong and Nyong (1992), there is wide consensus in Nigeria that government policies are skewed in favour of the formal sector to the detriment of the informal sector. This skewness is to the great disadvantage of SMEs in Nigeria since they are more disposed to the funds of the informal sector.

Formal Sources of Financing SMEs

The commercial banks, merchant banks, and development banks provide the formal sources of finance to SMEs. The financial system in Nigeria is not in short supply of liquidity, but banks have been very reluctant to grant loans to SMEs, which they regard as a high-risk sector. Most of the banks would rather pay the penalty imposed for not meeting the minimum exposure to preferred sectors of the economy than actually run the risk of being exposed to them.

According to Ojo (1984), the sources of investment finance for SMEs include owner's savings and assistance from banks, government institutions, local authorities, co-operative societies, relatives and friends, and moneylenders. The study shows that almost all the funds came from personal savings (96.4%) with about 3% from the informal sector and 0.21% from the formal financial institutions. This trend is further established by a 1983/84 study by the Nigerian institute for Social and Economic Research (NISER). NISER findings show that about 73% respondents raised their funds from personal savings, while only about 2% obtained their funds from the formal financial institutions.

The Small and Medium Industries Equity Investment Scheme (SMIEIS) Fund

In Nigeria, the formal financial institutions have been organised to finance SMEs through venture capital financing in the form of a SMIEIS fund. This was in response to the Federal government's desire to promote SMEs as vehicles for rapid industrialisation, sustainable economic development, poverty alleviation and employment generation. Venture capital financing supplements or takes the place of credit facilities that the conventional banks are unwilling to give. The provider of the funds may initially part with the funds as a loan, but specifically with the idea of converting the debt capital into equity at some future period in the enterprise. The return from such investment should be high to compensate for the high risk. Venture capital may be regarded as an equity investment where investors expect significant capital gains in return for accepting the risk that they may lose all their equity (Golis, 1998).

The Nigerian government's version of venture capital financing of SMEs -SMIEIS, requires all licensed banks in Nigeria to set aside 10% of their pre-tax profit for equity investment and to promotion of small and medium-scale enterprises. The goal is to reduce interest rate burden and other financial service charges imposed under normal bank lending. The reason for the inability of the SMEs to avail themselves of this fund is yet unconfirmed. The apparent lack of investment in the micro-enterprises sub-sector could be informed by the absence of approved guidelines which is still being finalized (Osagie, 2004).

According to Sanusi (2004), a breakdown of the SMIEIS fund investment by sectoral distribution shows that 68.82% went to the real sector while service related investment accounted for 31.18%. This, he noted, is a sharp reversal from the initial trend recorded under the scheme. The Bankers Committee have allocated the investment of banks with respect to the fund as 60%, 30%, and 10% of their fund in core/real sector, service-related and micro-enterprises respectively. Analyzing the geographical spread of the SMIEIS fund, Sanusi (2004) reported that Lagos-based investments have gulped 56.63% of the fund, and Abuja and 18 states received the balance 43.47%.

The point is about the model of growth of SMEs and financing options available. Golis (1998) submit that venture capitalists do not seek enterprises on the start-up and survival stage but only in the stability and rapid growth stages did the venture capitalists appear. Yet the method of financing remains a critical success factor for SMEs.

To be eligible for equity funding under the scheme, a prospective beneficiary shall: i). Register as a limited liability company with the Corporate Affairs Commission and comply with all relevant regulations of the Companies and Allied Matters Act (1990) such as filling of annual returns, including audited financial statements; ii).Comply with all applicable tax laws and regulations and render regular returns to the appropriate authorities (Bankers Committee Revised, 2005).

Aruwa (2005) laments that, given the developmental stage of Nigeria's dominant SMEs; it is difficult for them to meet any of these requirements. Consequently, SMEs in Nigeria do not have the capacity to access funds from SMEEIS. Previous research works has not been able to critically assess the available financing options to SMEs with a view to ascertaining which of them is more patronized and the reason behind this patronage. This work is aimed at closing this existing gap.

