ENTERPRISE DEVELOPMENT CENTRE
PAN-ATLANTIC UNIVERSITY

Assessing the Financing Gaps of Nigerian MSMEs and Emerging Corporates

PREPARED FOR:

Development Bank of Nigeria Plc

DBN
Development Bank of Nigeria

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Foreword

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ACCESS to finance continues to be a never ending challenge for MSMEs and emerging corporates. Despite the availability of funds on one hand and plethora of interventions on the other hand, MSMEs and emerging corporates are finding it difficult to access majority of these funds. This research which aims at understanding why and what could be done to increase access is therefore apt. If MSMEs and emerging corporates are adjudged as growth engines, we must then be deliberate about financing them.

We are delighted to present this study: Assessing the Financing Gaps of Nigerian MSMEs and Emerging Corporates, prepared for the Development Bank of Nigeria. Given the rigour of the study which covered over 2000 entrepreneurs, 20 organizations comprising banks, development finance institutions, government agencies,MSME-allied institutions and Fintechs, we strongly believe that the report presents a balanced view of the contributions and expectations of all key stakeholders.

The recommendations in the report are as a result of copious and iterative engagements with major stakeholders underpinned by analytical appraisal from relevant data. We hope that the outcome of this extensive survey would expand the conversations aimed at strengthening access to finance for MSMEs and emerging corporates.

Executive Summary

THE Micro, Small and Medium Enterprise (MSME) sector remains a critical component of economic growth, social development and poverty reduction in Nigeria. In spite of the huge potentials of the sector, MSMEs continue to face myriads of challenges, with access to finance identified as a critical constraint to growth.

In most cases while there are different financing options, MSMEs and emerging corporates in Nigeria are unable to access these funds for their operations thus resulting in huge financing gaps.

The study

Assessing the Financing Gaps of Nigerian MSMEs and Emerging Corporates, which covered over 2,000 entrepreneurs, 20 organizations comprising banks, development finance institutions, government agencies, MSME-allied institutions and Fintechs, was aimed at investigating the financing gaps and critical challenges faced by this segment, the factors limiting key stakeholders from supporting the segment, and interventions from government as well as local and global players.

SURVEYS

> 2000

entrepreneurs

across all states

Major Impediments to MSMEs Access to Finance

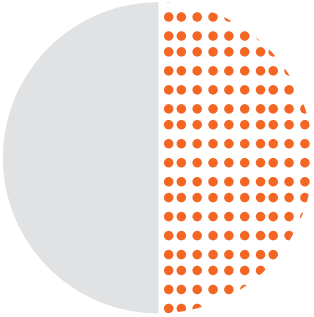
The study has identified among other issues hindering MSMEs from accessing finance in Nigeria to include: lack of information/strong market knowledge, lack of corporate governance structure, poor record keeping/documentation, pricing and collateral requirements, inconsistent government policies and other pre-requisites for bank loans.

Just as it obtains across various economies , enabling environment which is largely driven by government policies have direct impact on the ability of MSMEs to access finance. The government through the Central Bank of Nigeria (CBN) and development finance institutions has intervened through several lending and credit facilitation programs.

However due to the significant demand-supply constraints, lending available to this segment has reduced significantly over the last decade. Thus, the financing gap has grown and MSMEs continue to face challenges in accessing finance from banks to meet their business requirements.

In terms of the lending experience of the MSMEs, this study revealed that in the last two years, the rejection rate of MSME loan applications by commercial banks was about 50%. As a result, most MSMEs believe that the banks are unwilling to finance their businesses. This unmet demand presents a significant opportunity for the flow of banking credit.

REJECTION RATE OF MSME LOAN APPLICATIONS



50%

In the last two years

MSMEs are of the opinion that apart from the cost of credit, documentation requirements for obtaining loans from commercial banks are too stringent thereby constituting serious challenges. The MSMEs admitted that most of them lack business structure and do not have appropriate governance structure in place and as such, banks often cite this as one of the reasons why they are denied loans. The consensus on the part of the MSMEs is that lack of information or inadequate information on the available finances/interventions and their requirements from banks and development finance institutions constitute a roadblock in their ability to access finances.

Banks' Roles

Nearly all the banks interviewed reported that they have dedicated MSME units/desks with specialized products/offerings for the segment. Apart from deposit mobilization and cash management, the banks stated they also provide business development support in terms of capacity building/advisory services, and mentoring for the MSMEs. However, the banks attributed their limited participation in MSME financing to the informal nature of MSMEs leading to a limited knowledge of the segment and the higher risk involved in lending to the segment.

In ensuring more participation of the banks in the vast opportunities in the MSME segment, the banks would need to scale up activities in the following areas:

- Deliberate understanding of MSMEs and how they operate.
- Disruptive lending process to MSMEs.
- Risk sharing/co-financing with the Development Banks
- Provide support services to the MSMEs
- Build credit reporting system; reward & penalize for bad behaviour

Government's Role

Stakeholders agree that the role of government in increasing MSMEs access to finance is critical; from policy formulation to regulatory functions. In articulating favourable policies and championing initiatives aimed at making MSMEs have better access to finance, the following were the conclusions:

- Facilitate ease of doing business
- Lending and credit interventions for loan affordability
- Provision of grants especially for start-ups
- Improvements in basic infrastructural facilities
- Technical assistance to commercial banks through the development banks.

