CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The place of Small and Medium Enterprises (SMEs) in the achievement of economic growth especially in a developing country like Nigeria can never be over-emphasized. SMEs remain the foundation as well as the building block in the realization of any meaningful and sustainable growth in an economy. SMEs constitute the driving force in the attainment of industrial growth and development. This is basically due to their great potential in ensuring diversification and expansion of industrial production as well as the attainment of the basic objectives of growth. For sustainable economy, SMEs have been stressed as being capable of helping in bringing about positive economic turn around and complementing the effort of the existing medium and large scales industries (Osuagwu, 2001). The recognition of the importance of the roles of the SMEs as catalyst and engine of growth has prompted the increased attention and specific education on the method and approach to build and sustain a truly viable private sector dominated by small and medium scale enterprise (SMEs). Such economic contributions are obvious in the mobilization of idle financial resources, the conservation of foreign exchange, utilization of local raw materials, specialist suppliers to large companies, adding varieties and choice for the consumers, checking the monopolistic tendency power, providing a source or innovation, breeding ground for new industries and above all employment creation (Bamidele, 2012).

SMES utilize local raw materials and technology thereby aiding the realization of the goal of self-reliance. Also, governments at various levels (local, state and federal) have in one way or the other facilitated the performance of Small and SMEs. While some have formulated policies aimed at facilitating and empowering the growth and development and performance of the SMEs, others had focused on assisting the SMEs to grow through soft loans and other fiscal incentives in order to enhance the socio-economic development of the economy like alleviating poverty, employment generation, enhance human development, and improve social welfare of the people (Oreoluwa, 2011).

Finance has been viewed as a critical element for the development of SMEs. It is worth mentioning that firms depend on a variety of sources for their finance. These includes internal and external; formal and informal. However the relationships among these sources and their effects on investment remain unclear in the literature. In the case of SMEs, bank credit or loan is major alternative of external funding (James and Ashamu, 2014). Previous studies have decried the limited access to external financial resources available to smaller enterprises compared to larger organisations and the consequences for their growth and development

(Gbandi and Amissah, 2014; Omika, 2014; Wattanapruttipaisan, 2003; Berger and Udell, 2004; Ogujiuba et. al., 2004; etc). According to Valverde et al (2005) bank credit play a crucial role in providing external financing to Small and Medium Scale Enterprises (SMEs).

In Nigeria, it must be noted that SMEs have not received the needed attention and financing required for effective and viable operation. The challenges confronting SMEs in Nigeria seems multifaceted. Ekpenyong (1997) and Utomi (1997) identified inadequate capital and inaccessible credit facilities as two major bane facing SMEs. There has been dearth of long term loans needed for adequate financing of SMEs. This unpleasant scenario has continued over time majorly because many financial institutions do not believe in the potentials and viability of SMEs and thus considered it risky extending credit to them.

Typically, SMEs face higher transactions costs than larger enterprises in obtaining credit. Lee (2004) further argues that poor management and accounting practices have hampered the ability of SMEs to raise finance. Information asymmetries associated with lending to small-scale borrowers have restricted the flow of finance to SMEs (Berger and Udell, 2004). SMEs often operate at such a low scale that is unattractive to banks (Ugoani and Dike, 2013). Many of them are unincorporated and banks are not forthcoming in investing in a multiplicity of small ventures that are scattered all over the country. Besides, SMEs are mostly family businesses and they are therefore reluctant to open their businesses up, especially to the banks that they regard as intruders. Information such as financial accounts, business plans and feasibility studies which should be provided to external financiers is often lacking and when available, it lacks details and rigor. The concomitant effect is that less financial facilities are made available to SMEs by banks.

In spite of these claims however, some studies show a large number of SMEs fail because of non-financial reasons (Lawrence, 2003; Wattanapruttipaisan, 2003; Asaolu et al, 2005). For instance most entrepreneurs in Nigeria lack the appropriate management and business skill to turn their business around. Evbuomwan, Ikpi, Okoruwa and Akinyosoye (2012) noted other constraints to include poor power supply and inadequate relevant infrastructure. This is true because no business, SMEs inclusive, can operate efficiently in the absence relevant infrastructure.