Methodology

This study is designed to critically look at financing options available to SMEs in Nigeria and to identify the factors that militate against the exploration of the formal sources of financing such as SMEEIS. To achieve this purpose, the survey research design and an empirical method making use of Chi-square and correlation was used. Chi-square was used to test hypothesis concerning issue of accessibility of SMEEIs funds. Correlation was used to substantiate whether there is similarity in the identified problems of each financing option. Mean scores using 5 point likert scale was used to present and analyse the collected data via questionnaire. Simple percentages were also used to put together the data concerning responses about the financing mix of sampled SMEs. The questionnaire is used to obtain the views of the owners of SMEs on the operations and impact of SMEEIS.

The population of this study is made up of 700 SMEs with a minimum of five year life span operating within Benue and Nasarawa States. The study's sample size is 88 SMEs made up of 43 from Nassarawa state divided into 30 small-scale enterprises and 13 medium-scale enterprises. Similarly 45 SMEs were drawn from Benue State divided into 34 small-scale enterprises and 11 medium-scale enterprises. Unfortunately only 40 completed questionnaires were returned from Nasarawa made up of 28 small-scale enterprises and 12 medium-scale enterprises. Similarly, only 44 questionnaires were returned from Benue State made up of 33 small-scale enterprises and 11 medium-scale enterprises. The sample size was, therefore, limited to 84 SMEs.

Benue and Nassarawa were chosen because of proximity to the researcher. Time and resources could not permit the researcher to cover more than this. From literature review the researcher also discovered that financing problems were similar to SMEs which supposes that this study can stand external validity.

The research sample was computed using the following formula, allowing 10% tolerable sample error. Sample Formula (n) = $N/1 + N(e)^2$, where n is the required sample size, N is the research population, and e is the tolerable error in judging the population. Primary data were obtained using questionnaire designed for SMEs and financing institutions separately and structured interview instruments. The questionnaire employs likert-scale measures, a fifteen likert-like scale having four response categories labeled or weighted as strongly agree (4), agree (3) disagree (2) and strongly disagree (1).

Data Presentation, Analysis and Interpretation

Analysis and Interpretation of Responses on Formal Financing

The responses from the questionnaire administered in respect of formal financing sources available to SMEs in Nigeria are presented and analyzed below:

Table 1: Mean Scores on Formal Financing Sources

Variable	Mean	Standard Deviation	Minimum Score	Maximum Score
Formal finance as main source of Capital	1.34	0.71	4.00	1.00
Bank loan	1.33	0.69	4.00	1.00

Second-tier Security market (SSM)	1.00	1.18	0.00	0.00
SMEEIS	1.20	0.57	4.00	1.00
Others	1.19	0.50	3.00	1.00
Combined Mean/SD score	**6.06**	**3.65**	**6.06 < 12.5**	

Source: *Field data computation (November, 2011)*

In the analysis presented in table 1, none of the formal financing variables meet the cut-off mean of 2.5 for individual item. Respondents perceived that the utilization rate of formal financing sources among the SMEs sampled was low. The overall perception of formal financing sources that emerge from this analysis, therefore, is that there is low utilization rate of formal financing sources by SMEs in Nigeria given that the computed overall mean score of the variables (6.06) is less than the sections cut-off mean of 12.5. The standard deviation (3.65) shows that there is no much disparity in the respondents' perception as evidenced in the mean scores.

Table 2: Mean Scores on Informal Financing Sources

Variable		Mean	Standard Deviation	Minimum Score	Maximum Score
Informal finance as main source of Capital		3.86	0.48	1.00	4.00
Personal Savings		3.60	0.82	1.00	4.00
Cooperative Credits		3.91	3.39	1.00	4.00
Loans from Friends/Relatives		1.96	1.28	2.00	1.00
Ploughed-back profits		1.35	0.87	2.00	4.00
Combined Mean/SD score		**14.68**	**6.84**	**14.68 > 12.5**	

Source: *Field data computation (November, 2011)*

Table 2 depicts a favorable perception on utilization of informal financing sources than the data presented in Table1. The cooperative credit has the highest mean score of 3.91. What is significant in the table is that the SMEs' mean score of 14.68 on informal sources of finance is higher than the section's cut-off mean of 12.5. The disparity in perception as indicated by the standard deviation is low. Comparatively, the mean scores recorded for formal sources of finance in Table 1 was 1.34. This is less than the mean score of 3.86 recorded for informal sources of finance (Table 2). This is interpreted that informal sources of finance are more available and more utilized by SMEs in Nigeria than the formal sources.