MSMES' Roles

For the MSMEs and emerging corporates, the following were the conclusions:

- Capacity building
- Relationship with financial institutions
- Financial advice/expert knowledge
- Financial discipline and willingness to embrace best practices

About the Study

THE objective of the study was to investigate critical factors hindering MSMEs and emerging corporates in Nigeria from accessing finance. The study captured the perspectives of key stakeholders: MSMEs, commercial banks, microfinance banks, Fintechs, private sector organizations, professional bodies and some government agencies involved in MSME development in Nigeria.

We deployed a combination of techniques: surveys, focus group sessions and interviews to facilitate accuracy and triangulation of data obtained from the different sources for reliability.

MSMEs

SURVEYS

> 2000

entrepreneurs across all states

FOCUS GROUP SESSIONS

Lagos
Kano
Abuja
Port Harcourt

Financial Institutions

SURVEYS

12

INTERVIEWS

11

Commercial banks - **7**

Microfinance Banks - **2**

FinTech - **2**

Other Stakeholders

INTERVIEWS

9

CBN
BOI
LSETF
SMEDAN
NASME
NASSI
LCCI
WIMBIZ
FATE Foundation

The MSME e-survey respondents were selected through a random sampling approach, though at the targeted market across the 36-states and FCT before aggregating to the six geo-political zones of the country, to ensure a holistic view of the segment.

The MSMEs' questionnaire focused on the following areas:

- Demographics;
- Key issues facing MSMEs and emerging corporates;
- MSMEs and emerging corporates lending experience with commercial banks, and other financial institutions;
- MSMEs and emerging corporates perception of government initiatives/ efforts and perception of banking products and services;
- Key considerations in bridging the financing gaps

The financial institutions' questionnaire centered on the following areas:

- Banks' perception on MSMEs and emerging corporates banking;
- Bank's perception on government's interventions to the segment;
- Limitations to MSMEs and emerging corporates banking;
- Key considerations in bridging the financing gaps

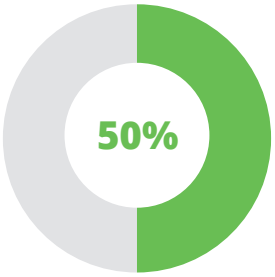
Assessing the Financing Gaps of Nigerian MSMEs and Emerging Corporates: Introduction

AS in most developing economies, micro, small and medium enterprises (MSMEs) are widely believed to be critical in the economic growth process.

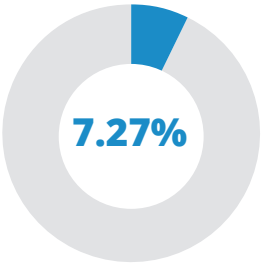
According to the National Bureau of Statistics Survey 2013, there are

37.76 million
MSMEs

59.7 million
EMPLOYED



Contribution to GDP



To exports

68,000
For small enterprises

4,670
For medium enterprises

According to the Central Bank of Nigeria (CBN), MSMEs are responsible for most of the new products and services; provide most of the employment opportunities (employing 84.02% of the total labour force) and their 48% contribution to national gross domestic product (GDP) is a key indicator of the economic growth of the country (CBN, 2016). MSMEs are also important sources of innovation (CBN, 2014). They exhibit such behavior including products or services re-engineering to meet market demands, exploration of innovative distribution or sales techniques, or developing new and untapped markets (IFC, 2014). In spite of these enormous contributions, MSMEs have grappled with the challenge of access to finance which constraints their growth and performance. Many researchers (Ayadi & Gadi, 2013; Nwosu & Ochu, 2017; Soludo, 2006) note that given the importance that MSMEs play in economic development and job creation, financing of MSMEs has emerged as a popular topic of discussion and research.

Similarly, accessing finance has been identified as a key element for any business organization to be productive, compete, create jobs, help in poverty alleviation especially in developing nations and generally succeed (KPMG 2014; World Bank, 2017). Over the last decade, many researchers and academics have tried to analyze the challenges of MSME access to finance, emphasizing their dependence on credit and cash flows. These studies posit that MSMEs are more likely to face more credit constraints than larger firms and that most MSMEs appear to be severely underfunded (World Bank, 2017). The World Bank Enterprise Surveys reveal for example, that in developing countries, on the average, 43 percent of businesses with 20 to 99 employees, considered access to finance or cost of finance as a major restraint to current operations. In high-income countries, only 11 percent of businesses of the same size listed access to finance as a constraint (World Bank, 2014).

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Solar Dryer

Macroeconomic trends and impacts on Nigerian MSMEs and emerging corporates

In the Nigerian macroeconomic environment, MSMEs and emerging corporates have compelling growth potential and like other emerging economies, are likely to constitute a significant portion of GDP in the near future (CBN, 2016).

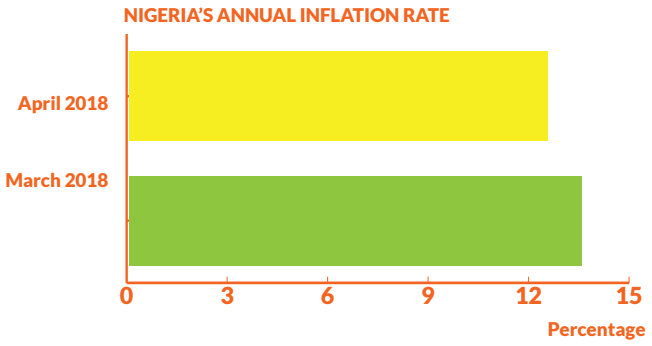
Inflation has a negative impact on MSMEs savings (Adeoye 2012; Orogbu et al., 2017)

MSMEs and emerging corporates have compelling growth potential (CBN 2016).

