

**SOURCES OF FINANCE FOR SMALL
AND GROWING BUSINESSES (MSMEs)**

BY

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INTRODUCTION

The topic we are going to discuss today is "Small and Growing Business and the Source of Finance."

All businesses need some form of finance at one time or the other. The need could be start-up finance, working capital finance, expansion or growth finance, etc. Indeed small and growing businesses have been identified all over the world as the bedrock of any successful economy. Be it America, the Asian Tigers, their success story starts with the success of Micro Small and Medium Enterprises (MSMEs).

In Nigeria, there is no shortage of potential businessmen/women wanting to join this group of people world over and recording good success. However, in Nigeria we do not have the same success story. This could be due to lack of statistics, but the general view is that this group of business entrepreneurs in Nigeria have not been adequately empowered i.e. no adequate soft finance, infrastructural support is poor, human capacity with relevant skills are

scanty, etc. Generally, for the entrepreneur to record success as in other parts of the world a lot more need to be done.

Today we are going to focus on just one aspect of the enabling framework – Source of Finance for Small and Growing Businesses. Most Micro Small and Medium Enterprises be it frying of akara, manufacturing or making cane chairs, start with injection of one's own funds, help from friends and family or even borrowing for the initial seed capital – this is the norm all over the world.

Over and above this initial stage of finance, many other strategies have been developed and applied world over – for MSME is now the biggest business opportunity in the provision of finance. In Nigeria, several such initiatives have been sponsored by the Nigerian Government to promote and support MSMEs. These include SME1 and SME II Loans, ADB/ESL, NERFUND to mention a few. These are all loan Schemes and government initiated. The latest Scheme

initiated by Banks (SMIEIS) to promote Small and Medium Industries is an equity investment Scheme not a loan.

DEFINITION

The concept of micro small and medium enterprises is dynamic in character and varies with time. It also varies among institutions and countries. These basic variations notwithstanding, the definitional parameters are the same.

The parameters include:

- Number of employees
- Asset Base
- Turnover;

Hence current definitions are based on a mix of the above parameters.

For instance, Nigeria Industrial Policy 1989 defined SMEs as those with total investment of between =N=100,000.00 and =N=2m excluding land and working capital, while micro

enterprises and cottage industries were defined as those with investments not exceeding =N=100,000.00 excluding land but including working capital.

The SME of the World Bank Group prescribes the following definitions:

a) MICRO ENTERPRISES

Employees	10 or less
Total Assets	\$100,000.00 or less
Turnover	\$100,000.00 or less

b) SMALL ENTERPRISES

Employee	10 – 50
Total Asset	\$100,000.00 - \$3m
Turnover	\$100,000.00 - \$3m

c) MEDIUM ENTERPRISES

Employee	50 – 300
Total Asset	\$3m - \$15m

Turnover

\$3m - \$15m

SMIEIS a private initiative of the Banks defined SMEs as an enterprise with an asset base not exceeding =N=200m excluding land and working capital with staff strength of not less than 10 and not more than 300. A cursory glance at the structure of MSME in Nigeria reveals that 50% are engaged in distributive trade, 10% in manufacturing, 30% in agriculture and the rest 10% in other services.

Before discussing sources of finance for MSMEs I wish to mention that the success, survival and growth of MSMEs rest on efficient interplay of:

- Entrepreneurship
- Technology/Management and
- Finance

Beyond finance, certain factors contribute to the success or failure of MSME.

- Ability and attitude of owners' of the business
- Effect of competition
- Access to skill manpower
- Business location
- Marketing – Strong marketing programmes or the lack of them
- Government regulations (stable or epileptic)
- Clear definition of owner's role (separation of roles)
- Tax burden (Local, State and Federal)
- Cash flow and cash planning. (Best Business practices)

The above list is not exhaustive; hence Promoters of MSME should continuously review the environment (internal/external) in which they operate.

SOURCES OF FINANCE

1. Individual Funds
2. Family and Friends
3. Bank (Financial Institutions)

4. Capital Market
5. SMIEIS

I wish to state here that whenever a businessman seeks additional finance, he will be led to do so by a particular need or multiplicity of needs. The businessman will be greatly helped by having a clear picture of exactly why he wants fresh money, because the suitability and availability of the sources for the provision of the finance will vary with the underlying need or needs. The reason is that each type of finance can be particularly appropriate for some situations but can be quite inappropriate for others.