Table3: Mean Score on Financing Problems

Variable		Formal Sources	Informal Sources
Cost		2.02	1.03
Accessibility		1.31	3.71
Collateral		3.71	1.62
Awareness		3.38	2.10
Risk (others)		2.57	1.36
Combined Mean Scores		**13.99 > 12.5**	**9.82 < 12.5**

Source: *Field data computation (November, 2011)*

The study investigated what could be the likely financing problem that brought about deviation in the use of both formal and informal financing sources. Table 3 provides the analysis along five variables on likert scale measures. The formal sources of finance combined mean score (13.99) on the cost, accessibility to source of finance, collateral security requirement, awareness of existence of sources of finance and the risk inherent in use is higher than the cut-off mean whereas the cut-off mean on informal sources, which is within acceptable mean score (9.82 < 12.5). However, the informal sources of finance mean score on awareness is lower than that of the formal sources. This could mean that the existence of formal sources of finance like SMEEIS is not to the knowledge of most SMEs.

A further test of correlation between the mean scores of formal and informal sources of finance shows negatively- correlated relationship of -0.5000 on the variables of financing problems. This is shown in Table 4 below:

Table 4: Correlation Coefficient of Financing Problem Variables

Variable	Mean	
	Formal Sources	Informal Sources
Cost	2.02	1.03
Accessibility	1.31	3.71
Collateral Security	3.71	1.62
Awareness	3.38	2.10
Risk (others)	2.57	1.36
Correlation Coefficient (r)	-0.5000	

Source: *Field data computation (November, 2011)*

It is no doubt that there is a relationship between formal and informal sources of finance as far as SME financing is concerned. The calculation of correlation coefficient (r) revealed an average negative relationship between these variables. This could be explained that accessibility may be a problem more of the formal sources than of the informal sources. Similarly, the level at which collateral is demanded in formal sources is not the same as in an informal source. A positive correlation coefficient would on the other hand mean, the more collateral is needed in formal source, the more it is needed also in an informal source. The negative correlation therefore, shows that the variables move on average in the opposite direction.

Test of Hypothesis 1

Table 5: Sampled SME Financing Mix

Sources of Finance	**Small Enterprise (percentage of Total Capital)**	**Medium Enterprise (percentage of Total Capital)**
Formal Sources		
Bank loans	04	24
NDE/NACRDB	25	00
SMIEIS	03	05
SSM	00	00
Equipment Leasing **Total**	00 **32**	01 **30**
Informal Sources		
Personal Savings	20	23
Cooperative Loans	31	33
Loan from friends/ Relatives	15	12
Others **Total**	02 **68**	02 **70**

Source: *Interview Questionnaire Responses (November, 2011).*

Table 5: depicts the percentage of the formal and informal component sources of financing in the capital structure of the SMEs. The results in the table show that the SMEs benefited more from informal sources than the formal sources of finance. The informal source of finance makes up 68% of small enterprise's capital and 70% of medium enterprise's capital respectively. None of the enterprises secured

capital from the Second-Tier Security Market (SSM). Cooperative credits constituted the highest contribution to the capital of these enterprises, accounting for 31% and 33% in the small and medium enterprises, respectively.

Test of Hypothesis 2

HO_2: Conditions for accessing SMEEIS funds are beyond the reach of most SMEs in Nigeria.

Chi-square was used to test this hypothesis. The data used for the testing are the responses obtained from the research Questionnaire. The summary of the responses are presented in the table below:

Table 8: Responses from Question 17 of the Questionnaire

Respondents	Responses		Total
	Stiff conditions	Other reasons	
Small-scale enterprises	56	5	61
Medium-scale enterprises	20	3	23
Total	76	8	84

The above shows that a total of 56 owners of small-scale enterprises from Nassarawa and Benue States lamented that stiff conditions are responsible for their inability to access SMEEIS funds, while five owners of small-scale enterprises from the two states did not attribute their inability to access the funds to tough conditions. In the same vein, a total of 20 owners of medium-scale enterprises said they could not access the funds because of the stringent conditions given by SMEEIS, while three owners of medium-scale enterprises gave other reasons, outside stiff conditions, as being responsible for their inability to access the funds. On the whole, 76 owners of SMEs from the two states stated that SMEEIS funds were beyond their reach because of the tough conditions given to access the funds, while eight owners of SMEs from both states encountered other factors that hampered their ability to access the funds.