Multiple taxations and interest rates affects their operations (Tolu 2013; Orogbu et al., 2017).

This is in line with the submissions of African Development Bank which observe that MSMEs produce a significant share of their increases in Gross Domestic Product (GDP), while the contributions of larger enterprises tend to remain stable. Studies by the International Finance Corporation show that approximately 96% of Nigerian businesses are MSMEs compared to 53% in the US and 65% in Europe and are contributing about 45 per cent of manufacturing employment and 29 per cent of manufacturing GDP in developing countries including Nigeria, in contrast to 67 per cent and 49 per cent in developed countries, respectively (IFC, 2010).

The complications arising from the fluctuations of economic factors constitute core challenges affecting the operations of the MSMEs which have led to collapse of businesses, loss of jobs and unprecedented decline on their performances. Bakare (2015) argues that of all the macroeconomic indicators, exchange rate, interest rate and inflation rate can be singled out to affect mostly small businesses in Nigeria.



According to James (2010), inflation affects savings and investment decisions through different channels as unanticipated inflation distorts the planning horizon of economic units including that of MSMEs. Inflation also indicates a reduction in the purchasing power of individuals as well as small scale businesses (Orogbu et al., 2017).

On government tax revenue which is a proportionate measure of total tax revenue that is collected by government through taxation, Tolu (2013) observes that multiple taxations affect the operations of MSMEs especially their purchasing power. Consequently when the purchasing power of the firms is affected, their productive capacities are also affected and the resultant effect is decline in gross domestic products (Orogbu et al. (2017). Interest rate which is the proportion of a loan that is charged as interest to the borrower affects MSMEs as the high interest rates on loans are hampering the operations of MSMEs and small corporates (Bakare 2015; Orogbu et al. 2017).

Exchange rates on the other hand are expected to have either positive or negative effect on MSMEs [Orogbu et al. (2017)]. Accordingly, high exchange rates amount to hike in price of raw materials used for production. James (2010) posits that price increase on raw materials translate to increase in unit cost of production.


SE PAINTS

Financing Gaps of Nigerian MSMEs and Emerging Corporates

According to the National Bureau of Statistics 2013 Survey, less than 5 percent of SMEs access finance for their activities. 73.24% of the top most priority of assistance needed by MSME operators was access to finance (SMEDAN 2010). The International Finance Corporation reports that MSMEs especially in developing countries face a financing gap of over $136 billion annually (IFC 2014).

Compared to other developing countries there is very low levels of bank financing for MSMEs in Nigeria according to studies by the World Bank, Central Bank of Nigeria and other organizations. MSMEs accessibility to formal financing in Nigeria is very limited (Sanusi, 2003; Taiwo et al., 2016).

The MSME sector's capacity to provide more employment, boost production and reduce poverty in Nigeria has been limited by their inability to secure credit from Money Deposit Banks, a development that has created a huge financing gap of N9.6 trillion (CBN 2016). Studies have shown that more than 70% of the Micro, Small and Medium Scale Enterprises (MSMEs) in Africa, including Nigeria, lack access to medium-longer-term finance, creating an SME funding gap of more than $140 billion in the continent (Oyelaran-Oyeyinka, 2016).

A study by KPMG and Enterprise Development Centre, Pan-Atlantic University in 2014 showed that for three years, the rejection rate of MSME loan applications by commercial banks was greater than 50% for nine of eighteen banks considered and as high as 90% for three of the banks (KPMG/EDC 2014).

Information from the Central Bank of Nigeria survey bulletin on SME financing 2014, indicate that commercial bank loans and advances to MSMEs have been decreasing over the years. Accordingly commercial bank loans to MSMEs as a percentage of total credit decreased from 48.8 per cent in 1992 to 22.19 per cent in 1994.

The trend increased marginally to 22.94 per cent and 25.0 per cent in 1995 and 1996, respectively. According to the survey there was a sharp reduction from 25 per cent to 16.96 per cent in 1997 and the total credit to the commercial banks increased from N2.5 trillion level in 2006, N4.8 trillion in 2007 and N7.8 trillion in 2008. Only 9.5 per cent of Nigerian SMEs had a loan in the books or line of credit in 2011 and SME lending made up only 5 per cent of total commercial bank lending.

In 2009 up to 2012 commercial bank credit to the economy continued to increase while total credit to MSMEs decreased until it reached 0.13 percent in 2012. Also available statistics from the CBN show that the conventional banks' lending rate in Nigeria grew to 17.69% in the third quarter of 2017 from 16.82% in 2016.

The emerging trend is therefore a systematic crowding out of MSMEs in the commercial lending space.

Key Players Financing Nigerian MSMEs and Emerging Corporates: Capabilities and Limitations

Commercial Banks

Despite continuous reduction in lending to this segment, the dominant formal channel of lending to MSMEs remains the commercial banks. According to the Central Bank of Nigeria, loans and advances to MSMEs reached an all-time low of 0.13% in 2012. Adekola et al. (2018) conclude that the reasons for this trend is based on the inherent belief that lending to the MSME sub-sector is risky as they do not have sufficient assets, their capitalization is low, they are vulnerable to market fluctuations, they lack capacity to manage business effectively and also mortality rates is very high.

From the CBN survey bulletin on SME Financing 2014, only 9.5 per cent of Nigerian SMEs had a loan in the books or line of credit in 2011 and SME lending made up only 5 per cent of total commercial bank lending. In other words, commercial banks are only able to meet the financial needs of about 5 per cent of the MSMEs. The inability of the MSMEs to secure credit from Money Deposit Banks created a huge financing gap of N9.6 trillion (CBN 2014).