NEED FOR FINANCE

Essentially, firms need finance for:

- a) Start-up capital to help new concern
- b) Existing businesses need finance for two purposes:
 - i. For expansion of the business

- ii. To adjust existing structure of the balance sheet such as the proportion of equity to debt or the proportions of long term to short term debts.

TYPES OF FINANCE

The various forms of finance and ways of obtaining credit include:

- Equity – Individual, Family Friends, Capital Market and SMIEIS
- Overdraft
- Term Loan (Short, Medium and Long Term)
- Leasing
- Hire Purchase
- Factoring
- Invoice Discounting

SMALL MEDIUM INDUSTRY EQUITY INVESTMENT SCHEME (SMIEIS)

SMIEIS is an equity investment scheme NOT a Loan Scheme. Under the scheme banks are expected to set aside

10% of profit before tax for investment in small and medium enterprises.

As at end of March 2004 a total of =N=22.02bn has been set aside by the banks. Of this amount =N=8.06bn has been invested in 166 projects nationwide.

The increase in both amount invested and projects after December 2003 publication of the participation of banks under the scheme, indicate that banks and entrepreneurs now understanding better the mechanism of the scheme.

The increased pace of investments in the last three months portend great opportunity of massive industrialization of the country, which will generate employment with corresponding reduction of poverty.

In fact at current pace of investment by banks the projected provision of 5 million jobs contained in NEEDS (National Economic Empowerment Development Strategies) document is achievable. The social return of the scheme on the

economy is tremendous. What we need now is patience, discipline and keep faith with the drive for SMIEIS to impact on the economy and differentiate itself as a Private Sector Initiative.

To ensure that all economic activities benefit from the scheme, the Bankers Committee approved the ratio of aggregate investment as follows:

Real Sector	60%
Services	30%
Micro Enterprises	10%

OBJECTIVES OF SMIEIS

- To establish a pool of investible funds for financing the micro, small and medium enterprises (MSMEs).
- To provide interest-free, long tenured funds to the real sector of the economy.

- To financially support the government efforts to massively create employment opportunities to teeming unemployed Nigerians.
- To use the investment opportunities provided by SMIEIS as a veritable forum for banks and MSMEs to work collectively in projects of interest to both parties.
- To create a more direct platform for MSMEs to avail the financial, managerial and technical advisory services domiciled in the banks.
- To financially empower MSMEs to add more goods and services to the Nigerian market.

ELIGIBILITY

- To qualify for SMIEIS funding, all applicants must in addition to a formal application be legally registered as Limited Liability Company operating in Nigeria and a company complying with all statutory responsibilities such as holding of meetings, filing of returns at CAC Abuja, preparation of annual audited accounts, etc.

- Have existing assets excluding working capital, of not more than =N200m and with a staff strength of not more than 300 persons.

- Accept that its ownership and control (through share ownership) of the company shall be diluted through equity investment by the bank.

- Be prepared to subject itself for due diligence investigation including enquiry at applicant's bank by an independent organization to be selected by the bank.

- Be prepared to accept additional member(s) of Board of Directors to represent the interest of the bank.

- Be prepared to disclose all liabilities, direct and contingent on the company.

- Present three different proforma invoices from different countries for imported items.
- Submit copies of subsisting technical, managerial or supply agreement with third parties.
- Submit CTC of Form CAC 2 & 7.
- Submit a detailed feasibility or appraisal report and a business plan in respect of the project.
- Submit a detailed profile of existing shareholders, Directors and key management.

DURATION OF PARTICIPATION

The bank shall be free to exit from the project after 3 years.

EXIT PROCEDURE

After 3 years, the bank can exit through the disposal of its shares as it deems fit. At that time, the first option to purchase will be given to current shareholders.

LEVEL OF INVESTMENT

Bank's investment in any project will be determined after appraisal of the project subject, however, to a maximum of 40% of the paid up share capital of the company.

The other source of equity finance is the capital market. As the businesses grow their funding needs will be so much that meeting them through the money market with the attendant costs could cripple the business. The burden becomes heavy for the promoter(s) to bear. At this point a well-run enterprise could approach the Nigerian Stock Exchange for listing. Upon meeting the listing requirements (which are usually less stringent for small incorporated companies) they will be taken to the market where funds are raised on their behalf.