If the calculated chi-square (X^2) is greater than the table value (critical value), the difference is significant, and so the null hypothesis is rejected. But if X^2 is less than the table value, the difference is insignificant, and so the null hypothesis is accepted.
The critical value of X^2 at 0.05 1df is 3.841. The calculated value in this case 0.73 which is less than the critical value. Therefore the difference is insignificant and so the null hypothesis, which states that conditions for accessing SMEEIS funds are beyond the reach of most SMEs, is accepted.

The Critique and Discussion of Findings

Banks dominate the financial system in Nigeria (Agusto, 2000). It is pertinent to note that a well functioning financial system contributes to investment and economic growth. Table 5 shows that bank lending to small-scale enterprises in Nigeria was just four percent of the total finance of the sector during the period under review. This is at variance with the pecking order theory or hypothesis which implies that banks should lend to SMEs where they have exhausted their retained earnings to finance their investment. SMEs by their nature cannot raise substantial internal finance. It, therefore, becomes necessary for them to seek bank lending to bridge the gap between their retained earnings and their potential investment outlay.

Table 5 also shows that bank lending to medium-scale enterprises was 24% of the total finance of the sector, which is relatively higher than the figure for small-scale enterprises. This is also at variance with the pecking order theory. Going by the theory, it is to be expected that small-scale enterprises should get more bank loans than medium-scale enterprises since they can raise more internal finance than small-scale enterprises. It could, therefore, be inferred from the above that banks in Nigeria only lend to enterprises that have high potentials to repay loans. With this type of philosophy, they can hardly support small-scale enterprises.

SMEEIS comprise banks, the behavior of banks can correctly be predicted in the Scheme. Right from the definition of SMEs by the scheme it can be reasonably inferred that the predominant SMEs in the country were not captured or considered. This was an indigenous initiative which was supposed to capture our predominant SMEs if it was designed for them. It becomes worrisome that the SMEs in Nigeria were not recognized and so the scheme could not reach out to them. This Scheme was again not popular with SMEs. Even those who knew about the scheme have not been able to benefit from it. The result of the test of hypothesis two shows that conditions for accessing SMEEIS funds were too stringent for owners of SMEs.

SMEEIS is just one of the initiatives of government housed under formal financing option. From the literature it is clear that government has over the years enacted various policies and schemes aimed at financing SMEs. All of them have not been able to measure up to expectation. What then has been done to remedy this situation?. In 1995 and 1996 when commercial bank loans to SMEs as a percentage of their total credit increased because there was a legislation that their loan to SMEs should not fall below 20%. This was however abolished in1996 and since then there is a noticeable steady decrease. If legislation can be a solution, then when will a workable one be in place?

The factors that have favored informal financing of SMEs in Nigeria over the formal financing were cost of finance, ease of accessibility, nature of collateral security and risk mitigation capacity. It is evident from the study that it costs SMEs less interest charges on borrowings from informal sources than prevailing rates in the formal sources. Whereas accessibility to informal sources of finance was less a problem, it was still difficult for SMEs to access funds from the formal sources because of stringent collateral security requirement and inadequate risk mitigation schemes for the formal sources of finance. In the informal sources, individual's reputation and community acceptance or cooperative society membership were sufficient to access the funds for business purposes. Regrettably the funds from these sources are not enough for long term investment.

Some studies done twenty eight years ago by NISER, (1984); Ojo, (1984) collaborates the results of this study showing that majority of SMEs were funded by informal sources of finance. For how long will this continue unchallenged? Stakeholders should wake up if Nigeria is to realize her developmental dreams.

Having said all these, it must be made clear that if SMEs do not 'formally' package themselves by effectively managing their business, they should not expect funding from formal sources.

Conclusions and Recommendations

It is obvious that a dynamic SME sub-sector is needed for Nigeria to attain industrialization and sustainable economic development and for its Vision 20-20-20 to be achieved. This subsector is, therefore, vital and imperative for the actualization of Nigeria's vision. This is also a prerequisite for Nigeria to actively interact at the international arena with other economies of the world. The observed weak performance of notable formal financing options, like SMEEIS, occasioned by lingering constraints should, however, be seen as a big challenge for policy makers in the country.