Some of the commercial banks perceived to be MSME-friendly include;

Fidelity

Diamond

FirstBank
Since 1894

access

FCMB

WEMA BANK

Sterling Bank
Your one-customer bank.

Microfinance Institutions

Microfinance banks were set up primarily to increase access of micro & small enterprises to credit. Ezeoha & Botha (2012) observe that across developing countries, MSMEs are turning to Microfinance Institutions (MFIs) for an array of financial services.

The existing microfinance banks in Nigeria serve less than 1 million people out of 40 million potential people that need the service (CBN, 2014). As at September 2017, there are about 1,003 authorized Microfinance banks in the country. Some of the popular microfinance banks are:

FORTISMFB
FORTIS MICROFINANCE BANK PLC

ACCION
Microfinance Bank

LAPO
Microfinance Bank

Letshego
Let's improve life

Mortgage Banks

Mortgage banks usually come with fairly extended facility tenor, though rates remain high. For small businesses, the lending rates offered by mortgage banks seem not to be favourable. The operators prefer lending to corporations due to the sufficiency of assets in most cases (Ajagbe 2012). Key players include;

- Union Homes Savings and Loans Plc
- Federal Mortgage Bank
- Aso Saving and Loans

Leasing Companies

According to the Equipment Leasing Association of Nigeria, about 38 per cent of leasing transactions were to MSMEs. The non-bank lessors contributed 80 per cent of lease transactions concentrating majorly on Micro, Small and Medium Enterprises (MSMEs). Although leasing has a tremendous potential to address effectively the shortage of medium to long-term finance, it is however underdeveloped in Nigeria (World Bank, 2006). This is perhaps an area of opportunity in addressing the financing gap to this sector, if well harnessed.

Equity Financing

In Nigeria, although equity investors are very few, activities are beginning to pick up as MSMEs are now willing to give up part of their company to such investors. We are beginning to see traction in the tech and/or tech-enabled businesses and MSMEs are tapping into that. Most of these companies are led by young persons and diaspora entrepreneurs. The spectrum of equity investors includes angel investors with bias for start-up / early-stage ventures such as:

ABAN african business angel network

eVA Fund

OXFAM

AFRICINVEST

echoVC

LAGOS ANGEL NETWORK

VC4A

Alitheia

GroFin

adlevo CAPITAL

Shell liveWIRE supporting bright young business

Key Government Initiatives to Support MSMEs

The Federal Government of Nigeria at different times came up with interventions and policies aimed at providing credit facilities to SMEs. Some of these interventions are considered:

BoI Funds

The Bank of Industry (BoI) provides MSMEs with single-digit funds typically between 5%-9%. The Bank has a number of funds that entrepreneurs at different stages of growth can access. These includes the Graduate Entrepreneurship Fund (GEF), Cottage Agro Processing (CAP), Nolly Fund, Fashion Fund, BoI also manages funds for state governments and high net worth individuals. An example is the Dangote fund of N5billion at 5% interest rate. They have others focusing on youth (YES-P) and women.

Social Intervention Fund

A total of N6 billion was allocated under the Social Intervention Fund of the 2017 budget for artisans and owners of micro businesses. The artisans or business owners can only access a maximum of N100, 000 at three percent interest rate over a year period.

Agriculture, Small and Medium Enterprises Investment Scheme (AgSMEIS)

The AGSMEIS was conceived by the Bankers' Committee in 2017 to support the Federal Government's efforts, through the Central bank of Nigeria, at promoting Nigerian small and medium enterprises in agricultural investments (production, storage, processing and logistics), real sector, services sector, mining, manufacturing, modular refineries, local initiatives in information and communications technology. The maximum loan amount is N10m at an interest rate of 5% intetest per annum and a maximum tenor of 7 years without collateral. It has a moratorium of up to 18 months and could potentially solve the medium to long term capital needs of MSMEs This was flagged off in the first half of 2018. Though as at the time of this report, limited number of MSMES have accessed it.

Real Sector Support Facility (RSSF)

The N300 billion Real Sector Support Facility (RSSF) is aimed at closing the short-term and high- interest financing gap for SME/Manufacturing and start-ups, as well as create jobs. Cumulatively, a total of ten (10) projects valued N35.581bn have so far been disbursed under RSSF. This intervention seems to have focused on the medium and emerging corporates rather than micro and small businesses.

The Micro Small and Medium Enterprises Development Fund (MSMEDF)

The CBN launched the MSME development Fund on August 15, 2013, with a share capital of N220 billion. The Participating Financial Institutions (PFIs) lend at maximum interest rate of 9% per annum to MSMEs, that could access up to N50m. This intervention has recorded mixed success.

N50 Billion Textile Sector Intervention Fund

The Central Bank of Nigeria has put in place a N50 billion for the restructuring of existing facilities and provision of further facilities for textile companies with a genuine need for intervention.

Small and Medium Enterprises Credit Guarantee Scheme (SMECGS)

The Scheme was introduced in April 2010 to fast-track the development of the manufacturing and SME sub-sector by providing 80 percent guarantee for bank credits. The purpose of the intervention is to create more jobs and to provide N100 million maximum loan facility with five (5) years tenor for each project.

Anchor Borrower Program

This is a value chain based lending intended to create a linkage between processing companies (anchors) and small holder farmers of key agricultural commodities to boost production of these commodities, stabilize input supply to agro processors and address the negative balance of payments on food. Rice value chain has benefitted immensely from this program, and this could be replicated for other sectors.