Equity capital does not attract costs. The investors expect dividends and capital growth.

NATIONAL CREDIT GUARANTEE SCHEME

To further promote MSMEs the Central Bank of Nigeria (CBN) in its monetary/credit policy guidelines for 2004/2005 indicates that the National Credit Guarantee Scheme would be established in 2004 to mitigate the risks associated with lending to the sector. This will no doubt remove the issue of collateral, which has been a major constraining factor to bank financing of MSMEs.

OVERDRAFT

This is particularly used to provide short-term working capital to tide over the production cycle, finance for seasonal requirements, bridging finance for the purchase of a property or plant with repayment coming from the realization of another asset. Advantages of overdraft include the following:

- The system is simple and arrangement can be negotiated and set up very quickly.
- The system is flexible, there is no minimum level, and sums can be drawn and repaid within the agreed limit at any time entirely at the option of the borrower without prior notice.
- It is one of the cheapest forms of borrowing; interest is repayable only on the amount outstanding each day building up and being charged at the end of the month.
- A facility once approved is renewable subject to the credit worthiness of the borrower and any special factors.

The disadvantages are that overdraft is repayable on demand, though this is rarely required, and that rate of interest is increased if the bank's base rate is raised.

TERM LOANS

These are classified into short, medium and long term.

Overdraft discussed above is a short-term loan. Short-term

loan has a life of between 3 months to a year in practice; though theoretically and in more developed financial markets, short-term loans have expiry of between 1 – 3 years.

Medium-term loans are principally provided by banks. Repayment may occasionally be made in one sum at an agreed date, by installments over a period. The pattern of repayment can be tailored to fit the earning capacity of the asset being acquired. The lender will seek to satisfy himself in advance about the quality of a firm's management and about projected cash flow so as to establish that repayment can be met.

ADVANTAGES OF TERM-LOANS ARE

- It contractually assures the borrower of the stability of finance as to both term and amount

- If at a fixed rate of interest, it enables the borrower to estimate his future cash flow with greater confidence
- It enables a hardcore overdraft to be funded (with the discipline of scheduled reduction and repayment)
- It can strengthen the firm's balance sheet by showing that borrowing is firmly available for a definite period ahead, and is not dependent on the vicissitudes, which affect the availability of short-term finance.

LEASING

The leasing of equipment and vehicles, particularly cars, is another way by which firms may be able to obtain short-term finance. This is a distinctive form of finance under which the leasing company or bank buys plant or required equipment as chosen by a business and leases it to the business at an agreed rental. There are two types of lease:

OPERATING LEASE

Where goods are leased for only part of their estimated life, and so the rental covers only part of their capital costs.

Finance lease

Sometimes called a full pay out lease, entails payment over an obligatory period of amounts, which are sufficient to cover the capital cost of the leased goods and give the leasing organization some profit.

HIRE PURCHASE

This source avails the businessman ownership of property after making initial down payment and paying regular fixed amounts over an agreed period.

FACTORING

This is a continuing arrangement by which the factoring company purchases all the trade debts due to a business as they arise; providing a sales ledger accounting service and relieving the businessman from debt collection, thereby providing cash for his day-to-day needs.

The factor may provide funds either by making cash payments of up to 80% of the value of each new sales invoice raised.

INVOICE DISCOUNTING

This is another source of finance to the entrepreneur. It is a means of generating cash by selling to an invoice discount

company either a selection of invoices on a firm's larger debtors or an entire sales ledger. By this arrangement the client receives an agreed proportion (up to 75%) of the gross amount due on the assigned invoices. Unlike factoring, the responsibility for collection of the debts sold remains with the client.

In all, invoice discounting is a simple, flexible source of finance enabling a business temporarily to increase its working capital.

CONCLUSION

The central position of finance equity/credit in the life of an enterprise cannot be over emphasized. The USA is a typical country thriving on a well-articulated and controlled credit culture. While we recognize this, almost all available finance has cost(s) attached. They also vary in structure hence the need for a proper articulation of the finance needs so as to

source the appropriate finance type that will meet the needs without dislocating the business. To this end entrepreneurs are advised to engage the services of financial advisers.

Also to attract finance to their business, entrepreneurs are enjoined to be more disciplined in the running of their businesses by ensuring due diligence, best practices and keeping proper accounting records. These will endear them to the providers of finance.

Thank you for listening and God bless you.

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