Limitations

The main limitation for this work was finance. If the researcher had adequate finance, this work would have had wide coverage of SMEs in Nigeria. It was inadequate finance that limited the scope of this work as it is. It is however adviced that subsequent research in this area should touch on the management of SMEs as it affects the way investors look at them.

Irrespective of the limitation and the suggested further research path, the study hereby reveals the following major findings:

The financing mix of SMEs in Nigeria is predominantly from informal sources of finance. This is shown by the use of this option more than the formal sources by the SMEs. Cooperative credit ranks highest in this category while the second-tier security market (SSM) is left un-patronized.

A comparative analysis of the inherent problems of the formal and informal sources of finance to SMEs shows that the formal sources are inherently more problematic to SMEs in Nigeria than the informal sources. Most of the banks in the country do not pay sufficient attention to the development of SMEs via financing because of the inherent risk in them.

Stringent conditions of SMEEIS prevent SMEs from accessing the funds under the scheme.

The following recommendations are hereby made in response to the above findings:
Banks, by their nature and in line with their objective, do try to minimize risk; while SMEs, on the other hand, are inherently risky. Consequently, the government and the banks should mutually agree on a credit guarantee scheme that will incorporate a risk-sharing arrangement as a way of encouraging banks to channel funds to SMEs.

SMEs should show evidence of seriousness by how their business is managed and books kept, in order to attract providers of funds to invest in them.

Government should encourage banks to indentify good business proposals and run such businesses with those people rather than releasing funds out rightly to them. In doing this, profit should be shared at an agreed ratio by both parties whereas losses should be borne by the provider of funds.

A legislation regarding funding of SMEs should be introduced and maintained for a long period even when there is change in administrations.

Diversification of financial support for start-ups, growing and successfully operating SMEs will significantly contribute to the creation and development of SMEs. Start-ups, growing and successful SMEs should get 50%, 30% and 20%, respectively of whatever financial support is available for SMEs.

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Appendix I: Ratio of Loans to small scale enterprises to commercial banks total credit.

Year	Commercial Banks Loans To Small Enterprises (₦'m)	Commercial Banks Loans Total Credit (₦'m)	Commercial Banks Loans To Small Scale Enterprises as Percentage of Total Credit (%)
1992	20,400.0	41,810.0	48.8
1993	15,462.9	48,056.0	32.2
1994	20,552.5	92,624.0	22.2
1995	32,374.5	141,146.0	22.9
1996	42,302.1	169,242.0	25.0
1997	40,844.3	240,782.0	17.0
1998	42,260.7	272.895.5	15.5
1999	46,824.0	353,081.1	13.3
2000	44,542.3	508,302.2	8.7
2001	52,428.4	796,164.8	6.6

2002	82,368.4	954,628.8	8.6
2003	90,175.5	1,210,033.1	7.5
2004	54,981.2	1,519,242.7	3.6
2005	50,672.6	1,899,346.4	2.7
Q1	73,161.3	1,650,952.5	4.4
Q2	86,431.2	1,823,610.7	4.7
Q3	77.320.9	2,017,380.7	3.8
Q4	50,672.6	1,899,346.4	2.7
2006			
Q1	24,503.3	2,286,812.9	1.1
Q2	26,401.6	2,233,741.4	1.2
Q3	8,188.1	2,497,721.1	0.3
Q4	25,713.7	2,524,297.9	1.0
2007			
Q1	26,989.9	2,964,453.6	0.9
Q2	23,811.4	3,389,045.5	0.7
Q3	14,023.4	4,118,140.9	0.3
Q4	41,100.4	4,813,488.8	0.9
2008			
Q1	18,523.3	5,815,927.4	0.3
Q2	20,527.3	6,640,644.5	0.3
Q3	22,862.2	7,302,820.0	0.3
Q4	13,383.9	7,725,818.9	0.2

The abolition of mandatory banks credit allocations of 20% of its total credit to small scale enterprises wholly owned by Nigerians took effect from October 1, 1996.
Source: Central Bank of Nigeria Statistical Bulletin, Golden Jubilee Edition (December, 2008).