Commercial Agricultural Credit Scheme (CACS)

The Commercial Agricultural Credit Scheme is designed to provide credit to commercial agricultural sector.

Accelerated Agricultural Development Scheme (AADS)

The AADS is targeted at empowering 10,000 youths in each State of the Federation with funds to enable them run commercially-viable agricultural ventures.

Other FGN Interventions

Other examples of Federal government SME initiatives include the Enterprise Graduate Empowerment Scheme funded by Nigeria's Enterprise Bank, the Youth Employment in Agriculture Programme (YEAP), Youth Enterprise with Innovation in Nigeria (YOUWIN!) and Business, Innovation & Growth (BIG).

Lagos State Employment Trust Fund

The Fund has the mandate to directly invest N25Billion in MSMEs that are operating in Lagos, to enable them grow their businesses or build the skill sets of Lagos residents to enable them get better jobs. The fund is divided into two categories; micro and small businesses. Under the micro, businesses can access up to N500, 000 loans with an interest rate of five percent and a tenor of one year. For the small business category, businesses can get up to N5 million for a tenor of three years.

GLOBAL PLAYERS

World Bank/International Finance Corporation (IFC)

Some of the interventions of the World Bank include; $200 million loan, the Growth and Employment in States (GEMS), Support to Youth Enterprise with Innovation in Nigeria (YouWiN!) initiative. IFC's US$12.5 million trade finance facility, US$140 million convertible senior loan, a Trade line of US$70 million and financing package of US$50 million.

$200 million

$12.5 million

$140 million

United States Agency for International Development (USAID)

The United States Agency for International Development (USAID) has earmarked $5 million for small businesses and $10 million, for housing development.

CBO Investment Management's (CBOIM) fund

The funding is being seeded by the Overseas Private Investment Corporation (OPIC), the US Government's development finance institution. The Fund will specifically invest in SMEs with scalable growth patterns and credible management teams across six core sectors, including agribusiness/ food processing, energy services, manufacturing and import substitution, education and healthcare services, technology and media, and real estate services.

From the plethora of funds/interventions available to MSMEs, there is now a growing opportunity for financial advisors to MSMEs that will help them navigate and access the appropriate funds.

Fintechs/Technology Platforms

Often referred to as Fintechs or Technology Platforms, these companies are leveraging on technology to provide funds for MSMEs. There are signs of growth trajectory as they are disrupting the financial services sector.

MSMEs are likely to focus more on Fintechs for finance because of their processes and other requirements. Some players are: Social Lender, One Finance, Paystack, RenMoney, PayLater, and they are growing by the day.

Social Lender RenMoney ...simple money solutions paystack paylater

Informal Financial Institutions

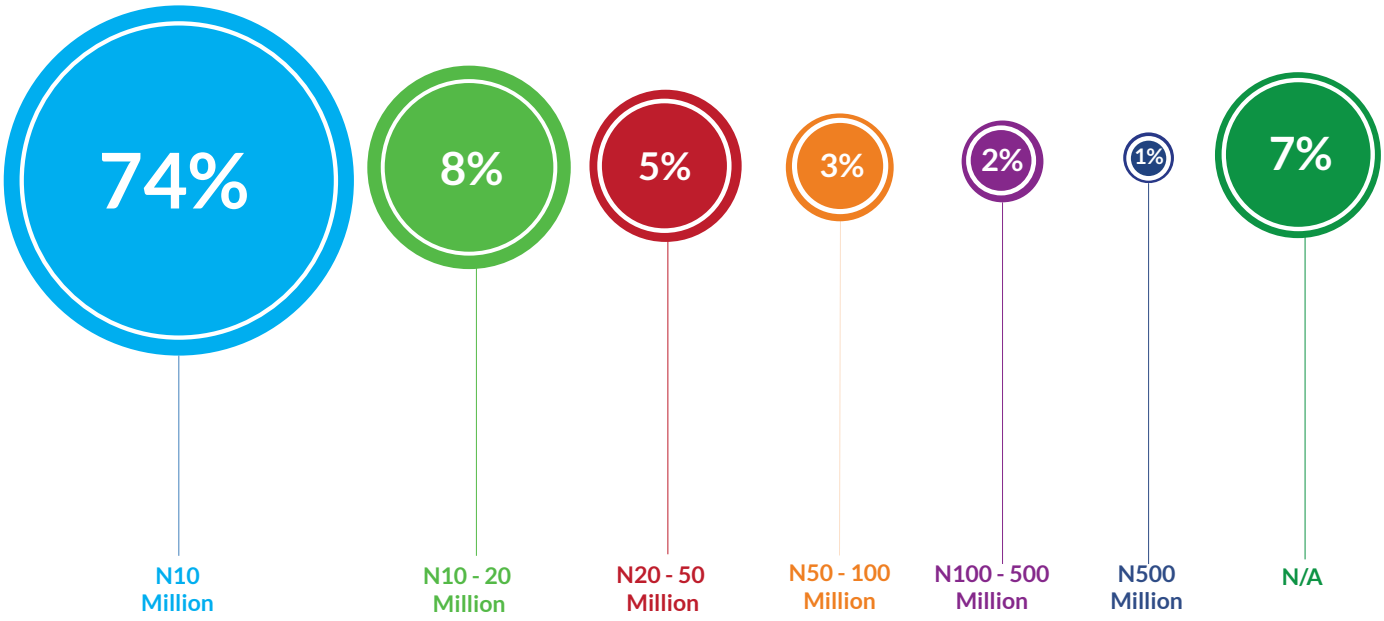
Informal financial institutions consisting of money lenders, landlords, credit and savings associations (co-operative societies) provide finance for MSMEs. Funds from partners and shareholders; Daily contribution (esusu, ajo, utu); Lending institutions, Small Business Administration and Financial Assistance (SBAFA) programme e.g. Donor agencies; Thrift and Credit cooperative societies. All of these are part of the established lending infrastructure to MSMEs and some commercial banks are modelling their products after these models of lending.


protex
FEIYA

Demographics

THREE in every four of the MSMEs surveyed makes a turnover of below 10 million naira while 8% make from 10 million to 20 million naira. Most of the MSMEs are in the agricultural sector. Around 43% of the respondents are in the agric-value chain while 13% are in the ICT sector.