1.2 STATEMENT OF THE PROBLEM

Several studies have identified financial constraint as the major obstacle to Small and Medium Scale Enterprises Development in developing countries including Nigeria. For instance, Adelaja (2003) argues that the access to institutional finance has always constituted a pandemic problem for SME development in Nigeria. He recalled that in the past, a number of schemes have been put in place to provide special credit lines/windows for SMEs but this achieved very limited impact.

Agwu and Emeti (2014) examined the issues, challenges and prospects of Small and Medium Scale Enterprises (SMEs) in Port-Harcourt City, Nigeria and found that that poor financing, inadequate social infrastructures, lack of managerial skills and multiple taxation were major challenges confronting SMEs in Port-Harcourt City. Also, ADB–OECD (2014) revealed that the 2008 global financial crisis impacted SMEs and entrepreneurs disproportionately, exacerbating their traditional financing constraints.

The primary focus of this study emanates from the fact that small scale enterprises owners do not have sufficient finance to carry on their due to the low saving culture of the people in this part of the world. The reason for this is not far fetch: low level of income basically. While it is an established fact that Small and Medium Scale Enterprises face financial challenges, few researches have been conducted to investigate the effect the financial problem on their contribution to economic development. Asaolu et al (2005) and many other authors and researchers have deduced that the financial challenges mar the developmental role of Small and Medium Scale Enterprises. But this may not be true especially in the case of Nigeria where the informal sector, which is constituted largely by the Small and Medium Scale.

In recognition of these constraints and in order to ensure the realization of the potential benefits of virile SME in the economy, the Central Bank of Nigeria has remained committed to the growth and development of the small and medium scale enterprises in Nigeria. This stance has been successively reflected in the Bank's policies over the years. In particular, the CBN has through its credit guidelines over the years, and until very recently, required the erstwhile commercial and merchant banks to allocate stipulated minimum of credit to the preferred sectors including the SME.

Unfortunately, all these policies have not been able to adequately address the fundamental problems which have constrained small scale enterprises access to credit. To this end, this study seeks to appraise the factors affecting SME financing in Nigeria, as well as ascertain the extent to which SME's have contributed to economic growth in Nigeria.

I.3 OBJECTIVES OF THE STUDY

The broad objective of this study is to carry out an analysis of SME financing in Nigeria and its impact on economic growth.

In view of the above, this study intends to find out the following:

1. To determine the extent to which SME financing affects Gross Domestic Product in Nigeria.
2. To ascertain the impact of money supply and interest rate on SME financing in Nigeria.

1.4 RESEARCH QUESTIONS

To achieve the above stated objectives, the study would examine the following questions;

1. To what extent is the Gross Domestic Product affected by SME financing?
2. To what extent do money supply and interest rate influence SME financing in Nigeria?

1.5 RESEARCH HYPOTHESES

The following hypotheses will be subjected to empirical tests to provide answers to our questions and also enable us achieve our research objective.

HO_1: SME financing has no significant positive effect on Nigeria's Gross Domestic Product (GDP)

HO_2: Money supply and interest rate do not have any significant positive impact on SME financing in Nigeria

1.6 SIGNIFICANCE OF THE STUDY

Small and Medium Scale Enterprises in Africa rely largely on own savings, not only to grow but also to innovate, firms often need real services support and formal finance assistance, failing which under-investment in long term capabilities (training and R & D) may result (Oyelaran-Oyeyinka, 2003). This study is significant because it would help to evaluate the operations of a vital segment of the industrial sector – Small and Medium Scale Enterprises, which have been identified as having very high potential in promoting economic growth and development (Oni and Daniya, 2012). The evaluation shall be done with special focus on their financing thereby adding to the existing literature on the subject matter.

1.7 SCOPE OF THE STUDY

This research work focuses on the financing of Small and Medium Scale Enterprises (SMEs) in Nigeria. This study pays more attention on the loan granted to SMEs by Commercial Banks, and also Microfinance banks' loans.

Most of the information and data needed for the study would be gathered from existing literature and from relevant government agencies such as the Central Bank of Nigeria, National Bureau of Statistics (NBS) etc.

The hypotheses testing are restricted to the period between 1999 and 2014. This period was chosen to coincide with the return of democracy in Nigeria.

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