Most of the MSMEs surveyed have been in business between 2 and less than 5 years while 20.8% fall between 1 and less than 2 years. Based on the turnover, most of the businesses can be classified as micro business which is in line with the national distribution as might be expected.

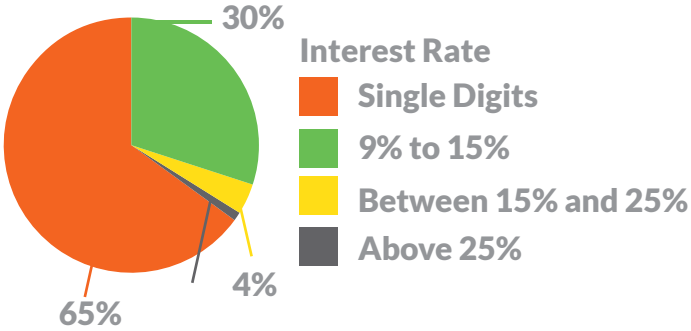


Accessing Finance: Major Impediments and Key Considerations

Findings from the surveys and interviews with stakeholders including MSMEs/small corporates, traditional and non-traditional lenders as well as public and private institutions within the MSME space re-emphasize key issues on access to finance by MSMEs

The general perception of MSMEs is that interest rate/cost of credit on loans by financial institutions remain a major impediment and constitutes a major reason why most MSMEs do not apply for loan.

Most of the MSMEs interviewed believe that interest rate of 25% to 30% is unsustainable. This was corroborated by other stakeholders through interviews. On the maximum interest rate the MSMEs can afford, two in every three of the respondents want interest rate at single digit. However, about 30% of the MSMEs responded that they could still accommodate interest rate of up to 15%, while a very few (4%) of the respondents, do not mind interest rate between 15% and 25%; the remaining 1% of the respondents could accommodate above 25% interest rate.



The implication is that any interest rate above 9% p.a. is likely to exclude more than two-thirds of the MSMEs and reduce the possibility of lending to this sector.

Apart from interest rate, collateral requirement is another major reason why MSMEs are unable to access finance as they are unable to provide the required collateral for qualification of loans and in some cases, some do not have at all. From the survey, one in every three of the MSMEs reported that collateral was the most important financing terms that they did not have when they applied for loan. And when asked reasons why their loan applications were turned down, 43% of the firms mentioned the lack of collateral. From the focus group sessions, collateral requirement often demanded by the financial institution is unrealistic as most MSMEs do not have the 'type and quality' of asset. ***Since collateral requirements have become increasingly stringent, stakeholders advocate for less emphasis on collateral but sound business models that will guarantee the safety and return of funds being lent to the sector.***

From the survey, other factors limiting MSMEs from accessing finance is the tenor of the loans and approval timing.

Participants at the focus group sessions noted that short repayment period constitutes a serious challenge even when such loans are accessed. In addressing this challenge, MSMEs suggest longer repayment period (from 3yrs and above).

Consistent with previous studies, the inability of the MSMEs to access finance has also been linked to poor record keeping/documentation. About 7% of the MSMEs reported reduced or minimal documentation as reason why their loan applications have been rejected. They are of the opinion that the documentation requirements for obtaining loans from commercial banks are too stringent thereby limiting their ability to access financing. Stakeholders attribute this to the informal nature of most MSMEs. Required documentation includes but not limited to accounting records, financial statements, bankable business plans, collateral, etc. As most MSMEs do not have these, it therefore becomes difficult for banks to attend to their loan requests. Stakeholders agree that financial institutions should make less stringent the requisite documents to support loan applications.

Stakeholders also agree that lack of knowledge on the type of funds available for the MSMEs is a hindrance. This has often resulted in avoidable pressures on their cash flow. In extreme cases, short term funds are used for long term investments. Closely related to lack of knowledge is skills gap as some MSMEs do not possess the capacity to effectively run their businesses.

The dynamic environment which companies operate today requires business leaders to be agile in addition to being fully grounded in effectively managing their businesses. While appreciating the need for access to capital for growth, most stakeholders agree that management capacity of MSMEs is indeed critical to growth.

- Pricing and Collateral Requirements
- Lack of Information/strong Market Knowledge
- Inconsistent Government Policies.
- Poor Record Keeping/ Documentation
- Lack of Corporate Governance Structure
- Other Pre-requisites for bank loans.

Stakeholders also cited mortality rate of most MSMEs which is considered very high as another reason why financial institutions are skeptical in lending to the sector. Consistent with most studies, eight out of every ten MSMEs do not continue operation after the first five years. MSMEs also have serious inherent structural defects and this makes them high risk borrowers. The MSME operators admitted that most of their businesses lacked structure and do not have corporate governance structure in place; which is one of the reasons why they are denied loans. The high rate of default by MSMEs have been cited as reason for their inability to access finance as well as weak or unavailable credit history making the credit-evaluation process more expensive. With the introduction of BVN and the evolution of credit bureaus, this is likely to improve.

Why MSMEs are not having access to finance

Lack of information or inadequate information

Poor record keeping/documentation

Lack of corporate governance structure

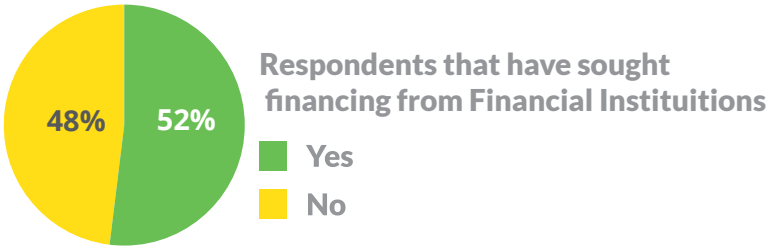
Collateral requirements

Cost of credit/interest rate

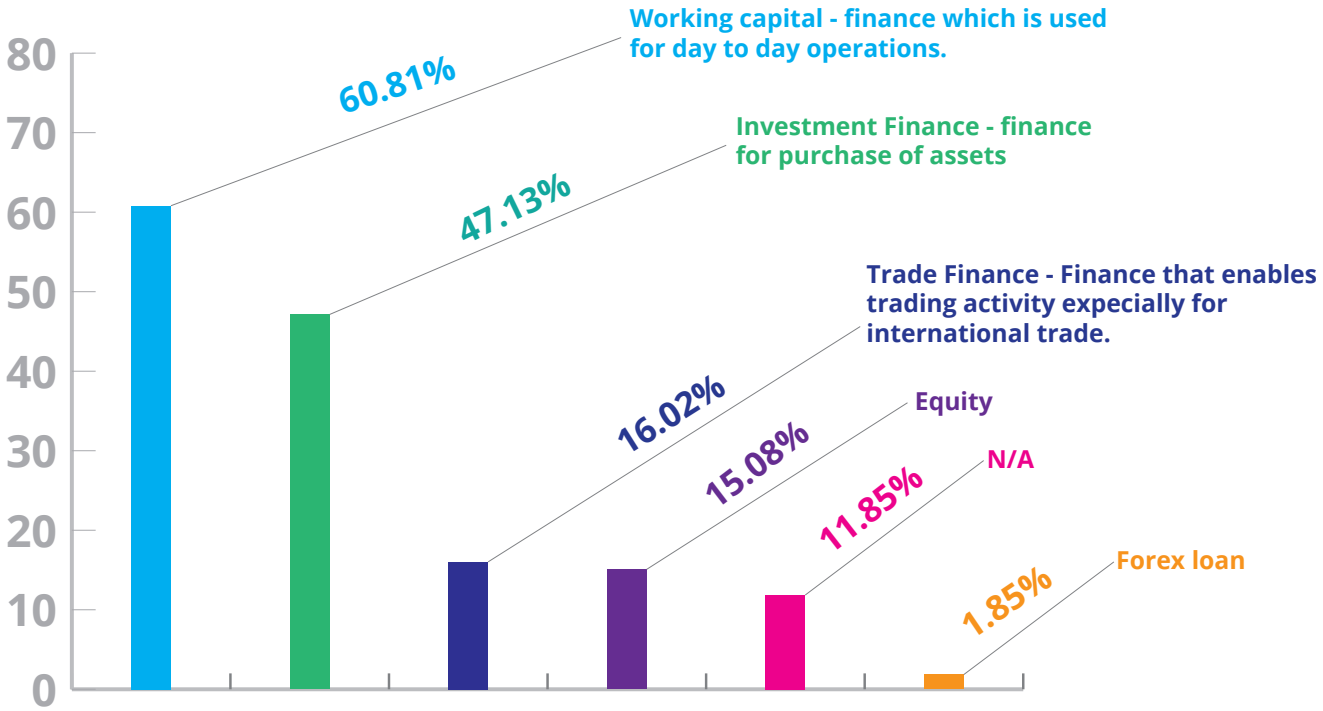
Hidden charges

Most MSMEs complained of insincerity on the part of financial institutions. According to them in some cases, the dynamics of the credit changed along the line with banks citing changes in policies and market dynamics as reasons. This according to them discourages most MSMEs from seeking finance. Similarly, some MSMEs stated that banks introduced other charges (maintenance, management etc.) along the line.

The result of the survey shows that more than half (52%) of the MSMEs have sought financing from commercial banks/microfinance institutions/leasing companies/mortgage companies and financing houses while about 48% have not. In terms of institutions where MSMEs seek financing from, the survey results revealed that majority of the MSMEs go to commercial banks while an insignificant minority goes to venture capitalists and Fintechs. Majority have applied for loans across multiple channels. Specifically, 63.38% of the MSMEs have sought financing from commercial banks, 45.68% from microfinance institutions, 33.38% from financing houses, 4.14% from mortgage companies and 3.40% from leasing companies. Apart from receiving finance from commercial and microfinance institutions, only 9.60% of the firms have received finance from venture capitalists, and Fintechs. This implies that commercial banks, microfinance banks and finance houses remain the top institutions MSMEs patronize more.



Based on the survey, the loans to MSMEs are largely used to increase their working capital and then for investments. 60.81% sought financing for working capital while about 47.13% sought for investment in equipment and machinery. On repayment terms, the result also shows that apart from interest rate, duration of loan above 2 years for trade finance is the most common repayment term followed by duration of loan between 1 and 2 years. For working capital, duration of loan less than 1 year is the most common repayment term followed by duration of loan above 2 years. For investment, duration of loan above 2 years is the most common repayment term.



On major reasons why banks (commercial and microfinance banks) refuse approval of loan applications from MSMEs, lack of business/technical experience and lack of track record was the most rated with a weighted average of (4.38) on a scale of 1 or 5. This is followed by lack of collateral, weak business plan and insufficient guarantees. This re-emphasizes the views of other stakeholders and as such, more emphasis should be placed on capacity building/ support services to the MSMEs and emerging corporates. The banks attributed the cases of non-performing loans to a number of reasons such as unrealistic cash flow and small businesses not being able to absorb the interest rate. There is the need to address these, if cases of non-performing loans are to be reduced.

Collateral requirements need to be addressed as majority of the banks surveyed reported that the inability to claim on collateral accounted for the reason why the banks do not recover the full amount of the non-performing loans. This is corroborated by responses from the interviews. When asked how they, as commercial banks can be supported by the development bank, the survey report showed that extended terms to the loan requests of MSMEs and emerging corporates is paramount. Also, the surveyed banks reported that apart from co-financing, business development support should be provided to the applicants.

On ways the MSMEs can be supported, more than half of the banks surveyed responded that capacity building for the MSMEs was crucial. 57.14% of the banks believe that MSMEs will benefit more in the area of risk management, followed by business development and portfolio management. There should be export advice for the MSMEs as most of them agree that this would help them grow their businesses. They also want assistance in the area of financial statement preparation and marketing advice. Stakeholders interviewed also believe support in these areas would improve the businesses of the MSMEs.

Other Challenges faced by MSMEs apart from Finance

Apart from finance, responses from the focus group sessions and interviews reveal other challenges MSMEs face to include poor infrastructure especially electricity and road network; identified skills gap for effective enterprise management; multiple taxations; lack of business structure; and lack of succession planning. Stakeholders interviewed also believed that most MSMEs do not have clear marketing strategies.

Lack of access to technology or low use of technology also hinders the growth of MSMEs. This is evident as most small businesses continue to rely on traditional means of production of goods and services which in effect has implications on the production capacity and quality of outputs. In some cases, the prevailing political, social and economic climate makes doing business difficult for the MSMEs.

Conclusion

Lack of information on the type and structure of various funds available, limited market knowledge on MSMEs preferences and documentation have been identified as major reasons why MSMEs are unable to access finance. Stakeholders maintain that the informal nature of most MSMEs makes it difficult for them to access finance. This ranges from lack of requisite information such as proper accounting records, financial statements, bankable business plans, lack of collateral, to operating in disconnected value chains; which makes it difficult for banks to assess their credit worthiness. The high rate of defaults by most MSMEs have been cited as reason for their inability to access finance as well as weak or unavailable credit history making the credit-evaluation process more expensive. Stakeholders also cited mortality rate of most MSMEs which is considered very high.

MSMEs also have serious inherent structural defects making them high risk borrowers, and thus, considered by financial institutions as high credit risks. Most MSMEs are unable to provide the required collateral for qualification of loans and in some cases, some do not have at all.

Pricing otherwise known as interest rate remains a serious concern as stakeholders believe that the interest rates are not attractive to MSMEs. It is noted that most MSMEs shy away from applying for loans due to the high cost of the credit and much as two-thirds are likely not to access if rates are above single digit.

Nearly all the banks interviewed reported that they have dedicated MSME units/desks with specialized products/offerings for the segment. In spite of this, the perception by the MSMEs is that the banks are unwilling to bridge the financing gaps. Apart from deposit mobilization and cash management, the banks stated that they also provide business development support in terms of capacity building/advisory services, and mentoring for the MSMEs. However, the banks attributed their limited participation in MSME financing to the informal nature of MSMEs.

In all of these, the general perception of the different stakeholders is that affordable loans will help MSMEs grow their businesses. Affordability in this case means single digit interest rate, less emphasis on collateral and longer repayment period.

Recommendations

In articulating favourable policies and championing initiatives aimed at making MSMEs have better access to finance, the government would need to:

- Incentivize the banks to provide affordable loans to MSMEs through CBN and other government agencies
- Address issues aimed at improving basic infrastructural facilities including electricity and road network
- Provide grants and credit guarantees
- Ensure ease of doing business through appropriate policy formulation and implementation
- Provide technical assistance to the banks through the development banks

For the financial institutions, in proposing initiatives that will enable MSMEs and emerging corporates have better access to finance, the following were the conclusions:

- There should be provision of affordable loans through interest rates at single digit, longer tenor and attractive collateral requirements
- The banks need to better understand the MSME space and disrupt the lending process and procedure to MSMEs
- There should also be risk sharing/co-financing with development banks
- There should be provision of support services to the MSMEs
- The banks need to work more with the credit bureaus to facilitate lending to MSMEs

MSMEs and emerging corporates on their part would need to:

- Build their capacity to run their businesses and in financial management.
- Maintain good relationships with financial institutions especially their account officer
- Seek financial advice/expert advice
- Exhibit financial discipline and embrace best practices

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Skye Bank
LAPO Microfinance Bank
Accion Microfinance Bank

Fintechs
One Finance
Social Lender

Other Stakeholders

Central Bank of Nigeria (CBN)
National Association of Small and Medium Enterprises (NASME)
Small & Medium Enterprise Development Agency of Nigeria (SMEDAN)
National Association of Small Scale Industrialists. (NASSI)
Bank of Industry (BoI)
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